



**Association of Global Custodians
European Focus Committee**
- SUBJECT TO ADDITIONAL COMMENTARY -

ESMA Draft Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments

The European Focus Committee of the Association of Global Custodians¹ (“AGC-EFC”) welcomes the opportunity to comment on ESMA’s consultation papers on 1) guidelines on reverse solicitation and 2) guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments.

The AGC is registered on the EU Transparency Register, registration number 813994623570-13.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Summary

ESMA’s proposed guidelines on reverse solicitation and the conditions and criteria for the qualification of crypto-assets as financial instruments have significant implications for the development of crypto-asset markets in the EU, as well as establishing a clear delineation between the MiCA framework and the established framework for financial instruments. We therefore encourage ESMA to take a considered approach to both sets of guidelines to mitigate possible negative and unintended consequences for crypto-asset and traditional financial markets. We believe both sets of guidelines would benefit from the following clarifications and changes:

- **Reverse solicitation:** we believe that ESMA should clarify the scope of the proposed guidelines by specifying explicitly that they apply exclusively to the cross-border provision of crypto-asset services under MiCA; we also believe that ESMA should consider allowing for more flexibility in wholesale arrangements so that EU market participants can utilise the services of third-country providers, where appropriate or necessary. In addition, ESMA should consider adjustments to allow for more flexibility to accommodate for possible future changes in relation to means of solicitation.
- **Conditions and criteria for the qualification of crypto-assets as financial instruments:** whilst ESMA’s proposed approach to consider qualification circumstances on a case-

¹ Established in 1996, the Association of Global Custodians (the “Association”) is a group of 12 global financial institutions that each provides securities custody and asset-servicing functions primarily to institutional cross-border investors worldwide. As a non-partisan advocacy organization, the Association represents members’ common interests on regulatory and market structure. The member banks are competitors, and the Association does not involve itself in member commercial activities or take positions concerning how members should conduct their custody and related businesses. The members of the Association are: BNP Paribas; BNY Mellon; Brown Brothers Harriman & Co; Citibank, N.A.; Deutsche Bank; HSBC Securities Services; JP Morgan; Northern Trust; RBC Investor & Treasury Services; Skandinaviska Enskilda Banken; Standard Chartered Bank; and State Street Bank and Trust Company.

by-case basis offers required flexibility, we believe that ESMA should take an active role in mitigating and harmonising possible divergent interpretations with respect to the same asset by either providing further guidance and/or maintaining a minimum list of crypto-assets. In addition, we believe that the proposed hierarchical approach to the qualification of hybrid-type tokens (where classification as financial instruments takes precedence over classification as crypto assets) may not sufficiently address risks associated with divergent interpretations and/or qualifications changing over the lifecycle of an asset – especially regulatory and liability risks – and requires further consideration. In these scenarios, ESMA should consider how it can support market participants to mitigate implications relating to these risks and prescribed requirements – including adopting forbearance and/or grace periods in circumstances in which the classification of an asset changes.

Questions

ESMA Consultation on draft guidelines on reverse solicitation under MiCA

Q1: Do you agree with the approach chosen by ESMA? Do you see any potential loophole that could be exploited by third-country firms to circumvent the MiCA authorisation requirements?

We broadly agree with ESMA's approach to base the reverse solicitation exemption under MiCA on the established practice under the MiFID II framework (as prescribed by ESMA Q&As). However, we support 1) a clarification on scope specifying that the proposed guidelines (including restrictions on means of solicitation) apply exclusively to the cross-border provision of crypto-asset services under MiCA, and 2) some adjustments to material differences proposed compared to the established practice under MiFID II.

We note that MiCA has a broad definition of a crypto asset service provider ("CASP"), as most services relating to crypto assets, including acting as a trading venue, fall within the definition of a CASP. We also note that there appears to be no prospect of differentiation based on classification of clients (e.g., retail vs. professional vs. eligible counterparty), yet the restrictive approach taken under MiCA seem developed with retail investors in mind. More troublingly, if an EU CASP regulated under MiCA wants, or needs, to use the services of a non-EU service provider (e.g., a trading venue), in order to provide services to its own client, we believe this should be accommodated.

First, regarding scope of application, in view of the significant differences between MiCA and the perimeters of EU legislation, we recommend that ESMA clarify that the proposed Guidelines apply exclusively to the provision of crypto asset services falling under MiCA. This is an important clarification for firms with multiple business lines and whose business model is not predominantly associated with the provision of crypto asset services, such that the proposed Guidelines would only apply to the provision of crypto asset services in scope of MiCA.

