



# The Regulation of Tokens in Europe

Parts A & B:  
The EU legal and regulatory  
framework

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This paper is a joint effort by legal and other professionals from across Europe, inspired by the initial "Statement on token regulation with a focus on token sales" by the Finance Working Group of the Blockchain Bundesverband issued in February 2018 and the related extended German version. In order to highlight the differences between EU jurisdictions, the paper has been restructured into (i) an EU section and (ii) various Annexes outlining the applicable legal and regulatory framework in thirteen European countries.

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# PART A

# INTRODUCTION

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## *ABOUT THINKBLOCKTANK*

thinkBLOCKtank is a Luxembourg based non-profit organisation, bringing together some of the most respected Blockchain and Distributed Ledger Technology experts from more than 15 countries.

The main goal of the association is to provide policy recommendations at an EU and worldwide level which will allow a proper regulated and prosperous ecosystem in regards to digital assets.

Our view is that regulatory responses should be clear, but proportionate, taking into the account the enduring imperatives of protecting consumers and maintaining financial stability; but also ensuring that innovation in this space is not stifled by over-regulation and legal complexity.

We are of the view that an EU-wide approach in this area is preferable to a state-by-state regulation. As noted by the European Commission in its 2018 FinTech Action Plan, cryptoassets are a “worldwide phenomenon”. Accordingly, a cohesive and co-ordinated approach at EU level will help providing certainty and facilitating cross-border scaling opportunities.

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## *ABOUT THIS PAPER*

The aim of this paper is to analyse the legal and regulatory frameworks applicable to token sales in certain jurisdictions in Europe, and to provide recommendations for improvement.

First, we look at the EU regulations in place, then the largest part of this document is taken up by an overview of relevant national legal and regulatory frameworks in a number of individual European jurisdictions.

We intend to update the paper from time to time and to include additional jurisdictions. At initial publication it includes 13 European country sections: Denmark, England & Wales, France, Germany, Gibraltar, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Poland, Slovenia and Switzerland.



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This paper is divided into three parts.

- *Part A* Introduction
- *Part B* Overview of the EU legal and regulatory framework applicable to token sales
- *Part C* Country-by-country analysis for a number of European jurisdictions.

We believe that token sales can have positive effects by providing innovators with alternative access to capital, and providing consumers with opportunities to invest and participate in assets and projects which would not otherwise be available to them.

As a result, any regulatory response should be proportionate, taking into account the imperatives of protecting consumers and maintaining financial stability, whilst also ensuring that innovation is not stifled by over-regulation and legal complexity.

We are of the view that an EU-wide approach to regulation in this area is preferable to a country-by-country approach. As noted by the European Commission in the FinTech Action Plan 2018, cryptoassets are a “worldwide phenomenon”.<sup>1</sup> A coherent and coordinated approach at EU level will help to provide certainty and facilitate cross-border scaling opportunities, and should help in combating regulatory arbitrage.

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## WHAT ARE BLOCKCHAIN AND DISTRIBUTED LEDGER TECHNOLOGIES?

Distributed Ledger Technology (“DLT”, such as blockchain technologies) is being looked at for various use cases – including examples such as secure and automated record keeping, time stamping, and transfer of various assets.

Whilst the best-known protocol using DLT is the Bitcoin blockchain, various other systems using DLT implemented emerged and have evolved in different ways.

Many “tokens” are in principle similar to existing *financial instruments*, however with technical parameters offering opportunities to lower the cost of issuing and servicing tokens due to the increased automation.

Like traditional financial assets, cryptoassets can be created by a centralised “*issuer*”, often via or in relation to a smart contract. Cryptoassets can, however, also be created in decentralised manners which were previously not possible.

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<sup>1</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0109>.



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The many opportunities this may offer are beyond the scope of this paper, however many examples are being discussed and developed. We believe these technologies present a fundamental paradigm shift in many areas of not only financial services, but also commerce and automation generally, and that this is just the beginning of that journey.







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# PART B

## EU LEGAL AND REGULATORY FRAMEWORK

Issuers of securities – and therefore tokens which qualify as securities – are required to publish a prospectus in accordance with the applicable national law in conjunction with the provisions of the EU Prospectus Regulation.

The EU Prospectus Regulation applies to securities offered to the public or admitted to trading on a regulated market located or operating in an EU Member State. As a result, it is important to determine when a token qualifies as a security.

In addition to the question whether a token may be a security or not, various other laws and regulations may apply to the tokens, or their issuance, or their transfer. These are driven not only by the classification of the tokens, but also by other aspects such as the activities of the issuing or transferring entities.

It is important to note that a uniform approach has not yet been adopted across Europe in relation to token classification, with diverging approaches having emerged in different countries.<sup>2</sup> To avoid further divergences, we would welcome the adoption of a uniform approach to token classification at EU level.

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<sup>2</sup> For example, the UK Cryptoassets Taskforce (which includes representatives from HM Treasury, the UK Financial Conduct Authority (FCA) and the Bank of England) recently distinguished between security tokens, utility tokens and “exchange tokens” (which is broadly interchangeable with the commonly referred to cryptocurrency classes used above). FINMA in Switzerland has opted to go with an “asset token” versus “utility token” versus “payment token” classification to describe (broadly) the same categories. The new Maltese Virtual Financial Assets Act by contrast introduces the concept of “virtual financial asset” offerings and incorporates a detailed “financial instrument test” to determine whether a particular token may fall within that definition.



## 1. OVERVIEW OF RELEVANT EU REGULATION

The most important EU-level regulatory frameworks that commonly apply to tokens, and in particular security tokens, include:

### *MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID II)*<sup>3</sup>

MiFID II applies to all financial instruments (which include transferable securities as well as others); the key requirement here is that most intermediaries and advisors involved in the space must be licensed by their respective local regulator (the licences can be passported across the EU)

### *PROSPECTUS REGULATION<sup>4</sup> (AND PROSPECTUS DIRECTIVE)<sup>5</sup>*

Unless an exemption applies, the Prospectus Regulation/Directive applies to transferable securities (using the definition from MiFID II), but not to other financial instruments.

A key requirement relates to adequate disclosure of information – no “*offer of securities*” may be made to the public without prior publication of a prospectus by the issuer of those securities.

### *MARKET ABUSE REGULATION (MAR)*<sup>6</sup>

MAR applies to securities whose definition is equivalent to MiFID II transferable securities; with the exception in Article 6 where a MAR-specific definition is used.

A key requirement is certain obligations with respect to market abuse, e.g. insider trading.

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<sup>3</sup> Directive 2014/65/EU and Regulation (EU) 600/2014.

<sup>4</sup> The Prospectus Regulation is Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 replacing and repealing Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 and related measures.

<sup>5</sup> The Prospectus Directive is Directive 2010/73/EU.

<sup>6</sup> Regulation (EU) 596/2014.



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## *ANTI-MONEY LAUNDERING DIRECTIVES (AMLD 4<sup>7</sup> AND AMLD 5<sup>8</sup>)*

The Anti-Money Laundering Directives and related texts (AMLD) may apply to token issuers and to various other market participants, for example when buying or selling tokens.

Key requirements include performing KYC (Know Your Customer) on clients as well as other checks regarding legitimacy of the sources of funds and respecting sanctions regimes.

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## *E-MONEY DIRECTIVE<sup>9</sup>*

Whilst the E-Money Directive is not believed to apply to cryptocurrencies or tokens, an argument could be made that fiat-backed stable coins should fall under this Directive. This Directive can also be a relevant licence for some market actors who provide fiat on-and-off ramps.

Its key regulatory concerns include the safekeeping of client assets and minimum safety requirements for the financial system.

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## *COMPETITION LAW AND UNFAIR COMMERCIAL PRACTICES*

In principle Competition Law and Unfair Commercial Practices regulations apply to all transactions involving tokens.

Key requirements are concerned with maintaining adequate market structures.

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## *CONSUMER RIGHTS AND INFORMATION DISCLOSURE REQUIREMENTS*

Depending on the type of product and the manner of its sales or transfer, various information disclosure requirements may apply.

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<sup>7</sup> AMLD 4 is Directive 2015/849/EU.

<sup>8</sup> AMLD 5 is Directive 2018/843/EU.

<sup>9</sup> Directive 2009/110/EC.

At the EU level, examples include (amongst others):

- the EU Consumer Rights Directives
- the EU Distance Marketing of Consumer Financial Services Directives
- the E-Commerce Directives

All of these regulations share a common purpose of investor and consumer protection, in particular by imposing requirements on transparency and timely provision of information.

Depending on the assessment of the token and surrounding activities, there may of course also be related activities or persons that require prior regulatory or other authorising licences and which may contain further or specific information and other obligations.



## 2. TOKEN CLASSIFICATIONS UNDER EU LAW

### TOKEN CLASSES

In the absence of uniform approaches and terminology across Europe at this stage in relation to token classification, for the purposes of this paper we have taken the terminology currently most referred to across EU jurisdictions and as also referred to in the ESMA Advice<sup>10</sup> and the EBA Advice<sup>11</sup> relating to cryptoassets (both documents together referred to as “*ESMA and EBA Crypto Assets Advice*”).

As a result, we have distinguished the following classes of tokens:

1. Security tokens
2. Cryptocurrency tokens
3. Utility tokens
4. Hybrid tokens

and will discuss these in turn.

### 2.1 SECURITY TOKENS

In this paper we have defined “*security tokens*” widely as all tokens (i.e. assets that are being registered on a blockchain) that are considered a financial instrument under applicable EU regulations.<sup>12</sup>

The core definition of financial instrument is provided in MiFID II<sup>13</sup> which provides a list of instruments that are considered financial instruments. One of those instruments is “*transferable securities*” which is defined in Article 4 (1) (44) of MiFID II as:

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<sup>10</sup> ESMA, Advice, Initial Coin Offerings and Crypto-Assets, 9 January 2019 (referred to as the “ESMA Advice”). Available at: [https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391\\_crypto\\_advice.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf).

<sup>11</sup> EBA, Report with Advice for the European Commission on crypto-assets, 9 January 2019 (referred to as the “EBA Advice”). Available at: <https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf>.

<sup>12</sup> The regulations in question are MiFID II (Directive 2014/65/EU), the Prospectus Regulation and the Market Abuse Regulation.

<sup>13</sup> Annex I, Section C of MiFID II (Directive 2014/65/EU).

*“those classes of securities which are negotiable on the capital market, with the exception of instruments of payments”*

followed by some specific examples such as shares, bonds as well as associated depository receipts and warrants.

There are, however, also important classes of financial instruments that are not *transferable securities* including, for example:

- units in collective investment undertakings (i.e. investment funds)
- derivatives related to financial instruments in the wider sense
- commodity derivatives, but only if they are or can be settled in cash
- emission allowances under Directive 2003/87/EC

To the extent that local regulators have a wider definition of regulated investments<sup>14</sup> a regulated investment will also be a “*security token*” even if it is not a security.

## 2.2 CRYPTOCURRENCY TOKENS

Pure “cryptocurrency tokens” which are instruments of payment appear to be explicitly exempted from the MiFID II definition of securities instruments.

We believe that cryptocurrency tokens serving solely the purpose of being used as a means of payment – within or beyond a given network – constitute an instrument of payment in such a sense.

Cryptocurrency tokens can be often distinguished from utility tokens by their multilateral reach: they are meant to be used by various parties (not always involving the token issuer). Utility tokens, on the other hand, are used primarily in relation to a defined party (being the token issuer).

There is no clear term used for this token class. The UK Taskforce uses the term “exchange token”<sup>15</sup>, the German supervisory authority BaFin the term “payment token”<sup>16</sup>. As the term “cryptocurrency” seems most widely used, we have used that term in this paper.

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<sup>14</sup> E.g. “Specified Investment” in the UK.

<sup>15</sup> Alternative definitions may be argued. For example, those used by the UK Taskforce cf. exchange token.



## 2.3 UTILITY TOKENS

We have used the term "*utility tokens*" for tokens other than security or cryptocurrency tokens.

Unlike cryptocurrency tokens, utility tokens do not typically represent digitally native assets (but rather represent a tokenised right to a product or service to be delivered by the token issuer).

## 2.4 HYBRID TOKENS

In practice, tokens often combine different functionalities. In this paper we refer to these hybrid instruments as "*hybrid tokens*".

This largely follows the classification adopted by regulators such as BaFin<sup>17</sup>, and has been adopted in this paper for the purposes of convenience only.

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<sup>16</sup> BaFin Perspektiven 1/2018, p. 57.

<sup>17</sup> BaFin Perspektiven 1/2018, p. 57.



### 3. WHEN DO TOKENS FALL WITHIN EU SECURITIES LAWS?

One of the key questions a token issuer must consider is whether its tokens could be classified as a Financial Instrument (or any other regulated investments to the extent that the latter class is wider), such that the token issuance could potentially fall within the scope of a financial markets' regulation at either EU or member state level.

Since the classification of tokens as securities triggers various consequences (in particular regulatory consequences<sup>18</sup>), the distinction between securities tokens and other types of tokens is of great interest for many participants in the market<sup>19</sup>. In addition, the classification may influence other aspects such as accounting and tax treatment of tokens.

A distinction can be drawn between the concept of "*(transferable) securities*" and the concept of "*financial instruments*" with the latter being the broader concept, and "*(transferable) securities*" being one of several sub-categories of financial instruments under EU legislation.

Regulatory requirements may therefore also arise for non-securities which are classified as (other types of) financial instruments.

It is also important to note that types of financial instruments vary on a national basis within the EU (where relevant, this is highlighted in the country-specific sections in Part C).

Most of the major European regulators – including at EU level the European Securities and Markets Authority (ESMA) – have issued some form of public statement indicating that a

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<sup>18</sup> BaFin, Aufsichtsrechtliche Einordnung von sog. Initial Coin Offerings (ICOs) zugrunde liegenden Token bzw. Kryptowährungen als Finanzinstrumente im Bereich der Wertpapieraufsicht (Regulatory classification of so-called initial coin offerings (ICOs) and cryptocurrencies as financial instruments in the area of securities supervision), note dated 20.02.2018, under 3. and 4.

<sup>19</sup> S. Comparable discussion until 2009 on whether shares in closed-end funds (i.e. KG and GmbH shares) are to be classified as securities (cf. Voß, BKR 2007, 45 ff.; Sester, ZBB 2008, 369 ff.). With the new version of Sec. 2 (2b) WpHG aF by the FinAnVermAnlG, the legislator has stipulated that investments in accordance with Sec. 1 (2b) aF. 2 VermAnlG, which also included the shares offered in closed-end funds in the form of a limited partnership or limited liability company share, are currently not securities and has therefore explicitly not followed the extension of the definition of securities proposed in the literature to improve investor protection (e.g. Assmann in Assmann/Schneider, Sec. 2 WpHG marginal 16) (see in detail Ritz in Just/Voß/Ritz/Becker, Sec. 2 WpHG marginal 22 f.).





coin or token may qualify as a transferable security or other form of financial instrument for the purposes of MiFID II and/or national laws.<sup>20</sup>

The following analysis focuses on the provisions of European securities laws relating to the issuance and trading of securities. European capital markets law defines the concept of “*transferable securities*” in MiFID II<sup>21</sup>, which also refers to Art. 3 para. 1 No. 1 of the Market Abuse Regulation (MAR)<sup>22</sup>.

### 3.1 THE MIFID II DEFINITION OF FINANCIAL INSTRUMENTS

MiFID II defines “*financial instruments*”<sup>23</sup> as:

- transferable securities,
- money market instruments,
- units in collective investment undertakings, and
- certain derivative agreements.

“*Transferable securities*” are defined as:

*“those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:*

- shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;*
- bonds or other forms of securitised debt, including depositary receipts in respect of such securities;*
- any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.”*

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<sup>20</sup> European Securities and Markets Authority (ESMA) – classification “depending how the ICO is structured”.

<sup>21</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJ EU, 12.6.2014, No. L 173/ p. 349.

<sup>22</sup> Regulation (EU) 2014/596 of the European Parliament and of the Council of 16 April 2014 of 16 April 2014 on market abuse (Market Abuse Regulation), OJ EU of 12.6.2014 No. L 173 p. 1.

<sup>23</sup> MiFID II, (Annex I Section C No. 1 MiFID II). In Art. 4 para. 1 No. 44.



In order to be “*negotiable*” under Art. 4, an instrument must therefore meet three formal criteria:

1. *transferability*,
2. *standardisation*, and
3. *negotiability on capital markets*  
(with negotiability being a subcategory of transferability).<sup>24</sup>

and then an informal criterion of *functional comparability* – one should also consider whether the instrument is functionally comparable with the non-exhaustive list of examples of transferable securities set out in that article<sup>25</sup> (as the actual substance of a token’s function and purpose, should prevail over form and name).

### 3.1.1 TRANSFERABILITY

Transferability means that units can be assigned to another person, irrespective of whether their existence is registered or documented by any certificates.

The fact that most tokens are actively traded on (crypto) exchanges indicates that tokens regularly fulfil the criterion of transferability.

Tokens that are not transferable (for example, due to technical restrictions) will usually not qualify as transferable securities.<sup>26</sup>

### 3.1.2 STANDARDISATION

The criterion of standardisation means that the units (i.e. the tokens) must share common characteristics and are identifiable and enumerable.

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<sup>24</sup> Assmann, in: Assmann/Schneider, Wertpapierhandelsgesetz Kommentar, 6. edition 2012, Sec. 2 recital 10.

<sup>25</sup> BaFin Perspektiven 1/2018, p. 61; similar: Klöhn/Parhofer/Resas, ZBB 2018, 89, 101 et seq.; Klöhn, Lars and Parhofer, Nicolas, Bitcoins under European and German Banking and Capital Markets Laws (November 19, 2018). Available at: SSRN: <https://ssrn.com/abstract=3287189> or <http://dx.doi.org/10.2139/ssrn.3287189>, p. 10.

<sup>26</sup> Hacker/Thomale, Chris, Crypto Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law (November 22, 2017), retrievable on <https://ssrn.com/abstract=3075820>, p. 20.



It should, therefore, be sufficient to transmit information on the type and quantity of the tokens in order to transfer the associated rights, with no further individual information needed.<sup>27</sup> This will usually apply to tokens by their nature.

### 3.1.3 NEGOTIABILITY ON A CAPITAL MARKET

Transferable securities must be tradable on a capital market in accordance with Art. 4 para. 1 No. 44 MiFID II.

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#### NEGOTIABILITY

While transferability refers to the mere fact of passing on ownership in securities, negotiability concerns the ease with which an instrument can be transferred, and includes possibilities such as using securities as a marketable object for barter transactions.

Negotiability implies transferability, but goes beyond mere transferability.

Most transferable rights are also negotiable, however not always. For example, under copyright laws certain rights may be transferred via inheritance but cannot be traded.

The European Commission has developed certain rules of evidence to determine negotiability. If the securities in question are of a kind that are capable of being traded on a regulated market or multilateral trading facility, this indicates that they are negotiable and therefore transferable securities. Provided they are capable of being traded on such a market, there is no requirement that they actually be traded on such a market.<sup>28</sup> Where tokens are actively traded on crypto exchanges, this will obviously constitute a clear indication that they are negotiable in this sense.<sup>29</sup>

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#### CAPITAL MARKET

The negotiability of tokens on crypto exchanges does not, however, automatically mean that all tokens in their different forms are actually traded on a capital market within the meaning of Art. 4 para. 1 No. 44 MiFID II.

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<sup>27</sup> Hacker/Thomale, *ibid.* (footnote 26), p. 22.

<sup>28</sup> European Commission, *Your questions on MiFID (updated version 2008) Question No. 115.*

<sup>29</sup> Hacker/Thomale, *ibid.* (footnote 26), p. 21 et seq.



The term “capital market” is not legally defined by MiFID II.

Legal experts discuss the term in the broader context of capital market regulation, tending to conclude that a capital market is a market on which, among other things, equity and debt securities can be traded, and includes both organised and non-organised financial markets.<sup>30</sup> Consequently, multilateral trading facilities and OTC transactions are included.<sup>31</sup>

Capital markets differ from other markets, such as markets for goods/commodities and services, and also from money, foreign exchange and derivatives markets.<sup>32</sup> In the Finnish fishing licences case<sup>33</sup>, the ECJ noted that not every liquid market is to be regarded as a capital market<sup>34</sup>.

The constitutive feature of a capital market is trading in equity or debt instruments – which should be distinguished from trading in goods and services.

Only a small number of the current (crypto) exchanges clearly distinguish between trading in security tokens and other types of tokens. As a result, there are crypto exchanges on which tokens representing equity and debt instruments (i.e. security tokens) are not only traded, but traded on an equal footing with other instruments which may not have the same status. It is unclear whether by trading all types of tokens on a single trading platform this creates a “capital market” only with respect to the equity and debt instruments traded on the platform, or whether all token classes listed on that same trading platform would then be regarded as being traded on a capital market.

### 3.1.4 NOT A PAYMENT INSTRUMENT

Payment instruments are excluded from the definition of transferable securities in Art. 4 para. 1 No. 44 MiFID II. The question therefore arises whether and under what circumstances tokens may be regarded as payment instruments for the purposes of this definition.

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<sup>30</sup> Cf. RegBegr FRUG BT-Drucks.16/4028 p. 54.

<sup>31</sup> Veil/Veil, *Europäisches Kapitalmarktrecht*, 2011, Sec. 3 I. 1; Grunewald/Schlitt, *Einführung in das Kapitalmarktrecht*, 2009, Sec. 1 I. 1; Ritz in Just/Voß/Ritz/Becker, *Wertpapierhandelsgesetz*, 1. Ed. 2015, Sec. 2 recital 19.

<sup>32</sup> Veil/Veil, *ibid.* (footnote 31), Sec. 3 I. 1; Grunewald/Schlitt, *ibid.* (footnote 31), Sec. 1 I. 1.

