Crypto-Assets, Securities?

What crypto-assets **may** (not) be considered a Security

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Introduction

In recent years, cryptocurrencies, stablecoins and other crypto-assets have garnered significant attention, prompting various organisations and countries around the world to develop legal frameworks for their oversight, particularly with regards to anti-money laundering (see FATF, Virtual currencies; FATF, Virtual assets).

Luxembourg was no exception in this landscape and implemented in 2020 a framework for the so-called 'Virtual Asset Service Providers' within the Luxembourg Law of 12 November 2004 on the fight against money laundering and terrorist financing (Art. 1.8 Law of 25 March 2020).

Regulation (EU) 2023/1114 of 31 May 2023 on markets in crypto-assets ('**MiCA**') represented still another important step in the regulation of crypto-assets within the European Union ('**EU**'). However, this groundbreaking regulation also left open some aspects, assigning specific authorities the task of providing further clarification.

For instance, MiCA mandated the European Securities and Markets Authority ('**ESMA**') to issue guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments (e.g., securities) (Art. 2(5) MiCA). The purpose of this mandate was not to clarify the entire scope of what constitutes a financial instrument (ESMA, Consultation Paper, §5). Instead, it is only intended to focus on the 'products' that meet, both MiCA's crypto-asset definition and the financial instrument definition outlined in MiFID II (ESMA, Consultation Paper, §16).

On 29 January 2024, ESMA finally released a Consultation Paper on the '*Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments*' ('**Consultation Paper**'). It is this Paper that inspired the preparation of this Document and that served as a

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You may take notes in this side-space:

pivotal reference for the discussions held herein.

Tokenized financial instruments, such as shares represented by tokens issued and transferred using distributed ledger technology, are relatively straightforward in classification (see Art. 4.1(44) MiFID II). These are called 'security tokens' and are crypto-assets that qualify as financial instruments in all regulatory contexts (ESMA, Consultation Paper, §29).

However, the situation may be more complex for certain crypto-assets, especially those that do not entirely fall within MiCA's application scope or that are not explicitly mentioned with names used by the market. This includes:

- non-fungible tokens (NFT) (Art. 2.3 MiCA; Recital (10) MiCA)
- so-called cryptocurrencies (Recital (22) MiCA)
- utility tokens (Art. 4.3(c) MiCA; Recital (26) MiCA)

Unlike ESMA's Consultation Paper, this document exclusively addresses specific types of crypto-assets and their potential qualification as financial instruments, in particular as securities. After outlining the legal context and analyzing the definitions of financial instruments and of securities, we will examine four (4) distinct crypto-assets, dedicating about five pages to each.

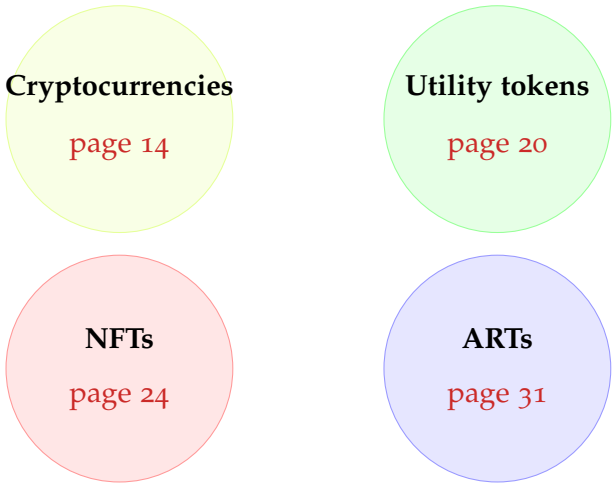

Figure 1.1: Types of crypto-assets analysed in this Document

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Crypto-assets regulation: MiCA & MiFID II?

2.1 A bit of context

MiCA broadly defines a crypto-asset as (i) a digital representation of a value or of a right, (ii) that is able to be transferred and stored electronically, (iii) using distributed ledger technology or similar technology (Art. 3.2(5) MiCA).

Drawing from this three-part definition, key characteristics of crypto-assets include (i) their transferability to other holders, and (ii) their acceptance by other persons than the issuer (ESMA, Consultation Paper, §64). Digital assets that cannot be transferred to other holders do not fall within the definition of crypto-assets. Therefore, digital assets that are accepted only by the issuer or the offeror and that are technically impossible to transfer directly to other holders are excluded from MiCA's application scope. An example of such assets includes loyalty schemes where the loyalty points can be exchanged for benefits only with the issuer or offeror of these points (Recital (4) MiCA; ESMA, Consultation Paper, §64).

The above definition captures a wide variety of crypto-assets, including not only cryptocurrencies, such as Bitcoin or Ethereum, but also stablecoins and utility tokens (ESMA, Consultation Paper, §58).

It is important to note, however, that even though a given crypto-asset may meet MiCA's definition, it does not necessarily fall under the scope of this regulation. Instead, MiCA specifically targets types of crypto-assets for which no rules existed until recently, other than those related to anti-money laundering (Recital (4) MiCA).

Those crypto-assets that fall under MiCA's application scope are classified into three subtypes, each governed by distinct requirements according to the risks they entail: (i) electronic money tokens (EMTs);

(ii) asset-referenced tokens (ARTs); and (iii) crypto-assets other than ARTs or EMTs (Recital (18) MiCA; ESMA, Consultation Paper, §58).

Conversely, some crypto-assets lie outside the scope of this regulation (see Art. 2.3 & 2.4 MiCA). These include crypto-assets that qualify as financial instruments within the meaning of Directive 2014/65/EU of 15 May 2014 on markets in financial instruments ('**MiFID II**') (Art. 2.4(a) MiCA; Recital (3) MiCA). Such crypto-assets, often known as security tokens, already fell within the scope of legal frameworks on financial services. Therefore, a full set of rules applies to their issuers and to firms conducting activities related to them (Recital (3) MiCA).

In line with the regulatory principles of *"same activities, same risks, same rules"* and of *"technology neutrality"*, crypto-assets falling under the scope of those legal frameworks are regulated and will remain regulated by them, regardless of the technology used for their issuance or their transfer — including if issued or transferred using distributed ledger technology (Recital (9) MiCA; ESMA, Consultation Paper, §7).

More specifically, crypto-assets that are issued through a distributed ledger technology and that qualify as financial instruments within the meaning of MiFID II are subject to their sectoral regulatory frameworks, notably the MiFID II framework (ESMA, Consultation Paper, §2).

As a result, MiCA expressly provides that it does *"not apply to crypto-assets that qualify as [...] financial instruments"* (Art. 2.4(a) MiCA; Recital (9) MiCA) as defined *"in Article 4(1), point (15), of Directive 2014/65/EU [i.e., MiFID II]"* (Art. 3.1(49) MiCA).

Conversely, all crypto-assets that are not covered by any other legal framework, including not by those applicable to financial instruments, are likely — though not automatically — to fall under MiCA's application scope (ESMA, Consultation Paper, §10). Consequently, MiCA could be seen as serving a subsidiary application, governing only those crypto-assets that are not covered by other provisions (ESMA, Consultation Paper, §7).

Type of crypto-asset	**MiCA's application**
Crypto-asset qualifies as financial instrument	Out of MiCA's scope
Crypto-asset does **not** qualify as financial instrument	Potentially in-MiCA's scope

Table 2.1: MiCA's application scope.

MiCA's application	Type of crypto-asset
Crypto-asset in MiCA's scope	Crypto-asset does **not** qualify as financial instrument
Crypto-asset **not** in MiCA's scope	Crypto-asset could potentially qualify as financial instrument

2.2 *MiFID II definition of 'financial instrument'*

Regulatory obligations for professionals vary depending on the type of crypto-asset. Specifically, crypto-assets that qualify as financial instruments under MiFID II typically face more extensive and stringent regulatory requirements than those governed by MiCA. Relevant regulations may include

- the Prospectus Regulation (Regulation (EU) 2017/1129);
- the Transparency Directive (Directive 2013/50/EU);
- the Market Abuse Regulation (Regulation (EU) No 596/2014);
- the Short Selling Regulation (Regulation (EU) No 236/2012);
- the Settlement Finality Directive (Directive 2009/44/EC);
- the Central Securities Depositories Regulation (Regulation (EU) No 909/2014)

(ESMA, Advice ICO, §90 & ff.; ESMA, Statement ICO 1, end p.1; European Commission, Impact Assessment, beginning p. 6).

