

Recommendations for delivering supervisory convergence on the regulation of crypto-assets in Europe

November 2019



Executive Summary

The range and pace of development in crypto-assets, from tokenised securities issued by regulated entities to fully decentralised crypto-currencies (e.g. Bitcoin), indicates that Europe has the opportunity to become a global leader in their regulation. When used safely, crypto-assets can deliver many potential benefits to end users, such as cheaper cross border transactions, faster settlement times and enhanced regulatory compliance capabilities.

However, greater supervisory convergence is needed to help realise crypto-assets' full potential and address the following challenges:

- **Inconsistent regulation:** Regulators across Europe have taken varying approaches to the regulation of crypto-assets. This can inhibit innovation, as market participants can be discouraged from conducting crypto-asset activity across borders due to uncertainty regarding different regulatory requirements in each jurisdiction; and
- **Regulatory application:** Existing regulations may not always fit to crypto-assets due to their use of Distributed Ledger Technology (DLT) and cryptography, and the creation of bespoke regulation by European National Competent Authorities (NCAs) may further fragment the market and bring operational challenges.

This position paper has been developed by AFME's Digital Assets Task Force to provide an analysis of the current European crypto-asset regulatory landscape and to set out five recommendations to support supervisory convergence across Europe:

1. **Establish a pan-European crypto-asset taxonomy:**
 - We believe a harmonised, pan-European taxonomy for crypto-assets is a crucial first step towards common understanding, easing collaboration across jurisdictions and providing greater regulatory certainty for participants engaged in cross border activity.
2. **Provide clear expectations for market participants regarding the process for issuing crypto-assets:**
 - Clear guidance on the process to follow (e.g. what regulations apply, if any, and necessary steps for authorisation) for issuance (e.g. authorisation, licensing and registration) will help provide regulatory certainty for an individual crypto-asset at the point of issuance.
3. **Apply activities based and technology agnostic regulation:**
 - Regulation of crypto-assets should be agnostic to the technology used to undertake the crypto-asset activity and should address the risks and outcomes of the activity.
4. **Apply existing regulation for regulated activities, with any necessary amendments, if required:**
 - Existing regulation can effectively be applied in some cases to activities conducted using crypto-assets which are equivalent to currently regulated activities. Under the principle of 'same activity, same regulation', this should apply to any entities conducting a regulated activity.

5. Prioritise convergence of regulatory frameworks with other global and regional initiatives:

- Given the borderless nature of crypto-assets, engagement across relevant regional and global regulatory bodies and initiatives will remain critical to ensure a consistent approach to crypto-asset classification and supervisory oversight within global financial services.
- Greater supervisory convergence in Europe will be an important first step towards formulating a globally coordinated approach to the regulation of crypto-assets; AFME believes that any European initiatives to facilitate supervisory convergence should input into and be aligned with global initiatives from the outset.

It is our aim that these recommendations will encourage innovation and a competitive level-playing field in relation to crypto-assets development, as well as protect the financial system and mitigate risks to end users. Implementation of these recommendations will also help to establish Europe as a global leader in crypto-assets.

AFME and its members look forward to continuing to work with regulators and other market participants to achieve this aim.

1. Introduction

Crypto-assets are a digital representation of value which incorporate cryptography¹ and DLT². The term “crypto-asset” is broad, encompassing various products and serving many purposes: for instance, they can be a digital representation of existing financial products on a DLT network (non-native crypto-assets), or they can represent products issued directly on a DLT network (native crypto-assets)³.

What differentiates crypto-assets in financial markets today is their use of cryptography and DLT. This in turn allows multiple participants to access or create crypto-assets in a decentralised manner, in which each ledger on the network maintains a tamper-proof record of activity. This underlying technology offers a range of potential benefits within financial services, including faster, cheaper and more efficient cross-border transactions⁴. However, DLT’s innovative and unique capabilities are also what makes developing an approach to the regulation of crypto-assets challenging, because existing regulations may not always fit.

The number and type of crypto-assets being developed and used today has increased, and accordingly, governmental bodies and regulators are actively beginning to conceptualise, categorise and apply an appropriate regulatory framework to mitigate risks related to their activity⁵. In response, we have conducted a cross-jurisdictional analysis of the crypto-asset taxonomies and regulatory approaches in use across 11 jurisdictions in Europe to provide a perspective on the current landscape (for more detail see Annex 2 p. 17).

