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ESMA CONSULTATION PAPER ON THE DRAFT GUIDELINES ON THE CONDITIONS AND CRITERIA FOR THE QUALIFICATION OF CRYPTO-ASSETS AS FINANCIAL INSTRUMENTS

AFG's response

AFG

The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 700 management companies, with €4600 billion under management and 102,000 jobs, including 27,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

AFG'S RESPONSE

GENERAL COMMENT ON ESMA'S PROPOSAL

We would like to thank ESMA for its initiative on draft guidelines for the qualification of crypto-assets as financial instruments and for giving AFG the opportunity to express its views on the proposal.

We welcome ESMA's observation regarding the need for clarifications on the classification of Crypto Assets (CAs) as financial instruments (FIs), considering the various national transposition of MiFID within EU Member States while still relying on existing regulatory frameworks, such as MiFID II, as stated in recital 30 for the qualification of 'transferable securities.'

We also support the principle of technological neutrality, as outlined in recital 29: '*Financial instruments that have been tokenised should continue to be recognised as financial instruments in all regulatory contexts. The technology neutrality principle as outlined in MiCA, ensures that analogous activities and assets are regulated under the same rules, irrespective of their technological format. This assessment should be done on the case-by-case basis.*.'

The reasoning we endorse is as follows: If a crypto asset does not fit the legal qualification of an FI under the regulation, then it should not be considered as an IF.

These guidelines represent an initial step in the context of forthcoming EU regulations for the entire decentralized finance (DeFi) sector.

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?

National laws have different interpretations regarding crypto assets. For instance, a German branch is not able to use its parent company's CASP status in another EU country, whereas subsidiaries can. In other EU countries, this may not necessarily be the case.

If we choose an approach that leaves interpretation to national authorities, it could hinder business development and innovation. The ecosystem requires major institutional players to expand internationally. However, it is challenging to reconcile having a Markets in Crypto Assets (MiCA) authorisation that can be passported in EU countries while simultaneously dealing with non-harmonized interpretations of instruments falling under MICA's scope. This would impede the growth of EU actors and potentially direct savings toward foreign actors outside the EU or, worse, unregulated solutions.

It is evident that we also face the limitations of MiFID II, where financial instruments are defined through a list rather than based on harmonized criteria that could override local regulators' interpretations. Therefore, we must adhere to the following principle: tokens meeting MiFID II classification criteria should continue to be treated under MiFID II, while other tokens will fall under MICA regulations.

The blockchain provides a technological solution for a standardised infrastructure, but it is not the sole common denominator for categorizing assets that can circulate on the blockchain. However, it is conceivable that ESMA could issue guidelines or, even better, a more concrete list of criteria that can be uniformly applied by EU countries.

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

The AFG fully supports the technologically neutral approach proposed by ESMA in its draft Guideline 1.

Despite the different definitions adopted in EU Member States, all securities represent a monetary claim against the issuer and carry specific rights vis-à-vis that issuer. Furthermore, transferable securities are defined by a list of securities that have been implemented in the national law of each jurisdiction. For crypto assets to be considered as transferable securities, they must correspond to one of the types of seucrities defined in the applicable law. If this is not the case, they should not be considered as such, regardless of the cumulative criteria listed below.

Therefore, crypto assets should only be classified as transferable securities under MiCA if they cumulatively satisfy the following conditions:

1. They represent a monetary claim against the issuer.
2. They meet the cumulative criteria identified by ESMA, namely:
   (i) They are not instrument of payment: AFG supports a case-by-case analysis for this condition. However, relying solely on the most appropriate qualification leaves too much room for interpretation by National Competent Authorities (NCAs);
   (ii) They are issued in a category (are "classes of securities"): AFG supports a precise interpretation of this notion which should be understood as requiring that all assets issued within a category confer identical rights. It should be clarified that crypto assets belonging to the same category must grant their holders the same rights/obligations vis-à-vis their issuer; and
   (iii) They are negotiable on the capital markets. With negotiability that should be understood as referring to the opposability/enforceability of asset transfers to third parties and to the issuer without any formality. It should not be mixed up with other concepts such as standardization and fungibility.
3. They characterize one of the types of securities defined in the applicable legislation.

We strongly support the exclusion of the economic criterion, as mentioned in recital 105. It states that "*while it can serve as an indicator, relying solely on the investment component or anticipated profits (cash flow) should not be sufficient to consider a crypto asset as a security*". This exclusion must be explicit and reflected in all guidelines. We reiterate our desire to clarify this exclusion in the drafting of the guidelines.