Therefore, the first two steps that any crypto-asset offeror and service provider must take are (1) to verify whether a given asset fits MiCA's definition of 'crypto-assets', and (2) to determine if that asset could qualify as a financial instrument under MiFID II.

MiCA itself requires offerors, persons seeking admission to trading, and operators of trading platforms to notify to the competent authority an explanation of why the crypto-asset described in their white paper is not to be considered a financial instrument within the meaning of MiFID II (Art. 8.1 MiCA; Art. 8.4(a) MiCA). This aspect is also one of the first verifications that will be conducted by the Luxembourg Financial Sector Supervisory Commission ('**CSSF**'), as confirmed during a recent conference (IDEB, MiCA et DORA).

However, MiFID II does not provide a universal definition for financial instruments. Instead, its definition of 'financial instruments' refers to a list that contains no less than eleven categories (Art. 4.1(15) MiFID II).

The following categories of financial instruments are encompassed by that list: (i) transferable securities, (ii) money-market instruments, (iii) units of collective investment undertakings, (iv) various derivative contracts, and (v) emission allowances (Annex I, Section C, MiFID II).

With the introduction of Regulation (EU) 2022/858 of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology ('**DLT Pilot Regime**'), the MiFID II definition of financial instruments now explicitly provides that it also aims instruments issued via distributed ledger technology ('**DLT**') (Art. 18(1) DLT Pilot Regime; Art. 4.1(15) MiFID II).

Consequently, crypto-assets that qualify as financial instruments and issued by means of a DLT will be considered and treated the same way as any other financial instrument.

In this regard, Luxembourg itself enacted three laws, commonly referred to as 'Blockchain laws' (which should have been called Distributed ledger laws). These laws were adopted to align national law with the DLT Pilot Regime and to provide legal certainty for the issuance and transfer of crypto-assets that qualify as financial instruments.

- the Blockchain Law I in 2019, that acknowledges the use of distributed ledgers (such as blockchain) to hold and transfer securities (Law of 1 March 2019);
- the Blockchain Law II in 2021, that allows the use of distributed ledgers to issue securities (Law of 22 January 2021); and
- the Blockchain Law III in 2023, that explicitly clarifies in national law that all financial instruments issued in distributed ledgers are considered financial instruments within the meaning of the MiFID II (Law of 15 March 2023).

Crypto-asset issued via DLT		
If	**Then**	
Transferable security	Financial instrument within the meaning of MiFID II	Application of the MiFID II framework
Money-market instrument		
Unit of collective investment undertakings		
Derivative contract		
Emission allowance		

Table 2.2: Crypto-asset issued via DLT - does MiFID II framework apply to it?

2.3 *MiFID II definition of 'security'*

In light of some recent decisions by the U.S. Securities and Exchange Commission ('**SEC**'), a persistent concern has emerged: that of determining whether a specific crypto-asset qualifies as a transferable security and, therefore, as a financial instrument.

However, these decisions of the U.S. SEC are based on the definition of 'security' outlined in two laws of the United States ('**U.S.**'): the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws include a comprehensive list of assets that are considered securities (Section 2, Securities Act of 1933; Section 2, Securities Exchange Act of 1934). Additionally, the U.S. SEC applies the 'Howey Test', which was introduced by the 1946 U.S. Supreme Court case, *SEC v. W.J. Howey Co.*. This test establishes four criteria to determine if an asset qualifies as an 'investment contract' and, therefore, as a security. Assets classified as securities are subject to SEC regulations, including requirements for disclosure and registration (U.S.SEC, Framework; H. Peirce (U.S.SEC), How do we Howey).

In contrast, the MiFID II offers a broad definition of 'transferable security' that, obviously, does not entail the Howey Test. Under MiFID II, a crypto-asset is considered a transferable security if it meets the following three criteria:

i. it is part of a 'class of securities',

ii. negotiable on the capital market, and

iii. not an instrument of payment (Art. 4.1(44) MiFID II).

Should a crypto-asset qualify as a transferable security within the meaning of MiFID II, it would fall under the regulatory domain of financial instruments, rather than in MiCA.

However, the broad concept of 'transferable securities' and, more specifically, of 'class of securities', is the most controversial among all categories of financial instruments under MiFID II (European Crypto Initiative, EUCI's response, p.3). Some National authorities apply a more restrictive interpretation, on the basis of the definition of transferable securities of MiFID II (e.g., they apply a closed list of securities, like shares, bonds), **whilst** others are taking into account other factors such as the existence of attached profit rights, without having necessarily ownership or governance rights attached (ESMA, Annex 1, §8).

Given the wide variety of crypto-assets offered in the market, each with unique characteristics and associated rights, a significant regulatory challenge is to determine which features qualify a crypto-asset as

a financial instrument, specifically as a transferable security (European Crypto Initiative, EUCI's response, p.3).

The Consultation Paper, with its proposed guidelines, partially addressed this challenge, by clarifying the three criteria of a 'transferable security'.

2.3.1 *Class of securities*

The terms 'class' and 'security' are not defined by MiFID II. According to ESMA, for a group of crypto-assets to form a class, they must confer similar rights to investors, so as to ensure their tradability on markets (ESMA, Consultation Paper, §32). Any 'crypto-asset class' representing an abstract category of securities (e.g. an ownership in a company) or conferring rights akin to shares in companies, to bonds or to other forms of securitised debt, or embedding a derivative, might qualify as securities and must be considered under that ambit (Art. 4.1(44) MiFID II; ESMA, Consultation Paper, §32; BaFin, Guidance Notice II, p.7).

In essence, a crypto-asset may form a class of securities and be defined *prima facie* as a security if it is **(a)** interchangeable, **(b)** issued by the same issuer, **(c)** having similarities, and **(d)** providing access to equal rights akin to those mentioned above in the previous paragraph (ESMA, Consultation Paper, §32). The following questions should then be asked to determine whether a crypto-asset qualifies as a security:

- What is the purpose of the token being issued? Is the token associated with a business or with a financing project?
- Are these share-type or bond-type rights?
- Why is a person buying the token? Does he/she have an interest in the profit or in the economic development of the company or of the project? (J.-L. Schiltz, N. Manzari, The Virtual Currency Regulation Review, p.197).

Some argue that the functionality of certain crypto-assets, which allow holders to vote on some project decisions, does not in any way transfer governance rights or resemble financial instruments such as shares (European Crypto Initiative, EUCI's response, p.4).

2.3.2 *Negotiability*

Negotiability is a key criterion, but it is also not defined by MiFID II. According to ESMA, it must be broadly interpreted and includes crypto-assets which are capable of being transferred or traded on capital markets. Negotiability thus implies for crypto-assets (i) to be trans-

ferable or tradable on the capital market; and (ii) to be fungible (ESMA, Consultation Paper, end §33).

The fungibility is measured by having regard to the capability of the crypto-assets to express the same value per unit (ESMA, Consultation Paper, §33). It implies a minimum level of standardisation, and hence tokens featuring the same rights. The tokens must be comparable with each other in the sense of a class of securities' (BaFin, Guidance Notice II, p.7).

The large majority of crypto-assets seems to be negotiable (ESMA, Legal qualification, §20).

2.3.3 *Capital Market*

The terms 'capital market' are not defined either, but they encompass venues where securities are traded as well as over-the-counter markets. According to ESMA, it includes all contexts, where buying and selling interests in securities meet. If a crypto-asset can be traded on such trading platforms or other electronic and/or voice trading platforms, where buying and selling interest in securities meet, the capital market criterion has in principle been met (ESMA, Consultation Paper, §34).