We have observed that within Europe⁶, current crypto-asset regulatory approaches are wide-ranging and lack harmonisation. As the European Central Bank (ECB) has observed, “there is currently no international agreement on how crypto-assets should be defined”⁷. For example, some European NCAs regulate a narrower range of activities⁸ whilst others have developed bespoke regimes which bring all crypto-asset activities into their regulatory perimeter⁹. However, if regulators in Europe were to converge towards a harmonised approach to crypto-assets regulation, this could remove barriers to innovation and provide an opportunity to further the objectives set by the European Union to create a European Capital Markets Union (CMU)¹⁰ and Digital Single Market (DSM)¹¹.

This position paper is organised into five sections as outlined below:

- **Section 2** examines the opportunity for Europe to become a global leader in crypto-assets;
- **Section 3** examines crypto-asset taxonomies in use across European jurisdictions;
- **Section 4** examines crypto-asset regulatory approaches in use across European jurisdictions;
- **Section 5** outlines five recommendations for increasing supervisory convergence on the treatment of crypto-assets in Europe; and
- **Section 6** summarises the paper’s findings.

¹ The conversion of data into private code using encryption algorithms, typically for transmission over a public network, see <https://www.fsb.org/wp-content/uploads/P310519.pdf>

² For a sample of definitions see Annex 1.

³ For a sample of definitions see Annex 1.

⁴ <https://www.afme.eu/globalassets/downloads/consultation-responses/afme-tao-fca-distributed-ledger-consultation-paper-response.pdf>

⁵ See page 14 <https://www.bis.org/publ/bppdf/bispap101.pdf>

⁶ The geography of “Europe” as used in this paper refers to countries that are a part of the European Single Market (i.e. EU 28, European Economic Area, Switzerland).

⁷ <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf>; https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf

⁸ E.g. UK Financial Conduct Authority (FCA), Italian Commissione Nazionale per le Società e la Borsa (Consob).

⁹ E.g. Gibraltar Financial Services Commission (GFSC), Malta Financial Services Authority (MFSA), French Autorité des Marchés Financiers (AMF), Estonia Financial Services Authority (EFSA).

¹⁰ https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_en

¹¹ <https://ec.europa.eu/digital-single-market/>

2. The opportunity for Europe to become a global leader in crypto-assets

In this section we identify the multiple benefits, risks and operational challenges related to crypto-assets to illustrate the need for supervisory convergence in the regulation of crypto-assets in Europe.

AFME believes it is crucial that market participants and regulators collaborate further to better understand the market and end user needs, the underlying technology, the benefits provided and the risks involved with crypto-asset activity in order to develop an appropriate response. This will support Europe becoming a leader in financial innovation and contribute to the European Commission's (EC) ambition to make "Europe fit for the digital age"¹².

Potential benefits relating to the use of crypto-assets

Crypto-assets have the potential to bring significant benefits to both market participants and consumers, including increased efficiencies at various stages of the capital markets transaction lifecycle (from trading to settlement). These efficiencies could include, amongst others:

- Faster - potentially real-time - and cheaper cross-border transactions;
- An ability to trade beyond current market hours;
- More efficient allocation of capital (improved treasury, liquidity and collateral management);
- Faster and cheaper time to market for securities issuances;
- Faster settlement times, reduced trade breaks and reconciliations required; and
- Enhanced auditability, transparency and regulatory compliance¹³.

In addition, it is important to note that DLT can also provide additional benefits in capital markets, outside the use of crypto-assets. For instance, DLT could enhance the handling of data between parties, reduce data processing costs, limit disputes or automate the processing of contractual obligations through the use of smart contracts (e.g. for asset servicing or event processing in derivatives).

Potential risks and operational challenges relating to the use of crypto-assets

There are also a number of potential risks and operational challenges associated with the use of crypto-assets in financial markets, relating to:

- Maintaining financial stability (e.g. outlining prudential treatment of crypto-asset exposures¹⁴);
- Asset and data security (e.g. ensuring crypto-assets cannot be stolen, lost or hacked and that private and sensitive data and information stored on a DLT network is protected);
- Consumer and investor protection (e.g. protection against fraud and price volatility);
- Upholding global anti-money laundering and counter-terrorist financing standards¹⁵; and

¹²p 13 https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf

¹³<https://www.bis.org/publ/work811.pdf>

¹⁴<https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf?f2e9a2596a8f9c38c95f4735c05a0d47>

¹⁵<https://www.fatf-gafi.org/publications/fatfrecommendations/documents/public-statement-virtual-assets.html>

- Building the resilience of DLT networks.

Crypto-assets also raise broader questions that will need to be addressed as their adoption grows. Some of those questions are set out in Table 1 below. As outlined in this table, whilst existing regulations are an important starting point, there are multiple more detailed considerations which need to be addressed.

