Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

ABBL's response to ESMAs Consultation paper

On the draft Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments (ESMA75-453128700-52)

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Question 1:
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?

We agree, subject to ESMA considering ABBL's comments and amendments.

Avoidance of One-Size-Fits-All Guidance

We admit that establishing a one-size-fits-all guidance on the conditions and criteria to determine whether a crypto-asset can be classified as a financial instrument is not desirable.

Indeed, MiFID II does not include a one-size-fits-all definition for all types of financial instruments. The concept of financial instrument is delineated through a list of instruments having certain characteristics and essential features, as outlined in Annex I section C, rather than a strict and distinct set of conditions and criteria. Moreover, a sub-category of financial instruments, the transferable securities, is not exhaustively defined, leading to uncertainty and divergent applications in practice. As a result, practices and interpretations at national level are not fully aligned regarding the exact perimeter of the financial instrument definition, and, furthermore, Member States, when transposing MiFID II into their national laws, have not defined the term "financial instrument" in a fully harmonized way.

Consequently, both a "one-size-fits-all" approach and the establishment of too concrete conditions and criteria would be difficult to reconcile with the use of the concept "financial instrument", as defined under MiFID II, and with the principle of "technology neutrality".

Case-by-Case Flexibility and Legal Ambiguity

Given this context, we understand ESMA's approach on providing general conditions and criteria. However, this approach makes it difficult and costly to apply the guidance in practice, as a case-by-case analysis will be required with the resulting lack of legal certainty and a time-consuming process.

It is obvious that the approach proposed by ESMA entails a case-by-case assessment as to whether a crypto-asset shall be considered a financial instrument. As such, it is conceptually a good approach as

it gives certain flexibility. The crypto-asset space is very dynamic, and it is difficult to anticipate all the features that crypto-assets may have in the future. However, the proposed approach also implies potential legal ambiguity, additional costs, and possibility to have different views on the same crypto-asset depending on the national competent authority (NCA) consulted. What concerns the latter, each NCA may have their different points of views. For example, the French *Authorité des Marchés Financieres (AMF)* in a document dated 2018[1], based on an analysis in 2015[2], excluded that "cryptocurrencies" can be financial instruments, since they are not included in the list of financial instruments under the existing French regulation. It cannot be excluded that NCAs may have varying positions further to the principles laid down in these ESMA guidelines.

Finally, providing a one-size-fit-all guidance may create a disconnection between MiCA and MiFID II, due to the different implementations of MiFID II throughout the EU.

Need for Illustrative examples, Enhanced Clarity and Convergence

We find that the application and/or interpretation of the criteria proposed in the guidelines is challenging at times and any further clarifications or guidance from ESMA would be welcomed. Even though, it is crucial to maintain technological neutrality and avoiding a one-size-fits-all approach, more concrete ESMA's set of criteria for analysis, building on the experience of other NCAs for instance, would be welcomed.

Specifically, we would suggest ESMA to provide some illustrative examples to the industry to facilitate the assessment exercise.

In our opinion, the only way to promote convergent practices, respect technology neutrality and keep the link with MiFID II, would be to harmonize practices regarding the application of the definition of financial instrument under MiFID II and, by observing key lessons learned from MiFID II, to provide elements necessary to promote and support principles that would allow a harmonized practice in respect to crypto-assets.

We suggest that ESMA should implement certain convergence tools for the application of the definition of financial instrument under MiFID II, for example, by conducting peer reviews with the NCAs to strengthen the consistency in supervisory outcomes, and promoting a cooperation structure that brings together the NCAs and ensures that it serves as the forum for coordination of supervisory activities on this point.

Passportability

We would like to see more clarification of draft conditions backed with examples and a clear inclusion of passportability rights. We are of the opinion that once a classification of an asset has been recognised by the home NCA, all other NCAs should recognise this classification enabling "real" and streamlined passportability of assets across the EU and not creating legal uncertainty. The guidelines should lay down the ground for the minimisation of discrepancies in assessments carried out by the home and host NCA. A process of solving different views needs to be foreseen.