2.3.4 *Exclusion of instruments of payment*

The definition of 'transferable securities' explicitly excludes from its scope the so-called instruments of payment.

MiFID II does not provide any definition of 'instruments of payment'. However, a crypto-asset that is used only as a medium of exchange could potentially qualify as such instrument (ESMA, Consultation Paper, §99).

Accordingly, if a crypto-asset conforms to the definition of an instrument of payment it does not qualify as a transferable security (ESMA, Consultation Paper, §98).

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Types of crypto-assets

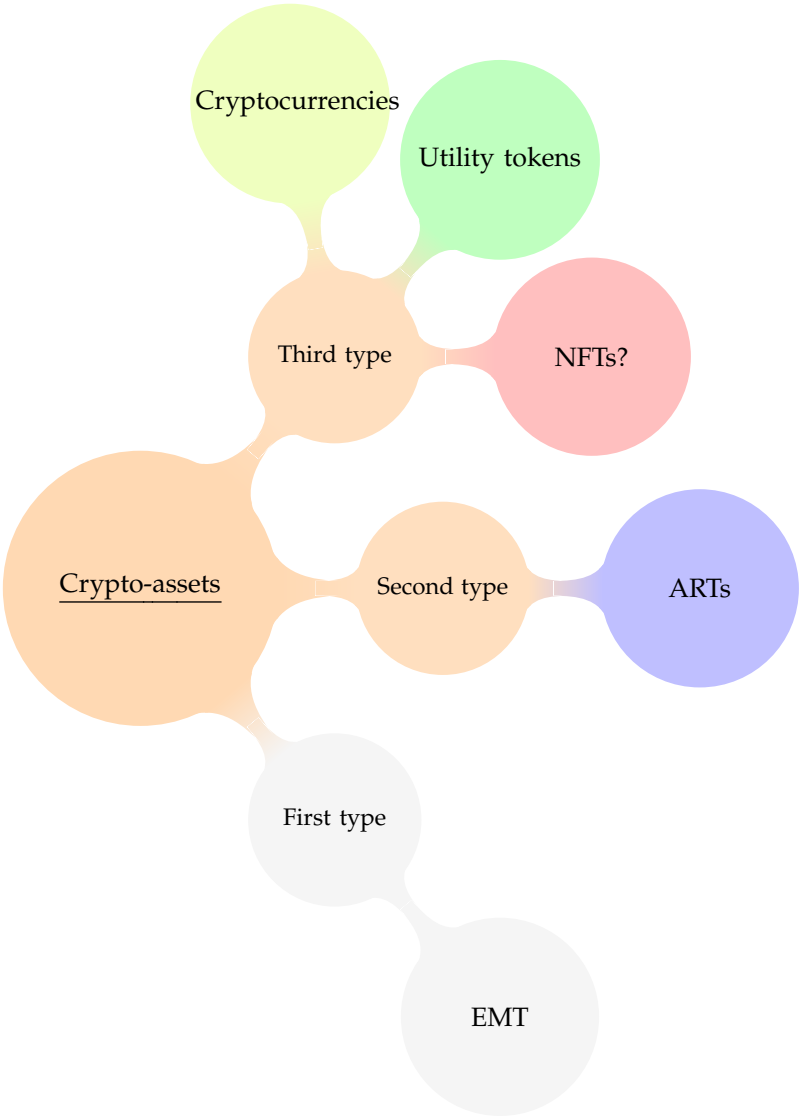

Figure 3.1: Types of crypto-assets.

3.1 *Cryptocurrencies*

The term 'cryptocurrency' still lacks today a legal definition, and most policymakers refrain from using it in their guidelines. Nevertheless, a cryptocurrency is commonly described as a 'decentralised virtual currency' that is distributed, peer-to-peer, with no central authority (FATF, Virtual currencies, p.5; ESMA, Advice, §11; Eur.Parl., Cryptocurrencies, p.23; ECB, Impact of digital innovation, end p.12, last para.; ECB, Virtual currency schemes, end p.6, last para.).

Accordingly, it is clear that cryptocurrencies are viewed as a specific subset of virtual currencies (FATF, Virtual currencies, p.5; CSSF, Warning, beginning of Introduction; ESMA, Advice, §11; Eur.Parl., Cryptocurrencies, p.23; ECB, Impact of digital innovation, end p.12, last para.; ECB, Virtual currency schemes, end p.6, last para.; IMF, Virtual currencies, end p.7, end §8, and p.8, schematic; BIS, Digital currencies, end p.1, footnote 2).

In turn, 'virtual currencies' are generally understood as a "*digital representation of value*", a definition that was adopted by Directive (EU) 2018/843 of 30 May 2018 ('**AMLD5**') as well as by Luxembourg law (Art.1.2(d) AMLD5; Art. 1.8 Law of 25 March 2020; FATF, Virtual currencies, p.4; ECB, Virtual currency schemes, p.4; ECB, Impact of digital innovation, p.11; EBA, Opinion, §20).

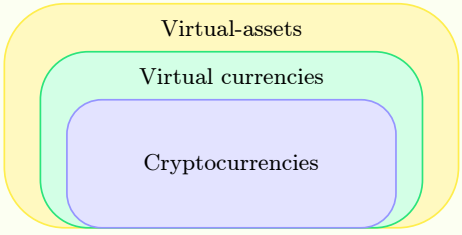

Figure 3.2: Diagram first published in beginning 2022 in LinkedIn.

As representations of value, both virtual and cryptocurrencies meet MiCA's definition of crypto-assets if transferred and stored using distributed ledger technology (DLT); however, their legal status continues to raise market concerns due to their somewhat murky regulatory history, as further discussed below.

In 2014, the innovation officer at the CSSF considered cryptocurrencies as money, "*more specifically as scriptural money*" (CSSF, Communiqué; Luxemburger Wort, Monnaies virtuelles). This surprising stance, which was a first among EU member states, appears to have been adopted by some authors (E. Omes, H. Hansen, Éclairages, p.8, right column; see also old position of ECB: ECB, Virtual Currency Schemes 2012, p.13).

In 2021, the CSSF seems to have completely abandoned its previous position, likely swayed by the opinions of other authorities. For instance, the European Banking Authority ('**EBA**') concluded early on that virtual currencies, such as cryptocurrencies, "*could potentially fulfil one or more of the functions of money*" but "*these functions are, at least currently, not comparable in terms of quality, and are not always fulfilled at the same time as each other or to the same extent*" (EBA, Opinion, §24).

Soon after, the European Central Bank ('**ECB**') would issue a position directly contrary to that of the CSSF by stating that virtual currencies, including cryptocurrencies, are not a full form of money, nor money or currency from a legal perspective (ECB, Virtual currency schemes, p.4; ECB, Virtual or virtueless?).

The debate would ultimately be brought to a close when the AMLD5 provided that virtual currencies do not possess a legal status of currency or money (Art.1.2(d) AMLD5).

Meanwhile, it has been noted that the German regulator ('**BaFin**') considers virtual currencies as financial instruments rather than as money (BaFin, Crypto tokens). Some also assert that all types of tokens, including virtual/cryptocurrencies, should be considered securities (FINMA, Guidelines, end p.4; G. Gensler, Kennedy and Crypto, under Crypto Tokens; U.S.SEC, Investor bulletin).

Where do we stand?

From the outset, it is important to note that the BaFin reached a different conclusion than the one previously mentioned, based on a German law transposing MiFID II. Under this law, it found that "*payment tokens such as Bitcoin — also commonly known among investors as virtual currencies or cryptocurrencies*" are not considered financial instruments (BaFin, Payment tokens; BaFin, Guidance Notice, p.5).