Table 1: Questions relating to the use of crypto-assets within financial services

Focus area	Example question
Governance	How can regulators and the industry ensure appropriate separation of roles and responsibilities between different actors and appropriate management of potential conflicts of interest?
	How can regulators and the industry ensure appropriate governance arrangements are in place across DLT networks and associated crypto-asset activities?
	How do regulators and the industry manage disputes between actors regarding crypto-asset activities?
Legal	How should legislators and the judiciary apply relevant laws in a DLT environment without precedent (e.g. property law, bankruptcy law and contractual law)?
	How can legal settlement finality be agreed?
	What consensus mechanisms are appropriate when conducting financial transactions?
Regulation	How can regulators appropriately regulate traditionally unregulated actors providing financial services activities using crypto-assets and DLT?
	How do regulators and the industry approach and appropriately regulate “miners” ¹⁶ where appropriate?
	How should the General Data Protection Regulation (GDPR) be addressed in the implementation of DLT networks in order to ensure adequate data privacy?
	How should forks on a DLT network be treated from a regulatory perspective?
Operations & Technology	How can the industry ensure integrity of issuance for crypto-assets?
	What are the implications for market fragmentation if DLT networks are not interoperable?
	How can the industry correct possible errors or records given the inherently tamper-proof nature of data stored on a DLT network?
	For settlement, how does the industry ensure delivery versus payment with i) “exchange tokens” ¹⁷ and ii) with existing Real-time Gross Settlement (RTGS) systems?
	How can the industry overcome other related challenges including, latency, scalability, and energy consumption?

¹⁶ A network of computers establishing consensus to verify and confirm transactions within a DLT environment. See https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_cryptocurrency_advice.pdf page 10

¹⁷ For a sample of definitions see Annex 1, or section II for more detail.

Many of these questions are already being considered by the industry. In certain cases, some may have already been addressed (e.g. errors can be corrected, or records amended on some private chains¹⁸) or partially solved (e.g. some public chains claim to be GDPR compliant¹⁹). There are still however some challenges that need to be considered further (e.g. where DLT networks operate as an infrastructure for the provision of financial services, there may be a need for appropriate operating standards).

The way forward for Europe

National governments and regulatory authorities have begun to develop their own approaches to the regulation of crypto-assets by clarifying how existing regulations would apply to crypto-assets and/or by establishing bespoke regimes for what has been identified as previously unregulated (i.e. falling outside of the regulatory perimeter).

However, there is currently an opportunity for the industry, NCAs and EU bodies (e.g. European Banking Authority (EBA), European Securities Markets Authority (ESMA), ECB, EC) to collaborate in fostering convergence on the regulatory treatment of crypto-assets in Europe. This will support the emergence of safe, innovative products and services at scale, as market participants will be clear on which rules apply to their activities, particularly when conducting business across European jurisdictions. Convergence towards a coordinated and fit for purpose regulatory framework that promotes a level playing field through activities-based regulation will also help to place Europe as a global leader in the regulation of crypto-asset activity.

¹⁸ https://www.accenture.com/_acnmedia/pdf-33/accenture-editing-uneditable-blockchain.pdf

¹⁹ [https://www.europarl.europa.eu/RegData/etudes/STUD/2019/634445/EPRS_STU\(2019\)634445_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2019/634445/EPRS_STU(2019)634445_EN.pdf)

3. Crypto-asset taxonomies in use across European jurisdictions

In this section we provide an overview and assessment of crypto-asset taxonomies²⁰ in use across several European jurisdictions (for more detail on our methodology please see Annex 2, p. 17).

It is important that regulators differentiate between different types of crypto-assets and identify an applicable regulatory framework so that market participants are clear on which regulatory obligations they may be subject to, based on the activity they are conducting.

While AFME agrees that the classification of crypto-assets by economic function is an important initial starting point for building a taxonomy, we also propose below some additional factors for consideration by regulators. We recommend that these considerations be used to inform a harmonised European taxonomy for crypto-assets.

Examining the crypto-asset taxonomy landscape in Europe

Many European jurisdictions have indicated their method for classifying crypto-assets when publishing guidance or when making legislative changes to encompass crypto-asset related activities. In our analysis, we have mapped the various crypto-asset taxonomies used by 11 different European jurisdictions (for more detail on our methodology please see Annex 2 p. 17).