"Crypto-currencies" and Classification of Crypto-Assets Under MiCA

[1] Analyse sur la qualification juridique des produits dérivés sur crypto-monnaies (amf-france.org)
[2] BD159_03-86.indb (revue-banque.fr)

MiCA classifies crypto-assets into three types. The last type consists of crypto-assets other than ARTs and EMTs, and covers a wide variety of crypto-assets, including utility tokens (Recital (18) MiCA). It is generally considered that "crypto-currencies" fall within this large type of crypto-assets (See ESMA Guidelines, §58).

According to our understanding, this last category only concerns crypto-assets that fall within the scope of MiCA and that are governed by its rules. Crypto-assets that fall within MiCA and to which MiCA applies cannot possibly qualify as financial instruments (see Art. 2.4(a) MiCA).

Should this understanding be correct, it is to be concluded that crypto-currencies are crypto-assets falling within the third type of crypto-assets, which fall within the scope of MiCA, and which cannot possibly be crypto-assets qualifying as financial instruments. ESMA explicitly states that crypto-currencies belong to the third type of crypto-assets referred by Recital (18) MiCA (see ESMA Guidelines, §58).

We would like ESMA to clarify whether the third type of crypto-assets referred in Recital (18) MiCA only aims at crypto-assets governed by MiCA. Indeed, ESMA states that crypto-currencies belong to this type (See ESMA Guidelines, §58). If this type only aims at crypto-assets governed by MiCA, it is to be concluded that crypto-currencies would themselves be governed by MiCA and would not be financial instruments.

We would suggest ESMA to provide clarity on the following questions: Does this third type of crypto-assets exclusively encompass crypto-assets falling within the scope of MiCA (no financial instruments), or does it also extend to crypto-assets that are regulated under the MiFID II? Does ESMA consider crypto-currencies (or virtual currencies) as pure payment tokens and if so would they fall under the MiCA scope?

Qualification in the context of an "ICO"

In many cases, a token or a coin may be called a 'virtual currency', which is a concept that also comprises 'crypto-currencies'. We understand that, by definition, 'virtual currencies' are not financial instruments. However, a token or a coin should only be considered a 'virtual currency' as long as it « is accepted by persons as a means of exchange » (e.g. see Art. 1(20a) Luxembourg AML law), or as long as it is a « medium of exchange » (see definition of 'virtual currency' by FATF, p. 26). In other words, as long as it is a « payment token ».

Meanwhile, what about "Initial Coin Offerings" (ICOs), where the so-called payment tokens are initially used, not as a means of exchange, but « as a way to raise funds » ? Should a token/coin be seen as a virtual currency because it has its form and it is called as such, or should it be treated as a financial instrument whenever it is used to raise funds through an ICO and can yield returns for investors similar to stocks?

Therefore, we would suggest ESMA to clarify the qualification of crypto-assets used in "ICOs", "ITOs" and "IDOs".

Inclusion of a "Grace Period" Provision

It might be beneficial to include a provision for a "grace period" within the Guidelines. This would allow for scenarios where an initial determination on the classification of an instrument differs from

that confirmed by an NCA. During this period, parties could rectify any non-conformities, thus ensuring alignment with client expectation and applicable laws and regulations.

Question 2:
Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as transferable securities? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples

We agree, subject to ESMA considering ABBL's comments and amendments.

Issues with Technology Neutral Approach and Substance over Form Principle

We support the technology neutral approach and substance over form principle laid down in guidelines 1 and 2. These principles combined with the recognition of the technology under MiFID II (with the adjustment of the notion of financial instrument further to Article 18 of the DLT Pilot Regime) and guideline 9 on hybrid tokens could open the possibility to have various crypto-assets falling within the scope of MiFID II and hence outside the scope of MiCA.