More importantly, classifying virtual and cryptocurrencies as financial instruments would contrast with the guidelines of the Financial Action Task Force ('**FATF**'). These guidelines address a close, albeit not synonymous concept to crypto-assets, known as 'virtual assets'. In this context, virtual currencies appear to be considered virtual assets (FATF, Virtual assets, §2 to 4 & 71; IMF, Virtual assets, beginning p.6), which are then defined as a digital representation of value that does "*not include digital representations of fiat currencies, securities and other financial assets*" (FATF, Virtual assets, §44, 49 & 51).

One could therefore infer from these FATF guidelines that, since virtual assets are not securities, neither can be virtual currencies as a subtype of virtual assets. The virtual currencies concerned could

include cryptocurrencies such as Bitcoin, Litecoin and Ripple (FATF, Virtual currencies, p.5; IMF, Virtual assets, beginning p.6), as well as PeerCoin, Zerocoin, Anoncoin and Dogecoin (FATF, Virtual currencies, p.6).

In line with the FATF guidelines seen above, Luxembourg law also defined 'virtual assets' as "*a digital representation of value, including a virtual currency, that can be digitally traded, or transferred, and can be used for payment or investment purposes, except [...] virtual assets that fulfil the conditions of financial instruments [...]*" (Art. 1.8 Law of 25 March 2020).

Hence, under Luxembourg law as well, virtual currencies are explicitly regarded as a subtype of virtual assets, which do not include financial instruments (e.g., securities).

In light of the above provisions, the CSSF derived three conclusions:

- First, it acknowledged that the definition of virtual assets "*excludes, among other things, digital assets that fulfil the conditions of financial instruments*" (CSSF, Virtual assets UCI, p.4, Q.1);
- From this, it also determined that "*virtual assets are not deemed to be financial instruments [...] and as such do not fall under the investor protection rules of MiFID*" (CSSF, Virtual assets - Credit institutions, p.5, Q.5);
- Conversely, it found that 'virtual assets' include virtual currencies like Bitcoin, Ethereum, and most stablecoins (CSSF, VASP guidelines, end p.3; CSSF, Virtual assets; CSSF, Annual report 2019, p.32, left column).

Consequently, we may conclude once again that virtual/cryptocurrencies are virtual assets and cannot possibly qualify as financial instruments (e.g., securities).

Ultimately, the CSSF would differentiate cryptocurrencies, which did not fall under any existing legislation (before MiCA), from those tokens that fulfil the conditions of financial instruments (CSSF, CSSF guidance).

For its part, MiCA does not explicitly mention virtual or cryptocurrencies in its text. These terms are avoided because they are considered misleading for several reasons: they suggest a similarity to traditional currencies and, therefore, to money, though they are considered as neither (EBA, Opinion, §18; Eur.Parl., Cryptocurrencies, p.21, footnote 61).

However, MiCA provides that crypto-assets with no identifiable issuer, such as crypto-assets automatically created as a reward for the

validation of transactions (i.e., cryptocurrencies), do not fall within the scope of specific sessions of MiCA (Recital (22) MiCA; Recital (26) MiCA; Art. 4.3(b) MiCA). A *contrario*, this suggests that the remaining sessions do apply to them. Supporting this interpretation, MiCA clarifies that crypto-asset services provided in relation with such crypto-assets are covered by MiCA (Recital (22) MiCA). Thus, cryptocurrencies with no identifiable issuer may fall within MiCA's application scope and do not qualify as securities within the meaning of MiFID II.

Furthermore, a crypto-asset that is used only as a medium of exchange could qualify as a instrument of payment (ESMA, Consultation Paper, §99), which are instruments expressly excluded from the definition of 'transferable security' (Art. 4.1(44) MiFID II). Since virtual and cryptocurrencies are defined as means of exchange (Art. 1.8 (20bis) Law of 25 March 2020; FATF, Virtual currencies, p.5; Eur.Parl., Cryptocurrencies, p.23), they seem to conform to the definition of 'instrument of payment', in which case they cannot be considered a transferable security (ESMA, Consultation Paper, §98).

It is also worth noting that, while some crypto-assets may constitute digital representations of rights (see definition at the beginning of this Document), virtual and cryptocurrencies generally do not represent or grant any such rights or claims (J.-L. Schiltz, N. Manzari, Virtual Currency Regulation, beginning p.196; BaFin, Payment tokens; FINMA, Guidelines, p.3). Instead, we already saw that they are defined as a digital representation of value, which explains why they are considered as payment tokens suitable to be used for payment or as a means of exchange (EBA, Report, p.6 & table p.7; LHOFT, A Guide, p.58; J.-L. Schiltz, N. Manzari, Virtual Currency Regulation, beginning p.196; BaFin, Payment tokens; FINMA, Guidelines, end p.4).

As long as they are pure payment tokens, virtual/cryptocurrencies lack a fundamental characteristic to form any class of securities: embodying a right or providing access to rights (see above, on 'Class of securities'). Consequently:

- "*pure payment-type crypto-assets [. . .] are unlikely to qualify as financial instruments*" such as securities (ESMA, Advice ICO, §80 & 81);
- "*payment tokens such as Bitcoin – also commonly known among investors as virtual currencies or crypto currencies*" are "*not financial instruments*" (BaFin, Payment tokens);
- "*payment tokens do not constitute securities within the meaning of the WpPG*" (BaFin, Guidance Notice, p.5);
- "*payment tokens / cryptocurrencies" are designed "to act as a means of*

payment and are not analogous in their function to traditional securities, [and therefore] FINMA will not treat payment tokens as securities" (FINMA, Guidelines, end p.4).

Regrettably, ESMA did not address this question in its recent Consultation Paper, in particular whether virtual and cryptocurrencies would be governed by the MiFID II or MiCA frameworks. The Consultation Paper mentions 'cryptocurrencies' only to clarify that MiCA's definition of crypto-assets captures cryptocurrencies, as well as stablecoins and utility tokens (ESMA, Consultation Paper, §58). It remains unclear if this statement automatically implies that those crypto-assets are governed by MiCA's provisions, which is never explicitly stated by ESMA. However, stablecoins (ARTs and EMTs) as well as utility tokens, both mentioned alongside cryptocurrencies, fall within MiCA's application scope and do not generally qualify as securities (ESMA, Consultation Paper, §62). One could therefore expect the same for cryptocurrencies themselves.

All these clusters of clues tell us that cryptocurrencies do not generally qualify as transferable securities as defined by MiFID II. Instead, they appear to fall within MiCA's application scope and belong to its third type of crypto-assets — namely, they are a crypto-asset other than ARTs or EMTs (see beginning of this Document).

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The above conclusion requires some nuance. Offerors, persons seeking admission to trading, and operators of trading platforms must notify to the competent authority an explanation of why the crypto-asset described in their white paper is not to be considered a financial instrument as defined by MiFID II (Art. 8.1 MiCA; Art. 8.4(a) MiCA). **Hence, a case-by-case analysis is still required for newly offered crypto-assets being labeled as cryptocurrencies or payment tokens, to determine whether they may be deemed financial instruments** (ESMA, Consultation Paper, end §12, 20, 29, 35; K. Pardaens, B. Nerriec, Tokenised securities, p.36).

Indeed, ESMA emphasised in its Consultation Paper that a substance over form approach needs always to be adopted to determine if a crypto-asset is or is not to be qualified as a financial instrument (ESMA, Consultation Paper, §30 & 82).

Additionally, the term cryptocurrencies is in practice often erroneously used in a very broad sense (Eur.Parl., Cryptocurrencies, p.23). This factor must be taken in consideration when classifying any given crypto-asset.

Furthermore, it may be worth to refer, as an example, the so-called 'initial coin offerings' ('**ICOs**') which are generally not subject to any specific regulation (CSSF, Warning; ESMA, Advice ICO, §87; ESMA, Statement ICO 1, p.1). ICO participants finance a new crypto-asset project in exchange for coins or tokens issued by the initiator. These coins and tokens may grant certain rights to their holders, such as a share in the capital of the company being formed or the right to a part of the profit (CSSF, Warning).

