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Law Commission
(submitted by email)

11 November 2022

Dear Law Commissioners,

Re: EMA response to the Law Commission's consultation on digital assets (CP 256)

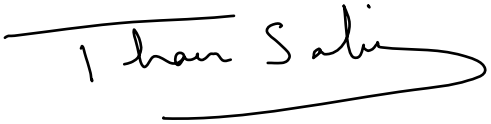
We welcome the opportunity to comment on the Law Commission's proposals relating to the introduction of a new category of personal property, data objects.

The EMA is the European trade body representing electronic money issuers, cryptoasset firms and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide, providing online payments, card-based products, electronic vouchers, mobile payment instruments and cryptoasset services.

In what follows below we are commenting on some aspects of the Law Commission's proposals as they relate to cryptoassets and electronic money. The views expressed here are those of the EMA rather than of individual members, of which a list is provided at the end of this document.

I would be grateful for your consideration of our comments and am at your disposal should you have any questions.

Yours sincerely,



Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

EMA responses

1. **Cryptoassets**

Question 11: "We provisionally conclude that in-game digital assets do not satisfy our proposed criteria of data objects and therefore that they fall outside of our proposed third category of personal property. Do you agree?"

Response:

We think that a broader and more inclusive approach to the delineation of data objects would be appropriate, not only in relation to in-game digital assets but also in relation to other assets that share the same functional attributes as objects that fall within the new category of personal property. Specifically, we refer here to electronic money, which we elaborate on below. A more inclusive approach could encompass digital assets that are based on centralised technical arrangements, providing for greater technological neutrality.

There is a danger of the legal construct influencing the technological solutions that are adopted to achieve the same or similar products and services. For instance, in relation to in-game digital assets, the Law Commission's ("**Commission**") view is that these would not give rise to personal property, as they are contingent for their existence on the technology within which they are sustained, which is accessed under licence. However, while such assets are currently issued centrally, future iterations of these products and services could move towards interoperability. This would allow artefacts from one game to be transferred to another and thus exist beyond the environment in which they were created. For an open standard that welcomes participants, it is conceivable that the object would be more and more independent of the supporting infrastructure, the more instances of interoperable games that participated.

We therefore request that the Commission re-considers the independence test as currently envisaged, recognising that legal independence is a spectrum of arrangements and could be conceived for multiple technologies. For instance, even in relation to distributed ledger designs, one can envisage entirely open and permissionless arrangements on the one hand, and permissioned and limited in the extent of participation on the other. It would be better if data objects could be contemplated in a functional manner, considering the roles and value that they were endowed with, and for these to be capable of expression irrespective of the technological design choices that are made.

A more technologically neutral approach, which recognises that legal independence in the digital environment must always be contingent to some greater or lesser extent on access to the infrastructure, the operations and technology that give form to it would be desirable. This should then allow multiple frameworks that give rise to game artefacts to exist and for the artefacts to be traded, without specifying the technological implementation. It should allow such artefacts, avatars and various forms of property to be owned, exchanged and transferred in multiple environments, however implemented. We believe the significance of the outcome is likely to increase as plans for virtual environments or 'metaverses' crystallise over the coming years, and

different operators adopt technological solutions that meet their needs, but which may vary in their design.

Question 19: "We provisionally conclude that it would be beneficial for a panel of industry, legal and technical experts to provide non-binding guidance on the complex and evolving issues relating to control and other issues involving data objects more broadly. Do you agree?"

Response:
We concur with this approach; there will be abroad range of digital assets that will be impacted by the new classification, and the more the discussions are informed by business and expert opinion, the more benefits are likely to ensue and the more disruption is avoided.

The EMA would like to express its interest in participating in such a panel and we would be happy to nominate a suitable individual.