Tokenisation vs. Native Crypto-Assets Classification

To be pragmatic, an initial distinction could be made between assets issued in a traditional environment, originally classified as financial instruments and then tokenized, and native crypto-assets, directly issued on a DLT. Tokenization does not fundamentally alter the nature of a traditional financial asset. If an asset, initially issued in a conventional financial setting and classified as a financial instrument, undergoes tokenization, it should retain its original classification as a financial instrument without necessitating re-evaluation. The tokenization process itself is indifferent to the asset's classification, serving primarily as a means to digitize the asset for DLT or similar platforms. Therefore, tokenized assets should mechanically preserve their original qualification as financial instruments. On the other hand, native crypto-assets, which are issued directly on a DLT or similar technology, do not have a prior existence in the traditional financial system and, as such, require a thorough examination against the conditions and criteria set forth by ESMA in its project of guidelines.

Beyond this initial distinction, for native crypto-assets, it would be appropriate to have a clearer view on certain type of assets to limit room for interpretation and allow the industry to have a higher level on certainty on the delineation between MiFID II and MiCA.

Need for Clarification on Transferable Securities

Regarding transferable securities, clarity is needed on defining securities within the context of MiFID II. This includes defining a class of securities, the concept of negotiability on capital markets, and the distinction between instruments of payment and financial instruments. Further clarification is required on these criteria, including the definition of the class, understanding different market types (centralised exchange, decentralised exchanges, and Over-the-Counter).

The Challenge of Decentralized Exchanges and MiFID II

What concerns decentralised exchanges, if, for instance, Bitcoin and other hybrid crypto-assets become financial instruments under MiFID II, this means that decentralised exchanges shall have the

necessary license for dealing with these instruments. This brings another difficulty and provides a view on how to regulate decentralised finance.

Cumulations of Functions of Crypto-Assets: Challenges with Interpretations

A crypto-assets that may cumulate (1) a potential payment, (2) an investment, and (3) store value functions. Some crypto-assets can have a variety of functions and it should not be possible for the issuer to arbitrage regulations against each other, meaning that, for example, to classify a crypto asset as a payment instrument to avoid a classification as a transferrable security – and thus since the crypto-assets are used or market within the European Union.

This could be obviously the case for different kind of tokens, which can be used as a payment function, as a way to store a value, as investments, etc. – e.g. stablecoins - which could be categorised as "instrument of payment" whereas they may have other features/characteristics allowing these to be theoretically classified as transferable security, money market instrument, derivative, and etc.

In order to ensure legal certainty to market players, the element of analysis on the "payment function" of an EMT and ART (part of PSD2, and PSR) would need to be developed and explained (among others within the Joint-ESA Guidelines for the content and form of the explanation accompanying the crypto-asset white paper and the legal opinions on the qualification of ARTs under Article 97(1) of MiCA).

These clarifications would have the merit to foster a consistent assessment where it relates to "other crypto-assets" such as Bitcoin. The notion of "instrument of payment" is key in the analysis and we would support clarification around that term to provide clear guidance on the treatment of assets and therefore having most crypto-assets sharing features of "transferable securities" being characterised as such.

Besides, it may be worth to consider whether EMTs and ARTs could be classified as investment tokens. Investment tokens are often viewed as financial instruments (see Bafin, under 'Security tokens'[3]; See FINMA, under 'Several activities requiring authorisation conducted'[4]; BIS, beginning p.11[5]).

Concerning the definition of ARTs (Art. 3.1(6) MiCA): If the rights referenced by the ART are rights similar to shares, bonds or other securities (e.g., securities embedding a derivative), they could theoretically be recognised as transferable securities and, therefore, as a financial instrument (ESMA Guidelines, §30 &32).

In this context, we would like to ask ESMA to provide clarity on whether an ART could be considered both an investment token and a financial instrument.

Given the wide range of possible interpretations of the criteria for the classification of crypto-assets, we would be in favour of a more centralised approach to make sure that consumers benefit from the same level of consumer protection in all European countries and that differences in interpretation between NCAs cannot be used to arbitrage regulation by issuers or to gain competitive advantages by certain countries.