ICOs can vary in structure and include investment-type, utility-type, and hybrids of investment-type, utility-type and payment-type crypto-assets (ESMA, Advice ICO, §80).

Features and purposes of the coins or tokens involved in the ICO may vary across ICOs (ESMA, Statement ICO 2, p.2). Some may perform distinct functions and 'hybridise' at different stages of their life cycle, either when they are created or during their lifetime (ESMA, Consultation Paper, §75; ESMA, Advice ICO, §19; Eur.Parl., Remaining challenges, end p.80). Theoretically, a coin or token that typically grants rights to a part of the profit of the ICO initiator, could also be classified as a payment token — and vice versa (FINMA, Guidelines, p.3; ESMA, Consultation Paper, §75).

Depending on how the ICO is structured, the crypto-asset being launched could fall at some point within a class of securities and potentially qualify as a security within the meaning of MiFID II (ESMA, Advice ICO, §81). ESMA suggested this in different statements (ESMA, Statement ICO 1, p.1; ESMA, Statement ICO 2, p.2). Should a token display features of a financial instrument, this characteristic takes precedence in its classifications (ESMA, Consultation Paper, §79).

It is worth noting that ESMA clarified that a crypto-asset accompanied by an expectation of a future profit is not in itself sufficient to qualify a crypto-asset as a financial instrument under EU law (ESMA, Consultation Paper, §131). However, it is unclear whether ESMA is referring only to the profit generated from selling the crypto-asset in the secondary market, or if it also includes a share of the profits from a crypto-company.

Type of crypto-asset	**Qualification (as a general tendency or principle)**
Cryptocurrency	Not a security, subject to a case-by-case analysis

Table 3.1: Cryptocurrency qualification

3.2 *Utility tokens*

An 'utility token' is defined by MiCA as a type of crypto-asset only intended to provide an access to a good or a service supplied by its issuer (Art. 3.1(9) MiCA). Simply put, it allows its holder to collect a good or to use a service (Recital (26) MiCA).

Such goods and services may be offered both on-chain and off-chain (LHOFT, A Guide, p.15), but are often provided within a DLT network, where the utility token is required to interact with a given DLT's ecosystem — e.g., Filecoin is used to access to file storage (ESMA, Consultation Paper, §61; Eur.Parl., Remaining challenges, end p.79). Based on this, comparisons have been made between utility tokens and tickets or vouchers (Ministry of Justice, Virtual asset service providers, p.7; Elvinger Hoss, Tokenization, p.32; BaFin, Guidance Notice, p.5).

Utility tokens are thus specifically designed to provide a certain utility or consumption rights, such as the right to access or collect goods/services within their own ecosystem. The rights they grant may vary depending on the business models of different DLT projects (ESMA, Consultation Paper, §61 & 62; ESMA, Advice ICO, §19).

An important difference between utility tokens and crypto-assets that are unique and not fungible with other crypto-assets (i.e., NFTs analysed in the next subtitle) is that the so-called utility tokens generally confer no ownership rights but grant certain rights of use or access (IMF, Virtual assets, beginning p.6).

These tokens align with MiCA's definition of crypto-assets since they are digital representations of rights transferred and stored electronically using a DLT (see definition at the beginning of this Document). As fungible and interchangeable tokens, they are also governed by MiCA's provisions and fall within its third type of crypto-assets. This type consists of crypto-assets other than ARTs and EMTs, which "*covers a wide variety of crypto-assets, including utility tokens*" (Recital (18) MiCA; ESMA, Consultation Paper, §58 & 64).

While these tokens are regulated by MiCA, they may also benefit from exemptions of obligations that typically apply to crypto-assets of the third type. For example, rules governing offers of these crypto-assets do not apply to offers of utility tokens that provide access to a good or service already in existence or in operation (Art. 4.3(c) MiCA; Recital (26) MiCA).

Conversely, utility tokens providing access to goods and services that do not yet exist or that are not yet in operation are subject to MiCA's provisions regulating the offer for crypto-assets of the third

type — including the drawing up of a white paper (Art. 4.1 MiCA). The duration of their offer to the public, as described in the crypto-asset white paper, also cannot exceed 12 months from the publication date of the white paper (Art. 4.6 MiCA).

The CSSF's perspective on utility tokens is interesting. As already seen hereunder, virtual assets are defined as "*digital representations of value*" rather than representations of rights (Art. 1.8 Law of 25 March 2020; FATF, Virtual assets, §44). Nevertheless, the CSSF considers that the concept of virtual assets encompasses "*complex representations of rights*" (CSSF, CSSF guidance). Consequently, although utility tokens are representations of rights and are not at all addressed in the FATF guidelines on virtual assets (FATF, Virtual assets), the CSSF still considers them as virtual assets (CSSF, CSSF guidance; CSSF, Annual report 2019, p.32).

If this stance is confirmed, it is once again reminded that the concept of virtual assets excludes "*virtual assets that fulfil the conditions of financial instruments*" (Art. 1.8 Law of 25 March 2020) and it also does "*not include digital representations of fiat currencies, securities and other financial assets*" (FATF, Virtual assets, §44, 49 & 51).

In any case, utility tokens are generally viewed as "*digital assets that give their owners access to products or services produced by a company. They are not designed to be an investment*" (ALFI, Tokenization, p.7).

Consequently, whether benefiting or not from MiCA's exemptions, pure utility tokens as defined by MiCA are governed by this regulation and, therefore, generally not seen as a security:

- "*A utility token is typically not regarded as a security or financial product*" (ESMA, Consultation Paper, §62);
- "*Pure utility-type crypto-assets may fall outside of the existing financial regulation across Member States. The rights that they convey seem to be too far away from the financial and monetary structure of a transferable security and/or a financial instrument*" (ESMA, Advice ICO, §86 & 182);
- "*As a general principle, utility tokens do not constitute securities within the meaning of the WPG or capital investment within the meaning of the VermAnIG. In many cases, tokens like this are also not financial instruments under the KWG*" (BaFin, Guidance Notice, p.5);
- "*A utility token falling into these schemes is not usually considered a traditional security or financial product: its aim is not to create future cash flows but rather enable functional use of a blockchain-based ecosystem*" (Eur.Parl., Remaining challenges, end p.79);
- "*the underlying function is to grant the access rights and the connection*

with capital markets, which is a typical feature of securities, is missing" (FINMA, Guidelines, p.5).

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As for cryptocurrencies, the conclusion reached above must be nuanced. Offerors, persons seeking admission to trading, and operators of trading platforms must notify a crypto-asset white paper to the competent authority, together with an explanation of why the crypto-asset described in it is not to be considered as a financial instrument as defined by MiFID II (Art. 8.1 MiCA; Art. 8.4(a) MiCA). **Therefore, a case-by-case analysis remains necessary for newly offered crypto-assets being labelled as utility tokens, to determine whether they may be deemed financial instruments** (ESMA, Consultation Paper, end §12, 20, 29, 35; K. Pardaens, B. Nerriec, Tokenised securities, p.36).

As already discussed herein, ESMA emphasised in its Consultation Paper that a substance over form approach needs indeed to be adopted to determine if a crypto-asset is or is not to be qualified as a financial instrument (ESMA, Consultation Paper, §30 & 82).

First of all, utility tokens are characterised by their fungibility, aligning themselves with a uniform set of crypto-assets with identical rights and characteristics, making them interchangeable (ESMA, Consultation Paper, §61). This is typically also a characteristic of transferable securities (see 'Class of securities' above in this Document).

More importantly, for a crypto-asset to be and remain an 'utility token' within the meaning of MiCA it should not replicate the rights attached to financial instruments, including not those attached to transferable securities as defined by MiFID II (Art. 4.1(44) MiFID II; ESMA, Consultation Paper, §62). It also should not give financial rights that would be related to a company's profits, capital, or liquidation surpluses — and thus representing an ownership position in a company's capital (e.g. unit of equity ownership in the capital stock of a corporation) — like voting rights which would lead the investor to participate in the company's decision-making process (e.g. token giving the right to vote on matters of corporate policymaking) (ESMA, Consultation Paper, §131, footnote 80).