This mapping demonstrates that most regulatory authorities in Europe have taken an approach to the classification of crypto-assets based on a crypto-asset's economic function²¹. There is relative convergence around the following three categories (although not all crypto-assets always fall neatly into one). The three categories and their definitions can be summarised as²²:

- “**Security/asset tokens**” – *crypto-assets which represent assets such as participations in real physical underlyings, companies, or earnings streams, or an entitlement to dividends or interest payments. They are analogous to equities, bonds or derivatives.*
- “**Exchange/payment tokens**” – *crypto-assets which are intended and designed to be used as a digital means of exchange, unit of account or store of value (e.g. crypto-currencies). They are, usually, a decentralised tool for buying and selling goods and services without traditional intermediaries.*
- “**Utility tokens**” – *crypto-assets which are intended to provide digital access to an application or service.*

AFME believes regulatory categorisation is a key foundation for determining how regulation is applied. It is important to consider whether crypto-asset products or related activities fall within the current regulatory perimeter. This depends on how a crypto-asset is defined and classified and whether the activity performed, or if the crypto-asset itself, is regulated.

AFME agrees that this high-level method of classification is an important initial starting point for further regulatory categorisation.

²⁰ A taxonomy as referred to in this paper is a scheme of classification.

²¹ e.g. Dutch Autoriteit Financiële Markten (AFM), Swiss Financial Market Supervisory Authority (FINMA), German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Malta Financial Services Authority (MFSA), Estonian Financial Supervision and Resolution Authority (EFSA), Lichtenstein Financial Markets Authority (FMA),

²² For a list of sample definitions used from European Member States see Annex 1.

Treatment of crypto-assets with additional traits or characteristics

However, we believe further consideration should also be given to the classification of those crypto-assets that contain specific traits or characteristics (such as price stabilising mechanisms, redemption rights, or clearly identifiable and regulated issuers), in order to better understand what criteria would further enhance or refine the initial above classification.

We therefore propose that there are other important factors that require consideration, which include:

- Is there a clearly identifiable legal entity issuing the crypto-asset? If so, what is the regulatory status of the issuer?
- What activity is being performed with the crypto-asset? What is the regulatory status of the entity performing the activity?
- Will the crypto-asset be available to all types of client categories (e.g. retail clients or professional clients)?
- What are the rights attached to the crypto-asset?

For instance, AFME considers stablecoins to be a diverse subset of crypto-assets, having within themselves several possible categorisations depending on their traits, such as their linkage to fiat currency, valuation stability, asset supply controls, risk management and central hedging. A number of authorities (e.g. UK Financial Conduct Authority (FCA)²³, Deutsche Bundesbank²⁴, ECB²⁵) have provided specific opinion on what stablecoins²⁶ are and how they would be treated, however our mapping of crypto-asset taxonomies in use by European NCAs identified that there is inconsistency in defining and classifying stablecoins.

We also note that the appearance of stablecoins have in some instances raised questions relating to data privacy, liquidity provision, monetary policy, and global systemic stability²⁷. These factors should be taken into account by regulators when determining what types of stablecoins there are and also what regulations apply to each specific type of stablecoin.

Finally, we note that, in some instances, regulators have observed examples of “hybrid” crypto-assets, which could fall into more than one category of crypto-asset at a time (i.e. having more than one economic function or being used for different purposes). AFME recommends that regulators look to ensure the regulatory treatment and activities associated with all types of crypto-asset is clear.

AFME recommends that regulators consider the above factors to create a harmonised European taxonomy for use by regulators and market participants. We believe this is a crucial first step in achieving supervisory convergence. A taxonomy that clarifies definitions and the application of existing or new regulation would help avoid further regulatory fragmentation across European jurisdictions. This taxonomy should also be aligned where possible with that of global initiatives (e.g. FSB, Bank of International Settlements (BIS), IOSCO).

²³p 18 <https://www.fca.org.uk/publication/policy/ps19-22.pdf>

²⁴p 5-6 <https://www.bundesbank.de/resource/blob/80338/64fd351df8b5997d157d8cee71c412cd/mL/2019-07-krypto-token-data.pdf>

²⁵<https://www.ecb.europa.eu/pub/pdf/scrops/ecb.op230~d57946be3b.en.pdf>

²⁶For a sample of definitions see Annex 1.

²⁷<https://www.ecb.europa.eu/pub/pdf/scrops/ecb.op230~d57946be3b.en.pdf>; <https://www.fsb.org/2019/10/regulatory-issues-of-stablecoins/> ;

<https://www.bis.org/cpmi/publ/d187.pdf>

4. Crypto-asset regulatory approaches in use across European jurisdictions

In this section we provide an overview of several European NCA regulatory approaches applied to crypto-assets to illustrate that there is both convergence and divergence. We also provide more detailed considerations on two main approaches.

AFME supports the application of existing regulation where possible and applicable, following the principle of ‘same activity, same regulation’.

