IRSG EU REGULATION STANDING COMMITTEE RESPONSE TO CONSULTATION ON AN EU FRAMEWORK FOR MARKETS IN CRYPTO-ASSETS

II. Classification of crypto-assets

Question 6

In your view, would it be useful to create a classification of crypto-assets at EU level?

- Yes

If you think it would be useful to create a classification of crypto-assets at EU level, please indicate the best way to achieve this classification (non-legislative guidance, regulatory classification, a combination of both...).

Due to the lack of a single accepted definition of what a cryptoasset is, there is merit in creating a classification of cryptoassets at the EU level. This would enable a consistent understanding of the concept and allow greater clarity for users. This does not necessarily have to be done via legislation, indeed, there may be some merit to using non-legislative guidance which may provide more flexibility to adapt the classification as the market evolves. In addition, any classification should reflect the work done by other international organisations in considering the best means of regulating cryptoassets at a global level.

Question 7

What would be the features of such a classification?

A cryptoasset is not a homogenous concept but rather a means to define a number of differing tokens which display differing characteristics. Therefore, any such classification has to take into consideration these differing characteristics – including but not limited to – the rights attached to the token, access to the token, and the economic purpose of the token.

Under the principle of 'same activity, same regulation', any future regulatory framework should treat cryptoassets that are comparable (in terms of their economic functions and potential risks) to other traditional asset classes equally. Where there are cryptoassets that are not comparable to other traditional asset classes the risks associated with those instruments need to be clearly identified and provided for.

The classification of crypto-assets based on the predominant economic function (i.e. payment, investment, utility) is also an important starting point and we recognise that there has been significant convergence towards this method of classification within Europe. However, a secondary and more detailed analysis is required to consider the various functionalities of different types of crypto-assets to more precisely determine their risks. This more granular level of crypto-asset classification based on an analysis of a crypto-asset's characteristics and functionalities, could then be used to determine the appropriate regulatory treatment that is adequate to the risks and level of oversight required. As part of this more detailed analysis, it will be important to consider what characteristics differentiate crypto-assets from traditional assets.

Due to the cross-border nature of cryptoassets, in considering the best features of such a classification, the European Commission should coordinate its work with other international bodies

and standard setters. This is in order to ensure a holistic global approach to the regulation of cryptoassets.

The Basel Committee is currently assessing the appropriate prudential treatment for cryptoassets, illustrated in their December 2019 paper on the topic. This paper discusses how to best define cryptoassets, based on their technological and economic functions and also outlines some key principles for any future prudential treatment. In addition, the February 2020 report from IOSCO on 'Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms' who underline that if a regulatory authority decides that a crypto-asset is a security and falls within its remit, the basic principles or objectives of securities regulation should apply.

In addition, any definition should not limit the potential evolution of the concept. The proposed classification should take into consideration the growth potential in the type of cryptoassets and what they can be used for. This means that the classification should be technology neutral and flexible to future change.

When providing your answer, please indicate the classification of crypto assets and the definitions of each type of crypto-assets in use in your jurisdiction (if applicable).

Please explain your reasoning:

In the UK, the 'Cryptoassets Taskforce' was announced in March 2018 by the Chancellor of the Exchequer, as part of the government's FinTech Sector Strategy. It consists of HM Treasury, the Financial Conduct Authority and the Bank of England. This group was set up in order to provide a higher degree of legal certainty for the industry and consumers, through the coordination of information sharing, learning and the pooling of resources.

In its final report, published in October 2018, the Taskforce outlined their framework for differentiating between types of cryptoassets, and their respective relationship with the current UK regulatory perimeter. The Taskforce considered there to be three broad types of cryptoassets, which are explained below. However, there are also examples of 'hybrid' cryptoassets. These are those that have multiple economic purposes or uses and therefore fit into more than one type. Regulators should guarantee that such cryptoassets are covered sufficiently by any legislative framework.

Exchange tokens: These tokens are often referred to as cryptocurrencies. They utilise a DLT platform and are not issued or backed by any central authority and are intended and designed to be used as a means of exchange. They tend to be a decentralised tool for buying and selling goods and services without traditional intermediaries. These tokens are usually outside the regulatory perimeter, however compliance with anti-money laundering legislation is required in certain instances.

Security tokens: These are tokens with specific characteristics that mean they provide rights and obligations akin to specified investments, like a share or a debt instrument. They may also be transferable securities or financial instruments under MiFID II. These tokens are within the regulatory perimeter.

Utility tokens: These tokens grant holders access to a current or prospective productor service but do not grant holders rights that are the same as those granted by specified investments. Although utility tokens are not specified investments, they might meet the definition of e-money in some circumstances (as could other tokens). In this case, activities involving them may be regulated.

III. Crypto-assets that are not currently covered by EU legislation

A. General questions: Opportunities and challenges raised by crypto-assets

Question 10

In your opinion, what is the importance of each of the potential benefits related to crypto-assets listed below?