If a utility token has an investment purpose, the authority may potentially treat it as a security (FINMA, Guidelines, p.5). Indeed, any crypto-asset, including utility tokens, might qualify as a transferable security if it grants rights similar to shares, bonds or other securities (e.g. securities embedding a derivative) (ESMA, Consultation Paper, §30).

See the DHN token case: The DHN token was launched by a foundation and its founder, during an ICO. It was initially planned as an utility token to grant access to a learning service provided in a platform as well as a marketplace where users could have bought crypto-related goods and services from other users. However, the DHN token was never usable as such because the platform never became operational. Instead, it served as an investment-token through which the foundation merely collected several million of euros and where, at some point, the investments were done with the promise of being repaid with returns. FINMA qualified it as an investment token and, consequently, as securities (FINMA, Press release).

3.3 *NFTs*

The FATF guidelines on virtual assets (which is a similar concept to crypto-assets) explicitly clarified that Non-Fungible Tokens ('**NFT**') are generally not considered to be virtual assets under the FATF definition (FATF, Virtual assets, §53; FATF, Target update, §37). Consequently, rules applicable to virtual assets naturally do not apply to NFTs.

In line with these guidelines, MiCA's provisions also do not apply to crypto-assets that are unique and not fungible with other crypto-assets (NFTs), including crypto-assets that represent digital art and collectibles (Art. 2.3 MiCA; Recital (10) MiCA; FATF, Virtual assets, §53). This equally applies to crypto-assets representing unique and non-fungible services or physical assets, such as product guarantees or real estate (Recital (10) MiCA). Therefore, NFTs which cumulatively meet the criteria of uniqueness and non-fungibility are exempt from MiCA (ESMA, Consultation Paper, §65).

While these tokens may be traded on the marketplace and be accumulated speculatively, they are not readily interchangeable with other crypto-assets (Recital (10) MiCA; FATF, Virtual assets, §53). Their relative value cannot be determined with a comparison to an existing market or equivalent asset (Recital (10) MiCA; ESMA, Consultation Paper, §66).

As these crypto-assets fall outside MiCA's application scope, the European Commission was tasked with presenting a report to the European Parliament and the Council by 30 December 2024, containing an assessment of the appropriate regulatory treatment for such crypto-assets (Arts. 142.1 & 142.2(d) MiCA).

Nevertheless, MiCA does not provide a definition for what constitutes a 'unique and non-fungible' crypto-asset, nor is there a widely accepted definition for it (ESMA, Consultation Paper, §66).

NFTs are generally unique in a technical sense based on the token standard being used: contrarily to fungible token standards, like ERC-20 (used for cryptocurrencies), which require each token to have the same values, the NFT standard ERC-721 allows the processing of several tokens having each different values compared to other tokens. Each token has therefore a globally unique identifier or '**token ID**' (Eur.Parl., Remaining regulatory challenges, p.96).

The criterion of uniqueness refers only to the technical characteristics and the individual identifier (token ID), but not necessarily to the content represented by the token (BaFin, Crypto tokens). Indeed, technical uniqueness does not imply any rareness or scarcity of the un-

derlying asset (Eur.Parl., Remaining regulatory challenges, p.96). The asset represented by the NFT may exist in different quantities with minor variations between them, similar to a postage stamp series or the printing of several bills of 100.- EUR, where each item is essentially the same but bears an unique individual number akin to a token ID (Eur.Parl., Remaining regulatory challenges, p.96).

MICA applies to these crypto-assets that appear to be unique and non-fungible (NFTs), but whose *de facto* features or uses make them either fungible or not unique (Recital (11) MiCA). Therefore, the mere attribution of a unique identifier to a crypto-asset, which is typical for NFTs, is not sufficient to classify that crypto-asset as unique and non-fungible and to exclude it from MiCA's framework (Recital (11) MiCA; ESMA, Consultation Paper, §68). Similarly, naming a token a NFT does not in any way assure that it will be out of MiCA's application scope (Eur.Parl., Remaining regulatory challenges, p.101).

The same way, the FATF concluded that "*some NFTs that on their face do not appear to constitute VAs [virtual assets] may fall under the VA definition if they are to be used for payment or investment purposes in practice*" (FATF, Virtual assets, §53; FATF, Target update, §37).

It is therefore important to distinguish between truly unique crypto-assets and those that might just appear unique due to specific technical identifiers or standards. The technical features and standards used remain an indicator but are not of primary importance when assessing the fungibility and uniqueness of crypto-asset (ESMA, Consultation Paper, §68).

In this context, the key legal question is the following: where is the difference between crypto-assets in scope of MiCA and of the tokens that are 'unique' and 'not fungible with other crypto-assets'? (Eur.Parl., Remaining regulatory challenges, p.101).

To answer that question, MiCA adopts a 'substance over form' approach (End Recital (11) MiCA; ESMA, Consultation Paper, §66; Eur.Parl., Remaining regulatory challenges, p.101; FINMA, Annual report 2022, p.20).

An '**interdependent value test**' must be performed as part of the assessment to classify a crypto-asset as unique and non-fungible. According to ESMA, the following elements must be taken in consideration:

i. Firstly, one must consider if the value of the crypto-asset primarily stems from the unique characteristics of each individual crypto-asset and of the utility it gives to its holder (Recital (10) MiCA;

ESMA, Consultation Paper, §136).

A given crypto-asset does not fall within MiCA's application scope if it is genuinely unique and not fungible, either because its characteristics and/or the rights it provides distinguish it from the other tokens (ESMA, Consultation Paper, §67).

Conversely, a crypto-asset falls within MiCA's application scope whenever it lacks genuine uniqueness because it has comparable and interchangeable attributes (ESMA, Consultation Paper, §67).

ii. Secondly, one must consider the extent to which the interconnection of various types of crypto-assets influences the value of one another (ESMA, Consultation Paper, §136).

For a crypto-asset to be considered unique, its value must be intrinsically linked to its individual attributes and the specific utility it gives to its holder. A key aspect that must therefore be considered is the value interdependency that may exist between different NFTs, or if the value of one crypto-asset influences the valuation of another (ESMA, Consultation Paper, §69).

Should that be the case, then the so-called NFT has no value of its own that would be decorrelated from other NFTs (ESMA, Consultation Paper, §136). This characteristic would tend to indicate a lack of uniqueness (ESMA, Consultation Paper, §69).

For example, an NFT representing a piece of digital artwork may lose its uniqueness if it is part of a larger collection, and if its value is influenced by other crypto-assets in the series. In other words, if the valuation of a crypto-asset originates from a comparison between crypto-assets possessing comparable attributes that make them interchangeable, the crypto-asset falls within MiCA's application scope (ESMA, Consultation Paper, §69).

iii. Lastly, one must consider the unique characteristics that distinguish these crypto-assets from others (ESMA, Consultation Paper, §136).

Crypto-assets that are called NFTs and that are part of a series or of a collection may fall within MiCA's application scope if they are interchangeable (ESMA, Consultation Paper, §70). Such crypto-assets could be considered as interchangeable in practice if they share equivalent characteristics (including the underlying represented asset). This can occur in scenarios where the market views certain NFTs as having similar value despite unique attributes. The existence of a series or a collection — and more precisely its size — is an indicator of fungibility of a given NFT, although it is

not an overriding criterion (Recital (11) MiCA; ESMA, Consultation Paper, §70).

The mere attribution of a unique identifier to a crypto-asset, which is typical for NFTs, is not sufficient to classify that crypto-asset as unique and non-fungible (Recital (11) MiCA).

For instance, in the case of a collection of NFTs where the uniqueness of each crypto-asset can be questioned (e.g. several NFTs representing the same image with minor modifications) all this collection falls under MiCA's application scope.

