EU Regulation

REGULATING CRYPTO-ASSETS
PART II: CRYPTOCURRENCIES AND UTILITY TOKENS

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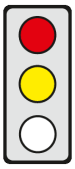
KEY ISSUES

Context: Markets for crypto-assets are developing fast but are only regulated nationally, if at all.

Objective of the Regulation: The Regulation aims to achieve legal certainty, support innovation, strengthen consumer and investor protection as well as market integrity and preserve financial stability.

Affected parties: Issuers of crypto-assets, crypto-asset service providers, investors and consumers.



Pro: EU legislation on crypto-assets and crypto-asset services may in principle increase legal certainty.

Contra: (1) The Regulation fails to provide sufficient legal certainty for cryptocurrencies which do not have a central issuer.

(2) In the case of utility tokens, the obligation to submit a white paper is not precisely tailored and thus disproportionate.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Proposal COM(2020) 593 of 24 September 2020 for a **Regulation on Markets in Crypto-assets**

Brief Summary

- **Context and objectives**
  - Crypto-assets are digital representations of value or rights that can be transferred and stored electronically in encrypted form, in particular, using distributed ledger technology (DLT) [p. 1, Art. 3 (1) Nos. (1) and (2)].
  - The term crypto-assets refers, in particular, to [Recital 3, Art. 3 (1) Nos. (3)-(5)]:
    - cryptocurrencies which serve as a means of payment, exchange or store of value. Examples are Bitcoin and Ethereum (this cep**PolicyBrief**).
    - utility-tokens which provide digital access to products or services and are only accepted by the issuer, e.g. grant access to computing power or act like vouchers. Examples are FunFair and Sia (this cep**PolicyBrief**).
    - stablecoins, which differ from cryptocurrencies in that they have an issuer and are often backed by assets. Examples are Tether and Diem (see cep**PolicyBrief**).
    - investment tokens that are considered to be financial instruments within the meaning of the MiFID II Directive [2014/65/EU] and use DLT. Examples are iZero and Stellar.
  - The Commission wants the Regulation to create a legal framework for all those crypto-assets that are not investment tokens and thus not deemed to be financial instruments within the meaning of the MiFID II Directive.
  - The Regulation aims to [p. 3].
    - achieve legal certainty in the markets for crypto-assets,
    - support innovation,
    - strengthen consumer and investor protection,
    - strengthen market integrity and
    - preserve financial stability.
- **Issuers of cryptocurrencies and utility tokens**
  - Issuers of cryptocurrencies and utility tokens intending to offer their crypto-assets to the public, or seeking authorisation to trade on a trading platform for crypto-assets, must [Art. 4 (1), Art. 6]
    - be a legal entity,
    - publish a whitepaper, which faithfully describes the issuer, the issuer's project and the rights and obligations attached to the crypto-assets, and notify the competent national authority,
    - ensure that marketing communications are clearly identifiable as such and are fair, clear and not misleading,
    - comply with consumer protection obligations, i.e. [Art. 13]
      - act honestly, fairly and professionally,
      - communicate with the holders of crypto-assets in a fair, clear and not misleading manner,
      - prevent, identify, manage and disclose any conflicts of interest,
      - maintain their systems and access security to EU standards, and

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- act in the best interests of the holders of crypto-assets and treat them equally.

– Except for the need to be a legal entity and to comply with consumer protection obligations, these requirements do not apply to cryptocurrencies and utility tokens which, in particular [Art. 4 (2)]
  - are automatically created through mining as a reward for the maintenance of the DLT or the validation of transactions,
  - are offered to fewer than 150 natural or legal persons, or
  - are solely addressed to qualified investors.
– After publication of the white paper, issuers may offer their crypto-assets throughout the EU ("EU passport") [Art. 10 (1)].
– Issuers are liable if white papers are incomplete, unfair, unclear or misleading. The burden of proof lies with the holder of the crypto-assets. [Art. 14]
– The said provisions do not apply to crypto-assets or utility tokens which were offered to the public or admitted to trading on a trading platform for crypto-assets before the date of entry into force [Art. 123 (1)].