An overview of crypto-asset regulatory approaches in Europe

There are several different regulatory approaches in use across Europe to date. In practise, regulatory authorities often use a combination of approaches to tackle the regulation of crypto-assets, including, but not limited to:

- Applying existing regulations to crypto-asset activities which are equivalent to currently regulated activities²⁸;
- Expanding the regulatory perimeter by:
 - Applying existing regulations to previously unregulated crypto-assets products and/or activities²⁹; and/or
 - Creating bespoke regulatory regimes for crypto-asset activities which are not covered by existing regulations³⁰;
- Maintaining the existing regulatory perimeter but enacting legislation to create a voluntary regime for unregulated assets and/or activities³¹;
- Issuing regulatory warnings for consumers or investors³²; and/or
- Establishing a new regulatory entity to regulate and oversee some aspects of DLT technology³³.

Below we provide more detailed considerations for regulators for enhancing supervisory convergence:

i) Applying existing regulations to crypto-asset activities which are equivalent to currently regulated activities:

AFME supports the view that regulators should look to regulate crypto-assets, following the principle of ‘same activity, same regulation’. This means that appropriate consideration must be given to whether the crypto-asset activity being conducted is akin to an existing regulated activity conducted by that entity. For example, where a regulated bank is undertaking crypto-asset related activity, existing banking regulations should be used as the starting point for analysing whether those regulations are sufficient to address the risks of the underlying activity. Conversely, e-money and/or payment regulations may be appropriate for non-banks seeking to use crypto-assets in a payment or money movement capacity.

The jurisdictions analysed have applied some existing regulations to crypto-asset activities as a first step. For instance, all jurisdictions in our analysis apply their own national securities laws to crypto-assets which fit the national definition of a security. We also observed that all of EU Member States analysed

²⁸ E.g. <https://www.fca.org.uk/publication/consultation/cp19-03.pdf>

²⁹ E.g. <https://www.finma.ch/en/news/2019/09/20190911-mm-stable-coins/>

³⁰ E.g. <http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=12872&l=1>

³¹ E.g. <https://www.amf-france.org/Reglementation/Dossiers-thematiques/Fintech/Vers-un-nouveau-regime-pour-les-crypto-actifs-en-France>

³² E.g. <https://www.fsma.be/en/warnings/cryptocurrency-fraud-fsma-warns-against-xtb-markets>

³³ The Malta Digital Innovation Authority (MDIA) Act (Chapter 591 of the Laws of Malta) covers the establishment of a regulatory authority, called the Malta Digital Innovation Authority (MDIA), dedicated towards the supervision and certification of DLT platforms and smart contracts, which are referred to as technology arrangements under the said Act.

apply the Second Markets in Financial Instruments Directive (MiFID II) to activities where a crypto-asset qualifies as a MiFID Financial Instrument. The same would apply to EU Member States for the categorisation of crypto-assets as e-money under the E-Money Regulations (EMRs) or funds under the local implementation of the Second Payment Services Directive (PSD2), unless the instrument is under scope of another specific local law and is conducting an activity considered as a ‘regulated activity’ under EU or local law. However, only a handful of EU Member States have so far published reports or other analysis indicating that crypto-assets will qualify as e-money in relevant cases (e.g. FCA, Malta Financial Services Authority (MFSA)).

When regulatory authorities undertake an assessment of existing regulation, AFME believes it is important to ensure no gaps are left in its applicability and that the regulation in question is suited to address the risks associated with the activity. A thorough assessment should be made of the relevant activities and entities, to determine whether existing regulation is fit for purpose, or cannot be enhanced to cover relevant crypto-assets products and activities. When crypto-asset activities are covered by existing rules, AFME believes that bespoke regulations should only be used to address new risks introduced by technological change when no amendments or clarifications to the existing rules are possible or effective to address these risks. In retrospective situations, some transition periods or provisions may also be needed to allow existing firms to comply with the relevant provisions.

ii) Making regulatory adjustments by expanding the perimeter through widening the application of existing regulation and/or creating a bespoke regime for crypto-asset activities which are not equivalent to existing regulated activities:

Where it is determined that it is necessary to expand the regulatory perimeter by widening the application of existing regulation and/or creating a bespoke regime, a coordinated and common pan-European approach would reduce fragmentation and promote wider harmonisation. We have also observed that in the absence of a pan-European approach, some NCAs have created a bespoke regime in order to cover several types of crypto-asset activities. For example:

- In Malta, all issuers of virtual financial assets³⁴ (i.e. exchange tokens) must register with the MFSA, possess a license and be subject to certain obligations.
- In France, issuers of crypto-assets that qualify as securities are required to register with the Autorité des Marchés Financiers (AMF) and comply with related supervisory obligations. However, “initial coin offering (ICO) initiators” (issuers of crypto-assets which are not securities) may apply for an optional visa from the AMF for their token offerings and “digital assets service providers” (DASPs)³⁵ can choose to opt-in to a specifically developed regulated regime, although certain services (e.g. custody of (access to) digital assets on behalf of third parties) will require DASPs to register with the AMF and fulfil certain obligations.
- In Germany, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) has specified that following the implementation of the Fifth Anti Money Laundering Directive (5AMLD) from January 2020, any “crypto-custody business”³⁶ will require a statutory license from BaFin and providers of crypto-custody services will qualify as a financial institution under the German Banking Act.

