

CRYPTO CONSULTATION – THE EUROPEAN COMMISSION’S PROPOSAL FOR AN EU CRYPTO FRAMEWORK

The European Commission launched a public consultation aiming to establish a European framework for regulating cryptoassets in December 2019. The consultation is the first step towards establishing a regulatory framework designed to facilitate the deployment of cryptoassets and the underlying blockchain or distributed ledger technology “within safe and ethical boundaries”, i.e. ensuring that potential risks are adequately monitored and mitigated. The cryptoasset consultation is running in parallel with a consultation on digital operational resilience, which together mark the first steps towards a new Digital Finance Strategy for the EU.

Existing crypto regulatory challenges

At present, there is no uniform global or European taxonomy for cryptoassets. While some types of cryptoassets more neatly fall within the scope of existing EU legislation, it is not always possible to apply existing frameworks to new assets. In some cases there are provisions that could inhibit the use of blockchain or distributed ledger technology (DLT), the technology underpinning cryptoassets.

Recently we have seen national initiatives in Member States including France, Italy and Luxembourg related to DLT and cryptoassets. While these have been welcomed by market participants in many cases, the European Commission is concerned about the lack of harmonisation in such legislative approaches. It is anticipated that this consultation will result in EU legislative action that provides greater harmonisation and clarity for market participants on the applicable regulatory treatment of cryptoassets across the EU.

Definition of cryptoassets

One of the key challenges for crypto offerings is a lack of consensus across Europe (and globally) around a taxonomy or definition. For the purposes of the consultation, a cryptoasset is defined as “a digital asset that may depend on cryptography and exists on a distributed ledger”.

Cryptoassets are not qualified other than by their reliance on DLT for the purposes of the consultation; accordingly, the consultation purports to apply to any type of cryptoassets (whether conceived as a means of payment, an investment, or for any other purpose).

Key issues

- As part of a new EU Digital Finance Strategy, the European Commission is consulting on a proposal to introduce a harmonised regulatory framework for cryptoassets.
- The Commission recognises the potential benefits that DLT and cryptoassets may bring and seeks to balance promotion of technology use with adequate regulation of the associated risks.
- Classification of the different types of cryptoassets is one of the biggest challenges for the Commission, particularly as Member States have already begun to introduce national initiatives.
- The Commission is taking a very thorough approach, even inviting respondents to consider whether harmonisation of national civil laws should be pursued to facilitate certainty for tokenisations.
- Responses are due by 19 March 2020.

Scope of the consultation

The consultation takes the form of a set of questionnaires focusing on the following 4 areas:

1. Questions for the general public – interestingly, this section targets not only market participants, but EU citizens generally, seeking their feedback on their experiences with cryptoassets. For example, the consultation asks about their views on the use or potential use of cryptoassets, whether they use a custodial wallet provider, if they plan to continue holding such assets and what knowledge they have of their rights and obligations when dealing with cryptoassets.
2. Classification of cryptoassets – this section seeks the views of stakeholders as to whether/how cryptoassets should be classified and the best means of classifying them, e.g. via legislative guidance or regulatory framework. It asks if the economic function classification which certain existing Member State guidance uses (i.e. dividing between payment tokens, security tokens, utility tokens and hybrid tokens) is appropriate for a European framework.
3. Unregulated Tokens Section – this section is concerned with the cryptoassets that currently fall outside the perimeter of the EU financial services legislation. It refers to the potential risks and challenges this type of cryptoassets poses and the best way of mitigating such risks. The outcome of responses to this section may be the extension of the regulatory perimeter to include certain currently unregulated cryptoassets.
4. Regulated Tokens Section – this section relates to security tokens and assessment of the applicable existing legislation. It aims to seek stakeholders' views on the application of the existing regulatory framework to this type of cryptoassets. Stakeholders are invited to share any existing regulatory impediments in relation to the use of DLT.

Consultation highlights

The consultation seeks input on a number of different topics relating to cryptoassets; below is a non-exhaustive list of these topics:

Harmonisation of civil law

Interestingly, the consultation includes a question that invites respondents to consider whether harmonisation of national civil laws can be pursued at an EU level in order to provide clarity on the legal validity of token transfers and the tokenisation of tangible (material) assets. Civil law jurisdictions include France, Germany, Italy and Spain.