Conversely, considering an economic criterion would risk qualifying any investment as a financial instrument, regardless of its nature and without regard to specific categories or precise financial securities. This would go against the MiFID II philosophy, which preferred listing financial instruments to limit 'forum shopping' among EU Member States. Using such a vague criterion would reinforce discrepancies and differences in interpretation among Member States, whereas the objective criteria of a financial instrument leave little room for discretion, namely: (i) the monetary claim against the issuer and (ii) the criteria defined by ESMA as mentioned above.
Furthermore, taking economic criteria into account could significantly expand the list of financial instruments, resulting in unnecessary legal uncertainty due to the impossibility, to date, of establishing a restrictive list of instruments that can and should be classified as financial instruments.

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

MiFID II does not introduce a single, general definition of derivatives, but sets out in Annex 1 section C (4) to (10) of MiFID II a list of examples of those contracts which may qualify as financial instruments. These types of contracts derive their value from an underlying asset (e.g. commodities, currencies, indices, etc.), and are settled either in cash or by delivery of the underlying asset (so-called physical settlement).

Unregulated platforms and trading venues under MiFID II/MiFIR

We also note that the emergence of "crypto" trading platforms, which now encompass financial contract transactions, is creating a new dynamic in the financial ecosystem. These platforms offer a wide range of cryptoasset derivatives that are sometimes settled in very different ways, even if cash settlement is the most widely used method for unwinding crypto derivative contracts.

As rightly pointed out by the FSB (link), crypto exchange platforms often offer combinations of cryptoasset-related services, products and functions that are generally provided by separate legal entities in the traditional financial sector: exchange, brokerage, trading, market-making, custody and clearing activities, for example.

The first difficulty identified is that of coordination between the exchange platforms that have emerged in this constantly evolving environment, handling 365/7/24. As a result, these platforms have created the following adapted settlement mechanisms:

- Transactions and initial margin deposits 365/7/24.
- Settlements can take place every day, and sometimes several times a day. At the time of settlement, the profits/losses of the session will be accounted for in the cash balance of the cryptoassets or stablecoins.

Despite this specificity, it is our view that this should not exempt these platforms from complying with existing European regulations such as MiFID II/MiFIR and EMIR.

At the same time, however, we recognize that the incorporation of these new players into the financial landscape may pose challenges for traditional players (trade repositories, clearing houses, etc.). The reporting, clearing and risk management processes associated with these transactions may differ considerably from those of traditional assets, requiring the adaptation and evolution of existing infrastructures and regulatory practices.

New challenges posed by DeFi

In addition, the rise of DeFi adds a further dimension to this ever-changing landscape. DeFi protocols such as dYdX offer crypto-asset derivatives trading functionality via smart contracts, often bypassing traditional centralized structures.

These platforms rely on autonomous protocols that automatically execute contract terms, including transaction settlement. While this may offer advantages in terms of efficiency and accessibility, it also raises questions about the applicability/enforceability of existing regulations, notably MiFID II, to these new operating models.

We invite ESMA to get in touch with traditional Market Infrastructures to find out how they will prepare and what solutions they will propose to adapt to this new framework. We would also like to know whether transitional arrangements will be put in place to allow infrastructures time to get up to speed.

Q4: Do you agree with the conditions and criteria to help the identification of cryptoassets 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?

As a general view, we remain in favor of an alignment of the criteria for qualification of financial instruments with those set in MiFID, by virtue of the "same activity, same risk, same rules" principle for each respective category of financial instrument.

The application of this principle would imply that crypto-assets that have the features of the related MiFID financial instrument would be captured by MiFID, thus echoing the exclusion approach laid down in MiCAR<;

Activities involving digital assets are partially open to UCITS and AIFM asset management companies. This possibility is not directly written into the AIFM / UCITS reform. However, it is expressly provided for in article 60 of the MiCA regulation, an extract of which is reproduced below:

> "*5. A UCITS management company or an alternative investment fund manager may provide crypto-asset services equivalent to the management of portfolios of investment and non-core services for which it is authorised under Directive 2009/65/EC or Directive 2011/61/EU if it notifies the competent authority of the home Member State of the information referred to in paragraph 7 of this Article at least 40 working days before providing those services for the first time.*
> *For the purposes of this paragraph:*
> *(a) the reception and transmission of orders for crypto-assets on behalf of clients is deemed equivalent to the reception and transmission of orders in relation to financial instruments referred* ***in Article 6(4), point (b)(iii), of Directive 2011/61/EU****;*
> *(b) providing advice on crypto-assets is deemed equivalent to investment advice referred to in Article 6(4), point (b)(i),* ***of Directive 2011/61/EU and in Article 6(3), point (b)(i), of Directive 2009/65/EC****;*
> *(c) providing portfolio management on crypto-assets is deemed equivalent to the services referred to* ***in Article 6(4), point (a), of Directive 2011/61/EU and in Article 6(3), point (a), of Directive 2009/65/EC****.*"

ESMA guidelines on key concepts of the AIFMD state the following :

> "*VI. Guidelines on 'collective investment undertaking'*
> *12. The following characteristics, if all of them are exhibited by an undertaking, should show that the undertaking is a collective investment undertaking mentioned in Article 4(1)(a) of the AIFMD. The characteristics are that:*
> *(a) the undertaking does not have a general commercial or industrial purpose;*
> *(b) the undertaking pools together capital raised from its investors for the purpose of investment with a view to generating a pooled return for those investors; and*
> *(c) the unitholders or shareholders of the undertaking – as a collective group – have no day-today discretion or control. The fact that one or more but not all of the aforementioned*

unitholders or shareholders are granted day-to-day discretion or control should not be taken to show that the undertaking is not a collective investment undertaking."

The AFG supports these 3 criteria, which, until now, only targets the "other AIFs" category for tokenized cryptoasset fund units. However, the combination of these 3 criteria should only concern the fund's assets. This combination should also serve as criteria when it comes to qualifying a smart contract as a tokenized fund.

Moreover, it should be noted that the absence of a general commercial or industrial purpose, which is mentioned at paragraph 57, is not included in the criteria provided in the text of the Draft Guidelines (Annex II), and more specifically in paragraphs 115 to 119. We suggest including this element in the Draft Guidelines, in accordance with the ESMA Guidelines on key concept of the AIFMD.

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.

The AFG supports clarification on the qualification of NFTs from the definition of cryptoassets under MiCA. However, the approach to the possible qualification of NFTs as cryptoassets should not be too inclusive, with the risk of too many NFT projects falling within the scope of MiCA while the resources of NCAs will not be adapted accordingly. As regards the treatment of NFTs in relation to the definition of a cryptoasset (only the assimilation to a financial instrument is provided for), the AFG would prefer not to anticipate the European Commission report that is due by December 30, 2024.

AFG supports a case-by-case analysis based on a series of indicators (bundle of clues), including, but not limited to, the technical specificities of the NFTs.

The NFT is a token registered in the blockchain, consisting of a sequence of alphanumeric characters complying with the rules of cryptography. The token contains metadata allowing the identification of its issuer and the underlying object. According to the rules defined by the creator of the NFT, the file to which it refers thus becomes unique.

The NFT also includes a link to the underlying object to which it points. This underlying can be of any digital nature.

From this description, it can be deduced that the underlying is the essential element. It is this element that is subject to the various technological processes.

Two hypotheses must be distinguished at this stage:

- The first, according to which the NFT incorporates the underlying, in other words, the NFT has no value and no real intrinsic interest other than evidential, and it can then be accepted that the NFT has no real legal "existence" other than evidential, it does not constitute an asset

distinct from the underlying, it merely attests to the transfer of rights and the existence of rights over the underlying as the case may be[1].

- The second hypothesis assumes that the NFT has a distinct intrinsic value, sometimes purely speculative; the NFT and the underlying must then be distinguished.

At this stage, there are two possible situations: one in which there are two distinct objects, each with its own value, and another in which, on the contrary, the NFT is merely the evidentiary title for the second, and therefore has a single market value, that of the underlying. In that case, the NFT only enables the tracking of transactions carried out on the underlying, or attesting to the uniqueness or authenticity of this object. In this situation, the NFT will follow the regime of the underlying.

Consequently, under current regulations, NFTs fall outside the definition of cryptoassets. Although it can be transferred, stored or exchanged electronically, it does not constitute a medium of exchange due to its non-fungibility.

Furthermore, the NFT cannot be qualified as a cryptoasset insofar as it is the object of the property right held by the user, and not the representation of "one or more rights" within the meaning of the legal definition.