Please rate from 1 (not important at all) to 5 (very important)

Issuance of utility tokens as a cheaper, more efficient capital raising tool than IPOs 2

Issuance of utility tokens as an alternative funding source for start-ups 2

Cheap, fast and swift payment instrument 3

Enhanced financial inclusion 3

Crypto-assets as a new investment opportunity for investors 2

Improved transparency and traceability of transactions 4

Enhanced innovation and competition 4

Improved liquidity and tradability of tokenised 'assets' 3

Enhanced operational resilience (including cyber resilience) 4

Security and management of personal data 4

Possibility of using tokenisation to coordinate social innovation or decentralised governance 2

Question 11

In your opinion, what are the most important risks related to crypto-assets?

Please rate from 1 (not important at all) to 5 (very important)

Fraudulent activities 5

Market integrity (e.g. price, volume manipulation, ...) 5

Investor/consumer protection 5

Anti-money laundering and CFT issues 5

Data protection issues 4

Competition issues 4

Cyber security and operational risks 4

Taxation issues 2

Energy consumption entailed in cryptoasset activities 3

Financial stability 4

Monetary sovereignty/monetary policy transmission 3

Are there any other important risks related to crypto-assets not mentioned above that you would foresee?

Please specify which one(s) and explain your reasoning:

The cryptoasset market has so far shown a high degree of volatility, with a global valuation of around $800 billion in January 2018 which fell to around $200 billion by August 2018. Moreover, the behaviour of cryptoassets during periods of financial stress has yet to be fully tested.

In addition, the sustainability aspect of certain cryptoasset activities is worrying. The practice of Bitcoin mining, for example, has detrimental implications for the climate. This should not be ignored, especially due to the ongoing efforts of the EU to green the wider economy.

Question 14

In your view, would a bespoke regime for crypto-assets (that are not currently covered by EU financial services legislation) enable a sustainable crypto-asset ecosystem in the EU (that could otherwise not emerge)?

- Yes

Please explain your reasoning for your answer to question 14:

The EU should promote regulatory harmonisation and create common standards across jurisdictions. Otherwise diverging supervisory practices can lead to a risk of fragmentation in the single market for capital. This is especially true for cryptoassets due to their high mobility and global nature. As well as risk of fragmentation is the possibility of regulatory arbitrage and potential for bad actors to leverage contradicting and diverging regimes.

The promotion of regulatory harmonisation by the EU is part of a global move to attribute regulatory clarity to the global crypto market. This in addition to boosting investor confidence in the global cryptoassets market due to oversight from a suitable regulator. It is the IRSG's opinion that international alignment with legislation from other jurisdictions is vital. Any bespoke regime should seek to be aligned to global standards and be a standard. The introduction of the Cryptocurrency Act 2020 to the US Congress in December 2019 is an example of this trend.

Question 15

What is your experience (if any) as regards national regimes on crypto-assets?

Please indicate which measures in these national laws are, in your view, an effective approach to crypto-assets regulation, which ones rather not.

In the UK, the FCA uses a case-by-case approach to determine if a cryptoasset falls under existing regulations, by for instance mimicking an IPO, a private placement of securities, a crowdfunding or a collective investment scheme.

The FCA has also successfully used its regulatory sandbox in order to inform better cryptoasset guidance. This is a result of the fact that over 30% of companies accepted onto cohorts since 2015 use DLT or provide services which utilise cryptoassets. Through testing these products in a controlled environment, the FCA has been able to work with firms to understand their business model as well as their potential market impacts. This is therefore an example of a measure which has provided policy makers with experience and empirical evidence to best inform cryptoasset regulation and shows the potential nexus between this and other aspects of innovation in the financial sector.

B. General questions: Opportunities and challenges raised by crypto-assets

Question 20

Do you consider that the issuer or sponsor of crypto-assets marketed to EU investors/consumers should be established or have a physical presence in the EU?

- No

Please explain your reasoning for your answer to question 20:

Due to the high mobility of cryptoassets, their cross-border nature, and the fact that access to crypto exchanges only requires internet access, requiring that the issuer or sponsor of cryptoassets marketed to EU investors/consumers should be established or have a physical presence in the EU is short-sighted. Both consumers and investors would benefit from a global approach.

Additionally, only 10% of cryptoassets issued globally are done so within the EU. Shutting off access to this global market would be detrimental to EU consumers.

C. Horizontal Questions

Question 51

In your opinion, how should the crypto-assets issued in third countries and that would not comply with EU requirements be treated?

Please rate from 1 (factor not relevant at all) to 5 (very relevant factor)

Those crypto-assets should be banned 1

Those crypto-assets should be still accessible to EU consumers/investors 5

Those crypto-assets should be still accessible to EU consumers/investors but accompanied by a warning that they do not necessarily comply with EU rules 5

Is there any other way the crypto-assets issued in third countries and that would not comply with EU requirements should be treated?

Where the cryptoasset in question is comparable (in terms of their economic functions and potential risks) to other traditional asset classes then the treatment of third country should mirror the third country treatment of these assets.

Where the cryptoasset is a novel asset, the risk associated with the asset must be taken into account when deciding the appropriate treatment.