National regulators may want to consider the implications of creating a bespoke regime which is specific to crypto-assets. If each jurisdiction were to create its own individual approach it could significantly increase the cost of compliance for firms. A bespoke regime created at the pan-European level could also

³⁴ Any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not (a) electronic money; (b) a financial instrument or a virtual token.

³⁵ The term “digital assets” as used in the French legislative text comprises tokens issued during ICOs and virtual currencies. Financial instruments are excluded from this regime.

³⁶ The new “crypto custody business” covers by definition not only the use of crypto-assets for exchange purposes, but also as a means of payment and investment.

take an extended period of time to agree and formulate legislation compared to extending existing regulation, and careful consideration of technology neutrality would need to be taken for a new regime to remain future-proof.

Consideration should be given to the extent that any such bespoke regulation is intended to apply to entities that are already regulated in their provision of traditional financial services (such as broker-dealers or banks). For example, whether a bespoke regulatory regime would create uncertainty or operational inconsistency as to how to apply the regulation of such activities when conducted without using crypto-assets.

5. Recommendations for delivering supervisory convergence on the regulation of crypto-assets in Europe

Based on the analysis in this paper, this section outlines five recommendations that can support supervisory convergence on the regulation of crypto-assets in Europe.

The use of crypto-assets in financial services is an area of rapid development, and these current recommendations will benefit from periodic review.

1. Establish a pan-European taxonomy for the classification of crypto-assets:

- A harmonised, pan-European taxonomy for crypto-assets is a crucial first step towards fostering common understanding, facilitating collaboration across jurisdictions and providing greater regulatory certainty for market participants engaged in cross border activity. This will provide the industry and regulators with a common baseline to consider how existing regulation could apply or not apply to crypto-assets and to establish where new regulations could be needed.
- As discussed in Section 2, we agree that this taxonomy should classify crypto-assets based on their economic function as an initial starting point. However, there are also a number of traits or characteristics to consider (such as price stabilising mechanisms, redemption rights, or the use of clearly identifiable and regulated issuers), in order to better understand what criteria would further enhance or refine the initial above classification.

2. Provide clear expectations regarding the process for issuing crypto-assets (such as authorisation, licensing and registration);

- Clear guidance (utilising a common pan-European taxonomy) on what processes to follow (such as what regulations apply, if any, and necessary steps for authorisation) is needed to provide regulatory certainty for a particular crypto-asset at the point of issuance. This guidance should be coordinated with that of other European NCAs.
- Clear guidance will further encourage innovation in crypto-assets in Europe and may be particularly relevant given the increasing issuance of hybrid crypto-assets, which could create further additional complexity for market participants.

3. Apply activities-based and technology agnostic regulation:

- Regulation should be agnostic to the type of technology used to undertake the activity that crypto-assets are facilitating and instead address the risks and outcomes of the activity. We recommend that crypto-assets be subject to regulation and oversight that is activities-based in order to meet standards on privacy, security, and resilience for the protection of end users.
- It would not be desirable to design prescriptive regulation, specifically around crypto-assets or the use of DLT, as this would dictate the use of a particular technology, where banks may seek to leverage other types of technologies to enhance the security and efficiency of financial services.

4. Apply existing regulation for regulated activities, with any necessary amendments, if required:

- Existing regulation can effectively be applied in some cases to activities conducted using crypto-assets which are equivalent to currently regulated activities. Under the principle of ‘same activity, same regulation’, this should apply to any entities conducting a regulated activity (bank regulations may be appropriate for bank use of crypto-assets, whereas e-money and/or payment regulations may be appropriate for non-banks seeking to use crypto-assets in a payment capacity).

- When using this approach, it is important that regulators consider and determine if any amendments or additional guidance are required in order to ensure there are no gaps in regulation and that the regulation fits suitably. For instance, certain EU financial services regulations such as the Settlement Finality Directive (SFD) or Central Securities Depository Regulations (CSDR) may not always fit to activities within a DLT environment.
- If, after appropriate review, it is determined that the existing regulation is not flexible enough to accommodate these issues, regulators should consider amending the existing regulatory provisions where possible and applicable, unless this would create unnecessary burden given the risks involved. As outlined in Section 3, the introduction of new risks should only be addressed separately through bespoke regulations in those cases where amendments to or clarification of existing rules are not possible or effective to address those risks. National regulators should consider the negative implications of creating a bespoke regime that is specific to crypto-assets (such as possible further fragmentation, operational inconsistency or additional costs to market participants).