Second, we note that material differences are proposed compared to the established practice under MiFID II. We acknowledge there may be a rationale for MiCA reverse solicitation rules being more restrictive than those falling within the MiFID perimeter since crypto assets, and

crypto asset markets, have some special features, such as access by private individuals. We recommend that ESMA consider reverse solicitation rules that distinguish between (a) private individuals and (b) wholesale market participants, with the new MiCA reverse solicitation rules applying to (a) and the current MiFID regime to (b): we note that MiCA already has a definition of “qualified investors”, which includes credit institutions. ESMA may consider whether this definition could be used for this purpose.

We also acknowledge that the provision of crypto asset services may lead to new ways of marketing with digital tools and channels and require adaptations to the restrictions on means of reverse solicitation, but we view that ESMA’s currently proposed approach to restrict solicitation by means of specific electronic and multimedia channels leads to a very broad interpretation of the means of solicitation under MiCA and may lack the flexibility to accommodate for future changes in technological means and communication patterns.

For example, the draft Guidelines take a strict approach in the following areas such that they would be considered as means of solicitation in breach of the exemption (under Guideline 1 and 2):

- Social media advertising, even where there is no direct reference to the provision of crypto asset services;
- Brand advertisements by way of sponsorship deals, even where there is no direct reference to the provision of crypto asset services; and
- Displaying of a third-country firm’s logo, even where there is no direct reference to the provision of crypto asset services, as an indication of a person acting on behalf of a third-country firm.

In the above areas, we view that ESMA should consider narrowing its interpretation of solicitation such that only means containing direct references to crypto asset services in scope of MiCA should be considered as a means of active solicitation. We believe ESMA’s proposals in this respect need further clarification and specificity in any case.

Q2: Are you able to provide further examples of pairs of crypto-assets that would not belong to the same type of crypto-assets for the purposes of Article 61 of MiCA? Or are you able to provide other criteria to be taken into account to determine whether two crypto-assets belong to the same type?

[No response]

Q3: Do you consider the proposed supervision practices effective with respect to detecting undue solicitations? Would you have other suggestions?

We agree that competent authorities should be empowered with the necessary tools to monitor entities targeting clients established or situated in the EU or active in the EU, where they have detected possible breaches of the reverse solicitation exemption. However, we view that the starting assumption should not be that firms adopting certain practices (local email or website addresses) are doing so in order to conduct prohibited activities. It should be clarified that a suspicion of wrongdoing (based on reasonable grounds) should be the determinant for investigating a firm.

ESMA Consultation on draft guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments

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?

This approach entails a case-by-case assessment as to whether a crypto-asset shall be considered a financial instrument or not. As such, it is conceptually a good approach as it gives flexibility. However, this approach also implies potential legal uncertainty, additional costs and possibility to have different views on the same asset depending on the national competent authority consulted.

We strongly welcome the technologically neutral approach of the draft Guidelines to ensure that assets are subject to the same qualification conditions and criteria regardless of their underlying technology. We also agree that the proposed approach supports the diversity of the types of existing crypto-assets and facilitates the innovation of financial technologies.

On the other hand, providing one-size-fit-all guidance may create a discontinuity between MiCA and MiFID, due to the different implementations of MiFID throughout the EU. In particular, we view that the flexible approach proposed may also lead to potential legal uncertainty, additional costs and the possibility to have different views on the same asset depending on the responsible National Competent Authority (NCA). For example, NCAs could take different interpretations of the proposed guidelines, which could lead to fragmentation in the implementation of MiCA also depending on the final guidelines' interaction with local law. In this context, we encourage ESMA to take an active role in ensuring that the conditions and criteria for the qualification of crypto-assets as financial instruments are sufficiently harmonised across Member States, for example through the issuance of Q&As. As an alternative solution, we view that ESMA could maintain a "minimum list" of crypto-assets to facilitate the assessment exercise whilst leaving open the possibility to assess the qualification of assets in case an asset has specific features which do not allow it to be appropriately categorised by applying the criteria.

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 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 (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.

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 blockchain. 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 blockchain or similar DLT 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 blockchain 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 of MiFID and MiCA. We note that the proposed principles combined with the recognition of instruments issued by means of DLT under MiFID (as amended under Article 18 of the DLT Pilot Regime) and proposed approach to hybrid-type tokens (under Guidelines 9) could open the possibility to have various crypto-assets falling within the scope of MiFID. As such, we support ESMA assuming an active role in limiting the room for regulatory uncertainty on the delineation between transferable securities and crypt-assets under MiCA.