In addition, one of the other criteria should also be to assess whether an NFT, as well as other assets, could give rise to a "public offering" as defined in the MiCA regulation. More specifically, it should be assessed whether, for this NFT and the other assets under consideration, there could be a "*communication to persons in any form, and by any means, presenting sufficient information on the terms of the offer and the crypto-assets to be offered so as to enable prospective holders to decide whether to purchase those crypto-assets*". The uniqueness and non-fungibility of certain NFTs may make it impossible to prepare a comprehensive communication containing sufficient global information on these NFTs to enable their purchase by potential holders, particularly if prices vary for each NFT depending on numerous factors.

Finally, the guidelines should explicitly exclude from the scope of MICA NFTs representing digital works of art and collectibles, product collateral or real estate. The guidelines should reaffirm this exclusion.

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.

The proposed approach of first checking whether the hybrid crypto asset positively qualifies as a financial instrument and to not go further if it does (i.e. notwithstanding any other characteristics of the hybrid token), appears rational, considering the principles of :

- "*substance over form*", with a case-by-case analysis ;
- technological neutrality;
- investor protection, particularly against the risk of regulatory circumvention.

However, here below a few observations on this approach :

[1] For example, Alfa Romeo plans to "mint" a maintenance booklet for each vehicle, in order to track maintenance. In this case, the NFT is no more than a certificate with no intrinsic value of its own. Indeed, when the NFT is used solely for probationary certification purposes, it makes no sense for it to have a market value independent of that of the underlying asset.

- It involves an examination, in the light of the rules defined in the MICA (of direct application), of whether the criteria defined in national law when MIFID II was transposed have been met. The national disparities resulting from these transpositions should gradually be attenuated by this examination, without which the risk of regulatory arbitrage between jurisdictions would weaken European regulation of crypto-assets.

- The question arises as to how best to achieve this harmonization, when a case-by-case, "*substance over form*" approach by each national authority is advocated.

- A specific difficulty arises from the definition of one of the categories of financial instruments (as listed in Section C of Annex I of MIFID II): transferable securities. These are identified by the cumulative satisfaction of 3 criteria (cf. art. 4.1.44 MIFID II): (i) not being a payment instrument (ii) being issued in categories and (iii) being tradable on capital markets. Thus, referring first and foremost to the criteria qualifying financial instruments, as proposed in the ESMA Guidelines for the analysis of hybrid crypto-assets, could in fact refer first and foremost to the criteria qualifying payment instruments. However, the definition of the latter is very general (cf. art 4.1.14 PSD), and for certain hybrid crypto-assets, the protection of "investors" may seem less relevant than that of MIFID II.

- The question obviously arises for crypto-assets that can simultaneously fulfil the functions of payment, investment, store of value and so on. For example, some "stablecoins" could be classified as payment instruments, even though they also have characteristics that would enable them to be classified as financial instruments.

- Further clarification therefore seems necessary in order to increase the legal certainty of the regulatory framework for crypto-assets in the EU. In particular, the constituent elements of a "*payment function*" will need to be specified, notably within the framework of the joint ESAs Guidelines on the qualification of asset-referenced tokens (ARTs), provided for in article 97.1 of MICA.

- Within the proposed hierarchical approach, the criterion "*if the hybrid token displays features of a financial instrument*" remains very imprecise and open to wide interpretation: how many "features" must be present for this qualification? What is the relative importance of these criteria? In the absence of sufficient clarification and coordination, the case-by-case substance-over-form approach is likely to result in highly heterogeneous supervisory practices, and therefore a risk of regulatory arbitrage.

- Finally, there is the question of the risk (for investors, players, markets, etc.) posed by conflicts of interpretation on the nature of a crypto-asset within a value chain, a fortiori if it is cross-border: an issuer and its crypto-asset service providers could find themselves in difficulty if the nature of a crypto-asset is called into question at some point in this chain, and/or in a country, and/or over time, and they do not all have the appropriate licenses (MIFID II and/or MiCA). The robustness and stability of the qualification of hybrid crypto-assets, such as a more collegial or centralized authority could provide, would bring a lot of added value to the crypto-asset market in the EU.

- In order to avoid the risk of regulatory arbitrage and competition between jurisdictions, we believe that the analysis of hybrid crypto-assets should be the subject of greater precision, or even more centralized supervision in the EU.

- In addition, the very general definition of "utility token" in article 3.1.9 of MICA further reinforces the risk of heterogeneous classification of tokens across jurisdictions and supervisors, as well as the risk of having a very large number of tokens categorized as financial instruments, which could congest the market and the capacities of supervisors.

AFG

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