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3 https://www.bafin.de/EN/Aufsicht/FinTech/Geschaeftsmodelle/DLT_Blockchain_Krypto/Kryptotoken/Kryptotoken_node_en.html

4 https://www.finma.ch/en/news/2023/05/20230517-mm-dohrnii-stiftung/

5 https://www.bis.org/fsi/publ/insights49.pdf

Stablecoins: Risk and Implications of incorrect Qualification

On the stablecoin point, we identify a potential risk of circumventing certain regulatory constraints by issuers targeting to avoid the financial instrument qualification and hence substituting it from all protection offered to consumers (including MiFID), from the mandatory contribution to the Single Resolution Fund or to guarantee schemes similar to the Deposit Guarantee Fund. In addition, as pointed out by the Bank for International Settlements (BIS) in a recent publication[6] echoing an IMF-FSB paper, the widespread use of stablecoins as payment instruments could generate additional risks for the broader financial system notably by undermining the effectiveness of the monetary policy, ultimately threatening the global financial system stability.

Question 3:
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.

We agree, subject to ESMA considering ABBL's comments and amendments.

In the context of derivatives, ESMA guidelines seem to clearly state that a crypto-asset can represent a possible underlying asset for a derivative contract, without altering the nature of the derivative as a financial instrument.

However, we would suggest ESMA to clarify how the settlement process occurs, especially if a crypto-asset are involved. One can ask if using a crypto-asset for settlement would classify the crypto-asset as a payment instruments. Further clarity is therefore needed on this point.

Question 4:
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 condition, criteria and/or concrete examples to suggest?

We agree, subject to ESMA considering ABBL's comments and amendments.

We understand that ESMA is making application of the "same activity, same rules" principle for each category of financial instrument (money market instrument, unit in collective investment undertakings, derivative, emission allowance instrument). This implies that crypto-assets that have the features of the related MiFID financial instrument could be captured by MiFID II, thus echoing the exclusion approach laid down in MiCA.

We support this position as we are of the opinion that MiCA's rules should not apply when the "same activity, same rules" principles can be in motion - for example when facing stablecoins having features of money market instruments, or even derivatives, they should be classified as financial instruments in this case. We would even argue that MiCA's exclusion approach might even be counterproductive and creates incentives which were certainly not intended by the regulator.

[6] "Stablecoins: regulatory responses to their promise of stability", April 2024

However, certain crypto-assets, such as asset-referenced tokens (ARTs), may show features of several different financial instruments.

With regard to units of collective investment undertakings, further clarifications by ESMA are needed for the analysis of the treatment of crypto-assets in the context of a Decentralized Autonomous Organization (DAO), especially when the DAO is set up for the acquisition of assets. Under these circumstances and considering the right attributed to the members of the DAO, it cannot be possible to exclude *a priori* that a particular DAO may be considered as a financial instrument.

Therefore, to facilitate the identification exercise, are of the view that an additional discussion is necessary to detail the criteria laid down in the guidelines (without engaging into a "one-size-fits-all" approach), including fractions of crypto-assets. General ESMA's guidance on the concrete method and elements to consider new type of assets within the MiFID II perimeter would certainly facilitate the assessment as we appreciate that MiCA "[…] *expressly excludes from its scope crypto-assets that qualify as financial instruments* […]".

Question 5:
Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

We agree, subject to ESMA considering ABBL's comments and amendments.

Being a MiCA crypto-asset does not necessarily and automatically imply that conditions to qualify as MiFID II financial instrument are not satisfied.

For example, certain utility tokens may pose a challenge, such as those used as reward or cashback on transactions. Further guidelines from ESMA are therefore needed for this type of tokens.

