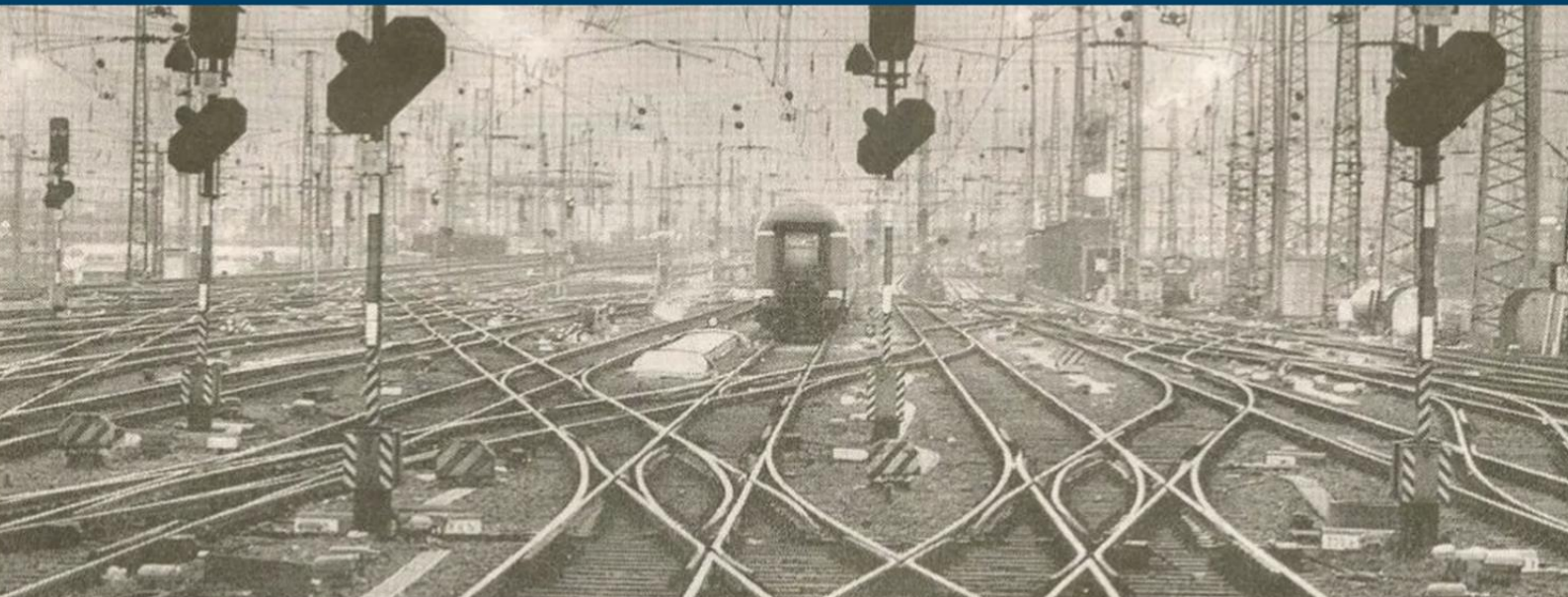


BETTER FINANCE Position on Crypto Assets and Distributed Ledger Technology

Regulations on Markets in Crypto-Assets and the EU Pilot Regime for Distributed Ledger Technology (DLT) based market infrastructures



BF BETTER FINANCE

The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE Draft Position on crypto assets and distributed ledger technology

Regulations on Markets in Crypto-Assets and the EU Pilot Regime for Distributed Ledger Technology (DLT) based market infrastructures

Ref:

- Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Digital Finance Strategy for the EU, [COM/2020/591 final](#) ("Digital Finance Strategy");
 - Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, [COM/2020/593 final](#) ("MiCA");
 - Proposal for a Regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology, [COM/2020/594 final](#) ("EU Pilot Regime")
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EXECUTIVE SUMMARY

General comment

BETTER FINANCE welcomes the initiatives and efforts of EU public authorities to accommodate emerging technologies in financial services whilst maintaining a safe and stable environment for consumers and financial services users to benefit of the advantages of our single market for capital movements and investments. In light of the rapidly evolving FinTech sector, the timeliness and decisiveness of such initiatives are key for the EU to keep a leading role on the global regulatory scene.

Although much work is still to be done, BETTER FINANCE acknowledges the difficulty of the task to keep up with technological developments, particularly when applied to financial services, and stimulate innovative products and business models. However, above all, EU regulation should maintain the **high standard of investor protection** as an overarching principle.

Crypto-Assets (MiCA)

BETTER FINANCE welcomes the proposal of the European Commission for the Markets in Crypto-Assets Regulation (MiCA). However, MiCA lacks a definition and legal treatment for "hybrid" assets. The exemptions for the publication of the Prospectus-like "white paper" should be reconsidered in light of its function: to protect individual, non-professional investors regardless of the market capitalisation value.

The Regulation should further clarify what "advice" means and what criteria are attached to it. Providing advice on crypto-assets to individual, non-professional clients by crypto-asset services providers should be subject at least to the same standard of investor protection under the Markets in Financial Instruments Directive (MiFID II, Art. 24); a full ban on "inducements" would be preferable.

The framework should also introduce a client categorisation system, following the MiFID II one but adding a third, intermediary class of qualified non-professional clients or investors.

EU Pilot Regime for DLT-based FMIs

The EU Pilot Regime should serve the purpose of enabling distributed-ledger technology (DLT) based financial market infrastructures (FMIs) to expand while regulators can observe what novel risks and challenges are posed by these technologies and whether a separate regime is justified or not.

Access to trading, selling and distribution of assets on DLT-based multilateral trading facilities (MTFs) should be allowed to non-professional (“retail”) investors only if the operator does not apply for exemptions under the Central Securities Depositories Regulation (CSDR), if the operator used a Trusted Third Party (TTP) or if the thresholds for admission of tokens are significantly reduced. TTPs should be held at a high standard of compliance with existing regulatory frameworks.

The scope of DLT-based FMIs should not be limited to already existing players (authorised under MiFID 2/ MiFIR / CSDR) but should promote “newcomers” to operate and stimulate competition on the market.

This is particularly the case for the identification of shareholders and the exercise of shareholders’ voting rights within the EU, as recommended by the High-Level Forum on the CMU,¹ as the existing process is antiquated and highly fragmented. This crucial process for sustainable corporate governance is an ideal and priority candidate for a pilot regime.