<sup>33</sup> EuGH v. 21.10.1999 – C-97/98 (Peter Jägerskiöld gegen Torolf Gustafsson), C-97/98, ECLI:EU:C:1999:515.

<sup>34</sup> EuGH, *ibid.* (footnote 33).



A common view is that cash, cheques or other liquid assets that are usually used for cash payments constitute payment instruments.<sup>35</sup>

According to the European Commission, instruments of payment<sup>36</sup> are:

*“securities, which are used only for the purpose of payment and not for investment”.*

For example, items such as cash and book money, electronic money, shopping vouchers, complementary currencies and cheques are often considered as payment instruments.<sup>37</sup>

In relation to fiat-linked “stable coins”, these practices suggest that these will not necessarily be considered as transferable securities. They could still be financial instruments should they be considered “money market instruments”. Money market instruments are generally instruments representing a financial claim on an issuer, and with a maturity of less than a year.

In our view, “pure” cryptocurrency tokens should not be considered as transferable securities within the meaning of MiFID II.

This position is also supported by the judgment of the European Court of Justice regarding the VAT treatment of Bitcoin. In essence, the argument is that where a token will be used exclusively as a means of payment, the token should also be treated as a means of payment.<sup>38</sup>

Some countries have since broadened this treatment to tokens other than Bitcoin and which are also meant to be used exclusively as a means of payment (whilst in some countries there has not yet been any official opinion). As pure cryptocurrency tokens (within the definitions outlined above) meet this criterion, they should therefore be classified as a means of payment and, therefore, not be regarded as Securities.

Hybrid tokens, however, do not exclusively serve as a means of payment, and may fall within the definition of Securities.

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<sup>35</sup> Cf. BaFin, Financial Instruments Fact Sheet, as of July 2013.

<sup>36</sup> EC, Q&A MiFID, p. 45. This is intended in particular to record cheques, bills of exchanges.

<sup>37</sup> Cf. BaFin, Financial Instruments Fact Sheet, as of July 2013.

<sup>38</sup> Letter from the German Federal Ministry of Finance on the VAT treatment of Bitcoin and other so-called virtual currencies dated February 27, 2018, No. II.

### 3.1.5 FUNCTIONAL COMPARABILITY WITH SHARES OR OTHER SECURITISED DEBT INSTRUMENTS

By including a (non-exhaustive) list of examples of securities (as discussed above), MiFID II provides a general indication of the European legislator's intentions regarding the concept of securities.<sup>39</sup>

Tokens that fulfil the three initial criteria of transferability, standardisation, and negotiability on a capital market, and are also comparable to one of the listed examples, will almost certainly also constitute transferable securities under European capital markets law.

Legal literature as well as certain national regulators consider that comparability of the rights attached to a token with these examples given in MiFID II should be used as an additional criteria.<sup>40</sup> The examples therefore can have a concretising effect by ensuring the focus is on substance over form.<sup>41</sup>

It is unclear how wide or narrow to interpret the scope of application of the term "*transferable securities*"<sup>42</sup> – and whether to limit it to instruments similar to the securities already mentioned in the list (such as those representing equivalents to tradable equity and debt instruments)? It is unfortunately not clear which comparison criteria should be applied when determining whether a particular instrument should be regarded as comparable, nor how wide or narrow the circle of comparable instruments should be drawn.<sup>43</sup> It is recommended to be prudent and treat the list as indicative, yet non-exhaustive.

Given that all of the examples given in Art. 4 para. 1 No. 44 MiFID II refer to instruments which impose direct obligations on the issuer of such an instrument and which are of financial value, this would appear to be the lowest common denominator for comparable

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<sup>39</sup> Art. 4 para. 1 No. 44 MiFID II.

<sup>40</sup> Hacker/Thomale, *ibid.* (footnote 26), p. 25.; BaFin Perspektiven Ausgabe 1/2018 (BaFin perspectives issue 1/2018), p. 61.

<sup>41</sup> Anzinger, The normative scope of the transparency requirement for investments in listed corporations, WM 2011, 391, 395 mwN.

<sup>42</sup> In accordance with Art. 4 para. 1 No. 44 MiFID II.

<sup>43</sup> For first attempts see Hacker/Thomale, *ibid.* (footnote 26), p. 25; BaFin Perspektiven Ausgabe 1/2018 (BaFin perspectives issue 1/2018), p. 61.

instruments to that list of examples: instruments which do not impose an obligation of financial value on the issuer should be less likely to constitute a security under MiFID II.<sup>44</sup>

## 3.2 THE MAR DEFINITION OF SECURITIES

The Market Abuse Regulation does not contain a separate concept of securities, and generally refers back to the definition of “transferable securities” outlined in MiFID II, as described above.

The exception to this is Art. 3 para. 2 MAR which includes a specific definition for securities, which applies only to Art. 5 MAR i.e. in the context of the exceptions exemption for buy-back programmes and stabilisation measures. This definition also sets out the examples from Art. 4 para. 1 No. 44 MiFID II as an enumerative list, restricting the definition of securities in that context to the instruments mentioned in the list.

Pursuant to Art. 3 para. 2(a) MAR, “securities” are defined as:

- shares and other securities equivalent to shares;
- bonds and other forms of securitised debt, or
- securitised debt convertible or exchangeable into shares or into other securities equivalent to shares.

The enumerative list of Art. 3 para. 2 MAR is however not precisely the same as the one as discussed above in relation to MiFID II.

As discussed above, in MiFID II “*transferable securities*” are defined as those classes of securities which are negotiable on a capital market, with the exception of instruments of payment, such as:

- shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
- bonds or other forms of securitised debt, including depositary receipts in respect of such securities;

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<sup>44</sup> This distinguishes EU securities laws in particular from US securities laws which do not require obligations against the issuer (although this requirement may implicitly arise in through the requirement (under the Howey Test) for an expectation of financial return due to the efforts of a third party).

- any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

This appears to underline the relevance of the examples listed in MiFID II as an indicative – yet non-exhaustive – list for assisting with the interpretation of the concept of securities under that Article.

This interpretation is in line with the views in the ESMA Crypto Assets Advice and the EBA Crypto Assets Advice – stating they do not consider crypto-asset-related activities as falling within the scope of current market integrity laws.<sup>45</sup>

### 3.3 THE UCITS DEFINITION OF SECURITIES

Article 2.1 (n) of the Undertakings for Collective Investment in Transferable Securities Directive IV (“UCITS IV”) defines “*transferable securities*” as follows:

1. shares in companies and other securities equivalent to shares in companies (shares);
2. bonds and other forms of securitised debt (debt securities);
3. any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange.

This definition is largely compatible with the definitions under MiFID.

### 3.4 CONCLUSION

European capital markets laws such as MiFID II and MAR regulate services in connection with securities, their issuance and trading if these securities are:

- (i) transferable,
- (ii) tradable and negotiable,
- (iii) standardised,

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<sup>45</sup> EBA Advice p. 29; ESMA Advice p. 13.



- (iv) not payment instruments, and
- (v) comparable to the instruments in the sample list in Art. 4 para. 1 No. 44 MiFID II.

However, not every transferable, tradable and standardised instrument should be considered a regulated security for EU legal purposes.

The instrument should also be comparable with the examples set out in MiFID II (or similar lists set out in other applicable laws, such as MAR), and have similarities to traditional equity and debt instruments.

The element of “*negotiability on the capital market*” must also be present in order for an instrument to constitute a transferable security. Capital market trading is currently restricted to equity and debt instruments. For example, using shares and bonds as a reference, the instrument in question will usually provide holders with:

1. a right to participate in some form of financial profit or return; and
2. a financial claim against the issuer of such an instrument.

Although the laws in question use (partially) non-exhaustive lists, none of these lists contain an instrument that is not in essence linked to a right to a return or some other type of financial claim against the issuer of such an instrument. This implies that legislators were likely to have been guided by the idea that only equity and debt instruments (and certain derivatives) should be traded on the capital market, and only these should be regulated in capital market law.

Hence, tokens for which a financial return is promised by the token issuer to the token holders (comparable to traditional equity/debt instruments) should be regarded as regulated securities within the meaning of the above-mentioned laws. Both the issue and trading of such tokens impose certain regulatory obligations on the token issuer (and on other participants).

Security tokens will generally meet all of these criteria, and should be regarded as transferable securities.

However, pure cryptocurrency and pure utility tokens should not be regarded as transferable securities.



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The category to which a token is to be assigned will depend on a case-by-case assessment based on the particular features and characteristics of the individual token.<sup>46</sup> For example, regulators have emphasised that “*the mere labelling of a token as a utility token*” will not be relevant. The outcome will be driven by the substance of the rights and obligations, and not form factors such as labels.

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<sup>46</sup> Applicable BaFin, regulatory classification of initial coin offerings (ICOs) and cryptocurrencies as financial instruments in the area of securities supervision, note dated 20.2.2018, under 1.



## 4. OBLIGATIONS UNDER THE AML REGIMES

Token issuers and/or other participants may have to comply with EU anti-money laundering laws.

Like other aspects of EU financial regulation, anti-money laundering (“AML”) requirements in the EU are governed by a patchwork of EU legislation and Member States’ national laws. The cornerstone of the current EU anti-money laundering framework is the Fourth Anti-Money Laundering Directive<sup>47</sup> (“AMLD 4”).

AMLD 4 imposes extensive AML requirements on “*obliged entities*” relating to customer due diligence, the identification of beneficial ownership, tax crimes and funds transfers.

It has been supplemented by a Fifth Anti-Money Laundering Directive<sup>48</sup> (“AMLD 5”), adopted by the EU in June 2018.<sup>49</sup>

A further Sixth Anti-Money Laundering Directive was adopted in October 2018.

Whilst AMLD 4 does not expressly include token issuers (or other players in the cryptospace) as “*obliged entities*”, once AMLD 5 has been implemented into national laws, “*providers engaged in exchange services between virtual currencies and fiat currencies,*” as well as custodian wallet providers, will be expressly brought within the scope of the EU anti-money laundering regime. AMLD 5 also requires EU member states to introduce measures for the registration of these businesses.

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<sup>47</sup> Fourth Anti-Money Laundering Directive (AMLD 4) – Directive 2015/849/EU.

<sup>48</sup> Fifth Anti-Money Laundering Directive (AMLD 5) – Directive 2018/843/EU.

<sup>49</sup> See also 2.1.1, EBA, January 9 2019, report with advice for the European Commission on crypto-assets and the qualification as e-money.



## 4.1 AML REGULATION UNDER AMLD 4

Pending the implementation of AMLD 5 across the EU, token issuers, exchanges and other market players must consider whether, by virtue of their activities, they may fall within the scope of scope of the current AMLD 4.

While token issuers are not currently expressly covered by AMLD 4, the directive takes a broad approach to combating money laundering. EU regulators have previously indicated that they do not generally regard “*virtual currencies*” as being subject to (current) EU anti-money laundering requirements.<sup>50</sup> However, depending on how the provisions of AMLD 4 have been incorporated into national law, it would be open to a national regulator to take a different view.

For example, AMLD 4 imposes anti-money laundering requirements on persons involved in:

*“trading in goods to the extent that payments are made or received in cash in an amount of EUR 10,000 or more”.*

As a result, whether or not AMLD 4 applies to a token issuer may depend on whether a national regulator would regard a sale and purchase of tokens as a “*trade of goods*” within the meaning of that section.

While the concept of “*goods*” is not defined in AMLD 4, it does include a definition of “*property*”.

Property is defined broadly to include:

*“assets of any asset of any kind, whether corporeal or incorporeal, movable or immovable, tangible or intangible, and legal documents or instruments in any form including electronic or digital, evidencing title to or an interest in such asset”.*

A national regulator could potentially take the view that tokens (irrespective of their characteristics) should be regarded as falling within that definition (albeit that such an approach would appear to be at odds with the position taken by the ESAs, outlined

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<sup>50</sup> [https://www.esma.europa.eu/sites/default/files/library/esma50-164-1284\\_joint\\_esas\\_warning\\_on\\_virtual\\_currenciesl.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-164-1284_joint_esas_warning_on_virtual_currenciesl.pdf).



above)<sup>51</sup>. While it is open to a national regulator to reach this conclusion, many token sales won't involve the receipt of "payments in cash in an amount of EUR 10,000 or more", and so will usually nonetheless fall outside the scope of the anti-money laundering requirements set out in AMLD 4. An exception to this would be where tokens are issued in exchange for fiat currency of EUR 10,000 or more, or if multiple transactions were considered to count as one.

AMLD 4 may also apply where a token issuer carries out activities of a financial institution or credit institution, or if the tokens qualify as "*financial instruments*", "*transferable securities*" or "*e-money*". If, for example, a token qualifies as e-money, the issuer could be regarded as a financial institution, and accordingly would be subject to obligations to conduct customer due diligence when entering into a business relationship and/or when entering into a transaction amounting to at least EUR 15,000.

## 4.2 AML REGULATION UNDER AMLD 5

AMLD 5 will widen the scope of the definition of "obliged entities" to include:

- (i) providers engaged in exchange services between virtual currencies and fiat currencies, and
- (ii) custodian wallet providers.

AMLD 5 does not expressly bring crypto-to-crypto exchanges within the scope of the EU AML regime. In its original proposal, the European Commission noted that it regarded its approach of targeting "gatekeepers that control access to virtual currencies" as a proportional attempt to address the risks associated with virtual currencies, while also "preserving" the innovative advances offered by such currencies.

AMLD 5 also designates "custodian wallet providers" as obliged entities for the purposes of the regime. The concept of "custodian wallet provider" is defined in AMLD 5 to mean "an entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer virtual currencies." This definition only appears to capture wallet providers that maintain control (via a private cryptographic key) over

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<sup>51</sup> This interpretation would be somewhat at odds with the statement of the ESAs referred to above in which they note that "virtual currency" is not regulated under the pre-AMLD 5 anti-money laundering framework. "Virtual currency" is defined broadly in AMLD 5 and would cover most token types – see further paragraph 2.3.2. AMLD 5 is focused on virtual currency "gatekeepers" between crypto and fiat currency.



customers' wallets and the assets in it. It does not appear to extend to non-custodian wallets where the user (rather than the provider) holds the private key.

Equally, AMLD 5 does not expressly bring token issuers within the scope of the EU AML regime. That said, it depends on how a particular token sale is structured (in particular, if tokens are issued in exchange for fiat currencies), and how these provisions are ultimately implemented in national law in each Member State. It may be broad enough to encompass certain token issuers.

### *What kind of tokens are within scope?*

"*Virtual currencies*" within the meaning of the Directive are defined as:

- (i) a digital representation of value that is neither issued nor guaranteed by a central bank or a public authority,
- (ii) is not necessarily attached to a legally established currency—and does not possess the legal status of currency or money;
- (iii) but is accepted by natural or legal persons as a means of exchange, and
- (iv) can be transferred, stored and traded electronically.

Given the broad nature of this definition, it is likely that, in practice, most forms of virtual currency and tokens (as we know them today)<sup>52</sup> will fall within the scope of AMLD 5.

This would appear to be in line with the objective of the Directive which states in its recitals that "*the objective of this Directive is to cover all the potential uses of virtual currencies*".

### *What kind of business is not within the scope?*

Even though the scope of AMLD 5 in respect of virtual currencies and tokens is very broad, there are still some cryptoasset activities which are not covered. In fact, by looking at the cryptoassets market, it seems:

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<sup>52</sup> Notable exceptions to this are tokens that solely serve a purpose intrinsic to a network (for example, a token that enables a smart contract or that is required in order to be chosen as validator in PoS-based systems). These tokens, insofar as they are limited to use within network, would not meet the requirement of being "accepted by natural or legal persons as a means of exchange".

- (i) providers of exchange services between cryptoassets and cryptoassets; and
- (ii) providers of financial services for ICOs;

do not appear to be covered by the current scope of AMLD 5.<sup>53</sup>

### 4.3 AML – CONCLUSION

The introduction of AMLD 5 is a helpful development, as it clarifies AML obligations in relation to certain players in the cryptospace.

However, it does not go far enough. AMLD 5 leaves scope for Member States to adopt inconsistent approaches. Certain regulators have already indicated that they plan to go significantly beyond the requirements set out in AMLD 5. For example, the UK has stated this intention<sup>54</sup>, and also plans to “consult” on whether crypto-to-crypto exchanges, as well as non-custodian wallet providers should be brought within the scope of the UK regime.

This is in line with the approach adopted by the Financial Action Task Force (FATF), which recently recommended bringing “*virtual asset service providers*” (including “*exchanges between one or more forms of virtual assets*” as well as those that participate in and provide financial services relating to an issuer’s offer and/or sale of a virtual asset) within the scope of international anti-money laundering requirements<sup>55</sup>.

This goes significantly beyond AMLD 5, which will likely need to be updated to bring the EU position in line with the latest FATF recommendations.

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<sup>53</sup> This reflects the results of the ESMA Advice, p. 36 and the EBA Advice.

<sup>54</sup> <https://www.gov.uk/government/publications/cryptoassets-taskforce>.

<sup>55</sup> <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/regulation-virtual-assets.html>.

## 5. OBLIGATIONS UNDER MIFID

### 5.1 MIFID FINANCIAL INSTRUMENTS

MiFID defines the concept of financial instruments that is then referenced in most other EU regulations on this topic.

The definition is provided in Article 4.15 as well as in Annex 1C and consists of the following instruments:

- transferable securities
- money market instruments
- units in collective investment undertakings
- most derivative contracts
- contracts for differences
- emission allowances.

As soon as an instrument is considered a financial instrument according to these definitions, then EU law imposes numerous requirements and restrictions on businesses originating, dealing and servicing them, including the requirement for most to be authorised.

### 5.2 MIFID AUTHORISATION OF INVESTMENT FIRMS

If an instrument is a Financial Instrument then a large number of activities with respect to that instrument *will require regulatory authorisation*. Firms providing those services are referred to as Investment Firms.

The services that require authorisation of the entity providing it are specified in Article 4 as well as in Annex 1A, including:

- reception, transmission, and execution of trading orders
- portfolio management and investment advice
- underwriting and placement of financial securities
- operating of trading facilities.



*Investment Firms* might also offer ancillary services as defined in Annex 1B, such as:

- safekeeping and other custody and collateral management services
- lending and foreign exchange services, to the extent that it is related to a financial transaction with that particular investment firm
- investment banking advisory services, e.g. on mergers and acquisitions, capital structure, industrial strategy
- investment research and financial analysis.

Investment firms cannot, however, offer only those ancillary services. So, for example, an investment firm can offer custody, but a pure custodian is not an investment firm (and requires a different type of licence).

### 5.3 MIFID CLIENT CLASSIFICATIONS

The obligations under MiFID depend greatly on the type of client served. MiFID recognises three types of investors:

- *Eligible counterparties*  
largely include financial services providers such as investment firms, credit institutions, and insurance companies.<sup>56</sup>  
  
Eligible counterparties are considered sophisticated, and therefore can always opt out of being considered as such, either across the board, or on a transaction-by-transaction basis, and are generally offered the least protections.
- *Professional clients*  
include categories such as entities which are required to be authorised or regulated to operate in the financial markets (e.g. banks, investment firms, insurance companies etc., large companies, public bodies, and other

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<sup>56</sup> Examples include investment firms, credit institutions, insurance companies, UCITS and their management companies, pension funds, other financial institutions authorised or regulated under relevant law, as well as national governments and their corresponding offices including public bodies that deal with public debt at national level, central banks and supranational organisations (Art. 30).

institutional investors whose main activity is to invest in financial instruments).<sup>57</sup> Eligible counterparties are typically also professional clients under this definition. Professional clients can ask to be treated as retail clients.<sup>58</sup>

- *Retail clients* are the rest i.e. those clients who are not professional clients (Art. 4).

## 5.4 TRADING VENUES UNDER MIFID

The MiFID regulations also define the different trading venues where financial instruments can be traded.<sup>59</sup>

*The regulation defines four classes of trading venues:*

1. regulated exchanges,
2. multilateral trading facilities ("MTFs"),
3. organised trading facilities ("OTFs")<sup>60</sup>, and
4. systematic internalisers<sup>61</sup>.

Regulated exchanges, MTFs and OTFs are largely similar in nature, except that exchanges are usually bigger, and more strictly regulated, than MTFs and OTFs. The majority of stock exchanges accessible to the public are Regulated Exchanges.

In the world of traditional securities, MTFs and OTFs usually serve professional counterparties and/or specific market segments. In the cryptoworld, however, it currently seems that the preferred licence for exchanges dealing in security tokens is as an MTF or OTF.

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<sup>57</sup> Examples such as (i) entities which are required to be authorised or regulated to operate in the financial markets (e.g. banks, investment firms, insurance companies etc.), (ii) large companies (balance sheet > €20m; revenues > €40m; equity > €2m), (iii) public bodies at the national or regional level who are involved in market activities because of their responsibilities (including central banks), and (iv) other institutional investors whose main activity is to invest in financial instrument. (Art. 4, Annex 2).

<sup>58</sup> For retail investors, however, this is only possible under specific circumstances. In any event, reclassifications have to be agreed in advance in writing (Art. 30).

<sup>59</sup> See "A Guide to Financial Regulation for Fintech Entrepreneurs" (Stefan Loesch, Wiley 2018). Used with permission.

<sup>60</sup> OTFs are restricted to trading bonds, structured finance products, emission allowances and derivatives, and cannot list shares (Art. 4).

<sup>61</sup> Cf. systematic internalisers (Art. 4). This last one is the odd one out, in that it refers a firm that trades on its own account with clients with the intention on earning the bid/offer spread rather than matching clients who want to trade and earning a fee, i.e. it is a dealer rather than a broker in our earlier nomenclature.

## 5.5 MIFID GENERAL OBLIGATIONS

MiFID imposes numerous obligations on potentially everyone participating in the sale or trading of tokens (including the requirement to be authorised by the relevant regulator) provided that those tokens fall under the MiFID definition of a financial instrument. Reversely, if tokens are not considered financial instruments then none of the obligations under MiFID apply.