Question 22: "We provisionally propose that:
(1) A special defence of good faith purchaser for value without notice (an innocent acquisition rule) should apply to a transfer of a crypto-token by a transfer operation that effects a state change. Do you agree?
(2) An innocent acquisition rule should apply to both "fungible" and "non-fungible" technical implementations of crypto-tokens. Do you agree?
(3) An innocent acquisition rule cannot and should not apply automatically to things that are linked to that crypto-token. Do you agree?"

Response:
We concur with the Commission that the innocent acquisition rule should apply for some crypto-tokens but think that it should not be applied to all. While parties to transfers of crypto-tokens that are intended to function in an analogous manner to money or to negotiable instruments may have such expectations, parties to transfers of other valuable assets may not.

We have discovered in recent years that instant transfers of funds bring both convenience and certainty, but also create increased opportunities for criminals to move funds repeatedly and in real time to obfuscate law enforcement and losers' attempts to retrieve such funds. The application of the innocent acquisition rule to all crypto-tokens will in certain respects contribute to a legal framework that advantages the perpetration of financial crimes. This could, for example, manifest in recipients of tokens exercising less care when purchasing digital assets. We concur that the rule is beneficial in relation to payment products and also in a number of related contexts. We caution against its application to all tokens, however. One significant category of tokens will be that of non-fungible tokens ("**NFT**"), representing various property rights.

NFTs describe a broad category of products, and serve a range of purposes, including the representation of rights attached to collectibles or other tangible and intangible property. Where

such NFTs are transferred, there is not likely to be an expectation of the application of the innocent acquisition rule. We are not therefore of the opinion that the rule should be equally applicable to all crypto tokens.

We acknowledge that, in proposing a universal application of the rule to all crypto-tokens, the Commission is seeking to avoid inconsistency in its application. We also note the proposed solution of distinguishing the transfer of NFTs from that of the rights linked to them. Our concern is that this may potentially provide insufficient certainty for products that would benefit from the rule on the one hand, such as payment products, while on the other hand creating doubt in relation to ownership of products that would likely not benefit from the rule. A more customised application where business can choose to apply the rule by contract, based on a statutory framework, would be preferable in our view.

The possibility of applying the 'innocent acquisition rule' to assets for which it is appropriate from a functional perspective would be greatly welcomed. This would enable commercial transactions to flow freely and facilitate the migration of tangible instruments from paper into the electronic and digital sphere without losing key attributes. Refraining from universal application but allowing for customised introduction would be our favoured approach. There is concern that if financial crime were to increase as a result of universal application, that this would discourage take-up of a range of products, including NFTs.

Question 31: "We provisionally conclude that a presumption of trust does not currently apply to crypto-token custody facilities and should not be introduced as a new interpretive principle. Do you agree?"

Response: We agree with the Commission's conclusion that that a presumption of trust should not be introduced at this point in time. Trust relationships involve complexity that may be both costly and inappropriate for many product propositions. For instance, there may be instances where the custodian is required to act in a manner that is comparable to an absolute title holder, and which may not be possible within a trust arrangement. Such arrangements may arise in the context of multifunction and multi-service platforms that may be deployed as the industry evolves. We therefore welcome the Commission's willingness to support flexibility for firms in structuring the relationships involved in the custody services that they offer.

In the absence of easily accessible information for consumers on the form that custody takes, it may be helpful to ensure good communication and disclosure by service providers. This would enable better decision making and promote the setting of expectations in relation to the services that will be delivered. These could include the risks that are borne by the customer and the extent of custody obligations.

Question 40: "We provisionally conclude that an action to enforce an obligation to 'pay' non-monetary units such as crypto-tokens would (and should) be characterised as a claim for unliquidated damages, unless and until crypto-tokens are generally considered to be money (or analogous thereto). Do you agree?"

