

CONSULTATION OF THE EUROPEAN COMMISSION ON THE CRYPTO-ASSETS MARKETS:

A key step towards a new regulatory framework at European level

On 19 December 2019, the European Commission launched a **public consultation**¹ on the potential changes to make to existing financial regulations and the novelties to include to ensure the sustainable development of the crypto-assets markets in Europe.

This consultation is the culmination of a regulatory process that began in March 2018 with the publication of the European Commission's Fintech action plan², and fed by the work of the EBA³ and ESMA⁴ published in January 2019. The responses to this consultation are intended to feed into the development by the Commission services of a **strategic roadmap for digital finance**, known as a "new Digital Finance Strategy for the EU"⁵. As such, it constitutes a **decisive step for future reforms of financial regulation, connected with innovation**, and it is therefore crucial that stakeholders build on it.

Alongside this consultation dedicated to the regulation of the crypto-assets markets, the European Commission also published a document on digital **operational resilience**⁶ in the field of financial services. Both publications are clear signals that **bode well for future legislative proposals**.

The document on the regulatory framework applicable to the crypto-assets markets is structured around four main axes. The first is of a general nature with a series of questions aimed at better understanding the use of crypto-assets by the general public. The other three topics are more technical: they concern the appropriateness of the financial regulations in place, or the advisability of adopting new rules to meet the specific characteristics of the crypto-assets markets. They are aimed at financial market practitioners (regulatory authorities, historical market participants, and new "crypto" players).

The deadline for responses via an online questionnaire is **19 March 2020 at the latest**.

The classification of crypto-assets as starting point for regulatory considerations

In this consultation, the European Commission adopts a broad definition of crypto-assets, defined as *"a digital asset that may depend on cryptography and exists on distributed ledger"*. However, this is a narrower category than the concept of "digital asset", which covers any digital representation of an asset.

The idea of classifying crypto-assets is not new. It has already been clearly identified in the Opinions of the European Supervisory Authorities and, in particular, by the EBA, which had suggested a draft taxonomy distinguishing three types of tokens (payment, investment and utility)⁷. The European Commission is once again addressing this issue **because the "type" of crypto-asset under consideration and its legal nature are determining factors in the body of rules applicable to crypto-asset activities**.

¹ European Commission, [Consultation Document on an EU framework for markets in crypto-assets](#), 19 December 2019 ("Consultation document").

² European Commission, [Plan d'action pour les technologies financières : pour un secteur financier européen plus compétitif et plus innovant](#), 8 March 2018.

³ European Banking Authority (EBA), [Report with advice for the European Commission on crypto-assets](#), 9 January 2019.

⁴ European Securities and Market Authority (ESMA), [Advice, Initial Coin Offerings and Crypto-Assets](#)", 9 January 2019.

⁵ Consultation document, p.3.

⁶ European Commission, [Consultation Document, Digital operational resilience framework for financial services : making the EU financial sector more secure](#)", 19 December 2019.

⁷ European Banking Authority (EBA), [Report with advice for the European Commission on crypto-assets](#)", 9 January 2019, p.7.

Categorisation is also essential because it would make it clear which instruments fall within the regulatory scope (because they meet the characteristics of a financial instrument or e-money within the meaning of the European regulations) and which are excluded from it.

In this regard, the European Commission is questioning stakeholders on the advisability of setting up such a classification, particularly in view of the difficulties involved in setting up any taxonomy that, by definition, establishes a certain vision of the market in a static manner.

Opportunity and necessity to extend the regulatory scope to the currently unregulated "crypto" activities

The European Commission's questions aim to assess the **advisability of setting up an *ad hoc* regime** (in the manner of what some Member States have done already) at European level to serve the sustainable development of the markets for crypto-assets in Europe, ensuring the readability of the legal framework applicable to these activities, while mitigating the associated risks.

Several "crypto" activities are the subject of dedicated questions, in particular : **(i)** the issuance of crypto-assets in general; **(ii)** the issuance of "stablecoins" backed by real assets; **(iii)** crypto-asset trading platforms; **(iv)** exchanges (fiat-to-crypto and crypto-to-crypto); and **(v)** custodial wallet services for crypto-assets.

