Consultation Response

MiCA: ESMA Consultations on Guidelines on Reverse Solicitation and the Conditions and Criteria for the Qualification of Crypto-Assets as Financial Instruments

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The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **ESMA's consultation papers on 1) guidelines on reverse solicitation and 2) guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

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

Executive Summary

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

- **Reverse solicitation**: We encourage ESMA to explicitly state that the scope of the proposed guidelines applies exclusively to the direct provision of crypto-asset services under MiCA from third-country firms to EU clients. We also encourage ESMA to consider adjustments to the proposed restrictions on the means of solicitation to allow for access to overseas crypto asset services as required by EU crypto-asset service providers (CASPs) and professional clients as well as possible future changes in relation to the means of solicitation.
- **Conditions and criteria for the qualification of crypto-assets as financial instruments**: Whilst ESMA's proposed approach to consider qualification circumstances on a case-by-case basis offers required flexibility, we view that ESMA should take an active role in mitigating and harmonising possible divergent interpretations on the same asset by either providing further guidance in consultation with industry and/or maintaining a minimum list of specific crypto-assets. This would help promote regulatory certainty, ensure that assets displaying features of financial instruments are characterised as such, and ultimately minimise arbitrage risks.

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Questions

ESMA Consultation on draft guidelines on reverse solicitation under MiCA

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

We broadly agree with ESMA's approach to base the reverse solicitation exemption under MiCA on the established practice under the MiFID II framework (as prescribed by ESMA Q&As). However, we support 1) a clarification on scope specifying that the proposed guidelines (including restrictions on means of solicitation) apply exclusively to the third-country provision of crypto-asset services under MiCA and are not extended to the established framework under MiFID II, and 2) some adjustments to the guidelines as they would apply to crypto asset services in scope of MiCA.

First, on scope clarification, ESMA should clarify that the proposed Guidelines apply exclusively to the provision of crypto-asset services or activities in scope of MiCA and should not be inferred to apply to the provision of services related to traditional asset classes. This is an important clarification for firms with multiple business lines and whose business model is not predominantly associated with the provision of crypto asset services or activities.

Second, we acknowledge that the provision of crypto asset services may lead to new ways of marketing with digital tools and channels and require adaptations to the restrictions on means of reverse solicitation particularly in relation to retail investors. However, the draft guidelines assume a very broad interpretation of the means of solicitation under MiCA that could restrict access to the broad range of crypto asset services and activities (including to trading venues) required by EU CASPs and professional clients from overseas providers.

It would appear that the majority of the proposed guidelines are aimed at addressing risks associated with the provision of crypto asset services and activities directly from third-country firms (that are not authorised in the EU under MiCA) to EU retail clients. This is understandable, but if applied to all clients in a blanket manner, the proposed approach could impact market integration and access, where, for example, an EU CASP seeks, or requires, to use the services of a non-EU crypto asset service provider to provide services to its own clients. We therefore view that the draft guidelines should differentiate between the treatment of retail and professional clients where necessary.

ESMA's currently proposed approach to restrict solicitation by means of specific electronic and multimedia channels may lack the flexibility to accommodate for future changes in technological means and communication patterns. For example, the draft Guidelines take a strict approach in the following areas such that they would be considered as means of solicitation in breach of the exemption (under Guideline 1 and 2):

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

In the above areas, we view that ESMA should consider narrowing its interpretation of solicitation such that such term only considers means containing direct references to crypto asset services in scope of MiCA as means of solicitation.

Finally, MiCA Article 61(1) states that the reverse solicitation exemption applies to a "relationship" between a client and a firm, which by definition can be an ongoing and long-term client relationship (as opposed to a one-off service). The draft Guidelines, however, assert that the exemption can only be used for a very short period of time. We therefore encourage ESMA to reassess whether the time-limited duration would be at odds with the Level 1 requirement.

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

No comment.

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

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

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

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?

We strongly welcome the technologically neutral approach of the draft Guidelines to ensure that assets are subject to the same qualification conditions and criteria regardless of their underlying technology. We also agree that the proposed approach supports the diversity of the types of existing crypto-assets and facilitates the innovation of financial technologies. We, however, view that the proposed flexible approach may also lead to potential legal uncertainty (due to its dependency on the underlying MiFID financial instruments definition) and the possibility to have different views on the same asset depending on the responsible National Competent Authority (NCA). For example, NCAs could take different interpretations of the proposed guidelines, which could lead to fragmentation in the implementation of MiCA also depending on the final guidelines' interaction with local law.

In this context, we encourage ESMA to take an active role in ensuring that the conditions and criteria for the qualification of crypto-assets as financial instruments are sufficiently harmonised across Member States, for example through the issuance of Q&As. As an alternative solution, we view that ESMA could maintain a "minimum list" of specific crypto-assets to facilitate the assessment exercise whilst leaving open the possibility to assess the qualification of assets if an asset has specific features that do not allow it to be appropriately categorised by applying the criteria. Without these solutions, the implementation costs would necessarily be higher for firms.