Some crypto-assets can have a variety of functions: an issuer should not be incentivised to arbitrage regulations against each other, e.g., by classifying a crypto asset as a payment instrument in order to avoid a classification as a transferrable security. The possibility of a payment function in particular introduces other, unique factors (such as impact on the financial system and monetary policy²) that should be considered carefully: we believe that a definition of an “instrument of payment” should be set out in order to address these other factors and prevent regulatory arbitrage. In particular, clarification should be made regarding the potential “*payment function*” of a crypto-assets that may combine (1) a potential payment function, (2) an investment purpose and (3) a store of value function.

In order to ensure legal certainty, the element of analysis on the “payment function” of an E-Money Token (EMT) and Asset-Referenced Token (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 also have the merit of fostering 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 characterized as such.

Given the wide range of possible interpretations of the criteria for the classification of crypto-assets, we would be in favour of a more centralized 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.

² The Bank for International Settlements (BIS) pointed out in a recent publication - echoing an IMF-FSB paper - that 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. See, BIS, *Stablecoins: regulatory responses to their promise of stability*, April 2024

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

[No response]

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 understand that ESMA is applying the “same activity, same rules” principle for each category of financial instrument (e.g., 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, 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” principle applies - for example, applying this principle, stablecoins having features of money market instruments, or even derivatives, should be classified as financial instruments. Indeed, MiCA’s exclusion approach might even be counterproductive and create incentives that run counter to the intent of regulators.

To facilitate the identification exercise, we 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). General guidance on the concrete method and elements to consider new type of assets within the MiFID perimeter would 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.

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

We understand that EMT and ART are excluded. Other crypto-assets may have various type of features and characteristics. 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. However, given the very broad definition of Art. 3(1)(9) MiCA, a utility token could include other types of assets as long as the distinctive criterion is the "access to a good or a service".

There is a possibility to have various tokens falling within the scope of MiFID, 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. For example, some utility tokens may accrue revenues from protocol fees to token holders or allow community voting by holders, and these characteristics could lead to an interpretation that the tokens could be considered as financial instruments due to the hierarchical approach being proposed for hybrid-type tokens (where

qualification as a financial instrument would take precedence over qualification as a crypto-asset). However, we do not agree sharing revenues accrued from protocol fees represents an ownership position in a company, nor do we agree that community voting on fund distribution is the same as participating in a company's decision-making process. As such, utility tokens with such characteristics should not be considered as financial instruments.

We therefore agree with the conditions and criteria to differentiate between MIFID II financial instruments and MiCA crypto assets, but we view that the inclusion of more concrete examples could enhance the delineation, strengthen harmonisation, and promote common understanding between supervisors and market participants.

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.

There is a distinction to be made between NFTs under MiCA and NFTs that would be considered outside of MiCA's scope. However, it may also be appropriate to expressly clarify the regime and concrete criteria for the various categories as there seems to be several possibilities:

We note that most NFT collections are valued at "floored price", which means that each piece of a collection would be valued at that price at a minimum. However, this pricing model does not mean that all pieces within a collection have the same value nor detract from the uniqueness of the pieces. In addition, there exist protocols which allow buyers to purchase and bid in a similar way to fungible tokens. We do not agree that the mere availability of collection valuation and bidding protocols should impact the non-fungibility and uniqueness of a NFT.

In addition, we support ESMA to consider providing clarifications in relation to the various sub-categories of NFTs, which display different characteristics:

- MiCA's eligible NFTs (i.e. those that are not unique/fungible/fractionable);
- NFTs that are out of the scope of MiCA (as they are truly unique) and that are also not in the scope of MiFID as they cannot be interchangeable/ do not constitute a class of transferable securities; and
- Fractionalised NFTs, as it remains possible for them to be qualified as transferable securities (eligible under MiFID 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.