Conversely, it is understood that a series of NFTs, in the manner of a series of numbered serigraphs or pictures, the numbering of which would have an impact on the value and uniqueness of the NFTs, each of these crypto-assets could be seen as a series of crypto-assets that are non-fungible (ESMA, Consultation Paper, §71). They would fall outside MiCA's application scope.

In addition, the utility function of NFTs can also play a role. In some cases, NFTs might confer similar utility or access rights. Owning an NFT might grant access to exclusive events or benefits. Here, the specific attributes of the NFT become less relevant compared to the utility it provides, making different NFTs functionally interchangeable for practical purposes (ESMA, Consultation Paper, §72).

It should be noted that the above is the position expressed in ESMA's Consultation Paper. However, a study made for the European Parliament has differently considered, based on decisions of the U.S. SEC, that "*NFT art collection series may well turn out to be a financial instrument*" (Eur.Parl., Remaining regulatory challenges, p.101 & 102; Bloomberg, Bored-Ape). Therefore, in this case, they would not fall under MiCA's application scope.

Finally, fractional parts of a unique and non-fungible crypto-asset cannot be considered unique and non-fungible (Recital (11) MiCA; ESMA, Consultation Paper, §73). Such parts involve dividing a NFT into several other crypto-assets, allowing multiple investors to collectively own a portion of such fractional-NFT (ESMA, Consultation Paper, §73).

The 'Fractional parts of a unique and non-fungible crypto-asset' is a different concept from a collection of NFTs in that each fraction represents a fractional ownership of the same NFT. It would be thus possible to reconstitute the entire NFT by holding all the fractional parts. The outcome of this operation of fractionalisation may consist for each frac-

tion to possess identical attributes and inherently devoid of uniqueness (ESMA, Consultation Paper, §73).

Consequently, fractionalised NFT may qualify as a crypto-asset within the meaning of MiCA. As part of an 'independent value test' it must be assessed the following elements:

i. whether crypto-assets represent a partial ownership stake in a single unique and non-fungible token;
ii. if fractional parts of a unique and non-fungible crypto-asset are themselves individually to be deemed unique and non-fungible;
iii. whether these fractional parts share identical attributes or characteristics; and the possibility of reconstructing complete ownership of the unique and non-fungible token by aggregating all its fractional components (ESMA, Consultation Paper, §140).

If the answer to all these questions is positive, then the fractional parts of the same NFT would be interchangeable and fungible (BaFin, Non-fungible tokens). Consequently, they could fall within MiCA's application scope.

As we have seen hereunder, a crypto-asset labeled as an NFT may in some instances fall under MiCA's application scope, while in others, it does not.

'Pure' NFTs, for instance, are excluded from this scope. However, this does not automatically mean that they are considered financial instruments (i.e., a transferable security). Indeed, pure NFTs, which represent unique and non-fungible underlying assets, are not easily interchangeable with other crypto-assets (Recital (10) MiCA; FATF, Virtual assets, §53). Yet, interchangeability is a critical characteristic of transferable securities to be "negotiable on the capital market" (see definition of 'transferable security' above in this Document; European Crypto Initiative, Regulation).

Because these crypto-assets may not fall within MiCA, nor qualify as financial instruments, the European Commission was tasked with presenting a report to the European Parliament and the Council by 30 December 2024, containing an assessment of the appropriate regulatory treatment for such crypto-assets (Arts. 142.1 & 142.2(d) MiCA).

Nevertheless, some argue that ESMA should explicitly state, in the guidelines of its Consultation Paper, that pure NFTs are not and will not be regulated as financial instruments under MiFID II (European Crypto Initiative, EUCI's response, p.8).

In reality, ESMA's Consultation Paper seem to briefly have expressed this idea in a footnote, and so did other authorities:

- *"the term 'class [of securities]' refers to the notions of interchangeability, fungibility and/or equivalence, meaning that the attributes of each crypto-assets allow such instruments to be traded. [...] The idea is to exclude [from the concept of 'class' and, therefore, from that of 'transferable securities'] those crypto-assets that would be unique or that would have been customised for a particular investor (e.g. NFTs)"* (ESMA, Consultation Paper, §101 & footnote 66).
- *"To date, BaFin is not aware of any NFTs that would have to be classified as securities for supervisory purposes. One reason is that the tokens have so far lacked embodied rights comparable to securities. Another reason is that NFTs are usually given individual rights and contents, and this rules out standardisation and thus negotiability in terms of the supervisory definition of securities"* (BaFin, Non-fungible tokens).

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A general classification of NFTs under law is not possible (FINMA, Annual report 2022, p.20). **Hence, a case-by-case analysis is still required for newly offered crypto-assets that may technically be considered as non-fungible tokens, to determine whether they may be deemed financial instruments** (ESMA, Consultation Paper, end §12, 20, 29, 35; K. Pardaens, B. Nerriec, Tokenised securities, p.36; FINMA, Annual report 2022, p.20).

Indeed, as it was already explained herein, ESMA emphasised in its Consultation Paper that a substance over form approach needs indeed to be adopted to determine if a crypto-asset is or is not to be qualified as a financial instrument (ESMA, Consultation Paper, §30 & 82).

NFTs may theoretically be classified as securities if they embody rights comparable to securities and are transferable and negotiable on the financial market. Rights comparable to securities include membership rights or contractual claims on assets, as in the case of shares and debt instruments (BaFin, Non-fungible tokens).

There is some possibility that NFTs may be classified as securities in future. This could be the case, for instance, if 1,000 NFTs were to embody the same repayment and interest claims (BaFin, Non-fungible tokens).

See the winery case: The integration of NFTs into the wine industry began around 2021 and continued ever since, garnering interest from Luxembourg businesses (Forbes (M. DeSimone & J. Jenssen), NFTs Have Arrived In The Wine Industry; Silicon Luxembourg (J. Bauldry), This Startup's NFTs).

An NFT could represent a bottle of wine with unique attributes

stemming from a limited production, grape varietals, vineyard conditions, production techniques, producer reputation, and perhaps artistic elements on the bottle or the label. Based on the rarity of the bottled wine, these NFTs might be viewed as crypto-assets that are unique and not fungible within the meaning of MiCA, and fall outside its application scope.

However, NFTs could also represent bottles of wine produced in larger quantities, where the value of each bottle and its corresponding NFT are interdependent. This interdependency could bring such NFTs within the scope of MiCA. If these NFTs do not confer ownership rights or promise future returns, they may not be considered securities.

Type of crypto-asset	**Qualification (as a general tendency or principle)**
NFT with characteristics and/or rights that distinguish it from other tokens (e.g., representing an unique and non-fungible asset)	Out of MiCA's scope
NFT with comparable and interchangeable attributes with other crypto-assets (e.g., representing non-unique and fungible assets - a series of tickets)	In-MiCA's scope Not a security, subject to a case-by-case analysis
NFTs that are part of a series or of a collection, and representing the same asset or assets with minor modifications between them that have no impact in its value	In-MiCA's scope Not a security, subject to a case-by-case analysis
NFTs that are part of a series or of a collection, and representing assets with modifications between them that have impact in its value	Out of MiCA's scope
Fractionised NFTs	In-MiCA's scope Not a security, subject to a case-by-case analysis

Table 3.2: NFT qualification

3.4 *Stablecoins: Asset-referenced tokens & Electronic money tokens*

MiCA only uses the term 'stablecoins' once. It defines it as tokens "*that aim to maintain a stable value in relation to an official currency, or in relation to one or several assets, via protocols*" (Recital (41) MiCA).

As their name implies, the key distinguishing feature of so-called stablecoins is that their value is meant to be stable relative to that of an underlying asset or benchmark. The value of a so-called stablecoin may be pegged to the value of a official fiat currency or a basket of assets that may include fiat currencies, digital currencies, investment securities, commodities and/or real estate. A so-called stablecoin may also employ algorithmic means to stabilise its market value (FATF, FATF Report to G20, §23).