Investment firms have a number of general obligations under MiFID, needing to fulfil a number of organisational requirements and also ensure compliance with investor protection rules.

MiFID organisational requirements. Organisational requirements mostly relate to the general duty of running the firm responsibly (Art. 16). There are a number of notable requirements, including:

- Firms that “*manufacture*” financial instruments must have approval and a review process in place (Art. 16.3).<sup>62</sup>
- Distributors and firms recommending those financial instruments must ensure provision of all relevant information (Art. 16.3).
- Extensive record-keeping requirements, including for phone calls and other electronic communications<sup>63</sup> (Art. 16.6-7).
- Keeping client funds segregated (Art. 16.8-9).<sup>64</sup>

MiFID general investor protection rules. There are a number of investor protection rules, some of which recast what has been said earlier regarding the manufacture of financial instruments (Art. D24). For example, financial instruments can only be offered or recommended when it is in the best interest of the client (Art. 24.2), and all marketing communications must always be clearly identifiable as such (Art. 24.3).

MiFID customer information requirements. Before investment advice is provided, firms must already provide certain preliminary information. They must inform their customers about items such as, for example, (i) the independence (or not) of the advice, (ii) whether

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<sup>62</sup> Those processes must include identification of target markets, assessment of the risks to these target markets, and ensuring the instrument's distribution strategy is consistent with reaching these target markets (Art. 16.3).

<sup>63</sup> And regardless of whether those specific communications did lead to a client order or not.

<sup>64</sup> Investment firms must not commingle client funds with their own. Only with the client's express consent can they use on own account a client's financial instruments e.g. for a securities lending transaction (Art. 16.8 – 9).



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the advice is based on a broad or a narrow scan of the market, (iii) suitability assessments, (iv) risk profiles, and (v) associated costs and charges (Art. 24.4, 5).

Investment firms also have numerous restrictions, which are extensive and very detailed. A few examples include restrictions on fees and commissions, competence, alignment of advisors' interest, most favourable execution terms, out-of-court settlement procedures, record-keeping requirements, and rules surrounding the use of tied agents<sup>65</sup> (such as prior public registration).

Depending on context, many of these rules are highly relevant for firms that are involved in security token business. They do however not always tie perfectly into the world of blockchains and cryptoassets, for example because there is no central identity running the token and/or the exchange contract.

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<sup>65</sup> "Tied agent" means a natural or legal person who, under the full and unconditional responsibility of only one investment firm on whose behalf it acts, promotes investment and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or financial instruments, places financial instruments or provides advice to clients or prospective clients in respect of those financial instruments or services (Art. 4).

## 6. OBLIGATIONS UNDER THE MARKET ABUSE REGULATIONS

The high liquidity of tokens traded on crypto exchanges raises the question of whether, and to what extent, the current regulations applying to secondary markets should apply. The Market Abuse Regulations ("MAR") establish regulations for

*"a common regulatory framework on insider dealing, the **unlawful disclosure of insider information and market manipulation (market abuse)** as well as measures to prevent market abuse to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets" (Art. 1 MAR).*

### 6.1 MAR – TRADING FACILITIES

As discussed above, the MiFID and MAR regulations also define the different **trading venues** where financial instruments can be traded.

*The regulations define four classes of trading venues:*

1. regulated exchanges,
2. multilateral trading facilities ("MTFs"),
3. organised trading facilities ("OTFs")<sup>66</sup>, and
4. systematic internalisers<sup>67</sup>.

Tokens are often traded on a number of crypto exchange platforms, which may be based inside or outside of the EU. Interestingly, in some cases, the trading on these platforms even takes place without consent from the token issuer. These platforms could potentially be classified as either MTF or OTF.

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<sup>66</sup> OTFs are restricted to trading bonds, structured finance products, emission allowances and derivatives, and cannot list shares (Art. 4).

<sup>67</sup> Cf systematic internalisers (Art. 4). This last one is the odd one out, in that it refers a firm that trades on its own account with clients with the intention on earning the bid/offer spread rather than matching clients who want to trade and earning a fee, i.e. it is a dealer rather than a broker in our earlier nomenclature.



An OTF is defined<sup>68</sup> as:

*“a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with Title II of this Directive”.*

As OTFs are restricted to trading bonds, structured finance products, emission allowances and derivatives, and cannot list shares, we believe that most crypto exchanges on which such tokens are traded cannot be classified as OTFs within this definition.

An MTF is defined<sup>69</sup> as:

*“a multilateral system operated by an investment firm or a market operator which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with Title II of this Directive”.*

For qualification as an MTF, it is sufficient that financial instruments are traded on that platform.<sup>70</sup>

It is possible that tokens could be classified as financial instruments by virtue of being transferable securities<sup>71</sup>. However, whether a token falls within this category will need to be assessed on a case-by-case basis, taking into account the rights and structure of the token in question.

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<sup>68</sup> OTF is defined under Art. 3 para. 1 No. 8 MAR and Art. 4 para. 1 No. 23 MiFID.

<sup>69</sup> MTF is defined under Art. 3 para. 1 No. 7 MAR and Art. 4 para. 1 No. 22 MiFID.

<sup>70</sup> With regard to the definition of financial instruments, Art. 3 para. 1 No. 1 MAR refers to Art. 4 para. 1 No. 15 MiFID and this further to Annex I Section C MiFID. According to the eleven-item catalogue of this Annex, the term financial instrument includes, in particular, transferable securities. According to Art. 4 para. 1 No. 44 MiFID II, these are classes of securities which are negotiable on the capital market. As an example, Art. 4 para. 1 No. 44 MiFID II lists shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares; bonds or other forms of securitised debt, including depositary receipts in respect of such securities; instruments and other securities which entitle to the purchase or sale of such securities or lead to a cash payment giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

<sup>71</sup> Transferable Securities – as defined by Art. 4 para. 1 No. 44 MiFID II.

As explained earlier, we believe that utility tokens and cryptocurrency tokens would not fall within the definition of transferable securities, and would therefore not be considered financial instruments under MiFID II and MAR.

As a result, an exchange which exclusively lists and trades such tokens should not fall within the scope of the MAR.

On the other hand, platforms on which tokens qualifying as financial instruments are traded are likely to meet the definition of an MTF, and would fall within the scope of the MAR.

## 6.2 MAR – INSIDER TRADING RESTRICTIONS

The MAR also contains insider trading rules as part of the market abuse law. Insider trading is primarily controlled by the prohibition of insider trading under Art. 14 MAR. This is further reinforced by further measures intended to prevent insider trading, such as:

- the ad hoc publicity requirements of Art. 17 MAR,
- the duty to report directors' dealings pursuant to Art. 19 MAR and
- the maintenance of insider lists in accordance with Art. 18 MAR.

When considering the applicability of such measures to tokens it is interesting to note that tokens are currently often sold by very early-stage start-ups looking for capital to finance the development of their proposed product. Such early stage (and often pre-minimum viable product) investments are particularly risky, with a total loss of the investment probably if the project fails.

In such early-stage companies, even minor developments at product level can have significant impacts on the market pricing of their tokens, and could therefore be classified as inside information and therefore should be disclosed to the public. This could risk markets being flooded with unnecessary information on a semi-continual basis that is more confusing than informative.

When assessing whether such information should be disclosed, it is important to consider whether that information *“would be likely to have a significant effect on the price”* (irrespective of the direction in which the price might fluctuate).

Even if, in hindsight, no clear price impact could be detected, provided a reasonable investor would have expected the information to have had an impact, the supervisory authority may still qualify the relevant information as having been inside information.

## 6.3 MAR – EXTENDED TERRITORIAL SCOPE

Unlike MiFID II, the MAR is not limited to the territory of the Member States of the European Union. This is due to the wording of Art. 2 para. 4 MAR which states that the prohibitions and requirements of the regulation apply to all acts and omissions that fall within its scope, whether in the European Union or in a third countries, concerning the instruments referred to in paragraphs 1 and 2.<sup>72</sup>

Due to the differing territorial scope, if electronic trading platforms such as crypto exchanges were to be qualified as MTFs or OTFs, the complex question of where these trading platforms are operated from must also be answered.

This already difficult question becomes even more complex when distributed ledger technologies and smart contracts enable these trading platforms to operate independently of financial institutions or a formal operator (so-called decentralised finance).

There is an urgent need for action on the part of the European legislator to create legal certainty around these points and, in particular, take a view on whether trading platforms such as crypto exchanges qualify as MTFs or OTFs, and if so, under which conditions.

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<sup>72</sup> The MAR only takes into account the legal limits of state sovereignty of the Member States and the European Union and thus indirectly regulates the territorial scope.

Pursuant to Art. 22 s. 3 MAR: “[...] the competent authority shall ensure that the provisions of this Regulation are applied on its territory, regarding all actions carried out on its territory, and actions carried out abroad relating to instruments admitted to trading on a regulated market, for which a request for admission to trading on such market has been made, auctioned on an auction platform or which are traded on an MTF or an OTF or for which a request for admission to trading has been made on an MTF operating within its territory.”





## EXTENDED SCOPE OF THE MAR MARKET MANIPULATION BAN

The provision of Art. 2 para. 2 MAR extends the scope of the Regulation for the provisions on market manipulation in Art. 12 and 15 MAR<sup>73</sup>. These articles also apply to:

- certain spot commodity contracts,
- certain types of financial instruments, such as derivative contracts or derivative instruments for the transfer of credit risk, and
- behaviour in relation to benchmarks.

Since tokens typically do not transfer any credit risks or reflect reference values, they usually do not fall under the second and third bullets above. However, tokens can embody rights of use, copyrights or services and make these values tradable like goods<sup>74</sup>.

In order to avoid risks of market manipulation in secondary token markets, the extension of the scope of MAR should be broadened as the current wording of the provisions is not sufficiently broad to ensure adequate restrictions on market manipulation.

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<sup>73</sup> Pursuant to Art. 2 para. 2 MAR, these Art. 12 and 15 MAR also apply to

- spot commodity contracts which are not wholesale energy products, where the transaction, order or behaviour has or is likely or intended to have an effect on the price or value of a financial instrument referred to in paragraph 1;
- types of financial instruments, including derivative contracts or derivative instruments for the transfer of credit risk, where the transaction, order, bid or behaviour has or is likely to have an effect on the price or value of a spot commodity contract where the price or value depends on the price or value of these financial instruments, and
- behaviour in relation to benchmarks.

<sup>74</sup> Pursuant to Art. 3 par. 1 No. 15 MAR

- “spot commodity contract” means a contract for the supply of a commodity traded on a spot market which is promptly delivered when the transaction is settled and a contract for the supply of a commodity that is not a financial instrument, including physically settled forward contracts” and pursuant to Art. 3 par. 1 No. 14 MAR in connection with Art. 2 para. 1 of Commission Regulation (EC) No 1287/2006/EC.
- Pursuant to Art. 2 (1) of Commission Regulation (EC) No 1287/2006/EC, “commodity” means any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity”. The wording of the definition of goods refers to deliverable material goods and therefore does not include the services, rights of use and copyrights typically embodied in tokens. It refers exclusively to physical objects and energy. In addition, the transactions must have an impact on the price or value of financial instruments falling within the scope of the MAR. This is unlikely for trading in utility tokens, which usually embody services, usage rights and copyrights. This means that the extended scope of application of the MAR is generally not available for this type of token.



## 7. OBLIGATIONS UNDER COMPETITION LAWS AND UNFAIR COMMERCIAL PRACTICES LAWS

European competition law, and in particular, restrictions on unfair commercial practices may apply to all messages and explanations of a token issuer with regard to its business and business model – not only the offer or trade in tokens.

In particular, restrictions on commercial practices would extend to false or misleading information about the main characteristics of a product, its benefits, risks, use, etc. As a result, any deceptive, incomplete and/or untruthful statements by the token issuer about the prospects of success and development of a token in secondary markets could lead to claims of unfair competition.

With respect to EU competition laws, parties must not engage in conduct contrary to competition (antitrust) laws, such as participating in unlawful exchanges of information. For example, competitors must not exchange strategically relevant information such as planned prices, quantities, customers and projects. Infringements can be punished with large fines and claims for damages.

## 8. OBLIGATIONS TO PROVIDE INFORMATION

Tokening offerings have tended towards the use of modern technologies for their communications and promotions – using the internet, social media and chat groups, along with publishing so-called “*White Papers*”.

Whilst there is no specific EU-wide regime regulating the nature of information to be disclosed by a token issuer in the context of a token sale, a token issuer will nonetheless be subject to a range of information disclosure requirements, both at EU and Member State level.

Depending on the nature and classification of the token in question, different information disclosure requirements may apply to token issuers. There may also be differences, for example, depending on whether tokens are regarded as goods, services, digital content or a combination of the three, for national law purposes.

Whilst there are a number of EU Consumer Protection and E-Commerce Directives that may apply to token sales, these do not apply uniformly to token sales across all Member States, with rules varying depending on how the relevant Directives have been implemented into national law (see further in that regard the section containing the Country-by-Country analyses).

Additionally, other national rules may also apply, including civil and company laws such as those with respect to misrepresentation, fraud or other provisions requiring disclosure of necessary information.

These information requirements are important also because if the information is missing, misleading or incorrect, the purchaser may have rights against the token issuer, such as rights to rescind the purchase, to claim compensation, or to have certain clauses deemed abusive and therefore not valid.

For the purposes of this section, we have assumed that the following EU Directives will apply to token sales:

- Information requirements pursuant to the EU Prospectus Regulations
- Information requirements pursuant to the EU Consumer Rights Directives
- Information requirements pursuant to the EU Distance Marketing of Consumer Financial Services Directive
- Information Requirements pursuant to the E-Commerce Directive



## 8.1 EU PROSPECTUS REGULATIONS INFORMATION REQUIREMENTS

The purpose of a Prospectus is to set out minimum required information to potential investors so they may make informed assessments of the offer prior to purchase.

The EU Prospectus Regulation applies to securities offered to the public or admitted to trading on a regulated market located or operating in an EU Member State. If a token qualifies as a *Transferable Security* under MiFID II, and the token issuance involves an “offer to the public”, it will be subject to the prospectus requirements set out in the EU Prospectus Directive<sup>75</sup>, i.e. the issuer is obliged to publish a prospectus in accordance with the applicable national law in conjunction with the provisions of the EU Prospectus Regulation.

This Directive is in the process of being replaced by the EU Prospectus Regulation<sup>76</sup>, which will be fully and directly applicable in all EU Member States for the most parts from 21 July 2019. The EU Prospectus Regulation further requires the Commission to introduce delegating acts dealing with a number of areas, and including annexes setting out minimum details to be published in a securities prospectus.

Exemptions include certain issuances to a very limited numbers of addressees, with large minimum subscriptions or made only to qualified investors. Very few token offerings would be able to use these exemptions. The Prospectus Regulation will include some new exemptions, including for small issuances.

The definition of “securities” refers to the definition of “transferable securities” in MiFID II, with the exception of “money market instruments”<sup>77</sup> (such as deposit certificates and treasury bills) with a maturity of less than 12 months. As a result, payment instruments are outside the scope of the Prospectus Regulation.

As noted earlier, token issuers who are early-stage companies are usually seeking (pre-)seed money to fund the actual development of the product. This situation is not unlike that for equity-based crowdfunding, and the EU Prospectus Regulation brings several welcome new possibilities with respect to equity crowdfunding.

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<sup>75</sup> Directive 2010/73/EU.

<sup>76</sup> Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 replacing and repealing Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 and related measures.

<sup>77</sup> “Money Market Instruments” as defined in Art. 4 para. 1 No. 17 of Directive 2014/65/EC.



The EU Prospectus Regulation further requires the Commission to introduce delegating acts dealing with a number of areas, and includes annexes setting out minimum details to be published in a securities prospectus. Current prospectus annexes requirements are not always fully appropriate to the specific situations of these early-stage token issuers as they presume a longer track record than can be provided by these. The relevant annexes to the Prospectus Regulation are based on traditional financial infrastructure that is not necessarily required in these new blockchain-based environments. For example, in addition to track records, they also require specific information which assume the involvement of financial intermediaries. Whilst blockchain-based tokens can of course be issued and traded on centralised platforms, such platforms can also be decentralised (or there might not be a platform at all), with participants trading directly peer-to-peer. Due to their different technical nature, certain risks involved in purchasing, holding & trading tokens differ from traditional securities managed by multiple intermediaries, and should also be addressed in order to adequately protect consumers, purchasers and investors.

When the European Commission adopts the delegated regulations setting out technical standards as to the content and format of the prospectuses to be published in accordance with the Prospectus Regulation, we recommend that these specific challenges be considered, including the decentralised nature of blockchain technologies whilst remaining technology-neutral in order to address the new risks for consumers and related changes to market infrastructure.

## 8.2 EU CONSUMER RIGHTS DIRECTIVES INFORMATION REQUIREMENTS

The Consumer Rights Directive<sup>78</sup> sets out specific information requirements that businesses must comply with prior to concluding certain types of contracts with consumers.

The Consumer Rights Directive also sets out specific additional information requirements for "*distance contracts*" with consumers.

Distance contracts are contracts in which the business and the consumer predominantly use distance communication for the negotiation and conclusion of a contract. Where token sales are conducted over the internet, token issuers will be subject to these additional requirements.

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<sup>78</sup> Directive 2011/83/EC.

Further details on these requirements are set out at *Appendix A*.

### 8.3 EU DISTANCE MARKETING OF CONSUMER FINANCIAL SERVICES DIRECTIVE INFORMATION REQUIREMENTS

The Distance Marketing of Consumer Financial Services Directive<sup>79</sup> imposes information requirements on service providers that conclude financial services contracts with consumers at a distance. This includes financial services contracts that are concluded over the internet.

The nature and scope of information that businesses are required to provide to consumers under this Directive varies according to the type of service provided.

Further details on these requirements are set out at *Appendix A*.

### 8.4 E-COMMERCE DIRECTIVE INFORMATION REQUIREMENTS

The E-Commerce Directive<sup>80</sup> regulates contracts concluded electronically (so-called “e-commerce contracts”). The E-Commerce Directive contains specific information requirements in relation to e-commerce contracts with consumers.

A summary of the applicable requirements is set out in *Appendix A*.

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<sup>79</sup> Directive 2002/65/EC.

<sup>80</sup> 2000/31/EC.



## 9. OBLIGATIONS UNDER E-MONEY REGULATIONS

### 9.1 E-MONEY LICENSING REQUIREMENTS

Unless an exclusion applies, anyone wishing to conduct the business of *electronic money* ("e-money") issuance within the EU requires a licence from a competent authority in the EU.

If a token qualifies as e-money, then the relevant token issuer will likely be subject to this requirement.

### 9.2 QUALIFICATION AS E-MONEY

The E-Money Directive<sup>81</sup> defines *e-money* as

*"electronically (including magnetically) stored monetary value as represented by a claim against the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in subsection 5 of Article 4 of Directive 2007/64/EC, and which is accepted by a natural or legal person other than the electronic money issuer".*

The European Central Bank (ECB) has previously commented that "*virtual currencies*" are:

*"not scriptural, electronic, digital or virtual forms of a particular currency. They are something else, different from known currencies".*

Accordingly, the ECB has indicated that in the EU "virtual currency is not currently regulated and cannot be regarded as being subject to the (current) Payment Services Directive or the E-Money Directive".<sup>82</sup>

This position was reiterated in a joint opinion issued by the European Banking Authority, ESMA and the European Occupational Pensions and Insurance Authority in February 2018.<sup>83</sup>

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<sup>81</sup> 2009/110/EC.

<sup>82</sup> <https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf>.



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Whilst not adopted uniformly by all regulators across EU member states, these statements from various EU regulators indicate most token sales should fall outside the scope of the E-Money Directive (unless, for example, the tokens are issued in exchange for, and are redeemable for, fiat currency so that the fiat element of the transaction could fall within scope).

Additionally, as a general rule the E-Money Directive should not apply to tokens due to there typically being no “*claim against the issuer*”.

### 9.3 E-MONEY LICENCES FOR PLAYERS HOLDING FIAT BALANCES

The EU e-money licence is often seen as a convenient licence for market participants who wish to hold client funds, but do not want to go through the process of obtaining one of the fuller licences such as that to be an investment firm or financial institution.

It has been a popular licence for players wishing to provide fiat on- or off-ramps, but who otherwise do not engage in regulated business. For example, exchanges only dealing in unregulated tokens and wallets offering the ability to convert from fiat to cryptoassets or vice versa.

The key requirement here is that the client fiat funds must not be commingled with the firm’s funds, but must be held in bankruptcy remote accounts with one or multiple deposit-taking institutions.

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<sup>83</sup> [https://www.esma.europa.eu/sites/default/files/library/esma50-164-1284\\_joint\\_esas\\_warning\\_on\\_virtual\\_currenciesl.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-164-1284_joint_esas_warning_on_virtual_currenciesl.pdf).





## 10. OBLIGATIONS UNDER EU INVESTMENT FUND REGULATIONS

Certain token offerings have features similar to those of a collective investment scheme, and therefore the launch of such token sales may be classified as the establishment of an investment fund under the UCITS and AIFM Directives or other relevant legislation.

### 10.1 OBLIGATIONS UNDER THE UCITS DIRECTIVE

The Undertakings for Collective Investment in Transferable Securities Directive<sup>84</sup> ("*UCITS IV*") is a consolidated EU Directive that allows collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state. EU member states are entitled to issue additional regulatory requirements for the benefit of investors.

The objective of the original UCITS Directive adopted in 1985<sup>85</sup>, was to allow for open-ended funds investing in transferable securities to be subject to the same regulation in every Member State.

If a token sale is classified as a "*collective investment scheme*" within the definition of the UCITS Directive, the UCITS regulations will apply to those token sales.

### 10.2 OBLIGATIONS UNDER AIFMD

The Alternative Investment Fund Managers Directive<sup>86</sup> ("*AIFMD*") is an EU Directive regulating collective investment schemes other than those falling within the definition by the UCITS Directives.