► **Crypto-asset service providers: Authorisation**
– Crypto-asset services may be offered with respect to all crypto-assets. They include the custody of crypto-assets, their exchange for fiat currencies, the operation of a trading platform for crypto-assets and the execution of orders for crypto-assets. [Art. 3 (9)]
– Crypto-asset service providers must be legal persons that [Art. 53]
  - have a registered office in a Member State of the EU and
  - are authorised by the competent national authority in their country of origin.
– National authorisation allows services to be provided EU-wide ("EU passport") [Art. 53 (3)].
– A provider from a third country does not require authorisation in the EU provided [Recital 51]
  - consumers from the EU use its services on their own initiative, and
  - the provider does not promote its services in the EU.
– The European Securities and Markets Authority (ESMA) will issue a register of all authorised crypto-asset service providers [Art. 57].
– The authorisation obligation does not apply to banks or investment firms [Art. 2 (5) and (6)].

► **Crypto-asset service providers: Requirements**
– Crypto-assets service providers must act honestly, fairly and professionally, and in the best interests of their clients. They must warn their clients of the risks associated with purchasing crypto-assets and make their pricing policy publicly available. [Art. 59]
– They must comply with prudential requirements. They must [Art. 60]
  - hold own funds of at least € 50,000 and at least 25% of annual overheads or
  - take out insurance which
    - covers certain risks - e.g. loss of documents or failure to prevent conflicts of interest - and
    - is valid in all EU countries where services are provided.
– They must comply with organisational requirements. They must [Art. 61]
  - ensure that the management body and those holding more than 20% of capital or voting rights have the necessary good repute and competence,
  - ensure that personnel have skills and knowledge commensurate with the responsibilities allocated to them,
  - have a business continuity policy and internal control mechanisms as well as effective risk assessment procedures.
– They must develop strategies to prevent, identify, manage and disclose conflicts of interest between themselves, their shareholders, members of the management body and clients [Art. 65].
– They also remain fully responsible towards their clients in the event that operational functions are outsourced to third parties. They must retain the ability to evaluate the quality of the services provided and manage the risks associated with the outsourcing. [Art. 66]
– Crypto-asset service providers who hold clients' crypto-assets or the means of accessing the crypto-assets, must guarantee their safekeeping. Clients' funds must be held in a separate (central) bank account. [Art. 63]

► **Supervision**
– The authorities in the Member State of origin are responsible for the supervision of the issuers of crypto-currencies and utility tokens and crypto-asset service providers. [Art. 7 (2) and Art. 54 (1)].
– Supervision of the issuers of crypto-currencies and utility tokens from third countries, that do not have an establishment in the EU, falls to the authorities of the Member States in which the crypto-assets are first offered or admitted to a trading platform for crypto-assets [Art. 3 (1) No. (22) (c)].
– In case of differences of opinion between the authorities of the Member State of origin and those of a Member State in which a crypto-asset or a crypto-asset service is offered, the latter can take its own measures to protect consumers. At the request of one of the authorities involved, the European Securities and Markets Authority (ESMA) can act as mediator and if necessary, issue direct instructions to the issuer of the crypto-assets or to the

crypto-asset service provider. [Art. 89 (3) in conjunction with Art. 10 ESMA Regulation 1095/2010].

Statement on Subsidiarity by the Commission

National rules on crypto-assets impede the cross-border provision of crypto-asset services and pose a risk to consumer and investor protection, market integrity and competition.

Policy Context

There is currently no EU legal framework for crypto-assets. There is legal uncertainty as to whether and how far existing EU financial market rules apply to crypto-assets, and their issuers and service providers (see cep**Input**). This limits innovation and has a negative effect on consumer and investor protection. At the same time, a number of Member States such as France, Germany and Malta have brought in national legislation on crypto-assets which has led to inconsistencies in the internal market.