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About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users. BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users.

Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

¹ Final Report of the High-Level Forum on the Future of the Capital Markets Union: *A New Vision for Europe’s Capital Markets*, p. 79-81, available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.

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KEY CONCEPTS

The following concepts and abbreviations are commonly used throughout this paper and, in general, in the EU public policy debate:

Blockchain	<i>“A form of distributed ledger in which details of transactions are held in the ledger in the form of blocks of information. A block of new information is attached into the chain of pre-existing blocks via a computerised process by which transactions are validated”².</i>
CCP	Central Clearing Counterparty, a financial institution that interposes between parties (investors) to a transaction to ensure the securities exist and validate the transaction; the official definition given by the Regulation (EU) 648/2012 is that of <i>“a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer”³.</i>
CMU	Capital Markets Union, the political objective of (and plan to build) the EU single market for capital movements and investments.
Crypto-assets	Digital assets based on cryptography and existing on a distributed ledger; according to the Financial Stability Board, a crypto-asset is <i>“a type of private asset that depends primarily on cryptography and distributed ledger or similar technology as part of their perceived or inherent value”⁴.</i>
CSD	Central Securities Depository, a financial institution that safekeeps transferable securities on behalf of investors; the official definition given by Regulation (EU) 909/2014 is that of <i>“a legal person that operates a securities settlement system referred to in point (3) of Section A of the Annex and provides at least one other core service listed in Section A of the Annex”⁵.</i>
Digital Finance Strategy	An action plan proposed by the European Commission to the EU co-legislators in October 2020 to strengthen EU regulation in digital finance.

² See the Glossary used by the Financial Stability Board, available at: <https://www.fsb.org/wp-content/uploads/P310519.pdf>.

³ Article 2(1) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, ELI: <http://data.europa.eu/eli/reg/2012/648/oj>.

⁴ FSB Glossary (n 2).

⁵ According to Art. 2(1) of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 ELI: <http://data.europa.eu/eli/reg/2014/909/oj>.

DLT	"A class of technologies which support the distributed recording of encrypted data" ⁶
ESAs	European (financial) Supervisory Authorities, i.e. ESMA, EIOPA and EBA (European Securities and Markets Authority, European Insurance and Occupational Pensions Authority and European Banking Authority).
EU Pilot Regime	European Commission's Proposal for a Regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology.
FinTech	A field of financial services (subset of Digital Finance) that comprises new technologies applied to financial instruments and services.
HLF CMU	High-Level Forum on the Future of the CMU, comprising finance experts and practitioners to put forward recommendations on what is necessary to build the CMU.
MiCA	European Commission Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-Assets, and amending Directive (EU) 2019/1937 (often referred to as "MiCA" after MiFID).
MiFID (II)	Markets in Financial Instruments Directive (II).
MTF	Multilateral Trading Facility, which is very similar to an RM (below) but it differs in that it can be operated by both an investment firm (as an investment service to clients) and by a market operators, whereas an RM can only be set up by an authorised market operator; in addition, Initial Public Offerings can be done only through a RM; according to MiFID II, the official definition of an MTF is " <i>means a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with Title II of this Directive</i> ". ⁷
RM	Regulated Market, which is a trading venue in which securities can be issued (new) or bought and sold on a non-discretionary basis; the official definition of a regulated market according to MiFID II is " <i>means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive</i> ". ⁸
TTP	Trusted Third-Party, which could be defined a reliable and neutral link ensuring regulatory compatibility and legal certainty.

BETTER FINANCE worked as part of the High-Level Forum on the Future of the CMU on the topics of crypto-assets and tokenisation, where the principles of technology neutrality, high standard of investor protection, and adequate disclosure were upheld – see here the [Final Report of the High-Level Forum on the Future of the CMU "A New Vision for Europe's Capital Markets"](#).

⁶ According to Art. 2(1) of the EU Pilot Regime.

⁷ According to Article 4(22) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II) ELI: <http://data.europa.eu/eli/dir/2014/65/2020-03-26>.

⁸ According to Article 4(21) of MiFID II.

GENERAL COMMENTS

BETTER FINANCE welcomes the initiatives and efforts of EU public authorities (ESAs, European Commission, EU co-legislators) to regulate capital markets and create a safe and stable environment for businesses, consumers and users of financial services to invest and benefit of the advantages of our single market for capital and investments. After the 2008 global crisis, many reforms and policy initiatives occurred, giving impetus to the EU as a leading actor on the global regulatory scene, most recently spearheading the fields of sustainable and digital finance.

In recent years, the EU pushed its agenda on sustainable finance by issuing a series of initiatives to stimulate and regulate the field in order to ensure fair competition and adequate investor protection. In 2018, the European Commission adopted the **Action Plan on Sustainable Finance**⁹ and, at the end of 2019, the **European Green Deal** setting a series of priorities to reach carbon neutrality by 2050.

The EU had already adopted a progressive approach to the regulation of digital tools and the emerging, new technologies integrated in financial services and capital markets with the **FinTech Action Plan**¹⁰ (2018). The recent **Digital Finance Strategy**¹¹ (2020), which takes important steps in creating a framework for regulatory and supervisory guidance on the use of artificial intelligence (AI) applications in finance, promoting data-driven innovation in finance by establishing a common financial data space, and two regulations concerning crypto-assets and distributed ledger technologies (DLT).

Considering the mutations triggered by the COVID-19 health crisis, online, digitally enabled business models in capital markets will be used more and more by individual, non-professional investors. At the same time, the increase in digital literacy and in the propensity of EU households to invest¹² underpins the necessity to ensure that the EU Digital Finance framework is by design built to protect financial services users, while enabling them to fully reap the benefits new technologies bring (such as transparency, democratisation, cost efficiency gains etc).

Although much work remains to be done in the field of Digital Finance, BETTER FINANCE acknowledges the difficulty of the task to keep up with technological developments, particularly when applied to financial services. The challenge is to stimulate innovative products and business models to flourish and expand while ensuring the safety, stability and integrity of EU capital markets and a **high standard of investor protection**.

This position paper conveys BETTER FINANCE's view and recommendations concerning the two legislative proposals on the Markets in Crypto Assets ("MiCA") Regulation and on the EU Pilot Regime for Distributed Ledger Technology (DLT) based market infrastructures ("EU Pilot Regime").