As a result, AIFMD covers hedge funds, private equity, real estate funds, and other "*Alternative Investment Fund Managers*" ("*AIFMs*") located in the EU. The Directive

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<sup>84</sup> Directive 2009/65/EC as amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending UCITS IV as regards depositary functions, remuneration policies and sanctions (UCITS V).

<sup>85</sup> UCITS Directive 85/611/EEC.

<sup>86</sup> Directive 2011/61/EU.



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requires all covered AIFMs to obtain a licence, and imposes various disclosure requirements as a condition of operation.

Certain token offerings have features similar to those of a collective investment scheme, and therefore the launch of such token sales may be classified as the establishment of an investment fund under AIFMD.

Where AIFMD applies, various requirements must be met, including pre-authorisation of the manager of the fund. Pursuant to AIFMD, an alternative investment fund must appoint a registered or a fully authorised AIFM, appoint various services providers (including a depository to take care of the assets of the investment fund), comply with delegation requirements and it cannot be marketed to retail investors.



## APPENDIX A: SUMMARY OF VARIOUS INFORMATION REQUIREMENTS

Information to be disclosed under certain European e-commerce and consumer protection rules:

1. E-Commerce Directive
2. Consumer Rights Directive
3. Directive on Distance Marketing of Consumer Financial Services

### 1. INFORMATION OBLIGATIONS IN ACCORDANCE WITH E-COMMERCE REGULATIONS

The entrepreneur must inform the customer with items such as:

1. the individual technical steps leading to the conclusion of the contract,
2. whether the contract text is stored by the entrepreneur after conclusion of the contract and whether it is accessible to the customer,
3. how the customer can identify and correct input errors before submitting the contract declaration,
4. the languages available for the conclusion of the contract,
5. all relevant codes of conduct to which the operator is subject and the possibility of electronic access to these rules; and
6. delivery restrictions and the various means of payment.

## 2. DUTY TO PROVIDE INFORMATION IN ACCORDANCE WITH CONSUMER PROTECTION REGULATIONS

### DISTANCE CONTRACTS – EXAMPLES OF INFORMATION OBLIGATIONS IN DISTANCE CONTRACTS

The entrepreneur must inform the customer about details including:

1. the essential characteristics of goods and services,
2. his identity, e.g. company name, address, telephone number, fax number and e-mail address as well as the address and identity of the company he works for,
3. where appropriate, the address of the entrepreneur or of the contractor for whom he works, if different from the above address, in the event of complaints,
4. the total price of the goods or services, including all taxes and duties,
5. the total price for open-ended contracts or subscriptions,
6. the duration of the contract or the terms and conditions of termination for open-ended or automatically renewed contracts,
7. any additional costs for the use of means of distance communication used for the conclusion of the contract, if the consumer incurs additional costs as a result,
8. the terms of payment, delivery and performance, the date by which the entrepreneur has to deliver the goods or provide the service and, where appropriate, the procedure of the entrepreneur for processing complaints,
9. the existence of a legal liability claim in the event of defects of goods,
10. the existence and conditions of after-sales services and guarantees, if any,
11. any existing relevant codes of conduct relating to specific business practices or sectors and how to obtain copies of these codes of conduct,
12. where appropriate, the minimum period of commitment entered into by the consumer with the contract,
13. where appropriate, the fact that the trader may require the consumer to lodge a security or other financial security and the conditions for such security or other financial security,
14. where appropriate, the functioning of digital content, including any applicable technical protection measures applicable to such content,

15. significant restrictions on the interoperability and compatibility of digital content with hardware and software, where appropriate, where the operator is or must be aware of such restrictions,
16. where appropriate, that the consumer may benefit from out-of-court redress and redress procedures to which the trader is subject and the conditions of access, and
17. the existence of a right of withdrawal, the conditions, time limits and procedures for the withdrawal and, where appropriate, the costs of the withdrawal and the conditions for the premature expiry of the right of withdrawal.

## FINANCIAL SERVICES – EXAMPLES OF INFORMATION OBLIGATIONS IN CONNECTION WITH FINANCIAL SERVICES

The trader must inform the consumer of details such as:

1. his identity as well as the commercial register and the registration number,
2. the main business activity and the supervisory authority responsible for approval,
3. the identity of the entrepreneur's representative in the Member State where the consumer is domiciled, if such a representative exists, or the identity of a commercial person other than the entrepreneur, if the consumer has business relations with that person, and the capacity in which that person acts vis-à-vis the consumer,
4. his summoned address and the name of the authorised representative if the entrepreneur is a legal person,
5. the essential characteristics of the financial service and information on how the contract is concluded,
6. the total price of the financial service, including all related costs and taxes paid by the entrepreneur, or, if it is not possible to specify a precise price, the basis for calculation so that the consumer can assess the price,
7. any additional costs incurred and the indication of additional taxes and costs which are not paid or invoiced by the entrepreneur,
8. the indication, where appropriate, that the financial service relates to financial instruments which, because of their particular characteristics or the transactions to be carried out, are subject to particular risks or whose price is subject to fluctuations on the financial market which cannot be influenced by the

- entrepreneur, and that income generated in the past is not an indicator of future income,
9. a limitation on the period of validity of the information provided, e.g. the validity of limited tenders, in particular as regards price,
  10. details of payment and performance of the contract,
  11. any specific additional costs for the use of means of distance communication which are incurred for the conclusion of the contract if the consumer incurs additional costs as a result,
  12. the existence or non-existence of a right of withdrawal, the conditions of that right, in particular the name and address of the body to which the withdrawal is addressed and the consequences of the withdrawal, including the amount to be paid for a service already provided,
  13. the minimum duration of the contract in the case of a continuous or recurring service,
  14. the contractual termination conditions, including any contractual penalties,
  15. the Member States of the European Union, the law of which the entrepreneur uses to establish relations with the consumer before the conclusion of the contract,
  16. the contractual clause concerning the applicable law and the competent court,
  17. the languages in which the contract terms and the prior information referred to in this provision are communicated and the languages in which the entrepreneur undertakes to communicate with the consent of the consumer during the term of this contract,
  18. where appropriate, that the consumer may use out-of-court redress and redress procedures to which the trader is subject, and the conditions for access, and
  19. the existence of a guarantee fund or other compensation schemes.

# The Regulation of Tokens in Europe

## Part C: National legal & regulatory frameworks in select European countries

June 2019  
Version 1.0

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Please note that this contribution is a document that will be updated and supplemented over time. The most recent version of this document will be found at [www.thinkblocktank.org](http://www.thinkblocktank.org).

This document does not constitute legal advice. Additionally, this document is the result of a series of thinkBLOCKtank meetings, discussions and debates. The views set out constitute the personal views of the contributors at the time of drafting, and are not necessarily the views of their firms or employers. These discussions and debates continue, and these views may evolve or change over time.

This paper is a joint effort by legal and other professionals from across Europe, inspired by the initial “*Statement on token regulation with a focus on token sales*” by the Finance Working Group of the Blockchain Bundesverband issued in February 2018 and the related extended German version. In order to highlight the differences between EU jurisdictions, the paper has been restructured into (i) an EU section and (ii) various Annexes outlining the applicable legal and regulatory framework in a number of European countries.

This version 1.0 contains thirteen country sections, and will be supplemented with additional jurisdictions over time. Contributors to this version included:

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# PART C

## NATIONAL LEGAL & REGULATORY FRAMEWORKS IN SELECT EUROPEAN COUNTRIES

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### ABOUT THINKBLOCKTANK

thinkBLOCKtank is a Luxembourg based non-profit organisation, bringing together some of the most respected Blockchain and Distributed Ledger Technology experts from more than 15 countries.

The main goal of the association is to provide policy recommendations at an EU and worldwide level which will allow a proper regulated and prosperous ecosystem in regards to Digital Assets.

Our view is that regulatory responses should be clear, but proportionate, taking into the account the enduring imperatives of protecting consumers and maintaining financial stability; but also ensuring that innovation in this space is not stifled by over-regulation and legal complexity.

We are of the view that an EU-wide approach in this area is preferable to a state-by-state regulation. As noted by the European Commission in its 2018 FinTech Action Plan, cryptoassets are a “worldwide phenomenon”. Accordingly, a cohesive and co-ordinated approach at EU level will help providing certainty and facilitating cross-border scaling opportunities.

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### ABOUT THIS PAPER

The aim of this paper is to analyse the legal and regulatory frameworks applicable to token sales in certain jurisdictions in Europe, and to provide recommendations for improvement.

First, we look at the EU regulations in place, then the largest part of this document is taken up by an overview of relevant national legal and regulatory frameworks in a number of individual European jurisdictions.

We intend to update the paper from time to time and to include additional jurisdictions. At initial publication, it includes 13 European country sections: Denmark, England & Wales, France, Germany, Gibraltar, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Poland, Slovenia and Switzerland.

This paper is divided into three parts.

- *Part A* Introduction
- *Part B* Overview of the EU legal and regulatory framework applicable to token sales
- *Part C* Country-by-country analysis for a number of European jurisdictions.

# I. DENMARK

# I. DENMARK

## 1. INTRODUCTION

At this stage, cryptocurrencies and tokens are not covered by any specific regulatory framework in Denmark. Hence, cryptocurrency and other aspects related hereto, such as initial coin offerings (ICOs) or smart contracts, are not necessarily subject to financial regulation, cf. however below. The Danish FSA (in Danish "*Finanstilsynet*") has published very limited guidance in relation to this topic, in total two publications. The below gives a high-level description of the publications made by the Danish FSA.

The first publication was based on EBAs warning to retail investors, and stipulated risks associated with purchase, sale and ownership of cryptocurrencies. In the said warning the Danish FSA emphasized, amongst others, cryptocurrencies' unregulated nature. Further, it has emphasized that cryptocurrency is a form of digital money that, in some cases, can be used as a means of payment which is not guaranteed or regulated by a central bank. The Danish FSA highlighted the extreme volatility, the absence of protection due to the lack of regulation under Danish or EU law, as well as the tendency to misuse crypto currency for criminal purposes.

In addition, the Danish FSA has highlighted that cryptocurrency is currently not subject to financial regulation in Denmark. The Danish FSA stated in a specific case that a company intending to carry out exchange of fiat currency onto cryptocurrency and vice versa, did not require any authorization from the Danish FSA. The main reason for the decision was that the activity could not be considered as issuance of electronic money, provision of payment services, currency exchange, receipt of deposits or securities trading activities. Therefore, the activity was not covered by the financial regulation.

The second publication issued by the Danish FSA regarded initial coin offerings, ICOs. The publication recapitulated ESMA's warning on ICOs. Moreover, the publication mentions other issues in relation hereto containing the following headlines: i) what is an ICO ii) is an ICO regulated by the Danish FSA, iii) how are ICOs carried out, and iv) what are the main risks of investing in ICOs. The publication has been regarded as a follow-up on the regulator's stand in relation to cryptocurrency stipulated in the first publication, cf. above. E.g. the regulator notes that crypto currencies, when solely used as a way of payment, are still not governed by the financial legislation in Denmark. Certain tokens, however, are increasingly recalling financial instruments, so they may potentially be covered by financial legislation. The regulator states that this will depend on a concrete case-by-case assessment.

As a consequence of the lack of a specific regulatory regime for cryptocurrency or tokens in Denmark the assessment of lawfulness of a given activity involving cryptocurrency or tokens is based on an analysis and interpretation of the existing framework regarding related regulation on financial instruments, anti-money laundering, consumer protection and tax etc. In this regard, the Danish FSA is most likely to act in accordance with other EU authorities.

## 2. APPLICATION OF MIFID II<sup>1</sup>, PROSPECTUS REGULATION<sup>2</sup> AND MIFIR<sup>3</sup>

Pursuant to the statement made by the Danish FSA, cryptocurrency is not, in general, classified by any financial regulation, if it is solely used as a way of payment.

Application of any national regulatory regime relating to MiFID II depends on the assessment of whether cryptocurrency or token in questions qualifies as a financial instrument.

A financial instrument is defined by the Danish Act on Capital Markets (in Danish "lov om kapitalmarkeder") implementing parts of MiFID II into Danish law without any significant national measures. The definition of financial instruments is identical with the definition set out in Annex 1, Section C of MiFID II.

The Danish Act on Capital Markets applies to participants and financial instruments on the capital market. Thus, it regulates the capital market and its structure as well as market behaviour. The participants on the capital market are regulated as financial companies and must obtain authorization to commence their business, such as banks, mortgage banks, brokerage companies, investment management companies and insurance companies. The act also regulates businesses that form part of the market organisation, the so-called structural companies, e.g. operators of regulated markets (exchanges), securities exchanges, etc.

Within cryptocurrency there are three key players, which can be covered by the financial regulation in different ways. These are;

- **platform providers** where issuers and investors meet

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<sup>1</sup> DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

<sup>2</sup> REGULATION (EU) 2017/1129 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

<sup>3</sup> REGULATION (EU) No 600/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

- **inventors** of the cryptocurrency/token
- **investors** (retail or professional).

As mentioned in the introductory part certain tokens are increasingly resembling financial instruments, and may therefore potentially be covered by MiFID II related regulation. Neither the Danish FSA or the Danish courts have made any decisions on what types of tokens would be deemed as financial instruments within the meaning of the Danish Act on Capital Markets. Notwithstanding the aforementioned, it is reasonable to assume that in the assessment the Danish FSA would be likely to consider whether the features of the token in question match features of any financial instrument.

In case cryptocurrency or tokens are considered to be financial instruments within the meaning of the Danish Act on Capital Markets, the Danish Financial Business Act (implementing amongst other "MiFID II" and "CRD IV") and certain Executive Orders issued pursuant to the said act will in addition to the Danish Act on Capital Markets will apply. The assessment of application of the relevant legislation onto cryptocurrency or tokens depends first and foremost on the assessment of the activity in relation to cryptocurrency. I.e. it should be considered whether the activity relates to issuance or MiFID II related **investment services** such as offering, portfolio management, investment advice, securities trading or dealing, transmission of orders etc. The emphasis on such assessment to be made on whether the activity is meant to replace the regulated activity in such a way that it in fact mirrors the activity aiming at the same result for the involved parties. In other words, it is not possible to avoid regulation of activities just because part or whole elements are replaced by "synthetic" exposure or derivative tokens or currencies. If a token for instance will receive a specific profit distribution from an issuer it is relevant whether such a participation is **standardised, transferable, tradeable and have an economical aim** as an asset investment. In a recent decision on application of the prospectus regulation (3 October 2018) the Danish FSA stated that participations that grant economical rights over a company's earnings or profit may cause it to be considered a financial instrument if it is also transferable and tradeable.

Even though the Danish FSA refers to "tradeability" in relation to the capital market, it has on earlier occasions stated that "**capital market**" shall be understood in a broad sense and not as a regulated market in MiFID terms. Registration and documentation on a blockchain chosen by the Issuer may in our view constitute a capital market in terms of free transferability and negotiability. As a result, a prospectus obligation may apply depending on the circumstances.

The Danish FSA has however stated that even though cryptocurrencies are not included in the financial regulation tokens will often be or closely resemble financial instruments and the Danish FSA reserves the right to assess these issuances case by case.

Furthermore, if a platform allows investors to trade cryptocurrency/tokens that in the light of financial regulation is considered as a financial instrument, it is relevant to assess whether



such platform qualifies as a regulated market, MTF or OTF pursuant to MiFIR, and as such requires a specific authorization. The type of authorization will depend on the governance of the marketplace and the type of the instruments being traded.

Finally, it is unknown how the Danish FSA will treat cryptocurrency and tokens with regard to EU Prospectus Regulation, which will come into full force from 21 July 2019.

### 3. APPLICATION OF AMLD<sup>4</sup>

The Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism (in Danish "Hvidvaskloven") (the Danish AML Act) transposes the AMLD into Danish Law. Denmark has fully implemented the AMLD into national legislation.

The Danish AML Act aims to reduce undeclared work and thus avoid money laundering. The entities and persons covered by the act must e.g. carry out customer due diligence procedures, where an assessment must be made of the risk in each customer relationship. The entities and persons must disclose relevant risk factors in the customer relationship in order to perform sufficient customer due diligence procedures. The act applies to both companies and individuals – worth mentioning financial institutions, mortgage banks, investment companies, life insurance companies and cross-border pension funds, savings companies, payment service providers and issuers of digital money, insurance brokers when they provide life insurance or other investment-related insurance, lawyers, auditors, real estate agencies, business service providers, currency exchange companies, and gambling companies (especially casinos).

Following the revision of the 4th AMLD, which will come into force during 2019, custodian wallet providers and providers of exchange services between virtual currencies and fiat currencies will become subject to AML regulation and KYC requirements. This might imply that ICO's could potentially fall under the term "providers of exchanging services" and thus become subject to the AML regulation. A further and more accurate assessment shall be based on the final wording of the amendment of the Danish AML Act implementing the directive which is expected to be presented during 2019.

Moreover, the Danish FSA has recently published new guidelines in relation to the Danish AML Act. The guidelines are a helpful tool for entities covered by the Danish AML Act in

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<sup>4</sup> DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

order to ensure compliance with the statutory regime. The guidelines do not explicitly address cryptocurrency or tokens.

#### 4. APPLICATION OF PAYMENT SERVICE DIRECTIVE (PSD II)<sup>5</sup>

The Danish Act on Payments (in Danish “lov om betalinger”) transposes PSD II into Danish Law. Denmark has fully implemented PSD II into national legislation.

The Danish Act on Payments applies to issuers of electronic money and payment service providers and payees. The act provides rules regarding authorization for issuers of electronic money and payment service providers. Further, the act contains rules regarding transparency and information requirements for payment service providers and rights and obligations in relation to the provision and use of payment services.

Both credit institutions and non-credit institutions are allowed to provide payment services or issue e-money in Denmark if necessary authorizations from the Danish FSA are obtained.

In principal the Danish Act on Payments does not cover issuance or offering of cryptocurrencies or tokens.

If a token allows a user to purchase and obtain digital goods and services either from the issuer itself or third-party participants, it could be argued that a token constitutes e-money and thus is covered by the Danish Act on Payments. In a newly published decision the Danish FSA considers whether a specific token issued in an ICO could be deemed as e-money. In this specific case the token did not fall under the definition of the e-money mainly due to the fact that the digital token did not represent a claim against the issuer. This means that the Danish regulator will deem a token as e-money if the features of the token match features of e-money.

The assessment of whether a specific token or activity falls within the scope of the Danish Act on Payments shall be made on a case by case basis.

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<sup>5</sup> DIRECTIVE (EU) 2015/2366 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (Text with EEA relevance).

## "CROWDFUNDING LAW"

In Denmark there is no specific regulatory environment with regard to crowdfunding. In the absence of such regulatory environment the assessment of application of the relevant legislation will depend on the type of the crowdfunding, nature, scope and value of the object being funded as well as the type of the investors. The assessment is closely related to the one described above regarding financial regulation. The current comprehensive financial regulation has not been developed with crowdfunding in mind. Hence, it contains a number of ambiguities.

Crowdfunding emerged in Denmark post the financial crisis, where many had difficulties obtaining traditional funding for their projects. Subsequently, in particular start-ups and SME-companies have seen crowdfunding as an alternative to traditional financing. In Denmark crowd funding is currently not possible if investors receive equity unless relevant prospectus requirements and related financial regulation is met.

## 5. APPLICATION OF AIFMD<sup>6</sup>

The Danish Act on Managers of Alternative Investment Funds (in Danish "*lov om forvaltelse af alternative investeringsfonde m.v.*") transposes the AIFMD into Danish law. Denmark has fully implemented the AIFMD into national legislation.

The Danish AIFM-Act provides rules aimed at Alternative fund managers ("AIFMs") as the subject of regulation and supervision. Hence, alternative investment funds (AIFs) are indirectly subject to the said act and supervision. The act stipulates a requirement for AIFMs to either file for an authorization or to be registered with the Danish FSA. In addition, licensed AIFMs must comply with rules regarding capital, remuneration, management, investment guidelines, annual reports, termination etc. as well as requirements as to how the funds shall be structured and operated.

AIFMs are able to manage alternative investment funds in Denmark provided that necessary authorizations are obtained. The authorization requirement depends on the size of the AIFs in question (either EUR 100 mil or EUR 500 mil, in case the AIFs are not using gearing and no investors in the funds have redemption rights exercisable during a period of at least 5 following the date of initial investment in each fund). In addition, an AIFM needs to be authorized if it offers shares in an AIF to retail investors who invest for less than EUR 100,000.

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<sup>6</sup> DIRECTIVE 2011/61/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

AIFMs which have their registered office in Denmark which are not required to apply for an authorization, due to the size of the AIFs being below the thresholds cf. above, shall be registered with the Danish FSA.

Currently, there is no official position from the regulator's stand whether the AIFMs managing a portfolio consisting of cryptocurrencies are covered by the Danish Act on Managers of Alternative Investment Funds.

Since vast majority of cryptocurrency/tokens are likely to be deemed as alternative assets, AIFMD is relevant. If e.g. a token represents a share of a company that ***pools investments from multiple investors to invest in a selection of projects or assets*** in accordance with a defined investment strategy in order to achieve returns to investors, it may be deemed to be an AIF that needs to be managed by an AIFM pursuant to the Danish AIFM-Act.

## 6. TAX LAW

SKAT (the Danish Tax Authority) has issued a number of statements on virtual and cryptocurrencies, but the issue as to whether tax gains are taxable or not is until now a case-by-case decision.

In 2014 the Danish Tax Authority took the position that an invoice amount cannot be issued in bitcoins, but must be issued in Danish kroner or another recognized currency<sup>7</sup>. Furthermore, SKAT stated that any bitcoin losses cannot be deducted as a cost of doing business when bitcoins are used as a means of payment, and that gains conversely were not taxable.