Criteria laid down in paragraphs 63 and 64 give a general view/guidance on what could be a utility token that does not fall within the scope of MiFID II. However, given the very broad definition of Art. 3(1)(9) MiCA, the notion of utility token could cover other type of assets as long as the distinctive criteria is the "access to a good or a service". There is a possibility to have various tokens falling within the scope of MiFID II, in particular, where these assets are hybrid or where these assets have some characteristics of a MiFID instrument (cf guideline 9, paragraph 79) by virtue of the hierarchical approach promoted.

Question 6:
Do you agree with the suggested 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 condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

We agree, subject to ESMA considering ABBL's comments and amendments.

ESMA's Mandate and the Need for More Clarity on NFTs

We are not sure that ESMA received a mandate under MiCA to develop conditions and criteria for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation. Preamble 14 of MiCA states that "guidelines should also allow for a better understanding of the cases where crypto-assets that are otherwise considered unique and not fungible with other crypto-assets might qualify as financial instruments." Article 2.5 of MiCA only gave a mandate to ESMA to issue guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments.

Notwithstanding the above, clarifications on the NFT concept are welcomed, especially since the concept is not defined and used as well in non-legal contexts. For example, in some cases, NFT may be used as proving the participation to a DAO specialised in certain types of financial activities (e.g. investment). As such, some features of these NFTs can resemble to the ones of units of UCIs.

Contradictions over Fractional Parts of NFTs

However, regarding the fractional parts of NFTs a contradiction seems to exist between the preamble of MiCA and the ESMA guidelines. While the former indicates that the fractional parts of a unique and non-fungible crypto-asset should not be considered unique and non-fungible, the draft guidelines seem to propose a case-by-case analysis based on a set of criteria.

From the technology perspective regarding fractional parts of NFTs: we observe that NFTs can be based on different standards. Most NFTs have in fact a unique hash. This single hash cannot be divided into fractions. It is possible that the ownership of the NFT, the one unique hash, is shared by multiple owners, each having full rights to the whole NFT.

Qualification of NFTs

In our opinion, the following seems to be missing in ESMA's guidelines: It is understood that, according to MiCA, NFTs representing assets that are themselves unique and non-fungible are excluded from MiCA ('real NFT'). On the contrary, it is also understood that 'NFTs' that are not at all unique but that are fungible fall within MiCA ('fake NFT') (ESMA Guideline, beginning p. 21 & 71).

However, the following question becomes apparent: Are 'real NFTs', which are not governed by MiCA, should automatically be considered financial instruments? In our perspective, they should not, but this should be explicitly clarified by ESMA.

ESMA should be aware of the fact that systematically allocating 'fake NFTs' to MiCA may contradict several doctrinal articles, including a study prepared for the European Parliament (EP, beginning p. 102)? (compare with ESMA §71)

What about a NFT representing an asset not yet in existence, such as something rare that is planned to be produced in limited quantities and not yet available in the market. Given that this asset is not unique and does not currently exist, could this 'fake NFT' be considered speculative and a future or a derivative contract? (See ESMA, §63 but with regard to utility tokens).

Collections and Series of NFTs

While the proposed criteria for NFTs to «classify a crypto-asset as unique and non-fungible» looks reasonable, their application to real cases will need further clarification from the authority. ESMA guidelines should be clearer on how and when NFTs can be considered as part of the class and fungible. For instance, popular NFT series, like Bored Ape Yacht Club (BAYC), may share similar rights, yet have distinct appearance.

In this regard, ESMA could suggest a ranking in the list of features to be considered to understand which ones are the most important to classify a series of NFTs as financial instrument? For instance, we would welcome clarification from ESMA on recital 11 of MiCA in particular what a large collection or series would mean in practice and how each indicator would be weighted when assessing the fungibility and uniqueness of a crypto-asset, namely its technical features (e.g. ERC-721 or ERC-20), intrinsic value, comparability with other crypto-assets, and functionality.