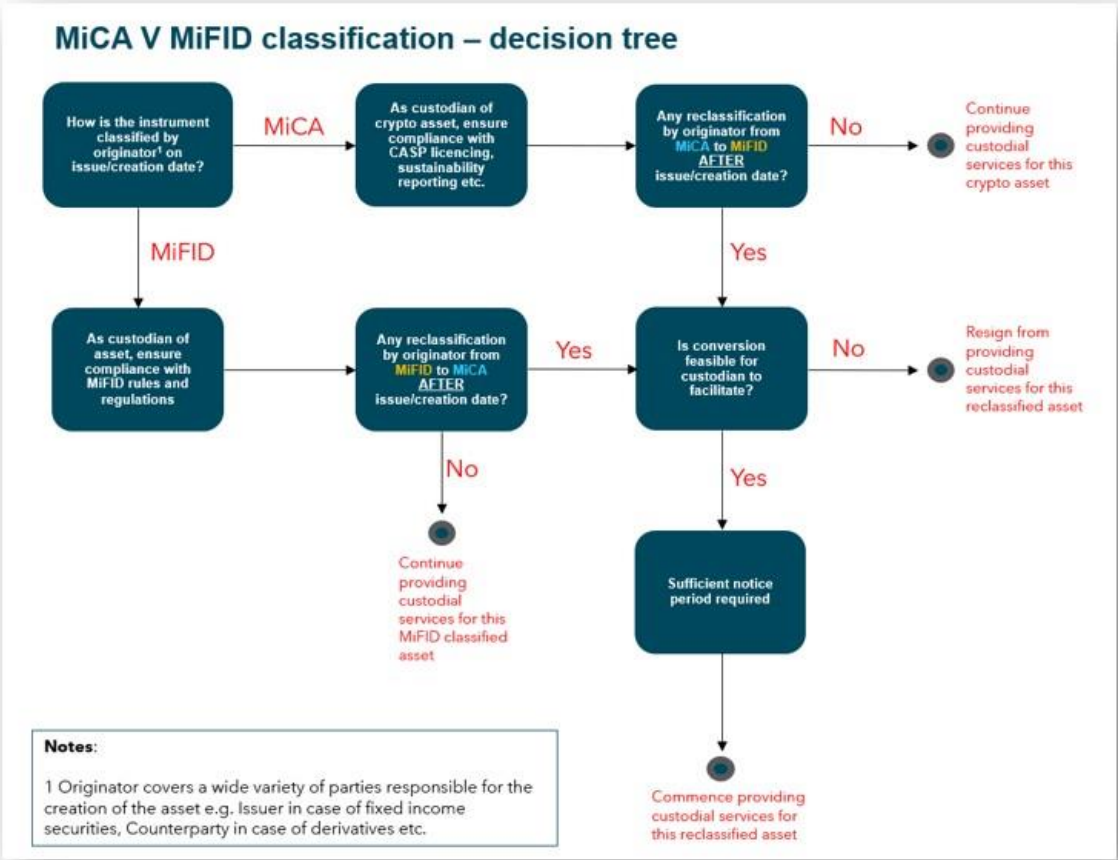
We are concerned about the implications for the responsibility and liability attached to the determination of the qualification of an asset that may result from ESMA's proposal that the criteria for the qualification of hybrid-type tokens should consider possible changes over the course of an asset's lifecycle. We therefore encourage ESMA to consider how it would minimise risks and provide satisfactory mitigation to market participants should such scenarios arise.

We understand that an issuer is responsible for an asset's qualification; however, this may pose uncertainty in case a participant in the value-chain takes a different view or challenges the qualification. This may result in situations where an issuer qualifies the assets as a MiFID instrument whereas a provider or another participant considers that the asset should qualify as a MiCA crypto-

asset. A divergent analysis could expose both the issuer and a service provider to uncontrollable risks relating to the qualification of the asset, the licencing regime of the service providers, as well as potential prudential implications.

As an example, a CASP authorised under MiCA may initially offer services for crypto assets considered within the scope of MiCA. However, if the assets are later reclassified as financial instrument subject to MiFID, then the CASP could find itself dealing with MiFID instruments without the necessary licensing. This scenario would expose investors to risks since the CASP, whilst compliant with MiCA, does not have the necessary authorisation to operate under MiFID. The converse example could also apply: a service provider which does not have authorisation to act as a CASP under MiCA could start to provide service over assets that are initially qualified as MiFID financial instrument but re-categorised as MiCA crypto-assets or vice-versa during the lifecycle. This would lead to risks for investors and for the service provider.

In any case, given the complexities and uncertainties described above, we recommend that at a minimum there should be a “grace period” where a responsible party makes the initial determination on the classification of the relevant instrument but which is subsequently not confirmed by, for example, an NCA. Market participants would need this time to address the issue of non-conformity with clients and regulators. The following diagram may assist in depicting the logic-flow that could be applied:



There is also a need to provide clarification on the number of features required to be captured by the definition of financial instrument. 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?

Adopting a position whereby all hybrid tokens should be categorized as MiFID financial instruments by virtue of the hierarchical approach may open the possibility for hybrid tokens such as bitcoin, ether, etc.. to be categorized as a financial instrument under MiFID 2, depending on the notion of "payment instrument" under PSD3/PSR and MiFID 2 (see question 2). There is therefore a need to clarify these key notions to provide a higher level of certainty on the qualification of this type of assets.

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 prioritize their identification as financial instruments when a hybrid token displays features (number to be determined) of a financial instrument.

Please contact the undersigned with any questions regarding this submission. The AGC-EFC looks forward to further supporting ESMA's work.

Sincerely,

John Siena
Chair, European Focus Committee
Association of Global Custodians