Note: **Digital Finance** is a large field which encompasses several, familiar concepts such as FinTech (robo-advisors, blockchain), alternative finance (crowdfunding, peer-to-peer lending) and the digitalisation of financial services (payment applications, web-comparison tools, online databases or fund supermarkets). Often digital finance is used alternatively with FinTech, although the latter is a sub-field of digital finance.

⁹ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

¹⁰ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - FinTech Action plan: For a more competitive and innovative European financial sector, COM/2018/0109 final.

¹¹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Digital Finance Strategy for the EU, COM/2020/591 final ("Digital Finance Strategy").

¹² See the explanatory memorandum of the Digital Finance Strategy.

The need to regulate crypto-assets and DLTs

BETTER FINANCE supports new initiatives and models aimed to make finance more efficient, accessible, transparent and inclusive for individual, non-professional investors. EU financial services users are the largest source of long-term financing for the EU economy¹³ and face many barriers to invest and directly participate into capital markets, such as: conflicts of interest in the distribution chain,¹⁴ lack of trust,¹⁵ financial literacy,¹⁶ transparency,¹⁷ adequate information disclosure,¹⁸ financial exclusion¹⁹ or inability to engage as shareholders in investee companies.²⁰ FinTech initiatives, such as automated investment platforms, crypto-assets and the DLTs can certainly help to improve, alleviate or eliminate at least part of the abovementioned obstacles.

However, there are several risks that can be highlighted in connection to crypto-assets and DLT.²¹ First, unlike in financial markets, there is no 'lender of last resort' to bail-out crypto-asset issuers, no protection system for investments or deposits, no clearing or settlement systems to certify that assets exist or clearing houses to shield from default risk, neither rules and supervision of the actors involved in issuing and trading crypto-assets. This is particularly important as specialised publications highlighted suspicions about the price volatility of certain crypto-tokens, market manipulation ("pump and dump") and potential illegal uses of these new technologies (money laundering, illegal financing etc).²²

¹³ See BETTER FINANCE CMU Assessment Report 2015-2019 (2019), available at: <https://betterfinance.eu/wp-content/uploads/CMU-Assessment-Report-2019.pdf>.

¹⁴ See Veerle Colaert, Thomas Incalza, 'Conflicts of Interest and Inducements in the Financial Sector' in Veerle Colaert, Danny Busch, Thomas Incalza (eds.), European Financial Regulation: Levelling the Cross-Sectoral Playing Field (2020) Hart Publishing, 377 – 394, 377; Michael Haliassos, Alexander Michaelides, 'Asset and Debt Participation of Households: Opportunities and Challenges in Eliminating Borders' in Ester Faia, Franklin Allen, Michael Haliassos and Katja Langenbucher (eds.), Capital Markets Union and Beyond (2019) MIT Press, 113 – 126, 118; Vanguard's European Manifesto: Three Steps to Improve the Financial Standing of people in the EU (February 2020), 9, available at:

¹⁵ For a literature review on the lack of trust of "retail" investors in financial services, see BETTER FINANCE, 'Robo-Advice 5.0: Can Consumers Trust Robots?' (2020) BETTER FINANCE, available at: <https://betterfinance.eu/publication/robo-advice-5-0-can-consumers-trust-robots/>.

¹⁶ According to studies done on the level of adult financial literacy in Europe, less than half of respondents can correctly answer three out of four basic financial literacy questions on inflation, numeracy, risk diversification and compounding – see Leora Klapper, Anamaria Lusardi, Peter van Oudeheusden, 'Financial Literacy Around the World: Insights from the Standard & Poor's Ratings Services -Global Financial Literacy Survey' (2014); see also the Organisation for Economic Cooperation and Development, 'G20/OECD INFE Report on Adult Financial Literacy in G20 Countries' (2017) OECD, available at: <http://www.oecd.org/daf/fin/financial-education/G20-OECD-INFE-report-adult-financial-literacy-in-G20-countries.pdf>.

¹⁷ See BETTER FINANCE Key Priorities for 2019-2020, available at: <https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Key-Priorities-2019-2024-with-Infographic.pdf>; see BEUC Green Paper on Retail Financial Services (March 2016) available at: https://www.beuc.eu/publications/beuc-x-2016-027_fal_beuc_position_green_paper_financial_services.pdf.

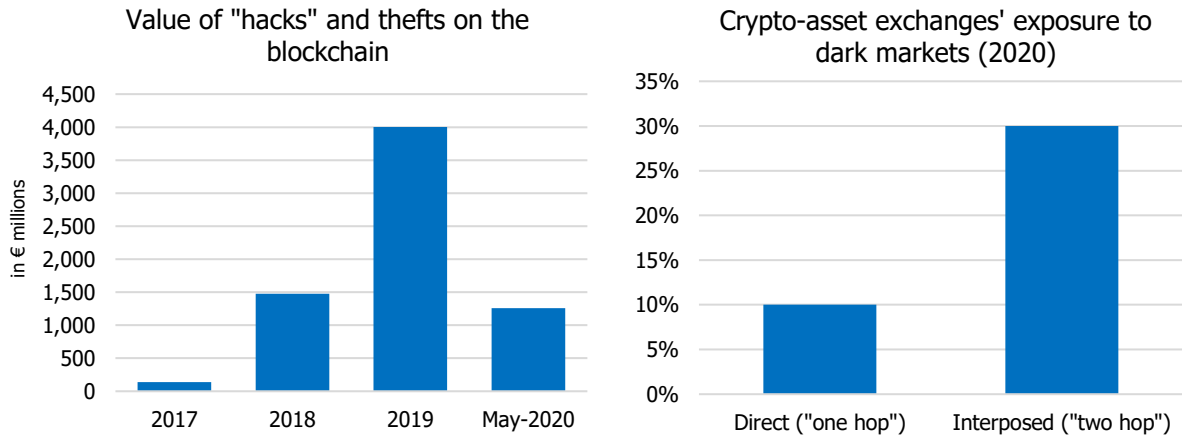
¹⁸ BETTER FINANCE Response to the ESAs JCP (16/10/2019) on amendments to the PRIIPs KID, <https://betterfinance.eu/publication/better-finance-response-to-the-esas-jcp-16-10-2019-on-amendments-to-the-priips-kid/>; BETTER FINANCE PEPP Technical Working Paper 1/2020, <https://betterfinance.eu/PEPP-TWP-1-2020/>.