Categories of NFTs

What concerns NFTs, we would suggest ESMA to expressly clarify the regime and concrete criteria for the various categories, as there seems to be several distinct possibilities for NFTs:

- MiCA's eligible NFTs (i.e. those that are not unique/fungible/fractionable);
- «true NFTs» which are out of the scope of MiCA (as they are truly unique) and which are also not in the scope of MiFID II as they are not interchangeable/ do not constitute a class of securities;
- NFT as a tokenised representation of ownership of real-world asset (such as classic cars, diamonds, rare watches, and etc);
- Possibility for a "fractioned" NFT that can be qualified as a transferable security and eventually eligible under MiFID II regime.

Question 7:
Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

We agree, subject to ESMA considering ABBL's comments and amendments.

Lack of Harmonisation

We are of the opinion that the guideline reflects the difficulties to promote convergent practices, while being bound to non-harmonized concepts. The resulting unresolved issue of shortage of legal certainty is made worse by seemingly allowing for the qualification of hybrid tokens as financial instruments without requiring the presence of all the traditionally required features.

Responsibility and Disputes over the Qualification of a Crypto-asset: The issue with Licensing

This question raises the important point of the responsibility attached to the determination of the nature of the asset. We understand that the issuer is responsible for the classification of an asset. This may pose difficulties in case if an actor in the value chain is challenging the qualification. This may indeed result in situations where an issuer qualifies the assets as MiFID II instruments whereas a provider/other party considers that the asset shall qualify as a MiCA crypto-asset. There might be situations where there is a divergent analysis which could expose both the issuer and a service provider to difficulties, as the problem would then not just be limited to the qualification of the asset but also on the licencing regime of the service providers. This situation can become even more complex in the context of the cross-border and global nature of the industry.

For example, consider a service provider authorized as a Crypto-Asset Service Provider (CASP) under the MiCA framework. This CASP might initially engage with assets considered within the scope of the MiCA regulation. However, if these assets are later reclassified as financial instruments subject to the MiFID II, the CASP could find itself dealing with MiFID-regulated instruments without the proper MiFID licensing. This scenario could expose investors to risks since the CASP, while compliant with MiCA, lacks the necessary authorisation to operate within the MiFID II framework. The example also applies the other way round: a service provider which does not have authorisation to act as CASP under MiCA could start to provide service over assets that are initially qualified as MiFID financial instrument but finally re-categorized as MiCA crypto-assets. All these will lead to multiple levels of issues related to licensing and may imply several risks for investors and for the service provider (legal, financial, and etc.).

Need for Convergence

We recommend that ESMA clarifies the application of the criteria further and promotes the convergence of practices in the industry to facilitate the adoption of the standards/taxonomy and minimise instances of divergent classification assessments among industry players.

We would suggest ESMA to provide clarification on the number of features required to be captured by the definition of financial instrument so that all the actors in the value chain could perform their assessment and arrive to the same conclusion.

Does ESMA intend to support the position that this hierarchical approach is to be adopted where all characteristics of a financial instrument are satisfied or when the instrument under consideration has only certain characteristics?

Complex Challenge of Hybrid Tokens

Hybrid tokens pose a complex challenge due their diverse features and rights. We are of the opinion that categorising hybrid tokens as a financial instrument may have unexpected consequences for traditional assets outside of the crypto-asset industry. Adopting a position whereby all hybrid tokens should be categorized as MiFID II financial instruments by virtue of the hierarchical approach may open the possibility for hybrid tokens such as Bitcoin, Ether and others to be categorized as financial instrument under MiFID II, depending on the notion of "payment instrument" under PSD3/PSR and MiFID II (see question 2).

There is therefore a need for ESMA to clarify these key notions to provide a higher level of certainty on the qualification of this type of assets, considering the consequences of the chosen solution in the current financial market.

In conclusion, we welcome ESMA's proposition and are of the opinion that the classification process for hybrid tokens should not only consider their multifaceted nature but mainly prioritise their identification as financial instruments when a hybrid token displays features (number to be determined) of a financial instrument.

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