With regard to **stablecoins**, the European Commission has addressed the subject on several occasions, referring in particular to recent reports published by international bodies⁸ that have highlighted the potential risks associated with these new instruments (in terms of financial stability, monetary sovereignty). In particular, the Commission is asking stakeholders about the transparency, liquidity and management requirements that could be imposed upon the underlying reserve that ensures the value of the instrument⁹ - a central issue revealed by the Facebook initiative with its Libra project.

With regard to **crypto-asset trading platforms**, the document describes the different models for organising the crypto-assets market, distinguishing between "centralised" platforms (which hold assets on behalf of their clients and execute trades "off chain") and "decentralised" platforms (which, conversely, do not hold their clients' assets and execute trades "on chain"). The Commission's questions relate to the requirements that could be imposed on the operators of these platforms in terms of, for example, governance, asset segregation, own funds, reporting; etc.¹⁰

With regard to the **custodial wallet services for crypto-assets**, the consultation document does not propose a precise definition but acknowledges that there are several market solutions. The document distinguishes between "software" and "hardware wallets", as well as between solutions that actually hold the crypto-assets on behalf of their clients, or custodial wallet providers¹¹. Questions cover the regulatory requirements that could be imposed on these providers in terms of governance; assets segregation; conflicts of interest; own funds; etc.¹² The Commission is also asking stakeholders about **(i)** the possibility for these providers to ensure the custody of all types of crypto-assets (unregulated and regulated, such as security tokens that have the characteristics of financial instruments); and **(ii)** the advisability of including within the regulatory perimeter other solutions related to the custody of crypto-assets, beyond custodial wallet providers¹³.

⁸ G7, "[Investigating the impact of global stablecoins](#)", October 2019 and Financial Stability Board (FSB) "[Regulatory issues of stablecoins](#)", 18 October 2019.

⁹ Consultation document, question 25, p.15.

¹⁰ Consultation document, question 28, p.17.

¹¹ Consultation document, p.19.

¹² Consultation document, question 32, p.20.

¹³ Consultation document, questions 33 et 34, p.21.

In addition to the above-mentioned services, the Commission also mentions other crypto-asset services based on traditional investment services (e.g. advice on the acquisition of crypto-assets; reception and transmission of orders in relation to crypto-assets; crypto-assets portfolio management; etc.) and questions whether they should be included in the regulatory scope, on a mandatory or optional basis¹⁴.

Lastly, the Commission poses several questions on **the scope of application of the rules on combating money laundering and countering the financing of terrorism (AML/CFT)**. In particular, it asks whether these requirements should be extended to all crypto-asset service providers¹⁵ (in the event that an *ad hoc* regime is set up), and how to cover AML/CFT risks arising from entirely disintermediated transactions (e.g. transactions carried out on decentralised platforms)¹⁶.

Applicability of current financial regulations to security tokens and e-money tokens

The last part of the consultation reviews all applicable financial regulations by asking stakeholders about the adequacy of these rules to meet the specifics of **security tokens** on the one hand, and of **e-money tokens** on the other.

Security tokens

In the consultation document, security tokens *"refer to crypto-assets issues on a DLT and that qualify as transferable securities or other types of MiFID financial instruments"*¹⁷. The document states that, by extension, activities provided in connection with these instruments and transactions carried out on trading platforms in relation to these instruments naturally fall within the scope of the provisions of MiFID II¹⁸ and other applicable regulations, such as the CSDR¹⁹ or EMIR²⁰ regulations.

The Commission therefore points out that, in principle, if a security token has the characteristics of a financial instrument, then the legislation applicable to 'traditional' financial instruments is also applicable to it. It is, however, aware of the intrinsic limits of the existing rules, which appear difficult to apply, particularly to new forms of exchange of security tokens, such as "permissionless" networks²¹ or decentralised platforms²².