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.

As indicated above, we support the technology-neutral approach and substance-over-form principle laid down in Guidelines 1 and 2. Relating to technological neutrality, we view that the proposed Guidelines could benefit from an additional clarification stating that the tokenisation of a transferable security does not impact its qualification as a transferable security.

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

As regards the exclusion of "instrument of payment" from the definition of "transferable security," we view that additional clarifications are required regarding the potential "payment function" of a crypto-asset that may result in both (1) a potential payment function and (2) an investment purpose. Such clarifications should be provided with regards to the Joint ESA Guidelines on the content and form of the explanation accompanying the crypto-asset white paper and the legal opinions on the qualification of ARTs under Article 97(1) of MiCA.

These clarifications would have the benefit of fostering a consistent assessment for the qualification of crypto-assets as transferable securities and also avoid situations where instruments that should be classified as transferable securities (including certain stablecoins) may seek to circumvent regulatory requirements under MiFID, including consumer protection rules. As the notion of "instrument of payment" is key in the assessment, we would support clarification around that term to provide clear guidance on the treatment of assets that would facilitate the qualification of crypto assets with features of transferable securities being qualified as such.

As noted under our answer to Question 1, given the wide range of possible interpretations of the criteria for the classification of crypto-assets, we support ESMA's taking an active role in harmonising the criteria to ensure consumers benefit from the same level of consumer protection across the EU and to minimise differences in interpretation between NCAs, which could create risks of regulatory arbitrage and offering competitive advantages to certain 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.

No comment.

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?
We understand that ESMA is applying the "same activity, same rules" principle to each category of financial instrument (money market instrument, unit in collective investment undertakings, derivative, emission allowance instrument). This implies that crypto-assets that have the features of the related MiFID financial instrument would be captured by MiFID, thus echoing the exclusion approach laid down in MiCA.

To facilitate the identification exercise, we view that additional and ongoing discussions with the industry are necessary to detail the criteria laid down in the guidelines and through examples (without resulting in a "one-size-fits-all" approach), so that crypto assets that have the features of other financial instruments should be classified as such.

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.

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

For example, we believe the guidelines for utility tokens require further clarifications. We have observed that some utility tokens may accrue revenues from protocol fees to token holders or allow community voting by holders, and these characteristics could lead to an interpretation that the tokens could be considered as financial instruments due to the hierarchical approach being proposed for hybrid-type tokens (where qualification as a financial instrument would take precedence over qualification as a crypto-asset). We do not agree, however, that sharing revenues accrued from protocol fees represents an ownership position in a company, nor do we agree that community voting on fund distribution is the same as participating in a company's decision-making process. As such, utility tokens with such characteristics should not be considered as financial instruments.

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.

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

We also support ESMA's considering providing clarifications on how the proposed Guidelines would apply to the various sub-categories of NFTs, which display different characteristics:

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

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.

We support the hierarchical approach to classifying hybrid-type tokens, which would prioritise their identification as financial instruments if displaying features of a financial instruments. We are concerned, however, about the implications for the responsibility and liability attached to the determination of an asset's qualification that may result from ESMA's proposal that the criteria for the qualification of hybrid-type tokens should consider possible changes over the course of an asset's lifecycle. We therefore encourage ESMA to consider how it would minimise risks and provide satisfactory mitigation to market participants should such scenarios arise. A potential solution is for ESMA to clarify that a hybrid-type token classified as a financial instrument at any point in its lifecycle should be considered as a financial instrument for its entire lifecycle.

We understand that an issuer is responsible for an asset's qualification; however, this may pose uncertainty in case a participant in the value-chain takes a different view or challenges the qualification. This may result in situations where an issuer qualifies the assets as a MiFID instrument whereas a provider or another participant considers that the asset should qualify as a MiCA crypto-asset. A divergent analysis could negatively expose both the issuer and a service provider to risks arising from the qualification of the asset, the licencing regime of the service providers, as well as potential prudential implications.

To further illustrate, a CASP authorised under MiCA may initially offer services for crypto assets considered within the scope of MiCA. However, if the assets are later reclassified as financial instrument subject to MiFID, then the CASP could find itself dealing with MiFID instruments without the necessary licensing. This scenario would expose investors to risks since the CASP, whilst compliant with MiCA, neither has the necessary authorisation to operate under MiFID nor be prepared to fulfil the different obligations between MiFID and MiCA. The converse example could also apply: a service provider that does not have authorisation to act as a CASP under MiCA could start to provide service for assets that are initially qualified as MiFID financial instrument but re-categorised as MiCA crypto-assets or vice-versa during the lifecycle. This would lead to risks for investors and for the service provider.

As highlighted above, there is also a need to provide clarification on the number of features required to be captured by the definition of financial instrument. For example, ESMA should clarify that the adoption of the proposed hierarchical approach is predicated on either certain or all of the characteristics of a financial instrument being satisfied. There is therefore a need to clarify these key notions to provide a higher level of regulatory certainty on the qualification of these assets.

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