

Reply form

on the Consultation Paper on guidelines on conditions and criteria for the classification of crypto-assets as financial instruments for MiCA implementation

Responding to this paper

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 April 2024**.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Use this form and send your responses in Word format (**pdf documents will not be considered except for annexes**);
3. Please do not remove tags of the type <ESMA_QUESTION_MIC3_1>. Your response to each question has to be framed by the two tags corresponding to the question.
4. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
5. When you have drafted your response, name your response form according to the following convention: ESMA_MIC3_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_MIC3_ABCD_RESPONSEFORM.
6. Upload the form containing your responses, **in Word format**, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open Consultations" -> Consultation Paper on guidelines on conditions and criteria for the classification of crypto-assets as financial instruments").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading [Legal Notice](#).

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites crypto-assets issuers, crypto-asset service providers and financial entities dealing with crypto-assets as well as all stakeholders that have an interest in crypto-assets.

General information about respondent

Name of the company / organisation	Electronic Money Association
Activity	Other Financial service providers
Are you representing an association?	<input checked="" type="checkbox"/>
Country/Region	Europe

Questions

Q1 Do you agree with the suggested approach on providing general conditions and criteria by avoiding establishing a one-size-fits-all guidance on the concepts of financial instruments and crypto-assets or would you support the establishment of more concrete condition and criteria?

<ESMA_QUESTION_MIC3_1>

The approach of providing general conditions and criteria for the qualification of crypto-assets as financial instruments, as outlined in section 5.2 of the consultation paper, appears to strike a prudent balance between flexibility and regulatory clarity. This methodology acknowledges the rapidly evolving nature of the crypto-asset market and its underlying technologies, which could render overly prescriptive or rigid criteria quickly obsolete.

Furthermore, the crypto-asset space is characterized by its diversity, with new asset types and functionalities emerging continuously. A one-size-fits-all guidance could inadvertently stifle innovation or lead to regulatory arbitrage, where market participants might design crypto-assets to circumvent stricter regulatory classifications.

However, while the proposed approach allows for adaptability in the face of technological advancements and market developments, it also places a significant burden on national competent authorities (NCAs) and market participants to interpret and apply these general guidelines consistently. This could lead to a divergence in the classification of similar crypto-assets across different jurisdictions, potentially fragmenting the market and creating uncertainty for issuers and investors.

Therefore, while supporting the ESMA's proposed approach for its flexibility and forward-looking perspective, it may be beneficial to complement it with more detailed guidance or illustrative examples that demonstrate the application of these general conditions and criteria to specific types of crypto-assets. This hybrid approach could offer the necessary adaptability while also providing clearer direction to NCAs and market participants, fostering a more harmonized regulatory landscape across the European Union.

<ESMA_QUESTION_MIC3_1>

Q2 Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as transferable securities? Do you have any additional conditions and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

<ESMA_QUESTION_MIC3_2>

The guidelines provided in section 5.3.1 for the identification of crypto-assets as transferable securities are robust and align with the principles of MiFID II, emphasising the need for such assets to be part of a "class of securities", negotiable on the capital market, and excluding instruments of payment. These criteria are essential for ensuring that crypto-assets align with the regulatory expectations for transferable securities, providing a basis for their classification and subsequent regulatory treatment.

The guidelines' focus on a substance over form approach is particularly commendable. Application of financial sector regulation and any product- or service-specific subset thereof must be determined by the economic reality and function that is by the financial substance of the given product or service. Variations regarding the form including the underlying technology must be disregarded. This is crucial in a rapidly evolving market, where the technological embodiment of assets continually changes. A substance over form approach is necessary to respond to potential regulatory arbitrage by ensuring that assets fulfilling the economic and functional criteria of transferable securities are regulated as such, regardless of their technological features.

However, to further enhance the utility of these guidelines, additional clarity on the application of the "negotiable on the capital market" criterion could be beneficial. Specifically, it would be helpful to delineate the thresholds or characteristics that define when a crypto-asset is considered "negotiable" on such markets. For example, does only listing on a cryptocurrency exchange suffice, or is there also a need for the asset to be listed on regulated markets, or to have a certain level of liquidity or market capitalization?

Additionally, given the evolving nature of the crypto-asset market and the emergence of decentralized finance (DeFi) platforms, further guidance on how these criteria apply to assets traded in these environments could be valuable.

In summary, while the guidelines in section 5.3.1 provide a solid foundation for classifying crypto-assets as transferable securities, additional details on the negotiability criterion and its application to novel trading venues could further strengthen the framework.