¹⁹ See Olivier Jérusalmy, Paul Fox, Nicolas Hercelin, Lin Mao, 'Financial Exclusion: Making the Invisible Visible' (March 2020) FinanceWatch Report, available at: https://www.finance-watch.org/wp-content/uploads/2020/03/FW-Report_Vulnerable_Groups_March2020.pdf; see also the study by Luisa Anderloni, Bernard Bayot, Piotr Błędowski, Małgorzata Iwanicz-Drozdowska, Elaine Kempson, 'Financial Services Provision and Prevention of Financial Exclusion' (2008) European Commission DG EMPL (VC/2006/0183), available at: <http://www.ecosocdoc.be/static/module/bibliographyDocument/document/001/242.pdf>.

²⁰ See EuroFinUse, 'Barriers to Shareholders Engagement' (2012) the European Federation of Financial Services Users, available at: https://betterfinance.eu/wp-content/uploads/publications/FINAL_Barriers_to_Shareholder_Engagement.pdf; see Christiane Hölz, 'The Future of General Shareholder Meetings: BETTER FINANCE – DSW Study on the 2020 Virtual Shareholder Meetings in the EU' (2020) Deutsche Schutzvereinigung für Wertpapierbesitz (DSW) and BETTER FINANCE, available at: <https://betterfinance.eu/wp-content/uploads/Virtual-AGMs-in-the-EU-FINAL.pdf>.

²¹ Also Maria Demertzis, Guntram B. Wolff, 'The Economic Potential and Risks of Crypto Assets: Is a Regulatory Framework Needed?' (September 2018) 14 Bruegel Policy Contribution, p. 10 *et seq.*, available at: https://www.bruegel.org/wp-content/uploads/2018/09/PC-14_2018.pdf.

²² See the Report of the FSB on crypto-assets – Financial Stability Board, 'Crypto-Assets: Report to the G20 on the Work by the FSB and Standard-Setting Boards' (16 July 2018) Financial Stability Board, p. 3, available at: <https://www.fsb.org/wp-content/uploads/P160718-1.pdf>.

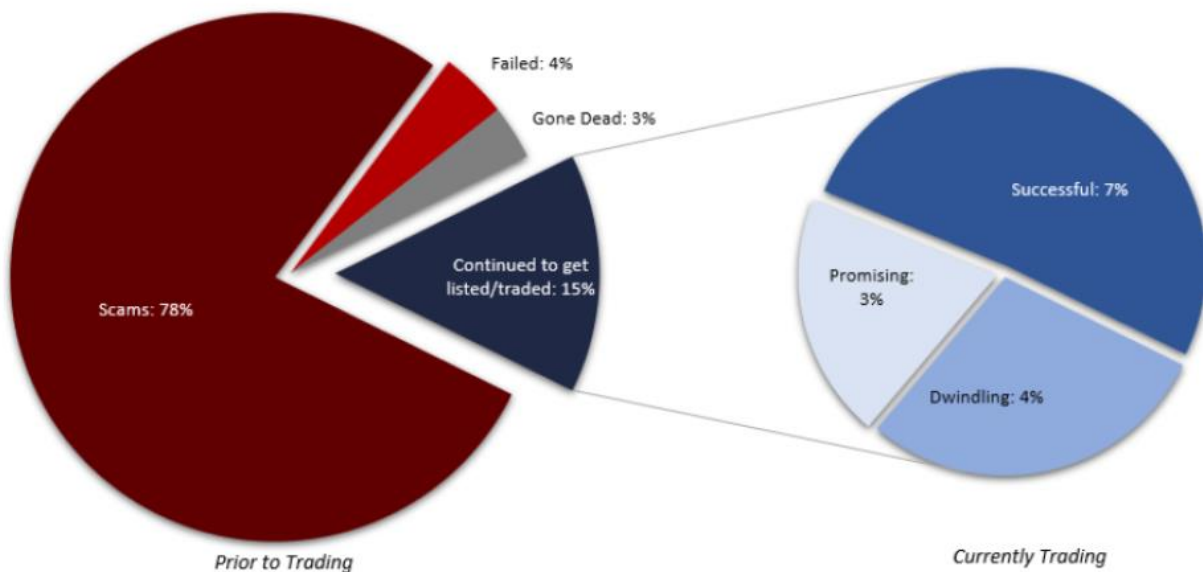


Source: CipherTrace Report 2020,²³ quoting CipherTrace Cryptocurrency Intelligence data; ECB forex data;

Note: Right-hand side title: "second hop" describes the number of intermediated transactions "savvy criminals" use to direct "tainted funds" to exchanges in order to cash out in fiat currencies.²⁴

Another example concerns initial coin offerings (ICOs) and to what extent these are used for genuine business purposes or as scams. According to an own initiative report of the Securities and Markets Stakeholder Group of ESMA, in 2018 around 78% of ICOs were scams, and only around 15% "went on to trade on an exchange".²⁵

Figure 29: Listed Coins/Tokens (in \$M USD), \$50M+ Market Cap



Source: Satis Research

Source: SMSG Advice to ESMA (ESNA22-106-1338) apud Satis Research

²³ CipherTrace, 'CipherTrace Cryptocurrency Crime and Anti-Money Laundering Report, Spring 2020' (June 2020) CipherTrace, (LHS) Figure 1, page 5, (RHS) Figure 3, p. 9, available at: <https://ciphertrace.com/wp-content/uploads/2020/06/spring-2020-cryptocurrency-anti-money-laundering-report.pdf>.

²⁴ According to CipherTrace, "As exchanges begin to develop stronger KYC [A/N- know your client] and AML [A/N - anti-money laundering] protocols, it becomes harder for criminals to directly deposit tainted funds into an exchange. Instead, savvy criminals must layer funds through multiple transactions and even private wallets before cashing out via regulated fiat off-ramps such as exchanges. This means exchanges must remain diligent to not only their direct (one-hop) exposure risk to criminal funds but should be looking at their multi-hop risk to best understand their risk exposure" – see *Ibid*, p. 8-9.

²⁵ Securities and Markets Stakeholder Group, 'Advice to ESMA: Own Initiative Report on Initial Coin Offerings and Crypto-Assets' (19 October 2018) ESMA22-106-1338, p. 7, available at: https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338_smsg_advice_report_on_icos_and_crypto-assets.pdf.