In 2016 the Authority discussed cryptocurrencies in relation to value-added tax (VAT) and found that cryptocurrencies are exempt from VAT, which is consistent with the decision of the Court of Justice of the European Union in 2015.

The tax authorities in Denmark have also commented on how the mining of bitcoins is to be treated from a VAT tax perspective. The case involved a Danish person who wanted to sell hashing capacity on the electrical grid, an activity that was subject to VAT.

The Danish Tax Council in 2018 declared that losses on sales of bitcoins purchased as an investment are tax deductible and that profits are subject to income taxation. However, the decision leaves discretion as to when an intent of speculation is deemed proven or not.

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<sup>7</sup> Bitcoins, Not Commercially Justified, Considered Special Activity, Apr. 1, 2014. Available at: <https://www.skat.dk/SKAT.aspx?oId=2156173>.

## 7. MARKETING ACT

The Danish Act on Marketing sets the minimum standard for companies' market behaviour, including general rules of market conduct, special forms of marketing, information requirement or consumer protection.

The general purpose of the Act is to ensure that business activities are carried out in an appropriate and reasonable manner with respect to both competitors and other businesses, as well as to consumers and general public interests.

The act applies to private business activity and to public activity to the extent that products and services are offered in the market. Some parts of the act do not apply in case the business is covered by the Danish Financial Business Act. The concept of "product" is defined as "an item or a service, including real estate, rights and duties".

Due to the broad applicability of the Danish Act on Marketing, the act will be relevant for every crypto-based business intending to carry out activities in Denmark.

## 8. CONSUMER PROTECTION AND E-COMMERCE

Danish consumer law provides a close implementation of the EU consumer law and E-commerce. In particular, it is relevant to mention the Danish Act on Consumer Agreements (in Danish "lov om forbrugerftaler") and the Danish Act on E-commerce (in Danish "E-handelsloven").

Whenever an agreement is entered into between a business and a consumer, the consumer provisions of the Danish Act on Consumer Agreements may be applied, for instance provisions relating to the right to withdraw from a transaction or information requirement. Further, cryptocurrency or tokens sold through the Internet must comply with the above, including the corresponding rules for consumer protection when sold to consumers.

## 9. ACT ON CONTRACTS

The Danish Act on Contracts (in Danish "Aftaleloven") provides a set of rules regarding e.g. conclusion of contracts, authority of agents, invalid declarations of intention or special provisions relating consumer contracts. The act is a product of a common Nordic cooperation that resulted in almost identical laws in Denmark, Sweden, Norway, Iceland and Finland.

The act covers every agreement regarding the law of property. Hence, the act will unavoidably be relevant in relation to cryptocurrency/tokens. The act will e.g. cover agreements (subscription declarations) concluded with investors in connection with an ICO. In this regard would be relevant to emphasize the general provision of the act stating the following:

*"A contract may be modified or set aside, in whole or in part, if it would be unreasonable or at variance with the principles of good faith to enforce it. The same applies to other juristic acts.*

*(2) In making a decision under subsection (1) hereof, regard shall be had to the circumstances existing at the time the contract was concluded, the terms of the contract and subsequent circumstances."*

In Danish law there is extensive practice in relation to the provision mentioned above, where an agreement has been set aside due to its unfair nature. However, at this stage, the Danish court has not yet considered a question regarding cryptocurrency/tokens with respect to the general clause. Risks arising from speculative characteristics of cryptocurrency/tokens may therefore constitute circumstances that justify neglect of an agreement.

# II. ENGLAND & WALES

## II. ENGLAND AND WALES

### 1. REGULATION IN THE UNITED KINGDOM

The question of whether and how cryptoassets are regulated under United Kingdom law, as it applies in England and Wales, turns primarily on whether activities carried on in relation to those cryptoassets are regulated under the UK's financial services and markets regime.

In the UK, the Financial Services and Markets Act 2000 ('FSMA') makes it a criminal offence for a person to carry on a '*regulated activity*' by way of business unless that person is an 'authorised person' or exempt because, for example, the person is a public body such as the Bank of England – the '*General Prohibition*'.<sup>8</sup> The list and description of regulated activities, such as dealing as dealing in investments as agent, and the '*specified investments*', such as shares, in respect of which a person carries on regulated activities is set out in secondary legislation made under the Act.<sup>9</sup> The most usual way of becoming an 'authorised person' is through an application to the Prudential Regulation Authority ('PRA'), responsible for authorising banks, large investment banks and insurance companies or the Financial Conduct Authority ('FCA'), responsible for authorising all other financial services firms under Part 4A of the FSMA.<sup>10</sup>

In addition to setting out the framework for regulating financial services in the UK, FSMA also deals with financial markets and amongst the prohibitions and restrictions, it makes it a criminal offence for a person to offer to the public or deal in transferable securities, such as shares, without a prospectus approved by the FCA in its capacity as the UK Listing Authority.<sup>11</sup>

The General Prohibition (together with the Financial Promotion Restriction) and the Part VI Restrictions are the most relevant in determining whether activities carried on in connection

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<sup>8</sup> See the FSMA, section 19 and the FSMA (Exemption) Order 2001 (as amended). FSMA, s 19 operates alongside the restriction on 'financial promotion' in FSMA, s 21. This makes it a criminal offence for a person, in the course of business, to communicate an invitation or inducement to engage in investment activity unless an authorised person makes or approves that communication – the '*Financial Promotion Restriction*'.

<sup>9</sup> See the FSMA (Regulated Activities) Order 2001 (as amended) ('RAO') which also sets out various exclusions, such as that for trustees and personal representatives.

<sup>10</sup> At the date of writing, the other type of authorised person includes a person exercising '*passport rights*' under one of the European Union ('EU') '*Single Market Directives*'. See FSMA, section 39 and Sch 3. This is likely to change after the UK leaves the EU.

<sup>11</sup> See the FSMA, s 85 and Part VI, more generally, which sets out other restrictions on and requirements on the issuers of transferable securities – the '*Part VI Restrictions*'. FSMA s 86 sets out various exclusions from this prohibition, including a less than 150 persons private placement exclusion.



with cryptoassets are regulated. As discussed below, these questions are, in turn, determined by how cryptoassets are classified under UK law because, if an activity is not carried on in connection with a 'specified investment' and/or 'transferable security' it will not be a 'regulated activity' and requirements, such as that for an approved prospectus, will apply in connection with that activity.<sup>12</sup>

It should be noted that, like many UK laws and regulations and regulatory rules, the General Prohibition and Part VI restrictions help give effect to the EU Single Market Directives, such as the Markets in Financial Instruments Directive 2014/65/EU (MiFID II) and Prospectus Directive 2003/71/EC, respectively, as supplemented by EU regulations, such as the Market Abuse Regulation 506/2014/EU and Central Securities Depositories Regulation 909/2014/EU, which have direct force in the UK. The provisions will continue in force, through on-shoring legislation, in the event of the UK leaving the EU.<sup>13</sup>

Although our analysis below focusses on the regulatory treatment of cryptoassets, and more particularly, 'tokens', services may be provided by using blockchain technology, for example to bring transparency to supply chains, without the use of a 'token'. Where this is the case, the use of blockchain does not alter the legal and regulatory treatment of the relevant business, as UK law generally takes a technology neutral approach.

Further, a single understanding of the term 'token' may be misleading insofar as it denotes an the existence of an asset itself in a distributed ledger. Where tokens are intangible, non-physical assets that derive their value from the distributed ledger technology ('DLT') platform, e.g. Bitcoin, this is less of an issue. Where, however, tokens represent tangible and/or financial assets that exist elsewhere, e.g. shares held in a company register, this separately existing thing and the effective legal recognition and protection of that separately existing thing becomes important. This distinction, in turn, reflects on the regulatory treatment of tokens, i.e. where a token represents a specified investment, this results in that token being treated as or as if it is a specified investment.

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<sup>12</sup> FCA Feedback Statement on Distributed Ledger Technology (December 2017). Available at: <https://www.fca.org.uk/publications/feedback-statements/fs17-4-distributed-ledger-technology>.

<sup>13</sup> See the EU (Withdrawal Act) 2018 and secondary legislation, such as the Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018 (2018/1403).

## 2. CLASSIFICATION OF TOKENS

The HM Treasury, the FCA and the Bank of England have categorised cryptoassets into three types of tokens (the ‘Classification’), set out below.<sup>14</sup>

Building on the Classification, the FCA published draft guidance<sup>15</sup>, with the purpose of clarifying the FCA’s expectations for firms carrying on cryptoasset activities within the UK, and to enable firms to understand whether certain tokens, as cryptoassets, fall within the regulatory perimeter. The regulatory treatment of tokens, therefore, is contingent on their functionality. In taking this approach, the FCA is focussed on addressing potential harm to consumers, market integrity and financial crime. The FCA’s draft guidance helps sets the Classification in context:

- (i) Security tokens – tokens that meet the definition of ‘specified investment’ as set out in the RAO and possibly also ‘financial instruments’ within the meaning of MiFID II. Security tokens include tokens that grant holders some, or all, of the rights conferred on shareholders or debt-holders, as well as those tokens that give rights to other tokens that are themselves Specified Investments.
- (ii) Exchange tokens – which are often referred to as ‘cryptocurrencies’ such as Bitcoin, Litecoin and equivalents. They utilise a DLT platform and are not issued or backed by a central bank or other central body. They do not provide the types of rights or access provided by security or utility tokens, including rights on other assets. Instead, they are used as a means of exchange or for the purpose of investment.
- (iii) Utility tokens – which can be redeemed for access to a specific product or service that is typically provided using a DLT platform.

Although this is a slightly different approach to the classification system proposed by European Securities and Markets Authority (‘ESMA’)<sup>16</sup> and the European Banking Authority (‘EBA’)<sup>17</sup>, there is a large degree of overlap, in particular:

- (i) The EBA/ESMA ‘Investment Tokens’ are most similar to the FCA’s ‘Security Tokens’, however whereas the EBA/ESMA focus on whether the token provides

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<sup>14</sup> Cryptoassets Taskforce: final report. Available at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752070/cryptoassets\\_taskforce\\_final\\_report\\_final\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf).

<sup>15</sup> <https://www.fca.org.uk/publication/consultation/cp19-03.pdf>.

<sup>16</sup> ESMA’s Advice on Initial Coin Offerings and Crypto-Assets (9 January 2019).

<sup>17</sup> EBA’s Report with advice for the European Commission: Crypto-assets.

rights, the FCA focuses on whether these have the same characteristics as a Specified Investment or a Financial Instrument.

- (ii) The EBA/ESMA 'Payment Token' is defined in a very similar way to the FCA's 'Exchange Token', and this token type and all of the authorities recognise these tokens as providing a means of exchange.
- (iii) All three authorities refer to 'Utility Tokens', which are commonly agreed as being tokens which enable access to a product or service.

### 3. SECURITY TOKENS

Security tokens are those which meet the definition of a Specified Investment in the RAO, and possibly also a Financial Instrument under MiFID II. For example, these tokens have characteristics which mean they are the same as or akin to traditional instruments like shares, debentures or units in a collective investment scheme. A full list of 'specified investments' is set out in the RAO, however the most common ones relevant to tokenised business are:

- (i) shares;
- (ii) bonds, debentures, certificates of deposit, and other instruments creating or acknowledging indebtedness;
- (iii) warrants and other instruments giving entitlements to investments in shares, bonds, debentures, certificates of deposit, and other instruments creating or acknowledging indebtedness;
- (iv) certificates representing certain securities: that is, certificates or other instruments that confer contractual or property rights in respect of certain types of securities held by another person and the transfer of which may be effected without the consent of that other person; and
- (v) units in a collective investment scheme.<sup>18</sup>

As a general rule of thumb, security tokens are relevant, therefore, when a title to a specified investment is recorded on the blockchain – and, since this is simply another way of recording ownership of a specified investment, the rules and requirements relating to their marketing and other activities carried on in connection with them. For example, if a token represents rights to a share, then it will be subject to the relevant requirements applicable to shares or certificates, depending on how it is described.

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<sup>18</sup> The FCA also sets out the full list and gives guidance in The Perimeter Guidance Manual. Available at: <https://www.handbook.fca.org.uk/handbook/PERG/2/6.html>.

Some aspects of security token represent particular challenges, and so are worth considering in greater detail:

### 3.1 UNITS IN A COLLECTIVE INVESTMENT SCHEME

The definition of a collective investment scheme is broad, generally encompassing any arrangements which:

- pools investment/profits from which payments are to be made;
- the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the investment or sums paid out of such profits or income; and
- where the participants do not have day-to-day control over the management of the investment and contributions of the participants.

Care is therefore needed when selling tokens which give an investment return as rules and restrictions on collective investment schemes will apply.<sup>19</sup>

### 3.2 TRANSFERABLE SECURITIES

The definition of 'transferable securities' links back to MiFID II and refers to 'those classes of securities which are negotiable on the capital market, with the exception of instruments of payment'. Tokens falling within this definition, therefore, are subject to the prospectus, disclosure and market abuse regimes, in the same way and to the same extent as the security which they represent.

## 4. EXCHANGE TOKENS

Although they can be used in a way that is functionally similar to fiat money, exchange tokens are not recognised as legal tender in the UK. The value of these tokens can be volatile, and as such they can be bought as an investment purposes, however this does not in itself mean that they are regulated, and indeed the FCA's view is that these tokens will tend not to be regulated.

In the future, although there are not currently indications that exchange tokens will become regulated, they will fall within the scope of the Fifth Anti-Money Laundering Directive, which

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<sup>19</sup> The rules implementing the Alternative Investment Fund Managers Directive 2011/61/EU and the UCITS Directive 2009/65/EC.

will enter into UK law before the end of 2019, which the FCA has indicated will be implemented if the UK leaves the EU. The scope of this directive will cover all tokens in relation to the following activities:

- exchange between cryptoassets and fiat currencies
- exchange between one or more other forms of cryptoassets
- transfer of cryptoassets
- safekeeping or administration of cryptoassets or instruments enabling control over cryptoassets
- participation in and provision of financial services related to an issuer's offer and/or
- sale of a cryptoasset.

## 5. UTILITY TOKENS AND ELECTRONIC MONEY ('E-MONEY')

Although the FCA acknowledges that utility tokens may be traded on crypto-exchanges like exchange tokens, the FCA are likened more to vouchers.<sup>20</sup> They are not generally regulated unless they meet the definition of e-money.<sup>21</sup>

E-money is electronically stored monetary value as represented by a claim on the electronic money issuer which is:

- issued on receipt of funds for the purpose of making payment transactions
- accepted by a person other than the e-money issuer
- not subject to an exemption

Whereas the Payment Services Regulations 2017 generally apply to 'cash', and hence are relevant only to the extent that blockchain is used to facilitate a fiat movement of value, the definition of e-money may encompass the token itself. Most commonly, therefore a token which has a 1:1 value ratio to fiat currency is likely to constitute e-money. Tokens which are used to store value but do not represent fiat money are, therefore, not regulated as e-money.

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<sup>20</sup> Splitting tokens out this way is also the approach taken by other functional classification systems, see e.g. Ledger, 'Developing a Cryptocurrency Assessment Framework: Function over Form', Andrew Burnie, James Burnie, Andrew Henderson: <https://ledgerjournal.org/ojs/index.php/ledger/article/view/121>.

<sup>21</sup> See further Andrew Henderson and James Burnie 'The Cryptoasset Taskforce: More Breadth Required?' (2019), Butterworths Journal of International Banking and Financial Law 101.

## 6. SPECIFIED INVESTMENTS WHICH DERIVE VALUE FROM CRYPTOASSETS

As well as tokens being themselves treated as designated investments or financial instruments, designated investments or financial instruments may derive their value from cryptoassets. The most common example of this is a derivative, such as a future, which has a token as its reference asset. The fact that the token may not have the characteristics of a specified investment or financial instrument should not render the derivative unregulated.

Derivatives which reference cryptoassets have been a particular area of regulatory focus, due to their perceived high risk nature. The FCA has stated that it will consult on a potential prohibition of the sale to retail consumers of derivatives referencing certain types of cryptoassets (for example, exchange tokens), including CFDs, options, futures and transferable securities.<sup>22</sup>

## 7. WHERE THE REGULATION IS NOT CLEAR

Although the FCA has put forward guidance regarding the treatment of cryptoassets under UK law, it recognises that, given the nascent nature of this technology, there will still be areas of a lack of clarity. As part, therefore, of its obligation to promote competition in the UK, the FCA has put in place mechanisms to assist firms seeking clarity on the regulatory treatment of their products and services, and in particular provides a dedicated contact for innovator businesses that are considering applying for authorisation or a variation of permission, need support when doing so<sup>23</sup>, as well as a regulatory sandbox which allows businesses to test with real consumers innovative propositions in the market.<sup>24</sup>

## 8. APPLICATION OF GENERAL LAW

There is sometimes a misconception that, because a token is classified as 'unregulated', this might somehow mean that there are no legal obligations which apply to them. We set out below some of the considerations which still apply to unregulated tokens.

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<sup>22</sup> Paragraph 2.36, FCA Guidance on Cryptoassets CP 19/3. Available at: <https://www.fca.org.uk/publication/consultation/cp19-03.pdf>.

<sup>23</sup> <https://www.fca.org.uk/firms/innovate-innovation-hub/request-support>.

<sup>24</sup> <https://www.fca.org.uk/firms/regulatory-sandbox>.

## 8.1 COMMON LAW INFORMATION OBLIGATIONS

English common law is separate from the civil systems present in continental Europe in that there is no general obligation of good faith between contracting parties. This position reflects the long held belief within English law that the individual is sovereign and that everyone must be free to contract in a manner that they see fit. As stated by Lord Atkin: '*the failure to disclose a material fact which might influence the mind of a prudent contractor does not give the right to avoid the contract*'<sup>25</sup>. Whilst there are some exceptions such as fiduciary relationships<sup>26</sup> or insurance contracts, such exceptions are unlikely to apply in the majority of situations when considering the provision of tokens.

In addition to the above, there is an offence of misrepresentation which is an amalgam of common law, equity and statute<sup>27</sup>. Whilst this places an obligation on contracting parties not to make false or misleading statements, silence will not usually of itself amount to a misrepresentation.

## 8.2 STATUTORY INFORMATION OBLIGATIONS

As there is no common law duty to disclose information it is necessary to review whether tokens are likely to fall within one of the legislative regimes which provide exceptions to this rule. In order for such legislation to apply tokens would have to fall within one of the following classifications:

### TOKENS AS PRODUCTS OR GOODS

A number of regulations which could potentially create information obligations in relation to the provision of tokens such as the E-commerce Regulations<sup>28</sup> and the Consumer Protection Regulations<sup>29</sup>, only apply to the provision of goods or services. As it is questionable whether the sale of tokens would be deemed a service they would need to fall within the category of goods which are defined as '*any tangible moveable items*'.<sup>30</sup> Based on recent case law it seems doubtful that such a categorisation would apply.

For example, in the matter of *The Software incubator Limited v Computer Associates UK Limited*, which concerned the question of whether software (not contained on a medium)

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<sup>25</sup> Bell v Lever Bros [1932] AC 161, HL.

<sup>26</sup> Banque Keyser Ullmann SA v Skandia [1990] 1QB 665.

<sup>27</sup> Misrepresentation Act 1967.

<sup>28</sup> Electronic Commerce (EC Directive) Regulations 2002.

<sup>29</sup> Consumer Protection from Unfair Trading Regulations 2008.

<sup>30</sup> Consumer Rights Act 2015 Part 1 Section 5.

could correctly be classed as a 'good' for the purposes of the agency regulations<sup>31</sup>, the Court of Appeal decided in the negative.<sup>32</sup> Based on the restrictive interpretation taken in this instance it seems unlikely that the courts would be willing to expand the definition of goods to include tokens. Indeed, it was the view of the court that it was the role of the government to expand the scope of legislation where technological advances demand it, as they had done with the introduction of the concept of 'digital content' within the Consumer Rights Act 2015 ('CRA').

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## TOKENS AS DIGITAL CONTENT

Although it seems unlikely that tokens will be classed as goods/products under English law, there is a possibility they could fall within the definition of digital content. Such a classification would be significant as it would bring tokens within the scope of the Consumer Contracts Regulations ('CCR')<sup>33</sup> and the CRA, which both require substantial pre-contract information to be provided.

Under both the CCR and the CRA digital content is defined as being '*data which are produced and supplied in digital form*'.<sup>34</sup> This is indeed a wide definition and has led to some suggestions that the CRA could indeed apply to tokens. Despite this, whilst the Explanatory Notes make explicit reference to '*cryptocurrencies*' and '*tokens*' as means to purchase digital content<sup>35</sup>, such terms are not included when examples are provided for what was intended to fall within this definition. When viewed in conjunction with the restrictive approach taken by the courts as outlined above, this places doubt on whether tokens are likely to be classed as digital content without an intervention from the government to assert the contrary.

Whilst tokens may not fall within the definition of digital content, there would be an argument to say that utility tokens could be treated under the CRA in the same manner as virtual currencies (which are not presently defined). This would mean that, whilst the information requirements would not apply to the utility tokens themselves, they would apply to items purchased with the utility tokens. If a refund was required the trader would be required to refund the money originally paid for the tokens.<sup>36</sup> This is in contrast to situations where the consumer uses Cryptocurrency Tokens to pay, in which case the trader must make any repayments using the same.<sup>37</sup>

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<sup>31</sup> Commercial Agents (Council Directive) Regulations 1993.

<sup>32</sup> Computer Associates UK Ltd v The Software Incubator Ltd [2018] EWCA Civ 518.

<sup>33</sup> Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013.

<sup>34</sup> CCR Part 1, 5 and CRA Part 1, 2.

<sup>35</sup> Consumer Rights Act 2015 Explanatory Notes Section 44.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.