<ESMA_QUESTION_MIC3_2>

Q3 Based on your experience, how is the settlement process for derivatives conducted using crypto-assets or stablecoins? Please illustrate, if possible, your response with concrete examples

<ESMA_QUESTION_MIC3_3>

In traditional derivatives markets, settlement typically involves the transfer of cash or other financial instruments as defined under MiFID II. However, with the emergence

of crypto-assets that emulate derivatives, there's a shift where the settlement does not necessarily involve traditional cash but may involve other types of crypto-assets. For example, a derivative contract might stipulate that the payout, typically a cash settlement, be made in a specific type of crypto-asset like Bitcoin, an EMT, or an ART.

Regulatory Implications Under MiFID II:

Settlement Risk: Traditional derivatives are subject to stringent regulations under MiFID II to mitigate settlement risk. When settlement involves crypto-assets instead of cash, assessing and managing this risk becomes complex due to the volatility and liquidity issues associated with crypto-assets.

Counterparty Risk: The risk associated with the counterparty's ability to fulfill the settlement in crypto-assets introduces another layer of complexity. Traditional financial systems have well-established mechanisms to mitigate such risks, including central clearinghouses that might not be present or fully developed in the crypto market.

Additional Criteria Suggestion for MiFID II Adaptation:

Risk Assessment and Management: Criteria should be developed to specifically address and quantify the risks associated with using crypto-assets for settlement. This includes the volatility of the asset, its liquidity on various exchanges, and the creditworthiness of parties involved in terms of their digital asset holdings.

Regulatory Clarity: There should be clear guidelines on how such settlements are reported and monitored. For example, should the crypto-assets used in settlements be treated akin to cash settlements or physical settlements? This distinction will affect the regulatory reporting requirements.

Settlement Infrastructure: Development and recognition of infrastructure capable of handling such types of settlements securely. This may involve the integration of traditional financial infrastructure with blockchain technology to ensure robust settlement mechanisms.

Legal Framework Adaptation: Adjusting the legal framework to clearly define and encompass crypto-assets as legitimate settlement mechanisms for derivative contracts. This involves both regulatory recognition and the development of standards for such practices.

<ESMA_QUESTION_MIC3_3>

Q4 Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as another financial instrument (i.e. a money market instrument, a unit in collective investment undertakings, a derivative or an

emission allowance instrument)? Do you have any additional conditions, criteria and/or concrete examples to suggest?

<ESMA_QUESTION_MIC3_4>

The conditions and criteria outlined for identifying crypto-assets as other types of financial instruments (such as money market instruments, units in collective investment undertakings, derivatives, or emission allowance instruments) appear comprehensive and appropriately tailored to fit within existing regulatory frameworks such as MiFID II. These guidelines help clarify the regulatory landscape by specifying how crypto-assets can be integrated into categories that are already well understood by market participants and regulators and subject to specific financial sector regulations and requirements.

Money Market Instruments - The criteria specifying that crypto-assets need to exhibit characteristics akin to traditional money market instruments, such as having a short maturity and being subject to yield adjustments in line with market conditions, are crucial for ensuring that these instruments behave in ways that are predictable and familiar to investors. However, it could be beneficial to introduce specific risk metrics or thresholds (such as Value-at-Risk) that a crypto-asset must meet to qualify as a money market instrument, reflecting the low-risk nature traditionally associated with such instruments.

Units in Collective Investment Undertakings - The guidelines that crypto-assets representing units in collective investment undertakings should provide rights similar to traditional units, such as participatory rights in the investment returns generated by the pool of assets, align well with the fundamental principles of collective investments. Additional criteria could specify liquidity requirements, ensuring that units can be readily bought and sold without significant price impacts, which is a hallmark of traditional collective investment units.

Derivatives - The criteria for derivatives are particularly relevant as they specify that the value of crypto-derivatives should be derived from an underlying financial instrument, which can include other crypto-assets. This is essential for ensuring that derivatives maintain their traditional role in hedging, speculation, and price discovery. More explicit guidelines on the standardization of contract terms could be helpful to ensure that crypto-derivatives are compatible with existing market infrastructure, like clearing houses.

Emission Allowances - The inclusion of criteria for crypto-assets that may qualify as emission allowances is innovative and recognizes the potential for digital assets to represent or be tied to environmental credits or allowances. Criteria could be introduced to ensure that any crypto-asset classified as an emission allowance is backed by a verifiable and certified claim, compliant with international environmental standards.