5. Prioritise convergence of regulatory frameworks with other global and regional initiatives:

- Given the borderless nature of crypto-assets, engagement across relevant regional and global regulatory supervisors will remain critical. This will ensure a consistent approach to their taxonomy and subsequent classification, regulatory categorisation, and supervisory oversight of crypto-asset related activities within global financial services.
- At the global level, we encourage European participation and cooperation with wider international forums such as the G20, G7, FSB, BIS and global standard setting bodies such as IOSCO to promote harmonisation, which proved effective in the implementation of the G20 recommendations³⁷. Initiatives of this nature have already been completed, such as the anti-money laundering recommendations set forth by the Financial Action Task Force (FATF) in June 2019³⁸.
- At the regional level, we encourage coordination through pan-European initiatives, for instance through initiatives relating to the accomplishment of the European Capital Markets Union (CMU)³⁹ and Digital Single Market (DSM)⁴⁰. Action at the EU level has also already been initiated in this regard, regarding Member State transposition of the 5AMLD by January 2020⁴¹.

³⁷ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD585.pdf>

³⁸ See note 32, *supra*, and text.

³⁹ https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_en

⁴⁰ https://ec.europa.eu/commission/priorities/digital-single-market_en

⁴¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32018L0843&from=EN>

6. Conclusion

Europe has the opportunity to create a supportive environment for crypto-asset innovation. This paper has discussed crypto-assets and their potential benefits and considerations for financial services and examined existing European regulatory approaches.

There is already some level of convergence amongst European NCAs on classifying crypto-assets based on their economic function. We agree that this approach is an important initial starting point, however we believe there are also other important factors which should be considered, including: whether an issuer is involved; the regulatory status of that issuer; and the rights attached to the crypto-asset.

Before additional regulation is introduced, a thorough assessment should be made to determine whether existing regulation is fit for purpose, or needs to be enhanced, to cover crypto-asset products and activities. In the case where a new regime is applied to existing regulated entities, thought should be given as to whether a bespoke regulatory regime would create uncertainty or operational inconsistency for market participants.

We have proposed five recommendations for supervisory convergence in crypto-asset regulation in Europe. These include developing a pan-European taxonomy, providing clear expectations for market participants, remaining activities-based and technology agnostic, applying existing regulations (where possible and applicable) and prioritising harmonisation at the regional and global level. It is our aim that these recommendations will help protect the financial system, mitigate risks to end users and encourage innovation and competition in relation to crypto-assets.

AFME and its members look forward to continuing to work with regulators and other market participants to achieve this aim.

Annex 1: Glossary

The below glossary lists a sample of terms used by European regulators and global organisations in relation to crypto-assets. Please note that the definitions used below do not necessarily reflect the views of AFME or its members.

Example glossary of terms relating to crypto-assets		
Crypto-asset	ESMA	A type of private asset that depends primarily on cryptography and Distributed Ledger Technology (DLT) or similar technology as part of their perceived or inherent value.
	FSB	A type of private asset that depends primarily on cryptography and distributed ledger or similar technology as part of their perceived or inherent value.
	BaFin	A digital, cryptography- and DLT-based representation of an intrinsic or perceived value.
	DNB	A digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.
Cryptography	FSB	The conversion of data into private code using encryption algorithms, typically for transmission over a public network.
Distributed Ledger Technology (DLT)	BIS	The processes and related technologies that enable nodes in a network (or arrangement) to securely propose, validate and record state changes (or updates) to a synchronised ledger that is distributed across a network's nodes.
	FCA	A set of technological solutions that enables a single, sequenced, standardised and cryptographically-secured record of activity to be safely distributed to, and acted upon by, a network of varied participants. This record could contain transactions, asset holdings or identity data. This contrasts with a traditional centralised ledger system, owned and operated by a single trusted entity.
Stablecoin	ECB	Digital units of value that are not a form of any specific currency (or basket thereof) but rather, by relying on a set of stabilisation tools, try to minimise fluctuations in their price in such currencies.
	FSB	A crypto-asset designed to maintain a stable value relative to another asset (typically a unit of currency or commodity) or a basket of assets.
Tokens	<i>Security Token</i>	FINMA (Asset token) Tokens which represent assets such as participations in real physical underlyings, companies, or earnings streams, or an entitlement to dividends or interest payments. In terms of their economic function, the tokens are analogous to equities, bonds, or derivatives.

