

SUBMITTED VIA WEB FORM TO: <https://www.esma.europa.eu/>

To whom it may concern,

Re: European Securities & Markets Authority (ESMA) Consultation Paper on the draft guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments

About Global Digital Finance (GDF)

GDF is the leading global members association advocating and accelerating the adoption of best practices for crypto and digital assets. GDF's mission is to promote and facilitate greater adoption of market standards for digital assets through the development of best practices and governance standards by convening industry, policymakers, and regulators.

The input to this response has been curated through a series of member discussions and roundtables, and GDF is grateful to its members who have taken part.

As always, GDF remains at your disposal for any further questions or clarifications you may have, and we would welcome a meeting with you to further discuss these matters in more detail with our members.

Yours faithfully,

Elise Soucie - Director of Global Policy & Regulatory Affairs - GDF



Response to the Consultation Report: Executive Summary

GDF convened its Markets in Crypto-Assets (MiCA) Working Group to analyse the European Securities & Markets Authority (ESMA) Consultation Paper on the draft guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments.

Overall GDF is supportive of the aim of the proposals made in the Consultation Paper on the draft guidelines on the qualification of crypto-assets as financial instruments under MiCA, and of ESMA's intent of providing much needed clarity to the market. We appreciate the agility and speed with which ESMA has developed the proposed guidance, and believe the Consultation is an important step towards building a comprehensive EU global framework for digital assets. As such, the response to the Consultation looks to provide suggestions of areas where additional specificity and practical implementation measures may be needed for effective implementation of the guidance.

GDF has worked with our members to provide a constructive assessment of how to overcome challenges in implementing the guidance. Through this process, the Working Group has identified key areas that may require further drafting consideration or additional guidance for purposes of clarity, proportionality, and effective implementation. The three core areas identified are:

- 1. Broad support for more specific and granular classification criteria**
- 2. Additional guidance for DeFi, NFTs, and DAOs in the absence of DeFi's inclusion in MiCA**
- 3. Further clarity for hybrid-tokens to ensure consistent mapping and implementation of requirements**

1. Broad support for more specific and granular classification criteria

Overall, GDF agrees with ESMA's decision to not take a one-size fits all approach as doing so would lead to unwelcome rigidity and would neither be flexible nor future proof. However, as further detailed in the response, GDF members have flagged that issues of consistent application across National Competent Authorities (NCAs) may arise without a bright line test. As such, GDF encourages ESMA to provide greater detail on these general conditions and criteria to help both firms and the NCAs understand how tokens should be classified. GDF recommends that ESMA sets out more detailed guidance for firms and training to NCAs to improve clarity. Members also noted the effectiveness in additional specificity through worked examples would be most beneficial such as through 'what good looks like' documents and urges ESMA to provide these.

2. Additional guidance for DeFi, NFTs, and DAOs in the absence of DeFi's inclusion in MiCA

GDF acknowledges that ESMA is considering Decentralised Finance (DeFi) as part of its broader future work programme but would note that it would be beneficial to provide some form of clarity to DeFi activities as they are currently excluded from MiCA, yet some of the



qualification criteria may capture DeFi activities. GDF notes that there are broader challenges relating to the criteria for assessing DeFi and Decentralised Autonomous Organisations (DAOs). There are many different DAO structures that either exist currently or are being developed, many may have qualities of financial instruments, but given the continuum on which DeFi exists they may not neatly fit into existing classifications of financial instruments. Given these challenges, GDF believes it would be beneficial to provide guidance to DeFi firms on if they should wait for future regulation or if they should be preparing to comply with guidance at Level 2 under MiCA in the absence of such a framework, especially as the market and structures of decentralised organisations continue to evolve.

3. Further clarity for hybrid-tokens to ensure consistent mapping and implementation of requirements

GDF members are concerned that an overly broad interpretation could result in all tokens falling under existing financial services regulations rather than MiCA which would be counterproductive to the overarching aims of the new framework. GDF members consider that further detail is required, as many financial instruments share characteristics. As such, it will be important to clarify which specific characteristics map to which instrument. Furthermore, it would be beneficial to set out a hierarchy of characteristics when cross-referencing. These clarifications are crucial as misunderstanding or lack of consistent implementation could be detrimental to new entrants who might find themselves needing to comply with Markets in Financial Instruments Directive (MiFID) requirements due to one small characteristic of a hybrid token.



Response to the Consultation Paper (CP): Questions for Public Consultation

Q1: Do you agree with the suggested approach on providing general conditions and criteria by avoiding establishing a one-size-fits-all guidance on the concepts of financial instruments and crypto-assets or would you support the establishment of more concrete condition and criteria?

GDF understands the rationale behind ESMA's approach in providing general conditions and criteria and the benefit that such an approach brings in an industry, such as this, where token classification may not be so clear cut. As such, GDF agrees with ESMA's decision to not take a one-size fits all approach as doing so would lead to unwelcome rigidity and would neither be flexible nor future proof.

That being said, without a bright line test, there will be issues of consistent application across NCAs, and, as such, GDF encourages ESMA to provide greater detail on these general conditions and criteria to help both firms and the NCAs understand how tokens should be classified. Members highlighted the unique risk that inconsistent application has with MiCA. Given existing EU financial services legislation applies before MiFID, in a situation where there is not clear guidance on what constitutes a financial instrument, firms can arbitrage and locate themselves in a location where they will not be considered to fall within existing EU financial services legislation and passport across using their MiCA authorisation. That firm will then be able to operate in a Member State where they would otherwise be classified as a financial instrument (for example).