Second, crypto-assets can raise concerns for financial stability. While the European Central Bank and the Financial Stability Board highlighted that no such risks are posed at the moment,²⁶ crises can trigger “crypto runs” which could lead to financial instability.²⁷

Note: Crypto-“currency” is a misnomer as crypto-assets are not a legal tender, money or fiat currency. Crypto-assets do not fulfil the characteristics of money, i.e. to be widely accepted, used, and trusted as a common medium for exchange.²⁸ In addition, these are not either species of money, i.e. commodity money, representative money or fiat currency. Commodity money must have a physical form, like gold,²⁹ whereas representative money must be backed and redeemable for commodity money.³⁰ Crypto-assets are neither fiat currency as these lack State tutelage,³¹ including central banks’ backing and monopoly over monetary policy.³² Most crypto-assets do not satisfy either the functions of money,³³ i.e. that of serving as a unit of account or store of value.³⁴ To take an example, the high volatility of Bitcoin “*makes it impossible to rely on Bitcoin as a means to maintain value*”,³⁵ the latter remark being equally valid for most altcoins as well.

Third, there is the risk of fraud. Following the DAO attack in 2017,³⁶ \$50mIn worth of “ether” were stolen from users’ wallets, which led to a significant market correction. Other notorious “hacks” include the \$65 million theft from Shift and Krypton,³⁷ or the \$2 billion from Mt. Gox.³⁸

The ESAs issued early warnings against the risks of the unregulated DLT and crypto-assets environment.³⁹

Advantages of DLT-based technologies

The COVID-19 pandemic created a distinct momentum for retail investments, in particular through digital tools. An AMF France (French Securities and Markets Supervisory Authority) analysis on the trading activity of retail investors during the first wave of COVID-19 lockdowns shows an increase in stock acquisition from the SBF 120 during the period of 24/02 – 03/04/2020: around 580,000 retail clients bought on average three (3.3) new stocks, of which “*more than 150,000 retail clients who has not made any direct financial investment transactions in 2018 and 2019*” (these new investors were significantly younger compared to the usual ones, i.e. 10-15 years younger).⁴⁰ A study on UK retail investors showed an increase in trading intensity roughly in the same period, with “*distinct spikes*” for

²⁶ Financial Stability Board, ‘Crypto-Assets: Report to the G20 on the Work by the FSB and Standard-Setting Boards’ (n 14); European Central Bank Occasional Paper Series – Crypto-Assets: Implications for Financial Stability, Monetary Policy, and Payments and Market Infrastructures (May 2019) No 223, available at: <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf>.

²⁷ For a wider discussion, see Dr. Robby Houben, Alexander Snyers, ‘Crypto-assets: Key Developments, Regulatory Concerns and Responses’ (April 2020) European Parliament Policy Department for Economic, Scientific and Quality of Life Policies, PE 648.774, 42, available at: [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU\(2020\)648779_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU(2020)648779_EN.pdf).

²⁸ The Governor of the Banque de France held that “*bitcoin is in no way a currency, or even a cryptocurrency*”, but the contrary – see Leigh Thomas, ‘BitCoin Isn’t a Currency or Even a Cryptocurrency, says France’s Central Bank Governor’ (Independent, 01 December 2017), available at: www.independent.co.uk/news/business/news/bitcoin-latest-updates-france-central-bank-currency-cryptocurrency-digital-francois-villeroys-de-a8086186.html.

²⁹ Thomas J. Sargent, Meil Wallace, ‘A Theory of Commodity Money’ (1983) 12(1) Journal of Monetary Economics 163, 165.

³⁰ Sergii Shcherbak, ‘How Should Bitcoin be Regulated?’ (2014) 7(1) European Journal of Legal Studies, 45-91, 52.

³¹ European Central Bank, ‘What is money?’ (European Central Bank website, 02 December 2017) available at www.ecb.europa.eu/explainers/tell-me-more/html/what_is_money.en.html.

³² For instance, in the EU the European Central Bank (as part of the European System of Central Banks) is responsible for monetary policy and price stability, according to Art. 127(1) of the Treaty on European Union and Arts. 127, 128 of the Treaty on the Functioning of the EU.

³³ Nicole D. Schwartz, ‘Bursting the Bitcoin Bubble: The Case to Regulate Digital Currency as a Security or Commodity’ (2014) 17 Tulane Journal of Technology and Intellectual Property Law 320, 329.

³⁴ John N. Smithin, *What is Money?* (2000) Routledge International Studies in Money and Banking, 19-20.

³⁵ Schwartz (n 22), 329.

³⁶ See David Siegel, ‘Understanding the DAO Attack’ (Coindesk.com, 25 June 2016) available at: <https://www.coindesk.com/understanding-dao-hack-journalists>.

³⁷ Demertzis, Wolff, ‘The Economic Potential and Risks of Crypto Assets: Is a Regulatory Framework Needed?’ (n 13) 11.

³⁸ Anna Baydakova, ‘\$2 Billion Lost in Mt. Gox Bitcoin Hack Can Be Recovered, Lawyer Claims’ (Coindesk.com, 12 September 2019), available at: <https://www.coindesk.com/2-billion-lost-in-mt-gox-bitcoin-hack-can-be-recovered-lawyer-claims>.

³⁹ ESMA, EBA and EIOPA Warn Consumers on the Risks of Virtual Currencies, (12 February 2018) available at:

https://www.esma.europa.eu/sites/default/files/library/esma50-164-1284_joint_esas_warning_on_virtual_currencies.pdf.

⁴⁰ Autorité des Marchés Financiers, ‘Retail Investor Behaviour During the COVID-19 Crisis’ (April 2020) Markets Directorate, p. 5, 7 and 8, available at: https://www.amf-france.org/sites/default/files/2020-04/retail_investors_equities_march_2020_en.pdf.

crypto-assets: the number of investors trading in crypto-assets increased from below 30,000 to almost 100,000 in a matter of 10 days, following the Dow fall.⁴¹

As such, it is even more important that regulators pay particular attention to these new technologies and create a safe investing environment for EU non-professional investors.

Tech enthusiasts hold that the DLT reforms finance by replacing the traditional concept of trust - based on the synergy between people, institutions and Governments, knit together by law and procedures - with a new form of trust deriving from the incorruptibility, publicity and seemingly flawless functioning of the new technology. Some refer to it as the “*new golden standard of trust*” as it is a “*programmable (“smart”) notarisational service*”, considered to be unbreakable, incorruptible, efficient, transparent and has validation as its general purpose.⁴²

Indeed, DLTs bring about increased transparency and cost efficiency gains (lower transaction and operational costs), democratise finance and may have the capacity to deliver better services in certain instances (through “smart contracts” that self-execute, where the code becomes the law). In short, crypto-assets and DLTs may give an essential stimulus to EU household participation in capital markets and benefit the EU economy as a whole.