Response: There will be classes of crypto-tokens that will either be analogous to money in their functionality or will in fact be regarded as money in legislation – e-money-like stable coins may for example be regarded as such. In such circumstances it would be appropriate to provide for an action in debt where payment has been pledged using crypto-tokens. The proposed application of the innocent acquisition rule to such products lends strength to this approach, confirming their use as a substitute for other forms of money. It would then be logical to regard the failure to pay as a monetary debt rather than as a failure to deliver a commodity. There are obvious advantages to an action in debt over claims for unliquidated damages and making these advantages available in disputes relating to payments in crypto-tokens will support their development (and particularly that of stablecoins) as alternative means of payment on an equal footing with more traditional means of payment.

2. Electronic money

Our comments in relation to electronic money ('e-money') do not relate to a specific consultation question, but we hope that the Commission will take them into account, nonetheless. Regulation 2(1) of the Electronic Money Regulations 2011 defines e-money as:

> *"electronically (including magnetically) stored monetary value as represented by a claim on the electronic money issuer which—*
> *(a) is issued on receipt of funds for the purpose of making payment transactions;*
> *(b)is accepted by a person other than the electronic money issuer. . . ."*

We note that e-money has not been considered for the new category of data objects. We think this is an important omission that will create legal uncertainty, particularly as some cryptoassets (such as fiat backed stablecoins) will likely be regulated as e-money in the near future. Categorising e-money as data objects would ensure equal treatment for all e-money, whether conceived within centralised systems or tokenised in distributed form.

E-money meets the three criteria for data objects:

i) Data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals

E-money is electronically recorded value in ledgers maintained by e-money issuers (although it is also possible to record this value on payment instruments, such as cards, directly). The value recorded is not a mere reflection of a claim right against the issuer but presents a thing that exists independently of persons and the legal system (see ii) below).

ii) Existence that is independent of persons and independent of the legal system

E-money exists as an electronic value recorded in the issuer's systems, independently from both the issuer and from the owner of the value, the customer. It is separate from the owner, and therefore capable of being owned, as contemplated at paragraph 5.28 of the consultation.

Whilst e-money provides for a claim for redemption against the issuer, its utility is as a means of payment that functions without the claim being exercised. It exists in the ledger of the issuer but is independent in its function from the issuer. It is transferable between persons as identifiable value that can be exchanged for goods or services or transferred as a gift to other parties.

E-money can therefore be conceived as existing independently of the legal system, it is not a mere thing in action. While e-money provides for a redemption right (i.e., the claim on the issuer to have returned funds to the value of the e-money held), this right is secondary in function to its use as a means of payment, which requires transfer of the value itself. This is for example distinct for a deposit, which represent a chose in action and which require the exercise of the holder's rights against the bank in any transfer, e-money can be transferred without the need to exercise any rights against the issuer. Once e-money has been purchased in exchange for funds, it can be used by the holder for direct transfers of value to any recipient within the e-money system. Within that system, the use of the e-money will be subject to the issuer's terms, but these terms do not involve the exercise of the right of redemption when making payment.

While e-money may be conceived as a centrally administered system, it may also be interoperable with other issuers, and may comprise a network or a single significantly large issuing system. The choice of technical arrangement is again dependent on a range of factors, and this should not be a determining factor in establishing whether a digital asset falls within the category of data objects.

It is conceivable that a centrally organised e-money system could in fact become interoperable with a distributed system or may act as a hybrid structure. As long as other elements of the criterial for data objects are met, we believe that (central) technical arrangements should not exclude e-money from being regarded as data objects. This is consistent with our submission in relation to question 11 above, we think that the law should be technologically neutral in this respect.

iii) Rivalrousness

E-money is rivalrous, in that access and use by one person prevents the same by another. Every transfer of e-money results in corresponding debit and credit entries in the accounts of transferor and transferee. Accounting processes and security systems ensure the integrity of the ledger.

We hope that this demonstrates how e-money falls within the category of data objects, and that this can be made explicit in the Commission's findings, paving the way for technological consistency between centrally issued e-money and that dependent on a distributed infrastructure.

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Allegro Group
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American Express
ArcaPay Ltd
Azimo Limited
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