However, MiCA avoids the term 'stablecoin' and, instead, it broke down such tokens into two different categories:

- electronic money tokens (**'EMTs'**); and
- asset-referenced tokens (**'ARTs'**).

The first one is a type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency (Art. 3.1(7) MiCA; Recital (18) MiCA); the second one is a type of crypto-asset, other than electronic money tokens, that purports to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies (Art. 3.1(6) MiCA; Recital (18) MiCA).

According to MiCA's categorisation, each of these tokens constitutes a specific type of crypto-asset: EMTs represent the first type, and ARTs represent the second type (Recital (18) MiCA).

Both types fall within MiCA's application scope and are, therefore, not considered as financial instruments within the meaning of MiFID II, including not as securities. ARTs are governed by Articles 16 to 47 of MiCA, and EMTs are regulated by Articles 48 to 58.

A fundamental characteristic stands out from the number of articles contained in each of those regimes:

- It seems clear that the EMTs regime encompasses fewer articles compared to ARTs. This is so because of two reasons: (i) EMTs issuers can only be entities already subject to strict regulatory rules, in particular authorised credit institutions and electronic money institutions (Art. 48.1(a) MiCA; Recital (66) MiCA); additionally, (ii) EMTs are deemed to be electronic money within the meaning of

Directive 2009/110/EC (Art. 48.2 MiCA; Recital (66) MiCA) and, as such, they are subject to some requirements set out in that Directive (Art. 48.3 MiCA; Recital (66) MiCA). In other words, EMTs are considered 'money', regulated as such, and MiCA only regulates specific aspects related to their transfer and storage using a DLT. The decision to deem EMTs as electronic money likely stemmed from the regulatory principles of *"same activities, same risks, same rules"* and of *"technology neutrality"*. The different technologies involved might not have been enough to set aside the functional similarities between electronic money tokens and electronic money;

- However, ARTs, unlike EMTs, are not subject to any other regime besides MiCA. They are not deemed to be (electronic) money. Accordingly, they are fully regulated within MiCA's framework.

In this regard, the FATF guidelines state that the definition of 'virtual asset' is expansive and that it also may cover and apply to so-called stablecoins (FATF, Virtual assets, §9, 54, 86 to 89; FATF, Money laundering risks; FATF, FATF Report to G20, §22; IMF, Virtual assets, beginning p.6). Stablecoins that fit the virtual asset definition cannot simultaneously be considered securities, as 'virtual assets' are defined as a digital representation of value that does "*not include digital representations of fiat currencies, securities and other financial assets*" (FATF, Virtual assets, §44, 49 & 51).

However, our understanding is that the term 'stablecoins' as used by the FATF could only refer to ARTs. Indeed, EMTs, that are deemed electronic money, do not qualify as virtual assets under the FATF guidelines on virtual assets, since they are covered by other guidelines (FATF, Virtual assets, §50). Conversely, ARTs are not deemed electronic money and, as a subset of virtual assets, they also cannot qualify as securities. They are simply virtual assets and regulated as such.

The same way, Luxembourg law defines 'virtual assets' as "*a digital representation of value [...] that can be digitally traded, or transferred, and can be used for payment or investment purposes, except for virtual assets that fulfil the conditions of electronic money [...], and virtual assets that fulfil the conditions of financial instruments [...]*" (Art. 1.8 Law of 25 March 2020).

Hence, under Luxembourg law as well, virtual assets do not include electronic money nor financial instruments (e.g., securities).

In this context, the CSSF found that virtual assets include most stablecoins (CSSF, VASP guidelines, end p.139). Consequently, stablecoins that classify as virtual assets cannot simultaneously be considered electronic money or financial instruments. Our understanding is that EMTs, that are deemed electronic money, are excluded from the vir-

tual asset definition. On the other hand, ARTs may potentially fit this definition, even if considered as payment tokens and as instruments of payment.

In this regard, stablecoins are considered, like cryptocurrencies, as a payment token (Eur.Parl., Remaining challenges, beginning p.80; EBA, Report, table p.7). Payment tokens are generally not considered as transferable securities.

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A case-by-case analysis remains necessary to determine whether any given crypto-asset labeled as an ART may be deemed a financial instrument (ESMA, Consultation Paper, end §12, 20, 29, 35; K. Pardaens, B. Nerriec, Tokenised securities, p.36; FINMA, Annual report 2022, p.20).

Indeed, as it was already explained herein, ESMA emphasised in its Consultation Paper that a substance over form approach needs to be adopted to determine if a crypto-asset is or is not to be qualified as a financial instrument (ESMA, Consultation Paper, §30 & 82).

ARTs value is stabilised by a reference to another value or right or a combination thereof. In other words, an ART may also reference rights, and it is possible that the rights referenced by an ART are analogous to those listed under MiFID II's definition of 'transferable securities' (e.g., a share or a bond) (see FATF, FATF Report to G20, §23)

However, unlike security tokens, the underlying assets or associated rights are not embodied in the token (BaFin, Crypto tokens). Depending on various factors such as its structure/design, their intended usages (payment token or investment token), the type of rights referenced, and whether it provides holders a direct claim on the 'right' belonging to the reserve, tokens that are *prima facie* labeled ARTs may potentially qualify as a transferable security (Eur.Parl., Remaining challenges, end p.80; FATF, Virtual assets, §54; BIS, FSI Insights, end p.21).

Although ESMA's Consultation Paper did not address ARTs, authorities have stated the following:

- "*Some crypto-assets, especially some "investment tokens" or some "stablecoins", could qualify as "financial instruments" under the Markets in Financial Instruments Directive (MiFID II). [...] Other crypto-assets, especially some other types of stablecoins, could qualify as electronic money under the Electronic Money Directive II (EMD2) if they satisfy all elements of the definition, notably by giving users a direct claim on the reserve backing the 'stablecoin'.*" (European Commission, Impact Assessment, beginning p.6; Eur.Parl., Stablecoins, end p.5);

- "*Stablecoins may be qualified as financial instruments, transferable securities, derivatives, collective investment schemes, units of account, e-money [EMTs], commodities, and/or deposits, depending on the particular design of the instrument and the relevant legal and regulatory system.*"(Eur.Parl., Remaining challenges, end p.80;
- "*A stablecoin is covered by the [FATF] Standards as either a VA [Virtual Asset] or a financial asset (e.g., a security) according to the same criteria used for any other kind of digital asset, depending on its exact nature and the regulatory regime in a country.*" (FATF, Virtual assets, §54; FATF, Money laundering risks; FATF, FATF Report to G20, §22 & 47);
- "*In some jurisdictions, stablecoins may constitute a security or financial instrument, such as a debt instrument, or represent an interest in a fund or collective investment vehicle and be subject to applicable laws relating to securities and financial instruments.*"(BIS, FSI Investigating, p.6 & p.10);
- "*global stablecoin initiatives may, depending on their structure, have features that are typical of regulated securities or other regulated financial instruments.*" (BIS, FSI Insights, end p.21);
- "*Under financial law, a stablecoin instrument may be potentially classified as a deposit, a security, e-money, or a commodity. The classification of the instrument will be informed by its private law nature and will in turn be relevant to consider the issuer, for example, as a depository institution, money transmitter, securities issuer, e-money provider, or trust.*" (IMF, Fintech Notes, p.24).

The "*other types of stablecoins*" that are lastly mentioned by the European Commission, and which "*could qualify as electronic money*", are likely to be EMTs under MiCA. Conversely, the stablecoins initially mentioned, which are not EMTs, could potentially be ARTs under MiCA and, therefore, meet MiFID II's definition of 'transferable securities' (European Commission, Impact Assessment, beginning p.6).

In our perspective, also when the CSSF states that virtual assets include most stablecoins (CSSF, VASP guidelines, end p.139), it is implied that other stablecoins may not be considered virtual assets and may, therefore, be considered, either as electronic money (in particular, EMTs) or as financial instruments (some ARTs?).

It would have been beneficial to have more guidance from ESMA regarding ARTs in its Consultation Paper. Such was not the case.