<ESMA_QUESTION_MIC3_4>

Q5 Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete conditions and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

<ESMA_QUESTION_MIC3_5>

The existing conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets, as outlined in the consultation paper, provide a solid foundation for distinguishing these two categories based on their regulatory and functional characteristics. The distinction is vital because it determines which regulatory framework applies to a particular asset, affecting how it's traded, who can trade it, and the kind of consumer protection that must be in place.

The criteria make clear distinctions based on the attributes of the assets:

Financial Instruments under MiFID II are typically characterized by investment purposes, including rights such as claims on dividends or interest, voting rights in corporate decisions, or capital appreciation.

MiCA Crypto-assets, on the other hand, often involve digital tokens that serve various utility functions within their ecosystems, do not necessarily confer ownership, financial rights, or have an investment purpose.

While the current guidelines are comprehensive, the rapidly evolving nature of digital assets suggests the benefit of additional criteria or clarifications:

Economic Purpose and Usage:

Criterion: Assessing the primary economic purpose and usage of the asset could help clarify its classification. If the asset's primary function is to serve as a means of capital raising for an entity (similar to traditional securities), it should be classified financial instrument subject to MiFID II. Conversely, if the asset is primarily used to access a specific service or utility provided by the issuer, it falls under MiCA.

Example: A token issued by a platform that allows token holders to use those tokens exclusively to purchase services or products on the platform would be considered a MiCA crypto-asset.

Integration with Traditional Financial Products:

Criterion: The degree of integration, linkage or equivalence with traditional financial products can be a criterion. Crypto-assets that are derivatives of other financial

instruments or that provide rights similar to financial instruments (such as ETFs or derivatives) should be classified under MiFID II.

Example: A crypto-asset that functions similarly to a share of an ETF (tracking the performance of a basket of stocks) would fall under MiFID II because it mirrors the characteristics and economic functions of a financial instrument.

Adding these criteria can enhance the clarity and enforceability of the regulatory framework, ensuring that assets are categorized correctly and that stakeholders are adequately protected. This approach would also provide greater predictability and stability to the market, benefiting both innovators and investors.

<ESMA_QUESTION_MIC3_5>

Q6 Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional conditions and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

<ESMA_QUESTION_MIC3_6>

With regards to ESMA's regulatory mandate concerning the classification of NFTs under the proposed guidelines, it appears that there is a potential misalignment in the application of MiCA regulation to as articulated in the consultation paper.

Under Article 2(5) of MiCA, ESMA is primarily tasked with the responsibility of providing guidelines on whether certain crypto-assets should be classified as financial instruments under MiFID II. This mandate directly relates to the interpretation of Article 2(4)(a), which states, "This Regulation does not apply to crypto-assets that qualify as one or more of the following: (a) financial instruments..."

However, it has been observed that the draft guidelines extensively discuss and apply Article 2(3), which stipulates, "This Regulation does not apply to crypto-assets that are unique and not fungible with other crypto-assets." The extensive discussion of Article 2(3) raises concerns about the scope of ESMA's remit, as this article primarily exempts certain types of crypto-assets, including NFTs, from MiCA, based on their unique and non-fungible characteristics rather than their classification under financial instruments regulations.

The focus of ESMA's guidelines, as per its mandate, should focus on clarifying the conditions under which crypto-assets (including those exempted under Article 2(3) such as NFTs) fall under the category of financial instruments as defined by MiFID II. This approach is critical for ensuring that ESMA's regulatory guidance remains within the boundaries set forth by MiCA and adheres to the legal framework intended by the European legislator.

As such, it may be necessary to reconsider the emphasis placed on Article 2(3) in the draft guidelines to align more closely with its designated role under Article 2(5) concerning the classification of crypto-assets as financial instruments. A more focused interpretation and application of Article 2(4)(a) in relation to MiFID II would potentially provide greater clarity and utility for market participants seeking guidance on the regulatory treatment of crypto-assets within the scope of European financial markets regulation.

<ESMA_QUESTION_MIC3_6>

Q7 Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional conditions and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

<ESMA_QUESTION_MIC3_7>

The proposed conditions and criteria for hybrid-type tokens in the consultation paper recognise the complexity of these assets, which may incorporate characteristics of multiple asset categories. The approach taken to prioritize the characteristics that align most closely with financial instruments when classifying hybrid tokens under MiFID II or MiCA is prudent and helps ensure regulatory clarity.

The methodology of using a hierarchical approach to prioritize financial instrument characteristics in hybrid tokens is commendable because it aligns with the principle of "same risks, same rules." This approach ensures that assets presenting similar risks to traditional financial instruments are regulated under the same strict frameworks to protect investors and maintain market integrity.

<ESMA_QUESTION_MIC3_7>