POLICY POSITION

Choice of instruments

In many fields of financial regulation covered by EU law, quasi-harmonisation through the use of Directives has been the preferred option by EU Member States. However, in many instances it has led to uneven playing fields (through gold plating or regulatory arbitrage) and has fragmented the single market.⁴³ This is all the more important in the context of crypto-assets as many EU Member States have already adopted laws in this field, from a lower (for taxation purposes) to a higher extent (taxonomy and applicable laws for crypto-assets).

BETTER FINANCE supports the use of Regulations over Directives as a choice of instrument as it provides more clarity, certainty, and harmonised application of financial regulation across EU Member States. This is all the more important as DLT-based assets and crypto-assets are cross-border in nature, which requires maximum harmonisation at EU level.

Technology neutrality: “same business, same risks, same rules”

BETTER FINANCE welcomes the legislative strategy adopted by the European Commission, i.e. that of technology neutrality. In order to ensure a consistent regulation of financial services and products regardless of whether these are provided in a traditional or digitally-innovative manner, new assets and services that embody the same characteristics and provide the same functions as traditional ones should be regulated the same. **BETTER FINANCE agrees with the proposal to extend the scope of application of MiFID II to all crypto-assets that qualify as a financial instrument and create a mirroring regulation (MiCA) for all other crypto-assets.**

This approach not only ensures legal certainty and clarity on the applicable law, but creates a level playing field across the EU and eliminates the risks of regulatory arbitrage and gold plating, stimulates the integration of local markets and upholds a high standard of investor protection.

⁴¹ Regina Ortmann, Matthias Pelster, Sascha Tobias Wengerek, ‘COVID-19 and Investor Behaviour’ (November 2020) 37 Finance Research Letters, available at: <https://www.sciencedirect.com/science/article/abs/pii/S1544612320307959?via%3Dihub>.

⁴² Fabio Tudone, ‘Why Distributed Ledger Technology’ (medium.com, 4 February 2019) available at: <https://medium.com/@fabio.tudone/why-distributed-ledger-technology-d76d4eacee6c>.

⁴³ The European Commission also highlighted in Recital (4) of the draft proposal on MiCA that “*The lack of an overall Union framework on crypto-assets could also lead to regulatory fragmentation, which will distort competition in the Single Market, make it more difficult for crypto-asset service providers to scale up their activities on a cross-border basis and will give rise to regulatory arbitrage*” – see Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final, Recital (4).

Sustainable finance considerations

Running and operating DLTs and crypto-assets may require high computational resources, which can translate into a high consumption of energy. An example is bitcoin's blockchain, whose annual operation (mining) consumes slightly more electric energy than Switzerland⁴⁴ or Argentina. Other DLTs have improved their protocols to require less computational power, but the emergence of so many crypto-assets (5,100 in 2020⁴⁵) and, hopefully, more in the future, many not be the most environmentally friendly models.⁴⁶

The inclusion of finance externalities (non-financial reporting, such as ESG risks) in pre-contractual disclosures should be extended to crypto-asset issuers as well. Such reporting should be tailored to the incipient stage of the market, and potentially to the size of the issuer (see *disclosure exemptions* below), but must necessarily inform consumers of its carbon footprint, if any.

Moreover, the Sustainable Finance taxonomy and the Non-Financial Reporting Directive should factor in these new technologies as well.

Markets in Crypto-assets (MiCA) Regulation

The MiCA proposal is a good example of progressive regulatory approach at a global level, and BETTER FINANCE generally agrees with the provisions comprised therein. To begin with, BETTER FINANCE highlights several good examples of regulation proposed by the European Commission in the MiCA Regulation:

- a) **Requiring adequate disclosures:** the publication of crypto-assets white papers (Art. 5) that must use a "fair, clear, and not misleading" language (Art. 5(2) MiCA, based on Art. 24(3) MiFID II) and be "presented in a concise and comprehensible form" underpins the objective to achieve adequate investor protection, which is commendable;
- b) **No assertion on future values:** contrary to securities markets disclosures, most notably the PRIIPs KID, crypto-assets' white papers must not make any assertion on the future value of the crypto-assets save where the issuer can guarantee that future value (Art. 5(4) MiCA) – BETTER FINANCE firmly congratulates and supports this approach;
- c) **White Paper Summary:** non-professional investors are already faced with significant amounts of disclosures which neither improve their understanding, nor help them make an informed decision; the provision of the summary in "brief, non-technical language" about the key and essential information (Art. 5(7) MiCA) is welcomed by BETTER FINANCE'
- d) **Withdrawal right:** considering the novelty of these technologies and assets, we welcome the proposal of the European Commission to grant consumers a 14 day withdrawal right from purchasing crypto-assets (Art. 12 MiCA).

However, BETTER FINANCE also highlights a few recommendations to improve the current regulatory proposal on the MiCA, in particular regarding the **taxonomy** of crypto-assets, **disclosures** by crypto-asset issuers and advice by crypto-asset services providers.

Taxonomy

BETTER FINANCE agrees with the European Commission that there is currently no consensus on the classification of crypto-assets. In this sense, based on desk research done by BETTER FINANCE, we agree that the non-security crypto-assets could be categorised as payment or utility tokens (incl. asset-referenced tokens) – Art. 3(1) MiCA. To further clarify what and when constitutes a utility token (MiCA) compared to an investment token (MiFID II), EU authorities should clarify that the categorisation must

⁴⁴ Chris Baraniuk, 'Bitcoin's energy consumption "equals that of Switzerland"' (BBC.com, 3 July 2019), available at: <https://www.bbc.com/news/technology-48853230#:~:text=Currently%2C%20the%20tool%20estimates%20that,same%20power%20consumption%20as%20Switzerland>, citing a University of Cambridge online tool.

⁴⁵ Houben, Snyers, 'Crypto-assets: Key Developments, Regulatory Concerns and Responses' (n 19), 21.