As such, GDF notes that ESMA has taken the widest possible definition of a security token in order to reduce / remove the chance of arbitrage. However, in doing so, there are considerable consequences. First of all, in the development of MiCA, there was careful consideration to avoid a heavy-handed approach of the whole suite of EU financial services legislation. However, in casting the net further, more tokens will be brought within this scope. Secondly, there is a tech-neutrality issue. In the same market, or in fact within the same entity, a firm can be offering the same product but the fact that the technology is different i.e., it uses distributed ledger technology (DLT), it will be treated as a MiFID instrument. This not only creates a disproportionate regulatory burden on firms, but it also stifles innovation in firms using new and efficient technologies in the fear that it will now be captured by a more onerous regime and creates unnecessary confusion in the market. Members noted a number of examples of where this could be the case, including for loyalty / reward schemes, where the current drafting appears to suggest that bringing an existing (exempt) scheme onto a distributed ledger would now bring them within the regulatory perimeter.

MiCA also intends to facilitate new market entrants as well as incumbents to support the adoption of this technology. However, the approach taken here will have a disproportionate impact on small and new market entrants. GDF is concerned that such a broad approach will drive a number of firms outside of the scope of MiCA and into existing financial services legislation instead.

If ESMA continues with such an approach, GDF recommends that ESMA sets out more detailed guidance for firms and training to NCAs to improve clarity. Members have noted the effectiveness in additional specificity through worked examples and 'what good looks like' documents and urge ESMA to provide these.



Q2: Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as transferable securities? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

GDF reiterates its comments under Q1, noting as well that EU member states have varying views on how widely they interpret the definition of ‘transferable security’. As ESMA has expressed a strong opposition to broadening the MIFID concept of transferable security, more concrete guidance on identification and classification would be beneficial. This would prevent unintended fragmentation risks as well as inconsistent qualification of crypto-assets across EU member states.

Q3: Based on your experience, how is the settlement process for derivatives conducted using crypto-assets or stablecoins? Please illustrate, if possible, your response with concrete examples

Q4: Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as another financial instrument (i.e., a money market instrument, a unit in collective investment undertakings, a derivative or an emission allowance instrument)? Do you have any additional condition, criteria and/or concrete examples to suggest?

Guideline 4 looks at the classification as Units in collective investment undertakings. GDF urges ESMA to provide clarity on the application of this to staking. GDF refers to work that has been done by [HMT](#) which intends to carve out certain manifestations of staking from the Collective Investment Scheme rules and encourages ESMA to follow suit. Staking forms an important part of the digital asset ecosystem and has the potential to be an important economic activity in the EU. However, the lack of current regulatory clarity could see staking disproportionately captured by the current CIS regime.

Q5: Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

Q6: Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

GDF notes that as per the Level 1 text, ESMA has taken a substance over form approach and when looking at the classification of a Non-Fungible Token (NFT) will also take into consideration the tokens interdependency to other tokens and how its value fluctuates in relation to them. GDF is broadly supportive of this approach and looks forward to further guidance on how to ascertain the uniqueness of an NFT. A couple specific areas of note are for example how to determine what a large series is. Existing guidance draws a couple of concerns around tech neutrality again. GDF notes that if someone buys, for example, a handbag as an investment, that is not regulated as a financial instrument, the treatment is different if this is made into an NFT vs if not. Members note that there should be consistency in the treatment, and we should not have a system where but for being digital and using DLT, the market would be unregulated.

Further to the specific categorisation challenges around NFTs, GDF also notes that there are broader challenges relating to the criteria for assessing DeFi and DAOs. There are many



different DAO structures that either exist currently or are being developed, many may have qualities of financial instruments, but given the continuum on which DeFi exists they may not neatly fit into existing classifications of financial instruments. GDF acknowledges that ESMA is considering DeFi as part of its broader future work programme but would note that it would be beneficial to provide some form of clarity to DeFi activities as they are currently excluded from MiCA, yet some of the qualification criteria may capture DeFi activities. It would be beneficial to provide guidance to DeFi firms on if they should wait for future regulation or if they should be preparing to comply with guidance at Level 2 under MiCA in the absence of such a framework. It would be beneficial in this guidance to also align with IOSCO implementation where possible.

Q7: Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

GDF acknowledges ESMA's approach and welcomes its aim to clarify guidance for hybrid-tokens where some crypto-assets may have characteristics of financial instruments. The Consultation proposes that if a token has characteristics of a financial instrument that those will take precedence and it should be categorised as a financial instrument.

GDF considers that further detail is required, as many financial instruments share characteristics. As such, it will be important to clarify which specific characteristics map to which instrument. Furthermore, it would be beneficial to set out a hierarchy of characteristics when cross-referencing. These clarifications are crucial as misunderstanding or lack of consistent implementation could be detrimental to new entrants who might find themselves needing to comply with MiFID requirements due to one small characteristic of a hybrid token.

There are other challenges that members note surrounding categorisation. New tools and innovations may result in crypto-assets changing categories through their lifecycle. For example, the proposed ERC-404 standard has NFTs that emit ERC-20s. If these fractionalised tokens then aggregate, they could form either an NFT or a financial instrument. However, without a clear understanding of what a NFT is and what characteristics it may bring into the scope of a financial instrument, it is unclear how this token should be defined.

An overly broad interpretation could also result in all tokens falling under existing financial services regulations rather than MiCA which would be counterproductive to the overarching aims of the new framework.