Legislative Procedure

24 September 2020	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, entry into force

Options for Influencing the Political Process

Directorates General:	DG Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs, Rapporteur: Stephan Berger (EPP, D)
Federal Ministries:	Finance (leading)
Committees of the German Bundestag:	Finance (leading)
Decision-making mode in the Council:	Qualified majority (acceptance by 55% of Member States which make up 65% of the EU population)

Formalities

Competence:	Art. 114 TFEU (Internal Market)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Uniform **EU provisions on crypto-assets and crypto-asset services** are appropriate. They **may in principle increase legal certainty** for investors, issuers and providers. Although some Member States have already brought in their own legislation, it is frequently unclear whether and which legal provisions apply. Also, existing provisions are often incompatible with the innovative characteristics of crypto-assets. Furthermore, uniform EU provisions may support crypto-asset markets by acting as a seal of approval which ensures that even market players who have previously been sceptical towards the segment, will gain the necessary confidence.

Some cryptocurrencies are not issued by central bodies but are “mined” by a large number of actors. **The Regulation** submitted **fails to provide sufficient legal certainty for** such **cryptocurrencies which do not have a central issuer.** On the one hand, cryptocurrencies that are already on the market, e.g. Bitcoin, are exempt from the provisions. They are not therefore subject to any uniform, EU-wide requirements. On the other hand, cryptocurrencies issued in the future will have to show that they have an issuer in the form of a legal entity. For such decentralised cryptocurrencies, however, this is impossible. It therefore remains unclear whether cryptocurrencies issued in the future will be de facto banned in the EU or whether they will simply not be covered by the Regulation, or only via the crypto-asset services performed with them.

Furthermore, the unequal treatment of existing as compared with future cryptocurrencies and utility tokens gives rise to gaps in consumer protection and distortions of competition.

The rules on issuing crypto-assets do not differentiate between crypto-assets that are financial in nature i.e. which act as a means of payment or investment, on the one hand, and utility tokens, which grant rights to use a product or a service and/or act like vouchers, on the other. **In the case of utility tokens,** in particular, **the obligation to submit a white paper,** which is based on the structure of a security prospectus, **is often not precisely tailored and thus disproportionate** because, unlike securities which represent financial assets, utility tokens generally only grant rights of use or access. The Commission should therefore bring the provisions more closely into line with the distinctive features of the various types of crypto-assets and make utility tokens exempt from the provisions. Insofar as they pose a risk to consumer protection, utility tokens should be regulated under consumer protection legislation rather than financial market laws.

Clarification is required as to which law will apply to hybrid crypto-assets, e.g. those displaying both the features of

crypto-assets within the meaning of the Regulation and those of financial instruments within the meaning of the MiFID-II Directive. Without this, there is a risk of regulatory conditions being poorly targeted, unclear and possibly duplicated. The fact that crypto-asset service providers in the EU are admitted and supervised by national authorities is justifiable as their size and cross-border relevance is currently still limited. Granting an EU passport to authorised providers strengthens the internal market, and the requirement for providers to have a registered office in the EU is what makes enforcement possible.

The complete exemption of banks and investment firms from the authorisation requirements is double-edged. Although banks and investment firms are already highly regulated under existing EU law, they do not necessarily have the expertise when it comes to providing crypto-asset services. They should also therefore be subject to the authorisation requirements. This is also necessary to ensure a level playing field with other crypto-asset service providers.

Entities that both issue crypto-assets and provide crypto-asset services have to undergo several authorisation procedures. This is costly for companies and for the supervisory authorities. Costs can be reduced by combining authorisation procedures. In addition, clarification is required as to how the issuance of a crypto-asset by way of a public offering differs from the crypto-asset service of exchanging crypto-assets for official currencies.

Legal Assessment

Legislative Competency

The Regulation is correctly based on the internal market competence (Art. 114 TFEU).

Subsidiarity and Proportionality with Respect to Member States

Unproblematic.

Conclusion

EU legislation on crypto-assets and crypto-asset services may in principle increase legal certainty. However, the Regulation fails to provide sufficient legal certainty for cryptocurrencies which do not have a central issuer. In the case of utility tokens, the obligation to submit a white paper is often not precisely tailored and thus disproportionate.