⁴⁶ See also the assessment of the Bank for International Settlements – BIS, 'Annual Economic Report' (July 2018) BIS, p. 99, available at: <https://www.bis.org/publ/arpdf/ar2018e.pdf>.

follow the “essential use” of the asset (see below), i.e. whether it is to “*generate or not future cash flows*” compared to “*granting access to an application, product or service*”.⁴⁷ The tiebreaker should be the use of the crypto-asset as determined by the issuer through the White Paper. In order to ensure responsibility of issuers and avoid “cherry picking” of regulatory frameworks, White Papers should be subject to authorisation or validation by National Competent Authorities (NCAs) or private bodies designated (outsourced) to perform this specific function.

Moreover, the MiCA Regulation could provide further clarity by also treating the cases of hybrid tokens, i.e. those that embody the characteristics of several crypto-assets. Two different circumstances (under MiCA) could arise:

- hybrid non-security assets: those tokens that cumulate the characteristics of both payment and utility tokens;
- hybrid financial / non-financial assets: those tokens that embody both functions or characteristics of financial instruments and of non-financial instruments.

The MiCA Regulation should add another definition under Art. 3(1) for “hybrid tokens” in order to capture the two circumstances above and should complement the provisions on the treatment of these tokens with two new rules:

- 1) **Applicable law:** when dealing with a “hybrid” token, it must first be decided whether MiFID II or MiCA are incident; to do so, BETTER FINANCE recommends to follow a “use” approach: whatever the “hybrid” is created, its classification and assignment must follow the essential function it fulfils, not the form or purpose it is created for.
- 2) **Lifecycle changes:** MiCA and MiFID II should stipulate what will the transitional measures be if, during the lifecycle of a crypto-asset, it changes from one type to another or if the creators add new functionalities to it that can change its nature.

Disclosure exemptions

BETTER FINANCE understands the need to ensure a balance between reducing regulatory barriers and compliance costs to new crypto-asset issuers and ensuring an adequate level of investor protection. However, we believe that the exemptions to the preparation and publication of white papers (Art. 4(2) MiCA) do not strike a fair balance between these two competing interests. While two of the exemptions are justified (mining or rewards and offers to qualified investors – Art. 4(2)(b) and (f) MiCA), the other four require further consideration.

We remind the policy makers that linking disclosures to market capitalisation (Art. 4(2)(e) MiCA), or other quantifiable thresholds, defeats their purpose. Pre-issuance disclosures, such as Prospectuses or white papers, are made to protect individuals which require this protection regardless of the amount or value of issuance. Moreover, the content of the white paper (Art. 5(1) read in conjunction with Annex I) already provides a more simplified document (compared to the securities Prospectus), entailing reduced compliance costs.

At the same time, the fact that a crypto-asset is unique and not fungible with other crypto-assets or the 150 natural or legal persons acting on their own account offered to per EU jurisdiction does not find any justification in BETTER FINANCE’s view (Art. 4(2)(c) and (d) MiCA). These exemptions should further specify:

- the crypto-asset is unique and not fungible with other crypto-assets or fiat currencies;
- the offer is made to natural persons that choose to be treated as qualified investors.

Finally, the fact that crypto-assets are initially offered for free does not suffice to exempt the issuer from drafting the white paper, particularly since those “free” crypto-assets may be traded on secondary

⁴⁷ In this sense, see the discussion on the distinction between investment and utility tokens made in Houben, Snyers, ‘Crypto-assets: Key Developments, Regulatory Concerns and Responses’ (n 18), pp. 21-22.

markets and offered to new investors. This exemption should further provide that the crypto-assets are offered for free and are nominal.

A potential approach to strike a balance between the two competing interests is to exempt crypto-asset issuers (below a certain threshold, such as the €1 million total consideration) from publishing a full white paper in accordance with Article 5 and Annex I of MiCA, thereby requiring only the summary (Art. 5(7) MiCA) to be drafted, published and notified.

Advice on crypto-assets

While BETTER FINANCE welcomes the intent to mirror organisational and conduct of business rules from MiFID II to MiCA, we are surprised to see the freedom granted to crypto-asset services providers when providing advice on buying, selling or using crypto-assets (Art. 73 MiCA).

Crypto-asset advisors should be held to the same standard of investor protection as under MiFID II [Art. 24(4)]: they should clearly and prominently disclose, on an ex-ante basis, to the client whether the advice is given on an independent basis or not, which third-party is paying the commission (and its exact amount, nature or means of calculation) and whether “inducements” can be passed on to the client.

In addition, while BETTER FINANCE welcomes the slightly more concise definition of advice under Art. 3(1)(17) MiCA (compared to Art. 4(1)(4) MiFID II), we recommend further clarifications on what can be considered advice. Clarifying the concept of “advice” is essential for a series of conduct of business and disclosure obligations that are intrinsically tied to the provision of advice. Building on the MiFID II experience with FinTech, automated platforms can make advice “demos” or simulations – gathering all necessary information for the suitability assessment – and still not qualify the recommendation as advice, thus circumventing the law. Moreover, it falls short of being clear whether the “compatibility test” (Art. 73(1) MiCA) is a requirement per se for a personal recommendation to be considered advice or it is just a conduct of business requirement.

To discern whether the recommendation is “personal” or not, attention should not be paid to how the end result is qualified, but at the information asked by the advisor. To the extent that certain categories of essential and personal information are asked by the advisor – for example those in paragraph (3) of Art. 73 MiCA – the recommendation can, and it should, be “personal” for the purpose of Art. 3(1)(17) MiCA. It would follow that the “compatibility test” (similar to the *suitability* or *appropriateness* assessment under MiFID II) will be required for all personal recommendations as a conduct of business rule.

Also, as for financial instruments (MiFID), BETTER FINANCE believes that “non independent advice” is at best biased, but is more usually marketing and selling than “advice”. The preferred solution would be - like for financial instruments and as ruled by the Netherlands and the UK, to ban altogether “inducements” (monetary and non-monetary benefits paid by third-parties for a particular recommendation) paid to crypto-asset advisors as there create a conflict of interest which cannot be overcome or compensated by disclosures (Art. 13(1)(c) MiCA).⁴⁸

Definitions

In order to provide more legal certainty on the consumer and investor protection regime, the MiCA Regulation should also contain a definition and provision on client categorisation, i.e. to distinguish between professional, qualified, semi-professional and “retail” clients. The definition of “qualified

⁴⁸ A more elaborate discussion on the need to ban commissions for “retail” investment advisors can be found in the BETTER FINANCE Robo-Advice Report 2020 (n 7), p. 27 - 33; See BETTER FINANCE’s Press Release concerning ESMA’s Advice on Cost and Charges Disclosures: ‘The EU Supervisor Falls Short of Advising Complete Ban on Commissions for “Retail” Investment Advisors’ (4 May 2020), available at: <https://betterfinance.eu/wp-content/uploads/PR-EU-supervisor-falls-short-of-recommending-complete-ban-on-commissions-for-retail-investments-2020-0404.pdf>; BETTER FINANCE’s Response to the same ESMA Public Consultation can be accessed here: <https://betterfinance.eu/publication/better-finance-response-to-the-european-commission-public-consultation-on-the-review-of-the-mifid-ii-mifir-regulatory-framework/>.

investor” as defined in Art. 2(e) of the Prospectus Regulation should be merged under a “professional client / investor” definition, comprising all clients and investors that are not semi-professional or retail.⁴⁹

The conditions for a “retail” client to opt-out from that category and be treated as a “semi-professional” or “professional” client or investor should be the same and, where applicable, similar as to those under MiFID II.