Local civil laws may represent the primary obstacle to (validly) creating and transferring tokenised assets in a given jurisdiction. Thus, before evaluating any regulatory implications, one must consider how a token is to be characterised under the laws of the relevant jurisdiction, as well as how it can be transferred (based on such classification). The following questions may arise in that regard:

1. Is the token an asset over which ownership rights can be claimed?
2. Does the token embed rights enforceable against a specific person and/or any third parties?
3. Can the token be transferred from a person to another? If so, which rules of law govern its transfer? Can the token be transferred according to the same rules governing the transfer of securities?

It is not often that the EU legislator seeks to pursue harmonisation at the level of basic principles of Civil law in the Member States – this shows how thorough an approach the Commission has adopted.

Use of permissionless platforms

The Commission intends to seek the views on the use of 'permissionless' networks and decentralised platforms, in relation to security tokens, and any possible regulatory changes needed as a consequence.

The Commission has confirmed that currently existing requirements in relation to trading and post-trading seem to be translatable to activities related to security tokens issued via permissioned networks and centralised platforms, overseen by a central body. However, existing rules do not facilitate the development of 'permissionless' networks and decentralised platforms. In these cases, activities are not entrusted to a central body or operator that is accountable for enforcing the rules, but rather occur on a peer-to-peer basis. These structures represent increased risk to the areas of market integrity and financial stability.

The Commission believes that 'permissionless' networks and decentralised platforms are still in their infancy, with uncertain prospects for future applications in financial services. They acknowledge that these platforms may develop in time, for example when technology has progressed to provide a more efficient trading structure.

The Commission concludes that it is 'premature' at present to make any structural changes to the EU regulatory framework to facilitate the creation of 'permissionless' platforms. Nevertheless, the Commission has not ruled out the possibility of such changes in the future. The priority at the moment seems to be to offer clarification to the current regulatory approach regarding permissioned networks.

Stablecoins

Stablecoins are a key focus of the consultation. The Commission demonstrates an openness to explore the potential for DLT, and stablecoins in particular, to increase efficiency in the payments sector. The consultation acknowledges that stablecoins may "*allow for more efficient and cheaper transactions, as a result of fewer intermediaries being involved, especially for cross-border payments*". However, this is tempered by a wariness of the challenges including the potential systemic risk arising from a widespread adoption of stablecoins within the EU markets. The Commission is particularly concerned with so-called 'global stablecoins' – i.e. those stablecoins having global outreach as a result of being built on existing large and cross-border customer base - which may pose risks in terms of financial stability, monetary policy transmission and monetary sovereignty; including the risk of a 'run', in the event that stablecoins are issued in an amount exceeding the value of the reserves backing them.

Taking part in the process

The European Commission is inviting responses via an [online questionnaire](#). Responses are due by midnight Brussels time on 19 March 2020 and will be published on the [consultation website](#).

The Clifford Chance tech group policy unit

Our global Tech Group Policy Unit assists clients in preparing responses to consultations and in alerting clients to the implications of government proposals.

The regulation of the tech space is evolving rapidly as governments around the world grapple with the legal implications of developments in a range of areas from e-commerce and connected vehicles to artificial intelligence, blockchain, data privacy and cybersecurity.

Public consultations and policy papers play an essential role in the process of regulating new and rapidly developing areas and they provide vital opportunities for organisations to provide input into the policy process.

Our combination of tech, legal and policy expertise ensures that the responses are targeted, informed and effective. The public policy practice can also advise on the legal aspects of consultations, including possible legal challenges and statutory requirements.

To learn more about the Tech Group Policy Unit or the topics covered in this briefing, please contact a member of the Clifford Chance team.

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AUTHORS



Riccardo Coassin
Senior Lawyer
Milan

T: +39 02 8063 4263
E: riccardo.coassin@cliffordchance.com



Fadeia Hossian
Lawyer
London

T: +44 20 7006 6238
E: fadeia.hossian@cliffordchance.com

CONTACTS



Laura Douglas
Senior Associate
Knowledge Lawyer
London

T: +44 20 7006 3907
E: laura.douglas@cliffordchance.com



Christian Hissnauer
Senior Associate
Frankfurt

T: +49 69 7199 3102
E: christian.hissnauer@cliffordchance.com



Jonathan Lewis
Partner
Paris

T: +33 1 4405 5281
E: jonathan.lewis@cliffordchance.com



Laura Nixon
Senior Associate
Knowledge Lawyer
London

T: +44 20 7006 8385
E: laura.nixon@cliffordchance.com



Olivier Plessis
Counsel
Paris

T: +33 1 4405 5487
E: olivier.plessis@cliffordchance.com



Phillip Souta
Head of Tech
Policy Unit
London

T: +44 20 7006 1097
E: phillip.souta@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street,
London, E14 5JJ

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