In its consultation document, and in view of the differences in transposition in the Member States of the concept of "financial instrument" inherited from MiFID II, the European Commission asks stakeholders about the need to adopt a **common and harmonised approach on when security tokens qualify as financial instruments**.²³

Referring to the work carried out by ESMA²⁴, the Commission then reviews the whole of the financial regulations²⁵ by considering (i) its applicability to security tokens and (ii) the possible need for adjustments to cover the new types of risks arising from these instruments (which the legislator had not taken into account when the texts were initially drafted). In this respect, the Commission naturally calls on **MiFID II** (rules applicable to investment companies; trading platforms; investor protection (marketing via social media and online), pre- and

¹⁴ Consultation document, question 35, p.21.

¹⁵ Consultation document, question 43, p.24.

¹⁶ Consultation document, question 44, p.25.

¹⁷ Consultation document, p.29.

¹⁸ 2014/65/EU directive on the financial instruments market ("**MiFID II directive**").

¹⁹ EU regulation no. 909/2014 on improving securities settlement in the European Union and on central securities depositories ("**CSDR regulation**").

²⁰ EU Regulation no. 648/2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR regulation**").

²¹ A blockchain network to which anyone can, in principle, take part in and contribute to the transaction validation process.

²² Platforms in which transactions are conducted peer-on-peer "on chain" without intermediation of a third party and thanks to smart contracts.

²³ Consultation document, questions 59-61, pp.32-33.

²⁴ European Securities and Market Authority (ESMA), "[Advice, Initial Coin Offerings and Crypto-Assets](#)", 9 January 2019.

²⁵ Consultation document, questions 59 - 107, pp.32-50.

post-trade transparency; system resilience); **Market Abuse Regulation**²⁶; **Short Selling Regulation**²⁷; **Prospectus Regulation**²⁸ (scope of exemptions; content of the prospectus; risk factors); **CSDR Regulation**; **Finality Directive**²⁹; **Collateral Directive**³⁰; **EMIR Regulation** and **AIFM Directive**³¹.

E-money tokens

In the consultation document, e-money tokens *"are a type of crypto-assets that qualify as electronic money under EMD2"*³². The cases specifically referred to by the Commission are payment instruments which have the characteristics of electronic money within the meaning of European regulations³³. The Commission is explicitly targeting certain stablecoins whose (relatively) stable value is ensured by means of backing by real assets.

The payment services provided in connection with these instruments, which are qualified as electronic money instruments, must also comply with the requirements of the Payment Services Directive³⁴. The Commission is asking stakeholders about the suitability of these two sets of rules (EMD2 and PSP2) regarding the specifics of e-money tokens, in particular stablecoins and global stablecoins³⁵.



This extensive consultation (117 questions) thus marks a turning point in European regulatory thinking as regards the crypto-assets markets. It **heralds future legislative proposals** which will be structuring for the future of the players, but also for the attractiveness of the single market.

It also seems that the work initiated in France has largely inspired the regulatory approaches being considered in this consultation. Indeed, the regimes provided for by the Loi Pacte³⁶ in France for issuers of ICOs³⁷ and Digital Asset Service Providers (DASPs) will no doubt be able to serve, to a certain extent, if not as a reference, at least as examples, in the feedback that will be given to this consultation. In this respect, **French stakeholders are ahead of the game** and it is important that, within the framework of this public consultation, they capitalise on the regulatory lessons learned from the French regime with a view to the potential establishment of a new regulatory framework at European level.

²⁶ EU Regulation no. 596/2014 from 16 April 2014 on market abuse ("**Market Abuse Regulation**").

²⁷ EU Regulation no. 236/2012 on short selling and certain aspects of credit default swaps.

²⁸ EU Regulation no. 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market ("**Prospectus regulation**").

²⁹ Directive 98/26/EC on settlement finality in payment and securities settlement systems ("**finality directive**").

³⁰ Directive 2002/47/EC on financial collateral arrangements ("**collateral directive**").

³¹ Directive 2011/61/EU on Alternative Investment Fund Managers ("**AIFM directive**").

³² Consultation document, p.57.

³³ Directive 2009/110/EC of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers ("**EMD2 directive**").

³⁴ EU directive 2015/2366 on payment services in the internal market ("**PSP2 directive**").

³⁵ Consultation document, questions 116 and 117, p.54.

³⁶ Law no. 2019-486 of 22 May 2019 on the growth and transformation of companies (*Loi Pacte*).

³⁷ Initial Coin Offering (ICO).

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