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## TREATMENT OF TOKENS UNDER THE FINANCIAL SERVICES (DISTANCE MARKETING) REGULATIONS

Under the Financial Services Regulations<sup>38</sup> a number of information requirements (as set out in appendix A) will apply where a 'financial service' is being provided. A financial service is defined as being '*any service of a banking, credit, insurance, personal pension, investment or payment nature*'. Due to the almost limitless potential uses for tokens and blockchain technology it seems likely that in some instances this regulation and the related information requirements will be applicable.

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<sup>38</sup> The Financial Services (Distance Marketing) Regulations 2004.

# III. FRANCE

## III. FRANCE

### 1. CORPORATE ASPECTS – INTRODUCTION

As stated by Bruno Le Maire, French Minister for the Economy and Finance, France is planning to become a major cryptoasset centre. Such, by proposing an *ad hoc* legislative framework enabling companies initiating Initial Coin Offerings (“ICOs”) in France to demonstrate their seriousness to potential investors. To date, legislature and regulatory bodies have taken a pragmatic approach to support safe ICOs in France. In order to tackle the diversity and complexity of ICOs, this approach is reflected in the legislation adopted by the Parliament on April 11, 2018 (hereinafter, the “**Pacte Law**”) which prioritizes a substance over form approach in the qualification and treatment of tokens.

It is worth mentioning that France was a pioneer in integrating blockchain technologies into the French legal framework.

As early as April 28, 2016, Order No. 2016-520 initiated the possibility of registering saving bonds in a “*shared electronic device*”. The term “*shared electronic recording device*” is currently undefined and could therefore include any kind of blockchain.

On December 8, 2017, Order No. 2017-1674 (hereinafter the “**Blockchain Order**”) allowed companies in France to keep track of their shares with the blockchain instead of with traditional paper registers. The Blockchain Order also provides that the blockchain may be used as a register for (i) debt securities (such as bonds, commercial papers and medium-term notes), (ii) shares of collective investment undertakings (not involving the listing on regulated markets), (iii) unlisted equity securities issued by joint stock companies – or financial securities that are not admitted to the operations of a central depository or delivered in a settlement and delivery system for financial instruments (wording from draft Article L.211-3-1 of the Monetary and Financial Code, resulting from the draft ordinance).

On December 24, 2018, the application decree of the Blockchain Order came into force setting minimum guarantees which, “*may be reinforced by the participants themselves or by supervisors, if the specific constraints of certain markets justify it*”, for the safety and authentication of, and the access to the blockchain described in the Blockchain Order.

This Note begins by addressing the steps taken by the French Financial Market Authority (*Autorité des marchés financiers* (hereinafter the “**AMF**”)) with its Universal Node to ICO’s Research & Network Program (hereinafter “**UNICORN**”). It shall then introduce the Pacte Law and its notable implications on ICOs, such as the visa mechanism. Finally, it will discuss various French tax and accounting aspects related to ICOs.

## 2. AMF'S TYPOLOGY

The AMF performed a 2-month consultation between October 26, 2017 and December 22, 2017 to meet 15 undertakings that had already completed an ICO in France or were intending to do so. The AMF furthered its analysis with foreign ICOs open to French investors.<sup>39</sup>

Although the AMF's UNICORN program recognized that tokens can in practice present many different technical features that may fall under various categories, it has identified two broad categories: (2.1) utility tokens and (2.2) security tokens that offer political or financial rights to their holders.<sup>40</sup>

### 2.1 UTILITY TOKENS

According to the AMF, utility tokens are: "tokens that grant a right of use to their holder allowing them to use the technology and/or services distributed by the ICO promoter." The AMF compares utility tokens to pre-existing marketing methods from the retail sector, such as loyalty cards, and rewards offered by other sectors, such as transportation. The AMF considers utility tokens to be between crowdfunding and captive marketing and therefore capable of enabling brands to locking their clients into the issuer eco system of their products and services.

### 2.2 SECURITY TOKENS

The second type of tokens identified by the AMF are security tokens, which grant their holder financial or voting rights. According to the AMF, such tokens represent a minority of tokens issued in the context of ICOs, and depending on the applicable law, security tokens can qualify as financial instruments. This Note will further address security tokens' legal qualification below.

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<sup>39</sup> Autorité des marchés financiers, Summary of responses to the public consultation on Initial Coin Offerings (ICO), 22.02.2018, p. 1.

<sup>40</sup> Autorité des marchés financiers, Summary of responses to the public consultation on Initial Coin Offerings (ICO), 22.02.2018, p. 3.

### 3. LEGAL QUALIFICATION OF ICOS AND TOKENS IN THE FRENCH LEGAL FRAMEWORK

The AMF UNICORN analyzed ICOs with regard to pre-existing legal qualifications: (3.1) financial instruments, (3.2) miscellaneous assets, (3.3) derivatives, (3.4) crowdfunding, and (3.5) payment services.

#### 3.1 FINANCIAL INSTRUMENTS

Article L.211-1 of the French Monetary and Financial Code sets forth the definition of financial instruments, which includes both financial securities and financial contracts. Financial securities, including transferable securities, are divided into three categories: (i) equity securities issued by joint-stock companies, (ii) debt securities, and (iii) units or shares in undertakings for collective investment. In the context of ICOs, a case-by-case analysis of the rights conferred by the token should be carried out to determine whether it may fall into one of these categories of financial instruments.

##### *EQUITY SECURITIES ISSUED BY JOINT-STOCK COMPANIES*

Equity securities grant their holders political rights (e.g. voting and information rights) and financial rights (e.g. rights to dividends and liquidation bonuses), usually determined based on the ownership interest realized in the form of share capital in a joint-stock company. This qualification could apply to security tokens, but based on ICOs already completed in France or analysed by the AMF, tokens rarely meet the standard features associated with equity securities.

##### *DEBT SECURITIES*

Debt securities represent a claim against the legal entity or securitization fund that issues it. Utility tokens are characterized by the ICO initiator's commitment to providing the right to service or technology. Therefore, utility tokens grant their holder a "non-pecuniary claim". Based on a classical interpretation (held by the AMF), a claim implies a "pecuniary debt", which means that, tokens without such a pecuniary debt will not qualify as debt securities.

Nevertheless, it is worth noting that part of French doctrine considers that, because there is no legal definition of "debt", debt securities could also include non-pecuniary debts and therefore qualify as "sui generis" debt securities.

##### *COLLECTIVE INVESTMENTS*

Tokens cannot qualify as units or shares in a collective investment because ICOs are (i) intended to finance a specific commercial or industrial project (and typically not to manage a

portfolio of financial instruments and deposits on behalf of investors), and are (ii) directed towards several potential investors and subscribers (and not towards a single person).

However, based on the AMF's current analysis of ICOs that took place in France, tokens should not qualify as financial instruments; therefore, ICOs should not fall within the scope of current legislation governing public offerings of financial instruments. However, the AMF also considers that if tokens issued in the context of an ICO present rights similar to those of a financial instrument, then they should be subject to the current legislation applicable to that financial instrument.<sup>41</sup>

### 3.2 MISCELLANEOUS ASSETS

According to Article L.550-1 of the French Monetary and Financial Code, transactions with miscellaneous assets may consist in the acquisition of rights over "*movable or immovable property where purchasers do not themselves manage it or where the contract offers a right of repossession or exchange and the revaluation of the capital invested*". This would be any transaction that might be appropriate and that has some economic utility to allow the circulation of the property.

The AMF considers that issuers of tokens may in some cases be related to intermediaries of miscellaneous assets. It is possible to distinguish two regimes, (i) the "*intermediary in miscellaneous assets regime 1*" that applies if the purchaser of assets does not manage the assets or if the sale contract offers the option of redemption or exchange and revaluation of its invested capital, and (ii) the "*intermediary in miscellaneous assets regime 2*" that applies if the intermediary offers a direct financial return or an indirect return with similar economic effect.

The AMF has initiated legal proceedings against platforms under the intermediary in miscellaneous assets regime 2 and is keeping a black list of websites identified as not compliant with this regulation. However, the AMF considers that its powers in this area are too limited and is planning to extend its jurisdiction to miscellaneous assets. The AMF has acknowledged that this approach would have drawbacks, as it does not encompass all offers of cryptoassets. Moreover, this procedure is limited to France and therefore would be difficult to export at the European level or worldwide.<sup>42</sup>

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<sup>41</sup> Summary of responses to the public consultation on Initial Coin Offerings (ICO). Autorité des marchés financiers. 22.02.2018, p. 7.

<sup>42</sup> Summary of responses to the public consultation on Initial Coin Offerings (ICO). Autorité des marchés financiers. 22.02.2018, p. 9.

### 3.3 DERIVATIVES

Articles L.211-1 and D.211-1 A of the French Monetary and Financial Code do not define derivatives, but instead restates the non-exhaustive list of derivatives set forth in the EU MiFID II Directive. Based on this list, derivatives are financial contracts (also referred to as “*financial futures*”) linked to the fluctuation in the price of an underlying asset or assets.

Part of the French doctrine emphasizes that such qualification could apply, in particular, to community tokens or asset tokens as their value/right is based on one or more underlying asset(s).

However, such qualification of derivatives could only apply if a particular token could, based on its functionality, fall within one of the categories of derivatives identified in the list set forth in Article D.211-1 A of the French Monetary and Financial Code.<sup>43</sup>

### 3.4 CROWDFUNDING

Order No. 2014-559 of May 30, 2014 on participatory financing sets forth rules applicable to crowdfunding platforms and crowdfunding advisers. Based on French regulation, crowdfunding operations (i) involve financial instruments or “*minibonds*” (i.e. securities pledged by a company in exchange for credit), (ii) give rise to investment advice, and (iii) are carried out on websites that meet certain regulatory criteria or are reserved for qualified investors or a restricted group of investors.

Some commentators consider that as the ICO initiators approach the internet community via an internet platform in order to obtain funds to finance their project, ICOs could qualify as a new type of crowdfunding.

However, as tokens generally do not have the above- standard features of crowdfunding, the AMF considers that ICO initiators should not be considered crowdfunding advisers or investment service providers (as they do not provide advice, select or present the projects to be financed and do not offer investments in financial instruments) and therefore that the current French regulation on crowdfunding is unlikely to apply to ICOs.<sup>44</sup>

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<sup>43</sup> Summary of responses to the public consultation on Initial Coin Offerings (ICO). Autorité des marchés financiers. 22.02.2018, p. 9.

<sup>44</sup> Summary of responses to the public consultation on Initial Coin Offerings (ICO). Autorité des marchés financiers. 22.02.2018, p. 11.

### 3.5 PAYMENT SERVICES

Means of payments, electronic money and payment services are defined by the French Monetary and Financial Code (in Articles L.311-3, L.314-1 and L.315-1, respectively). Payment services may in particular qualify as a service that allows (i) operations for managing a payment account, (ii) money transmission services or (iii) transfers, including standing orders.

Qualification as “*means of payments*”, “*electronic money*” or “*payment services*” could particularly apply to currency tokens, it being specified that in such instances, ICOs would be subject to regulations applicable to payment services. Certain ICOs could be exempt from obtaining prior authorization of the Prudential Supervision and Resolution Authority (*Autorité de contrôle prudentiel et de résolution* (ACPR)) as a payment institution or an electronic money institution, as such exemption applies to “*means of payments*” or “*electronic money*” used for the acquisition of non-financial goods or services or used on a limited network of acceptors.

However, some practitioners<sup>45</sup> consider that currency tokens cannot qualify as “*means of payments*” or “*electronic money*” even though such tokens could be used as a means of payment in a transaction, as these tokens (i) do not involve receipt of funds (and are therefore not representative of a monetary claim) and (ii) are issued to a restricted number of beneficiaries (tokens holders).<sup>46</sup> But the exchange of currencies for cryptocurrency can be qualified as a payment service within the meaning of the European Payment Services Directive.

To conclude, it has proven difficult to apply an existing French legal framework and a single legal qualification to ICOs and tokens due to the broad diversity of tokens’ functionalities.

Therefore, a case-by-case approach is the most sensible approach to apply a legal qualification in line with the type of rights conferred to tokens in a particular ICO.

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<sup>45</sup> Hubert de Vauplane, Blockchain, cryptomonnaies, finance et droit, état des lieux, Revue Lamy droit des affaires n°140 1er septembre 2018.

<sup>46</sup> Summary of responses to the public consultation on Initial Coin Offerings (ICO). Autorité des marchés financiers. 22.02.2018, p. 11.



## 4. ICO REGULATIONS

### 4.1 FRENCH LEGISLATION

The Pacte Law was passed by the National Assembly on April 11, 2019 and promulgated May 23, 2019. The Pacte Law establishes a framework for ICOs and Digital Asset Service Providers.

The Pacte Law gives the first definition of tokens in the context of ICOs (4.1.1.), ensures the issuer the right to open a bank account (4.1.2.), provides an opt-in mechanism to allow adequate investor protection (4.1.3.) and regulates the service providing of digital assets (4.1.4.).

#### 4.1.1 DEFINITION OF A TOKEN ACCORDING TO ARTICLE 26 OF THE PACTE LAW

The Pacte Law in Article 26 provides the first definition of tokens:

*"[...] any intangible asset representing, in digital form, one or more rights which may be issued, registered, kept or transferred by means of a shared electronic recording device enabling the owner of the said asset to be identified, directly or indirectly".<sup>47</sup>*

That first definition encompasses both types of tokens: security and utility tokens, and legally qualify them as intangible property. This broad definition does not exclude any of the other legal qualifications detailed above: financial instruments (3.1), miscellaneous assets (3.2), derivatives (3.3), crowdfunding (3.4), and payment services (3.5).

#### 4.1.2 PROTECTION OF THE ISSUERS –RIGHT TO OPEN A BANK ACCOUNT

In addition, the Pacte Law provides a new right for the issuers to have a bank account. In recent years, banks have denied issuers to open bank accounts for token issuers because they do not meet the KYC and AML requirements.

Under Article 26 of the Pacte Law, credit institutions shall establish objective, non-discriminatory and proportionate rules to govern access by issuers of tokens having obtained the Visa to their deposit and payment account services. This access shall be sufficiently extensive to allow these issuers to use banking services efficiently and without hindrance.

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<sup>47</sup> Article 26 of the Loi Pacte.

In the event of persistent difficulties in accessing deposit and payment services at credit institutions, token issuers who have obtained a Visa shall have access to a deposit and payment service from the *Caisse des dépôts et consignations*.

#### 4.1.3 PROTECTION OF THE INVESTORS –THE VISA MECHANISM

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##### **PUBLIC OFFER OF TOKENS ELIGIBLE UNDER THE VISA MECHANISM**

The core of the Pacte Law's Article 26 is the Visa mechanism. In order to qualify for the Visa the ICO must qualify as a public offer of tokens:

*“An offer to the public of tokens consists in proposing to the public, in any form whatsoever, to subscribe to these tokens.*

*An offer to the public of tokens does not include an offer of tokens open for subscription by a limited number of persons, as determined by the general regulations of the [AMF], acting on its own behalf.”*

According to this definition, sales of tokens to a limited number of persons do not qualify as a public offer of tokens and are therefore excluded from the Visa mechanism. The minimum number of persons threshold to qualify a public offer has not been defined in the regulation of the AMF yet.

The criterion of being an offer to the public raises the question of whether the pre-sale of tokens will be Visa eligible. Some ICOs including a pre-sale may receive the Visa for a public offering of tokens, but not for the pre-sale.

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##### **CONDITIONS FOR OBTAINING A VISA**

In order to request the Visa from the AMF, the issuer must, before the issuance of the tokens, prepare a document intended to provide all relevant information to the public about the proposed token offer and the issuer. Its content must be accurate, clear, and not misleading. It must include a comprehensible explanation of the risks associated with the offer of tokens.

If the ICO meets the requirement of a public offer, the AMF will check, in particular, whether it:

- is constituted in the form of a legal person established or registered in France;
- has set up a means to monitor and safeguard the assets collected as part of the offer (*i.e.* an escrow mechanism for invested funds).

If the above conditions are met, the AMF will affix its Visa to the information document in accordance with the procedures and within the time limit set by the AMF General Regulation.

Although no draft of the AMF General Regulation has been published, AMF consultations have noted that the following information would be required to ensure that the market is properly informed (and that a Visa should be granted):

- the quality of the information document intended for investors;
- the presence of a mechanism to secure the funds collected such as escrow, trust or *fiducie*;
- the nature of promotional communications;
- rights conferred by the token;
- competent court in the event of a dispute;
- economic and accounting treatment of funds collected under the ICO;
- the legal entity responsible for the offer, their managers and their competence;
- visa of an authority or other reference institution on the white paper;
- validation of white papers by independent experts.

Once the offer is completed, the issuer will be required to inform investors of the amounts raised and the presence of a secondary market, if any. In addition, issuers of tokens applying for AMF approval will be subject to anti-money laundering and anti-terrorist financing requirements.

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## POST VISA CONTROL

Most regulators highlight the need for continuous monitoring of potential macro-financial risks that may arise from ICOs and crypto-assets in general. Although optional, the AMF sets a Visa control mechanism.

After having affixed its Visa, if the AMF finds that the public offer no longer complies with the content of the information document or no longer presents the guarantees mentioned above, it may order the termination of any communication of a promotional nature concerning the offer and withdraw its Visa, either on a permanent basis or until the issuer once again satisfies the conditions of the Visa.

Finally, after having applied for a Visa from the AMF, if a person makes disclosures information containing inaccurate or misleading information concerning the issue of the Visa, its scope or consequences, the AMF may make a public statement mentioning these facts and the persons responsible for these communications.

In summary, the optional Visa relies on three fundamental guarantees: a white paper (information document) describing the project and modalities of the ICO, an escrow

mechanism for invested funds, and verification of the origin of funds (Anti-Money Laundering Requirements).<sup>48</sup>

## 4.1.4 THE REGULATION OF THE SERVICE PROVIDING OF DIGITAL ASSETS

### 4.1.4.1 DIGITAL ASSET SERVICES PROVIDERS

Article 26 Bis of the Pacte Law provides a new status for providers of Digital Assets Services (hereinafter “*Digital Assets Service Providers*”), which are defined as:

- tokens as defined by the Visa mechanism, excluding those fulfilling the characteristics of the financial instruments mentioned in Article L.211- and the cash vouchers mentioned in Article L.223-1 ; and
- cryptocurrencies, defined as: “Any digital representation of a security that is not issued or guaranteed by a central bank or public authority, that is not necessarily attached to a currency having a legal court and that does not have the legal status of a currency, but that is accepted by natural or legal persons as a means of exchange and that can be transferred, stored or exchanged electronically”.

Security tokens for financial instruments and cash vouchers are excluded from the definition of digital assets as they are otherwise regulated.

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### DEFINITION OF DIGITAL ASSETS SERVICES

In the event the service provider provides any of the following digital assets services (hereinafter “*Digital Assets Services*”) it must comply with the conditions set forth in Article 26 Bis of the Pacte Law:

- a) the storage of digital assets or private cryptographic keys on behalf of third parties, in order to hold, store and transfer digital assets;
- b) the purchase or sale of digital assets in legal tender;
- c) the exchange of digital assets for other digital assets;
- d) the operation of a platform for trading digital assets;
- e) the following services:

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<sup>48</sup> Anne Maréchal, Les ICOs vers quelle régulation? Le dilemme de la réglementation des ICO, la solution innovante proposée par l’AMF, Revue Lamy droit des affaires n°140 1er septembre 2018.

- i. the reception and transmission of orders on digital assets on behalf of third parties;
- ii. portfolio management of digital assets on behalf of third parties;
- iii. advice to subscribers of digital assets;
- iv. underwriting of digital assets;
- v. guaranteed investment of digital assets; and
- vi. the unsecured investment of digital assets.

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### MANDATORY REGISTRATION OF DIGITAL ASSETS SERVICES PROVIDERS

The provider of the following Digital Assets Services must be registered with the AMF:

- a) the storage of digital assets or private cryptographic keys on behalf of third parties, in order to hold, store and transfer digital assets; and
- b) the purchase or sale of digital assets in legal tender.

The first mission of the AMF is to verify whether the managers and beneficial owners of the service providers are of good repute and have the necessary competence to perform their duties, under conditions defined by decree. To this end, the AMF seeks the opinion of the "*Autorité de contrôle prudentiel et de résolution*".

Any change affecting a service provider's compliance with the above obligations, shall be reported to the AMF.

The AMF may deregister the service provider of Digital Assets Services on the basis of an opinion of the "*Autorité de contrôle prudentiel et de résolution*", on its own initiative or on the Authority's initiative, either at the request of the service provider or *ex officio*, if the service provider has not carried out its activity within 12 months, or has not carried out its activity for at least 6 months or if the service provider does not comply with the obligations mentioned above.

The service providers that have not filled the mandatory registration will be exposed to a one-year prison sentence and a fine of EUR 15,000.

Furthermore, service providers using a company name, advertisement or any other process suggesting that it is duly registered or creating a confusion in this regard, may be subject to a two-year sentence and a fine of EUR 30,000.

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## AMF APPROVAL DIGITAL ASSETS SERVICES PROVIDERS

In the event the service provider provides any Digital Assets Services on a regular basis, it could request an approval enabling it, in particular, to have permanent access to a civil liability insurance, IT system etc.

Digital Assets Services Providers that have been approved by the AMF have to provide their customers with clear, accurate and not misleading information and must warn customers of the risks associated with digital assets. In addition, they shall make their pricing policies public, establish and implement a policy to manage their customer's complaints and ensure rapid proceedings.

The AMF ensures that the service providers have healthy management by assessing the quality of their shareholders who hold a direct interest or an indirect interest consisting of more than 20 % of the company's share capital or voting rights.

To verify the security of the information systems, the AMF may request the opinion of the "Agence nationale de la sécurité des systèmes d'information" and of the Bank of France.

Pursuant to Article 26 Bis of the Pacte Law, the obligations of the services providers requesting an approval from the AMF, depends on the provided services.