Additional considerations:

- **sunset clause:** close supervision on the transition strategy for investment firms intending to continue the business once the EU Pilot Regime ends
- **FMI**s should be allowed to deal with asset-referenced tokens and e-money tokens, alongside banks and crypto-asset services providers;
- **FMI**s should be explicitly allowed to deal with digital or crypto-assets in the future (e.g. CCPs to accept crypto-assets as margins or CSDs to offer services on crypto-assets).

EU pilot regime for DLT-based market infrastructures

BETTER FINANCE is of the view that DLT-based financial market infrastructures (FMIs), fulfilling the same functions as traditional ones,⁵⁰ should be regulated through amendments to existing EU regulatory frameworks, i.e. MiFID II, MiFIR, EMIR, and CSDR under the principle of “same business, same risks, same rules”. However, given the unknown operational, transparency and cybersecurity risks and challenges that these venues or market participants can pose, BETTER FINANCE welcomes the approach adopted by the European Commission to create a regulatory sandbox for DLT-based FMIs.

BETTER FINANCE wishes to make two general remarks:

1. **Do not forget the end goal:** the purpose of the EU Pilot Regime is to enable DLT-based financial market infrastructures (FMIs) expand in a supervised environment, with the primary purpose of observing what novel risks or challenges could be posed (Recitals (4) and (5) of the EU Pilot Regime) and address them.

Therefore, the European Commission should have provided in the *Review clause* (Art. 10) that ESMA should undertake the report with the view of establishing what novel risks are posed by these FMIs and what amendments are necessary to integrate (converge) them in the existing environment, with all ensuing factors taken into account (Art. 10(2) EU Pilot Regime). Such an approach would be in line with the “technology neutrality” principle the Digital Finance Package adopted, which is also used in the MiCA proposal.

Separate regulatory frameworks – for actors fulfilling essentially the same functions – would lead to legal uncertainty and market fragmentation. In addition, it can also lead to “framework shopping”, a practice by which financial market actors would choose the framework it suits best and could lead to consumer detriment.

2. **Do not forget the nature of the framework:** as the name is self-describing, this regulatory framework for DLT-based FMIs is a “pilot”, or an experiment, and it must be kept within certain scales or scope that maintains this nature.

First, if the EU pilot regime is to be adopted as a “regulatory sandbox”, then it must be significantly scaled down and adequately supervised. The thresholds mentioned in Art. 3 must be reduced to reflect the nature of a “regulatory sandbox” – which is that to test new models at scales that are sufficiently high to be representative, but sufficiently low to avoid losses and failures. Otherwise, the same limits could be maintained provided that those assets traded on DLT-market infrastructures can be sold or

⁴⁹ For a wider discussion on the need and scope of the “semi-professional” investor under MiFID II, which we propose to be replicated under MiCA, see BETTER FINANCE’s Response to the European Commission’s Public Consultation on the review of the MiFID II/MiFIR regulatory framework, available at: <https://betterfinance.eu/wp-content/uploads/BETTER-FINANCE-Response-stylised-EC-MiFID-2-review.pdf>.

⁵⁰ The only distinction being in the underlying informatic systems used to identify, validate and store assets and transaction data.

marketed to individual, non-professional investors if the FMI does not apply for exemptions under Art. 5 from CSDR or use Trusted Third Parties (TTPs) for record keeping and safeguarding assets.

In line with the recommendations of the HLF CMU Final Report, retail investor protection could be ensured also through the use of Trusted Third Parties (TTPs). TTPs could perform the functions of securities settlement systems and depositories by controlling admission of crypto-assets to trading venues, ensuring compliance with various legal requirements (addressing and disclosing conflicts of interests, anti-money laundering or risk management arrangements). However, such TTPs must abide to the relevant regulatory frameworks (CSDR and SFD).

The HLF CMU Final Report gave the example of the added value of TTPs for smart contracts on derivatives trading:

*“it could check the adherence to ISO international standards, for example, in Master Agreements developed by International Swaps and Derivatives Association (for derivatives) or Global Master Repurchase Agreements (for repo transactions)”.*⁵¹

Another concern with the EU Pilot Regime’s scope is that it is only accessible to already regulated actors, not to newcomers, which conflicts with the aim of being innovation- and competition-friendly. Only those FMIs already authorised under MiFID II and MiFIR or CSDR are allowed to access the security token markets, following which these could ask for exemptions to financial regulations under Arts. 4 and 5 of the EU Pilot Regime. This will force new actors to become incumbents themselves (which takes time and delays their activities), even though this “regulatory sandbox” is supposed to promote innovation.

In what concerns the direct access of consumers to trading on DLT-based MTFs, BETTER FINANCE deems it an adequate approach, but which must be accompanied by the necessary regulatory safeguards in order to promote a high standard of investor protection.

Lastly, the scope of DLT-based FMIs should not be limited to already existing players (authorised under MiFID 2/ MiFIR / CSDR) but should promote “newcomers” to operate and stimulate competition on the market. This is particularly the case for the identification of shareholders and the exercise of shareholders’ voting rights within the EU, as recommended by the High-Level Forum on the CMU,⁵² as the existing process is antiquated and highly fragmented. This crucial process for sustainable corporate governance is an ideal and priority candidate for a pilot regime.

⁵¹ Final Report of the High-Level Forum on the Future of the CMU “A New Vision for Europe’s Capital Markets” (May 2020) European Commission, p. 75, available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.

⁵² Final Report of the High-Level Forum on the Future of the Capital Markets Union: A New Vision for Europe’s Capital Markets, p. 79-81, available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.