	FCA	Tokens that constitute specified investments excluding e-money tokens.
	BaFin	((Quasi-) security tokens) These tokens give investors membership rights or contractual claims on assets, (similar to those associated with shares and debt securities).
	Consob	(Investment or security-like tokens) Tokens that qualify as financial instruments or, as financial products.
<i>Exchange Token</i>	MFSA	(Virtual financial asset) Any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not (a) electronic money; (b) a financial instrument or (c) a virtual token.
	FINMA	(Payment token) Tokens that are synonymous with cryptocurrencies and have no further functions or links to other development projects. Tokens may in some cases only develop the necessary functionality and become accepted as a means of payment over a period of time.
	FCA	Exchange tokens are used in a way similar to traditional fiat currency. However, while exchange tokens can be used as a means of exchange, they are not currently recognised as legal tender in the UK, and they are not considered to be a currency or money. Exchange tokens typically do not grant the holder any of the rights associated with specified investments. This is because they tend to be decentralised, with no central issuer obliged to honour those contractual rights – if any existed.
	BaFin	(Payment token) These tend to fulfil the function of a private means of payment (either exclusively or as one of several functions). They generally have no intrinsic value and are not issued by a central bank.
<i>Utility Token</i>	FINMA	Tokens which are intended to provide digital access to an application or service.
	FCA	Utility tokens provide consumers with access to a current or prospective service or product and often grant rights similar to pre-payment vouchers. In some instances, they might have similarities with, or be the same as, rewards-based crowdfunding. They do not exhibit features that would make them security tokens or e-money.
	BaFin	Utility tokens can be used to purchase goods or services, but only within the network of the issuing institution. Utility tokens tend to have very complex legal structures.
	DNB	(Utility cryptos) Cryptos as an entitlement to the use of, or access to, a specific application or service offered by or through a provider's platform (blockchain-based or otherwise).

Annex 2: Overview of taxonomies and regulatory approaches in European jurisdictions

For this paper we conducted a cross jurisdictional analysis of 11 European jurisdictions. A list of the jurisdictions and the respective regulatory bodies where publications were analysed is listed below.

List of countries considered

Jurisdiction	Body
Estonia	Estonian Financial Supervision Authority (EFSA)
France	Autorité des Marchés Financiers (AMF)
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Deutsche Bundesbank
Gibraltar	Her Majesty's (HM) Government, GFSC
Italy	Commissione Nazionale per le Società e la Borsa (Consob), Banca d'Italia (BdI),
Lichtenstein	Financial Markets Authority (FMA)
Luxembourg	Parliament
Malta	Malta Financial Services Authority (MFSA), Parliament
Switzerland	Swiss Financial Market Supervisory Authority (FINMA), Federal Council
The Netherlands	Dutch National Bank (DNB), Autoriteit Financiële Markten (AFM), House of Representatives
United Kingdom	Financial Conduct Authority (FCA), HM Treasury (HMT)

The analysis looked for similarities and inconsistencies in the regulatory treatment of crypto-assets in each jurisdiction, based on:

- i) Taxonomy: terms and definitions
- ii) Regulatory approaches

Further detail on the analysis of each of these two items is tabled below:

Taxonomies in Europe: Terms and definitions examined	
1. Digital Asset	2. Security/asset token
3. Crypto-asset	4. Utility token
5. Token	6. Stablecoin
7. Virtual Currency	8. Distributed Ledger Technology
9. Payment/exchange token	10. Initial Coin Offering

Regulatory approaches in Europe: List of questions examined

1. What method of crypto-asset classification is used?
2. Can tokens qualify as financial instruments? (if yes, what regulation applies)
3. Can tokens qualify as e-money? (if yes, what regulation applies)
4. Do utility tokens in any case fall under regulation? (if yes, what regulation applies)
5. Do exchange/payment tokens in any case fall under regulation? (if yes, what regulation applies)
6. Do stablecoins in any case fall under regulation? (if yes, what regulation applies)
7. Are tokens subject to AML/CTF provisions?
8. Do tokens fall under any other existing regulation? (if yes, please specify)

Notes

Contributors to this Paper

We are grateful to our member firms and the individuals who contributed their time and thoughts in producing this report.

AFME Technology and Operations

AFME's Technology and Operations Division brings together senior technology and operations leaders to influence and respond to current pan-European market drivers and policy.

The *Recommendations for delivering supervisory convergence on the regulation of crypto-assets in Europe* paper was led by the AFME Digital Assets Task Force as an initiative within the broader Technology and Operations Division.

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/ About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

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We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

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