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## THE STORAGE OF DIGITAL ASSETS OR PRIVATE CRYPTOGRAPHIC KEYS ON BEHALF OF THIRD PARTIES, IN ORDER TO HOLD, STORE AND TRANSFER DIGITAL ASSETS

The provider of the following Digital Assets Service:

- the storage of digital assets or private cryptographic keys on behalf of third parties, in order to hold, store and transfer digital assets;

shall (i) conclude an agreement with its customers, (ii) establish a conservation policy, (iii) ensure that they may return the digital assets or cryptographic keys stored on behalf of their customers, (iv) separately store their own digital assets or private cryptographic keys from those of their customers, and (v) shall not use the digital assets or crypto keys stored on behalf of their customers without the prior consent of the customers.

## *THE PURCHASE OR SALE OF DIGITAL ASSETS IN LEGAL TENDER AND THE EXCHANGE OF DIGITAL ASSETS FOR OTHER DIGITAL ASSETS*

The provider of the following Digital Assets Service:

- the purchase or sale of digital assets in legal tender;
- the exchange of digital assets for other digital assets;

shall (i) establish a non-discriminatory trade policy, (ii) publish a firm price for the tokens or a method of determination of the price of the tokens, (iii) publish the volumes and prices of the transactions they have carried out, and (iv) execute the clients' orders at the prices published at the time of their receipt.

## *THE OPERATION OF A PLATFORM FOR TRADING DIGITAL ASSETS AND OTHER SERVICES*

The managers and beneficial owners of the following services

- a) the exchange of digital assets for other digital assets;
- b) the operation of a platform for trading digital assets;
- c) other services such as:
  - the reception and transmission of orders on digital assets on behalf of third parties;
  - portfolio management of digital assets on behalf of third parties;
  - advice to subscribers of digital assets;
  - underwriting of digital assets;
  - guaranteed investment of digital assets; and
  - Tthe unsecured investment of digital assets;

may justify that they are of good repute and that they have the necessary competence to perform their duties.

In addition, the provider of services mentioned in Point 2 above shall (i) set the operating rules, (ii) ensure fair and orderly negotiations, and (iii) only commit their own capital to the platforms they manage and only under conditions and within the limits set by the general regulation of the AMF. They shall also publish details about the orders and transactions concluded on their platforms.

The service provider mentioned in Point 3 shall have a program of activities for each service they intend to provide. The program shall specify the conditions under which they plan to provide the concerned services and indicate the type of operations and structure of their

organisation. The provider shall also have appropriate means for implementing said program.

In order to verify the compliance with the mentioned obligations, the AMF may request an opinion from the Prudential supervisory and resolution authority "*Autorité de contrôle prudentiel et de résolution*" at any time.

## 5. ACCOUNTING ASPECTS

On December 7, 2018, the French accounting authorities (ANC) issued regulations on the accounting treatment of ICOs and tokens. The ANC indicated that it will be necessary to analyse the characteristics of the token in a case-by-case manner in light of the white paper.

These regulations distinguish two types of token:

- Tokens with the characteristics of financial securities, financial contracts, or saving bonds that will be governed by the existing French generally accepted accounting principles (French GAAP or PCG) applicable to financial securities, forward financial instruments, or saving bonds.
- Tokens that do not have the characteristics of financial securities or savings bonds and may qualify as:
  - borrowings and similar debts for tokens with the characteristics of a repayable debt, even on a temporary basis;
  - deferred income for tokens that represent fees for services still to be performed or goods still to be delivered; or
  - operating income for tokens that do not create explicit or implicit obligations towards subscribers and token holders (as they should be regarded as definitively acquired by the issuer).

Therefore, issuers must ensure that the rights and obligations attached to tokens are clearly defined before any ICO. It is also important for issuers and subscribers to distinguish between tokens in order to treat them in accordance with the applicable accounting regime. This classification will also affect the tax treatment.



## 6. TAX ASPECTS

The French Finance Act for 2019 has provided for personal income tax treatment for certain sales of tokens. Besides that, the French tax authorities have not issued any guidelines on the tax treatments of tokens yet. The below is therefore a preliminary analysis of the possible tax treatment that might apply to token issuers and token holders and is subject to confirmation by the French tax authorities.

### 6.1 ICO INITIATOR

Corporate income tax applies differently depending on the type of token issued.

Utility tokens can be viewed as a sale of goods or services, in which case their issuance should be subject to corporate income tax as an ordinary income. Utility tokens may also have the characteristics of a future sale of goods or services that could span over several fiscal years, in which case they should qualify as a deferred income for accounting and tax purposes and could therefore be amortized over that period (instead of being fully taxable upon issuance). Other utility tokens that do not create explicit or implicit obligations towards the token subscriber or token holder would be fully taxable upon issuance as an ordinary income.

Security tokens would be treated as the financial securities they are most similar to. If the security token is viewed as debt or quasi-equity, it should not give rise to an increase in net assets upon issuance. Cryptocurrencies held by the ICO initiator (the token issuer) should be treated like investment securities. Since French GAAP now considers that unrealized exchange gains or losses on security tokens should be treated like unrealized foreign exchange gains or losses, it is possible, although uncertain at this time, that such gains or losses will have to be recognized on a mark-to-market basis for corporate tax purposes.

### 6.2 ICO HOLDERS

#### **CORPORATE INCOME TAX**

Corporate income tax would apply differently depending on the type of token purchased.

Utility tokens than can be viewed as a sale of goods or services should qualify as a deductible expense or as an intangible asset. Utility tokens that can be viewed as a future sale of goods or services should qualify as a prepaid expense, or in certain cases as an intangible asset.

Security tokens, if viewed as debt or quasi-equity, should have the same tax treatment as the security it is most similar to. However, it is unlikely that any participation exemption could

apply to financial income or capital gains derived from security tokens because security tokens usually lack key characteristics of equity securities.

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## PERSONAL INCOME TAX

Tokens qualifying as financial instruments should be taxed as such, which means that any financial income or capital gain derived from these tokens should be subject to a flat tax of 30 %.

Other tokens exchanged against fiat currencies can trigger the recognition of a gain equal to the difference between (i) the value of the fiat currency obtained in exchange of the token, and (ii) the prorated acquisition value of the token portfolio. If token trading is made on an occasional basis, the gains derived from the sales of tokens should be subject to a flat tax at a rate of 30 %. A token-for-token exchange is not regarded as a taxable transaction and the acquisition value of the token sold is carried over to the token purchased.

If token trading is made on a regular basis, the gains on the sale of tokens (which should include token-for-token exchanges) should be determined in a similar manner as for corporate tax purposes. The gain should be subject to progressive income tax rates and social charges of up to 62.2 %; social contributions could apply if such gains qualify as professional income.

Utility tokens exchanged against the goods or services to which they give right should not trigger the recognition of any income. However, it cannot be excluded that a gain (as defined above) should be recognized if the value of the goods or services to which the tokens give right has increased since the acquisition of the token. This will have to be confirmed by the French tax authorities.

Any token account opened, used or closed in a foreign jurisdiction in a given year must be reported on the income tax return of that year, failing which fines may apply.

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## VAT

The issuance of security tokens should be exempt from VAT in most cases (assuming they are similar to debt or quasi-equity instruments).

The issuance to a third party of any token qualifying as a present or future sale of goods or services should be subject to VAT where the transaction is carried out by a taxable person acting as such. Certain practitioners consider that the relationship between the token issued and the future sale of goods or services might be too weak to subject that token issuance to VAT; the merits of such a position should depend on the characteristics of the token issued. Additionally, the VAT treatment of utility tokens could involve dry VAT charges for the issuer in certain cases and should therefore be analysed on a case-by-case basis.

Assuming utility tokens can be construed as vouchers, the above analysis would be consistent with the VAT regime of vouchers provided by EU Directive 2016/1065, which was partially transposed into French law by the French Finance Act for 2019. Under this voucher regime, the transfer of single-purpose vouchers (i.e., vouchers where the place of supply of the goods or services to which the voucher relates, and the VAT due on those goods or services, are known at the time of issue of the voucher) is subject to VAT, but the underlying supply of goods or provision of services in exchange for the voucher is not. Transfers of multi-purpose vouchers (i.e., any voucher that is not a single-purpose voucher) is not subject to VAT, but the underlying supply of goods or provision of service in exchange for the voucher is. The application of this voucher regime to utility tokens will have to be confirmed by the French tax authorities.

The transfer of cryptocurrency to subscribe to tokens should be construed as a dual transaction for VAT purposes, i.e., a sale of the token and a sale of cryptocurrency. The sale of the cryptocurrency is likely to qualify as a provision of services, which might be subject to VAT if carried out by a taxable person acting as such. The sale of the token should be subject to VAT as the case may be in accordance with the above rules.

## 7. CONCLUSION

France is trying to create a supportive environment for the development of blockchain in its legal system. The government's action is developing a complete legislative framework around the blockchain by (i) introducing the blockchain in corporate law, (ii) creating a visa mechanism for ICO in order to protect investors and issuers and (iii) regulating digital assets services providers and consequently the secondary market.

Regarding the ICO, the AMF will be responsible to verify that the transaction provides certain minimum guarantees to ensure investor protection. Such guaranties are expected to be detailed in the AMF General Regulation after the promulgation of the Pacte Law. Nevertheless, it is safe to say to that in any case the anti-money laundering and anti-terrorist financing requirement will be necessary to obtain a Visa.

### *UPCOMING AGENDA*

The Pacte Law was adopted at its final reading in the French National Assembly on April 11, 2019 and promulgated May 23, 2019. The AMF is currently drafting amendments to the AMF General Regulation in order to complement the Pacte Law and detail, in particular, the information to be provided to investors, the presence of a mechanism to secure the funds collected, and the nature of promotional communications.

On the tax side, the French Finance Act for 2019 as implemented is a favourable regime for gains on the sale of tokens by non-professional individuals. However, there are still many

aspects that have yet to be clarified either by statutory law or by administrative guidelines, especially concerning corporate tax and VAT.

### *POST PACTE LAW*

Within two years of the promulgation of the Pacte Law, the Government, after having obtained the opinions of the Banque de France, the Prudential Supervision and Resolution Authority and the AMF, will submit a report to the Parliament in order to assess the implementation of the provisions regarding Digital Assets Services. The government will assess the opportunity to adapt the provisions, in view of the progress of European debates and the international development of digital assets market.

# IV. GERMANY

## IV. GERMANY

### 1. SECURITIES UNDER GERMAN CAPITAL MARKET LAW

Under German capital markets law, the term "securities" is defined in several statutory laws. The German Securities Trading Act (*Wertpapierhandelsgesetz* – "WpHG"), the German Securities Prospectus Act (*Wertpapierprospektgesetz* – "WpPG"), the German Securities Accounts Act (*Depotgesetz* – "DepotG") contain a definition of securities. In contrast to these laws, the German Investment Products Act (*Vermögensanlagengesetz* – "VermAnlG") regulates asset investments which do not qualify as securities (because they lack tradability on a capital market) or investment funds, respectively. However, if and to the extent an asset investment becomes tradable as result of its tokenisation, such product is comprised in the securities definition pursuant to WpHG and WpPG which precede VermAnlG. This triggers a variety of consequences which do not seem to be widely recognised yet.

#### 1.1 SECURITIES TRADING ACT

Pursuant to Sec. 2 para. 1 WpHG, securities, irrespective of their securitisation, are all classes of rights with the exception of payment instruments that are tradable on the financial markets, in particular

- shares,
- other holdings in domestic or foreign legal entities, partnerships and other companies, insofar as they are comparable with shares, as well as depository receipts representing shares,
- debt instruments, in particular participation certificates and bearer and order bonds and depository receipts representing debt instruments, as well as other securities which entitle to the purchase or sale of securities in accordance with points 1 and 2 or which result in a cash payment which is determined in dependence on securities, currencies, interest rates or other income, goods, indices or parameters. The Delegated Regulation (EU) 2017/565 of the Commission of 25 April 2016 contains more detailed provisions on this last element to which Sec. 2 para. 1 No. 3 letter b WpHG refers.

The definition of security was reworded when MiFID II was implemented and, in essence, matches the specifications of Art. 4 para. 1 No. 18 MiFID II.<sup>49</sup> It should be noted that in order to interpret the definition of security under the German WpHG, the rationale behind it needs to be taken into consideration. The German WpHG aims to regulate the behaviour and activities of capital market participants and not the creation, ownership or transfer of securities. Against this background, the term "security" under the German WpHG must be interpreted independently, taking both the rationale of the statutory law and the specifications of MiFID II into consideration.<sup>50</sup> The definition under the German WpHG equals the definition used in the German Banking Act (*Kreditwesengesetz*, "KWG") and both definitions are to be interpreted in the same way.<sup>51</sup>

## 1.2 SECURITIES PROSPECTUS ACT

According to Sec. 2 No. 1 WpPG, securities are transferable securities that can be traded on a market, in particular:

- shares and other securities comparable to shares or interests in corporations or other legal entities, and certificates representing shares,
- debt instruments, in particular debt securities and certificates representing securities other than those referred to in point (a),
- any other securities which give the right to acquire or dispose of such securities or which result in a cash payment determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures,

with the exception of money market instruments with a maturity of less than twelve months.

The securities definition under the WpPG is to be interpreted in a broad way but is generally also based on Art. 4 para. 1 No. 18 MiFID II.<sup>52</sup>

## 1.3 INVESTMENT LAW

The German Investment Code ("**KAGB**") provides the legal framework for investment funds in Germany. It uses the term securities in connection with the investment rules for UCITS (Sec. 193 KAGB) and the investment rules for special AIF with fixed investment conditions (Sec. 284 KAGB), without defining it itself<sup>53</sup>. For the definition of securities in Sec. 193 KAGB,

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<sup>49</sup> Kumpan/Schwark/Zimmer, Kapitalmarkrechtskommentar, § 2 WpHG recital. 4.

<sup>50</sup> Assmann, in: Assmann/Schneider/Mülbert, Wertpapierhandelsrecht, 7. Aufl. 2019, § 2 WpHG, recital 8; Kumpan/Schwark/Zimmer, Kapitalmarkrechtskommentar, § 2 WpHG recital. 4.

<sup>51</sup> Assmann, in: Assmann/Schneider/Mülbert, Wertpapierhandelsrecht, 7. Aufl. 2019, § 2 WpHG, recital. 9.

<sup>52</sup> Heidelberg/Schwark/Zimmer, § 2 WpPG recital. 3.

<sup>53</sup> von Rom, in Baur/Tappen(Ed.), Investmentgesetze, Band 1, 3. Aufl. 2015, Sec. 193 recital. 4.

the definition contained in the UCITS Directive (2009/65/EC) and in the Commission's Implementing Directive 2007/16/EC therefore applies by way of interpretation in conformity with the Directive. Pursuant to Art. 2 para. 1 lit. n of the UCITS Directive, "securities":

- shares and other securities equivalent to shares ("shares"),
- bonds and other securitised debt instruments ("debt instruments"),
- any other marketable securities which give the right to acquire securities within the meaning of this Directive by subscription or exchange.

For the interpretation of the term "securities" in Sec. 284 of the KAGB, the definition of the Investment Act in Sec. 2 para. 4 No. 1 of the InvG, which formed the legal framework for German funds before the German Investment Code, is used in supervisory and advisory practice.<sup>54</sup> According to the explanatory memorandum to the law, the concept of the security in Sec. 2 para. 4 No. 1 of the InvG must be interpreted in economic terms with a focus on the characteristics of the liquidity and transferability of the security concerned.<sup>55</sup> It thus comprises, in particular, shares, equity-like securities, bonds, promissory note loans which are repeatedly transferable as well as other bonds or other marketable securities.<sup>56</sup>

## 1.4 INVESTMENT PRODUCTS ACT

Sec. 1 para. 2 of the German Investment Products Act (VermAnlG) defines asset investments as investments which e.g. grant a participation in the profit of a company, qualified subordinated loans or participation rights (see list no. 1 – 7 of Sec. 1 para. 2 VermAnlG) and which do not qualify as securities or as an investment fund. The general purpose of the VermAnlG is to provide a regulatory regime for asset investments which are not subject to the German securities or investment funds regime. Since most tokens will typically have the standard features of securities, such as being fungible and fit for circulation, the VermAnlG will only apply in certain circumstances where tokens do not qualify as securities. This applies also to investment products traditionally comprised by VermAnlG, as e.g. in the form of Genussrechte (profit participation rights). Tokenisation moves traditional VermAnlG investment products into the securities regulation (which precedes VermAnlG) triggering consequences for e.g. the requirements for prospectus exemptions.

If the VermAnlG were to apply to tokens issued via an ICO, a crowdfunding exemption for certain obligations pursuant to Sec. 2a VermAnlG might be applicable, provided, however, that the following conditions are fulfilled:

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<sup>54</sup> Livonius/Riedl, in Moritz/Klebeck/Jesch, KAGB, Sec. 284 in recital. 24 et seq.

<sup>55</sup> See also Höring, § 193 KAGB recital 7.

<sup>56</sup> BT Drucks.15/1553 S. 75; Zingel, in Baur/Tappen (Ed.), Investmentgesetze, Band 2, 3. ed. 2015, Sec. 284 recital 12.



- (i) the instrument in question is a subordinated loan or a profit participation right; and
- (ii) the instrument in question is sold via an internet platform with investment advice or broker services being provided; and
- (iii) quantitative restrictions as follows:
  - a. an overall limit for the proceeds of EUR 2.5 million;
  - b. an individual limit per investor as follows:
    - i. EUR 1,000 per individual investor, or
    - ii. EUR 10,000 under the condition that the investor has provided a self-disclosure proving own asset of minimum EUR 100,000, or
    - iii. twice the average monthly net income of the respective investor on the basis of a self-disclosure to be provided by him, up to a maximum of EUR 10,000

Having said this, even if the requirements for the exemption set out above are met, most recent ICOs would not have been able to rely upon such exemption and would thus have to comply with the VermAnlG completely. The reason is that the exemption does not apply where the issuer can exert a direct or indirect significant influence on the company operating the internet service platform (crowdfunding platform).

## 1.5 UNITS OF ACCOUNT

Since the publication of its guidance notice "Notes on financial instruments pursuant to section 1 (11) sentences 1 to 3 KWG"<sup>57</sup> on 20 December 20, 2011, BaFin qualifies crypto currencies<sup>58</sup>, i.e. specifically Bitcoin, as units of account within the meaning of section 1 (11) sentence 1 no. 7 KWG.

The legal term "unit of account" was introduced into the German Banking Act in 1993. According to the legislator, the term unit of account includes, among others, the IMF's special drawing rights, the European Currency Unit (ECU) and units of account which function as private means of payment in countertrade transactions (barter transactions). The inclusion of "unit of account" in the KWG is an overarching implementation (so-called "gold-plating") of the underlying European directive. It represents an exclusively German approach which is

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<sup>57</sup> BaFin, Hinweise zu Finanzinstrumenten nach § 1 Abs. 11 Sätze 1 bis 3 KWG (Aktien, Vermögensanlagen, Schuldtitel, sonstige Rechte, Anteile an Investmentvermögen, Geldmarktinstrumente, Devisen, Rechnungseinheiten und Emissionszertifikate), [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb\\_111220\\_finanzinstrumente.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_111220_finanzinstrumente.html).

<sup>58</sup> In BaFin's terminology "virtual currencies".

broader than the definition of financial instrument under MiFID II. As a consequence, BaFin, by applying this German approach in its administrative practice, deviates from the view of other European financial supervisory authorities, which – in the absence of a comparable concept for the unit of account – generally do not consider such crypto currencies to be financial instruments. In addition to a number of unresolved regulatory issues in a cross-border context that arise from the different classification of crypto currencies, in individual cases this may also represent a significant regional disadvantage for companies operating in and marketing to Germany. This is mainly due to the classification as a unit of account, i.e. a financial instrument, certain commercial transactions involving crypto currencies are in Germany subject to licensing pursuant to Section 32 (1) sentence 1 KWG (this includes, for example, investment brokerage, financial commission business or operating a multilateral trading facility).

In a decision that drew a lot of media attention, the Higher Regional Court of Berlin (*Kammergericht*) ruled in September 2018 that Bitcoin are not a unit of account, i.e. a financial instrument under the KWG and that, consequently, there is no obligation to obtain a permission under section 32 (1) sentence 1 KWG for trading or brokering Bitcoin.<sup>59</sup> With this ruling, the *Kammergericht* very openly opposed the administrative practice and position taken by BaFin. The *Kammergericht* came to this decision as it concluded that Bitcoin lacks the general recognition required by the KWG framework and the corresponding predictable value stability and thus is not able to meet the comparability between units of account with foreign currencies required by law, because of its high volatility.

With regard to BaFin's view that Bitcoin is a complementary currency which should be included under the term "unit of account", the *Kammergericht* went on to state that BaFin, when extending the scope of unit of account beyond what was originally intended by the legislator, violates the principle of legal certainty stipulated in Article 103 (2) of the German Constitution (*Grundgesetz*) and thus exceeds its constitutional competence.

The criminal judgment of the *Kammergericht* has, however, very little to no impact on BaFin's administrative practice as it has no direct binding effect. The *Kammergericht* only ruled in a criminal proceeding, but did not interpret the concept of unit of account from an administrative perspective. BaFin has thus mentioned publicly numerous times that it does not intend to change its previous administrative practice.<sup>60</sup> This has recently received backing

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<sup>59</sup> Kammergericht Berlin, decision of 25.09.2018 – case no.: (4) 161 Ss 28/18 (35/18).

<sup>60</sup> See in particular BaFin president Felix Hufeld in Handelsblatt, 28 October 2018 "Bafin-Chef will globale Regulierung für ICOs". Available at: <https://www.handelsblatt.com/finanzen/maerkte/devisen-rohstoffe/virtuelle-boersengaenge-bafin-chef-will-globale-regulierung-fuer-icos/23239264.html?ticket=ST-658304-4dPZKlbNC4PJp9lwfgz-ap5>

from the Federal Government<sup>61</sup>, which explicitly stated that it stands behind BaFin in this regard. The practice of qualifying “virtual currencies” as units of account under KWG will thus likely remain as is, albeit there having been indications by BaFin in the recent past that it is willing – as the spectrum of crypto tokens broadens quickly – to apply a more differentiated approach when interpreting the term unit of account.

Pure payment tokens that are functionally comparable to conventional payment instruments (such as Bitcoin) are still regularly classified as units of account. The situation is different, however, with so-called utility tokens which are designed as pure “usage” tokens. As a rule, these are not classified as units of account and, therefore, not as financial instruments within the meaning of the KWG either. BaFin examines the distinction between payment and utility tokens in each individual case. This distinction, however, is often difficult to draw, not least because of the many hybrid forms of tokens on the market.

The necessary analysis of the token's functionality also depends on how (contractually) decentralised the use of the token is in the individual case. The distinction between payment and utility token, which is decisive for the classification as unit of account, seems to come down to the question of whether tokens are only used as means of payment vis-à-vis a singular counterparty (usually no unit of account) or peer-to-peer between the users of a (larger) network (usually unit of account).

## 1.6 CONCLUSION

BaFin's latest publication<sup>62</sup> sets out that in order to be deemed a security within the meaning of Sec. 2 para. 1 of the WpHG or Art. 4 para. 1 No. 44 of MiFID II, a token must meet the following criteria:

- transferability,
- negotiability on the financial market or capital market; trading platforms for cryptocurrencies can, in principle, be deemed financial or capital markets within the meaning of the definition of a security,
- the embodiment of rights in the token, i.e. either shareholder rights or creditor claims or claims comparable to shareholder rights or creditor claims, which must be embodied in the token, and

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<sup>61</sup> Cf. Answer of the Federal Government to the brief question posed by Member of Parliament Schäffler et al (FDP), “Die Rolle der BaFin bei Kryptowährungen und Token”, VII A 3b – WK 7031/18/10002 :002. Available at: [dip21.bundestag.de/dip21/btd/19/056/1905689.pdf](https://dip21.bundestag.de/dip21/btd/19/056/1905689.pdf).

<sup>62</sup> BaFin, Supervisory classification of tokens or cryptocurrencies underlying “initial coin offerings” (ICOs) as financial instruments in the field of securities supervision (WA 11-QB 4100-2017/0010) under 1 lit. a, published on 28 March 2018 in English language ; see also the newest publication of BaFin on Tokenization, “Tokenisierung”. Available at: [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2019/fa\\_bj\\_1904\\_Tokenisierung.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2019/fa_bj_1904_Tokenisierung.html).

- the token must not meet the criteria of a payment instrument (as set out in Sec. 2 para. 1 of the WpHG or Art. 4 para. 1 No. 44 of MiFID II).

Under Sec. 2 para. 1 of the WpHG or Art. 4 para. 1 No. 44 of MiFID II, it is not necessary for a token to be embodied in a deed to qualify as a transferable security. It is enough when the information of the token holder can be recorded, for example by means of distributed ledger or blockchain technology or through comparable technologies.<sup>63</sup>

In particular, the very generic statement by BaFin that one of the prerequisites for a security is the embodiment of rights in the token, i.e. either of shareholder rights or rights under the law of obligations or claims comparable with rights under the law of obligations or claims under the law of obligations, led to heavy concerns in the German and international blockchain community. The question raised was if such criteria for defining securities was to be interpreted in a way that any kind of embodiment of contractual claims in a token would qualify such token as a security. As a consequence, this interpretation would lead to a situation where no separate category of utility tokens could exist under German supervisory law, which in our experience (in close dialogue with BaFin) does not correspond to the existing administrative practice. In order to ensure legal certainty, not to block innovation and to stop the ongoing migration of crypto enterprises from Germany to other jurisdictions, a clarification by BaFin on the classification of different types of tokens should be sought as soon as possible. In our view, BaFin's interpretation of the various securities definitions under German law should provide sufficient room for utility tokens to be structured in a way that falls outside of the securities regime (thereby not triggering prospectus requirements).

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<sup>63</sup> Parts of the German legal literature require as a prerequisite for the qualification as securities the possibility that the security may be acquired in good faith (gutgläubiger Erwerb) pursuant to German property law (Sachenrecht). In general, we agree with BaFin and believe strong arguments can be made that certain tokens – depending on the individual features of the token – qualify as securities irrespective of the argument that securities must be subject to acquisition in good faith pursuant to property law. The blockchain mechanism itself provides a substitute for a good faith acquisition, as the ownership of a token is inherently linked to the token. Furthermore, it is doubtful that the argument of good faith acquisition pursuant to property law is still applicable to modern equity capital market transactions in which typically no individual share certificates are rendered and securities are rather traded in a dematerialised manner by way of book entry (Wertrecht).

## 2. PROSPECTUS PUBLICATION OBLIGATIONS

Based on to the still very generic regulatory position by BaFin on the classification of tokens as securities, it remains to be seen if and for which type of tokens the securities prospectus obligations according to applicable German laws and the EU Prospectus Regulation<sup>64</sup> apply. For tokens qualifying as securities, the WpPG would stipulate an obligation to publish a BaFin approved prospectus if the tokens are offered in Germany to the general public and no specific exemption applies (Section 3 WpPG). The mandatory content of such securities prospectus would, however, be unclear due to the fact that none of the Annexes of the EU Prospectus Regulation directly apply to tokens and, therefore, it would need to be decided which of the currently existing annexes is most appropriate. If the KAGB or VermAnlG were to tokens, a sales prospectus would also need to be published, in absence of applicable exemptions.

## 3. CIVIL LAW

### 3.1 CIVIL LAW PROSPECTUS LIABILITY

Civil law prospectus liability was developed by the German Federal Court of Justice (*Bundesgerichtshof*, "BGH") case law for the non-regulated so-called grey capital market. The jurisdiction of the BGH on the civil law prospectus liability specifies the conditions of liability for the completeness and correctness of advertising and selling documents, with which investors are attracted to investments.

According to the principles of civil law prospectus liability, there is an obligation to provide correct and complete information about all circumstances surrounding the offer of capital investments which are or may be relevant for the decision of the interested party. This also includes the obligation to clarify any disadvantages and risks associated with the offer as well as possible facts that could frustrate the purpose of the contract.<sup>65</sup>

Any token offering which does not qualify as a security offering according to the WpPG may be subject to civil law prospectus liability. Security token offerings within the meaning of the WpPG are subject to the prospectus and liability regime of the WpPG. Such specific prospectus legislation replaces civil law prospectus liability. However, where no specific

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<sup>64</sup> Means Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 replacing and repealing Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 and related measures.

<sup>65</sup> BGH judgement of 3 December 2007, II ZR 21/06.

legislation on prospectus requirements and liability exists, the principles of civil law prospectus liability may apply.

Consequently, token offerings, except for security token offerings, may be subject to information obligations as specified in case law on civil law prospectus liability. Such information obligations apply for capital investments and refer to information published in a document that meet the criteria of a prospectus.

So far there is no German court ruling on the question of whether a token qualifies as a capital investment product according to the principles of civil law prospectus liability. The comparison with common investment products is not too far-fetched though if tokens are traded on crypto exchanges and thus the general market expectation exists that tokens are (also) suitable for investment purposes. This is even more so if tokens are presented as a profitable investment.

Provided that tokens may be considered capital investment products, any documents informing on the token offering may also qualify as a prospectus. According to the relevant BGH case law, a prospectus is a market-related written statement which contains any relevant information for the assessment of the offer and which claims to be a complete and comprehensive description of the investment for the public, or at least gives the impression to include all relevant information in order to allow investors to make an informed decision prior to investing.<sup>66</sup> Thus, any documents relating to the token and token offering may be considered a prospectus if they represent a complete and comprehensive document or at least give the impression thereof.

Provided that a token offering is subject to civil law prospectus liability, investors may demand compensation for any damages that arise from having relied on the correctness and completeness of the prospectus. Not only the issuer itself, but also any party responsible for the published prospectus may be held liable for incorrectness and incompleteness.<sup>67</sup>

### 3.2 IMPLEMENTATION OF E-COMMERCE AND CONSUMER PROTECTION REGULATIONS INTO GERMAN LAW

A list of information to be disclosed when concluding e-commerce contracts and/or consumer contracts is attached as Annex A.

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<sup>66</sup> E.g. BGH judgement of 17 November 2011, III ZR 103/10.

<sup>67</sup> E.g. BGH judgement of 21 February 2013, III ZR 139/12.

### 3.3 INFORMATION OBLIGATIONS WHEN SELLING TOKENS VIA THE INTERNET

Information obligations in accordance with the E-Commerce Directive with regard to contract design, websites and order process were incorporated into German law in Sec. 312i BGB and Art. 246c EGBGB. According to its wording, Sec. 312i BGB only regulates contracts for the delivery of goods or the provision of services, with goods being all physical movable objects. Since tokens lack physicality, they do not constitute goods within the meaning of Sec. 312i BGB. It is questionable whether a token sale can be understood as a service. The underlying e-commerce directive does not distinguish between goods and services and thus has a very wide scope. Against this background, it is plausible to define any type of subject matter of the contract under Sec. 312i BGB when interpreting Sec. 312i BGB in conformity with the guidelines. A token sale therefore qualifies as a contract within the meaning of Sec. 312i BGB.

### 3.4 ANTI MONEY LAUNDERING REGULATIONS IN GERMANY

#### 3.4.1 OBLIGED ENTITIES – TOKEN ISSUER AS PERSON TRADING IN GOODS?

The AMLD has been incorporated into German law through the *Geldwäschegesetz* (“**GwG**”). In general, what has been stated above with respect to the AMLD applies under German law as well. Just like the AMLD, the GwG takes a wide approach in identifying money laundering sensitive business models as can, inter alia, be seen in Sec. 10 para. 3, 3 GwG. Both in the end aim at preventing any property that derives from a criminal activity to be implemented into the economic circle.<sup>68</sup>

If for some reason the token sale is structured in a way that the issuer is to be regarded as a credit institution or as a financial institution, they will have to be regarded as obliged entities under Sec. 2 para. 1 GwG, thus having to comply with the obligations set out in Sec. 10 GwG et seq. (e.g. obligation to identify the counterpart). BaFin defends its understanding that commercial trading in token generally requires complying with German AML regulations since such obliged persons provide regulated business under KWG and ZAG (even though the German Higher Court of Berlin has argued against this as explained above).<sup>69</sup>

Differently from the AMLD, the GwG has defined the term “person trading in goods” in Sec. 1 para 9 GwG as a person who trades in goods on a commercial basis irrespective on whose account or in whose name he or she trades (a “**Güterhändler**”). Güterhändler are obligated

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<sup>68</sup> With respect to the GwG, cf. the definition of Vermögensgegenstand in Sec. 1 para. 7 GwG.

<sup>69</sup> c.f. BaFin’s publication “*Virtuelle Währungen/Virtual Currency (VC)*”. Available at: [https://www.bafin.de/DE/Aufsicht/FinTech/VirtualCurrency/virtual\\_currency\\_node.html](https://www.bafin.de/DE/Aufsicht/FinTech/VirtualCurrency/virtual_currency_node.html) (last consulted on 12 December 2018).

by Sec. 2 para. 1 GwG to comply with AML requirements. According to Sec. 10 para. 6 GwG their obligations to comply with the GwG are triggered in two scenarios only: (i) there are circumstances which indicate money laundering or terrorism financing or (ii) they accept or make a payment of more than EUR 10,000 in **cash**. Therefore, even if one understands the selling entity to act as *Güterhändler*, in case the tokens in question are issued against other tokens and even if the value of the tokens paid exceeds EUR 10,000, obligations under the GwG are only triggered in case circumstances exist which indicate money laundering or terrorism financing.

### 3.4.2 TOKENS AS "GOODS" UNDER THE GWG?

The question whether the issuer in a token sale can be regarded as *Güterhändler*, however, is rather complex from a dogmatic point of view under German law and depends on whether tokens can be regarded as "goods". Such term remains undefined in the GwG. A uniform definition of the term "goods" does not exist under German law.

This poses a massive uncertainty for issuers of tokens. This uncertainty is further increased as the supervision of *Güterhändler*, and thereby the question of when the respective regulation is triggered, is handled on a local level by the regional administrative council (*Regierungspräsidium*) or the regional administration (*Bezirksregierung*) and not by BaFin. This means that the understanding and practice of BaFin does not apply when qualifying tokens as goods.

Therefore, irrespective of token specific questions, there are several approaches as to how to define "goods" within the GwG. For example, the regional administrative councils (*Regierungspräsidium*) of Hesse define "goods" within the meaning of Sec. 2 para 1 No. 16 GwG as all movable and non-movable property (*Sachen*), irrespective of its physical state, which have an economic value and can therefore be the subject of a commercial transaction.<sup>70</sup> This could be read as requiring a "good" to have a physical condition. Tokens would not meet such requirement. They may represent a claim to an underlying object but they are not properties.

However, such understanding would not be in line with the fact that some interpretations of the term "goods" in the GwG make references to the term "goods" in foreign trade law (*Außenwirtschaftsgesetz*) ("**AWG**").<sup>71</sup> Sec. 2 para 13 AWG defines "goods" as products, software and technology. Even though this interpretation does not explicitly state that the GwG and the AWG shall be interpreted in line, they may serve as an indication for a rather

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<sup>70</sup> Cf. [https://rp-kassel.hessen.de/sites/rp-kassel.hessen.de/files/content-downloads/Auslegungs-%20und%20Anwendungshinweise\\_0.pdf](https://rp-kassel.hessen.de/sites/rp-kassel.hessen.de/files/content-downloads/Auslegungs-%20und%20Anwendungshinweise_0.pdf), p. 13 (last consulted on 20 May 2018).

<sup>71</sup> Cf. [https://rp-kassel.hessen.de/sites/rp-kassel.hessen.de/files/content-downloads/Auslegungs-%20und%20Anwendungshinweise\\_0.pdf](https://rp-kassel.hessen.de/sites/rp-kassel.hessen.de/files/content-downloads/Auslegungs-%20und%20Anwendungshinweise_0.pdf), p. 16 (last consulted on 20 May 2018); Letter of the Financial Ministry dated 24 April 2012; VII A 3 – WK 5023/11 /10021.



extensive understanding of the term. This would conform to the general approach taken by the GwG as well as with the fact that also energy traders are regarded as Güterhändler.

In 2012 the Federal Ministry of Finance issued an interpretation dealing with the question of when a trader shall be regarded a Güterhändler. When issuing its interpretation letter the ministry implicitly dealt with the definition of "goods". One of the main characteristics of a Güterhändler shall be that such trade is effected by entering into a sale and purchase agreement within the meaning of Sec. 433 of the German Civil Code (as opposed to a service agreement).<sup>72</sup> In line with the historic origin of the GwG, the ministry intended to exclude service providers from the GwG: until 2008, all "other traders" were subject to the scope of application of the GwG. In accordance with the provisions of the earlier directive, the law should be limited to the group of persons dealing commercially in goods.<sup>73</sup> In this context, commercial service providers should primarily be excluded from the applicability of the law and, accordingly, a distinction should be made between providing services and trading in goods. In conclusion, the approach is to differentiate between Güterhändler and service provider as well as between goods and services.

The approach taken by the ministry brings up the question of whether a payment in token (which usually is the case in the token sales to date) can be regarded as payment of the purchase price within the meaning of Sec. 433 para. 2 of the German Civil Code. Such question is currently under discussion.<sup>74</sup> Denying this would lead to the issuer not acting as Güterhändler.<sup>75</sup> There are compelling reasons to argue that the sale and purchase agreement-criteria does not reflect what was intended when the definition of the person trading in goods was introduced in the GwG.<sup>76</sup> One main argument would be that the obligations of the person trading in goods refer to "transactions" within the meaning of the GwG. "Transaction" in turn is defined very broadly as any transfer of value (cf. Sec. 1 para. 5 GwG). This again shows the broad approach when determining money laundering sensitive areas. Restricting the definition of a person trading in goods to certain types of legal agreements underlying such transaction would be contradicting. Therefore, the approach of the ministry should not be deemed conclusive.

However, the general approach taken by the legislator as reflected in that adopted by the ministry should be noted: it is important to look behind the token. If the token is granting access to a platform or giving access to utilities, this may qualify as a "service" rather than a

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<sup>72</sup> Cf. Schreiben des Bundesfinanzministeriums vom 24.4.2012; VII A 3 – WK 5023/11/10021. (Letter from the Ministry of Finance).

<sup>73</sup> Cf. BT Drucksache 16/9038, explanatory memorandum to sec. 2 paragraph 1 No. 12 GwG.

<sup>74</sup> Cf. e.g. Beck/König JZ 2015, 130, 133 et seq.

<sup>75</sup> With respect to Bitcoin (BTC), i.e. a Cryptocurrency Token, cf. Spindler/Bille, WM 2014, 1357, 1362; Engelhardt/Klein, MMR 2014, 355, 359 understand the underlying agreement not to be sale and purchase agreement.

<sup>76</sup> Cf. Zeidler, CCZ 2014, 105, 108 et seq.

“good”. Therefore, trading with utility token should not trigger mandatory AML requirements.

### 3.4.3 DEVIATIONS FROM EU LAW

Also it is worthy to note that with respect to Germany the GwG requires the issuer to trade “on a commercial basis”. Therefore, even when arguing that tokens may qualify as “goods”, it is not possible to say that an entity accepting tokens during an ICO is trading in goods “on a commercial basis” and therefore qualifies as a good “trader”. The reason is that the reference to “on a commercial basis” (*gewerblich*) is read to be the same as the term used in the German Industrial Code (*Gewerbeordnung*).<sup>77</sup> Trade must be a recognizably planned, long-term, independent, profit-oriented, economic activity on the market through the trade of goods or merchandise. Since ICOs are not long-term but rather a one-time occasion, persons accepting tokens by a one-time ICO shall not fall under the “good traders” definition (the situation may differ for persons running regular ICOs and dealers such as crypto exchanges, who trade with tokens on a commercial basis).

### 3.4.5 NEW AML MEASURES REGARDING VIRTUAL CURRENCIES

In line with the AMLD 5 attempt to regulate Virtual Currencies and the G20 commitment to regulate crypto-assets for anti-money laundering and countering the financing of terrorism in accordance with FATF standards, BaFin – as some other European national competent authorities – has started to focus on AML issues in respect of Virtual Currency business. Whilst it is known that BaFin generally understands that Virtual Currency businesses require a licence and hence also compliance with the German AML regulations, it is now focusing on how the German financial market must deal with money transactions originating in Virtual Currency businesses. BaFin has yet started to tackle this issue by communicating to the German market through the consultation paper “Due diligence in relation to virtual currencies – guidance on appropriate risk-oriented approaches”.<sup>78</sup> In this consultation, it is recommended to draft a report of money transactions arising from Virtual Currency businesses. BaFin is using the Virtual Currency definition of the AMLD 5 without providing details on the understanding of this misleading – as argued above – definition. The German market has reacted critically to this approach by arguing that a) using the Virtual Currency definition for this purpose without giving clarification on its scope will trigger general suspicion against all token transactions (even for those which would not fall under AML requirements as explained above) and b) it is practically impossible for German banks to clarify the origin of money transactions with a Virtual Currency background.

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<sup>77</sup> Cf. Häberle, in Erbs/Kohlhaas, *Strafrechtliche Nebengesetze*, 217. EL Oktober 2017, Sec. 1 recital. 10.

<sup>78</sup> Cf. Konsultation 17/2018 – Rundschreiben „Sorgfaltspflichten im Zusammenhang mit virtuellen Währungen – Hinweise für ein angemessenes risikoorientiertes Vorgehen“. Available at: [https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Konsultation/2018/kon\\_1718\\_virtuelle\\_waerungen.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Konsultation/2018/kon_1718_virtuelle_waerungen.html) (last consulted on 12 December 2018).

## 3.5 FOREIGN TRADING ACT REPORTING DUTIES

### 3.5.1 ASSESSMENT

Accepting currency tokens with a value of more than EUR 12,500 may trigger reporting duties according to Sec. 11 of the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz, AWG*) together with Sec. 67 et seq of the Foreign Trade and Payments Regulation (*Außenwirtschaftsverordnung, AWM*). According to this reporting obligation all residents in Germany – natural and legal persons whose place of habitual abode, place of residence or domicile is in Germany – have to report payments of more than EUR 12,500 or the equivalent which they receive from non-residents or from residents for the account of non-residents (incoming payments) or make to non-residents or to residents for the account of non-residents (outgoing payments). Payments include credit transfers, cash payments, payments made by direct debit, cheque or bill as well as the contribution of assets and rights into enterprises, branches and permanent establishments.

Payment in token could be qualified as contribution in “assets” or “rights in enterprises, branches and permanent establishment”, respectively.

## 4. REGULATION IN RELATION TO TRADING IN TOKENS ON SECONDARY MARKETS

### 4.1 CAPITAL MARKETS LAW

#### 4.1.1 MAR –SPECIAL FEATURES OF GERMAN LAW

As explained above, utility tokens and cryptocurrency tokens should not fall under the securities concept of MiFID II. These tokens are, therefore, also not considered financial instruments under MiFID II and MAR.

In this context, it should be noted that the interpretation of the term financial instrument according to MiFID and MAR differs from the definition in the German Banking Act, despite the identical terminology. BaFin’s above described interpretation of token as a financial instrument does not refer to the concept of a financial instrument under MiFID II and MAR.

Since MTFs only refer to financial instruments according to MiFID II and MAR, crypto exchanges – which (exclusively) trade tokens that do not qualify as financial instruments – are not MTFs. Therefore, they do not fall within the scope of MAR. On the other hand, trading institutions where tokens qualifying as financial instruments are traded meet the characteristics of an MTF.

In its publication of 20 February 2018, BaFin does neither clarify the classification of crypto exchanges as financial market or capital market, nor as MTF or OTF. The classification of a crypto exchange as a MTF – since trading with units of account – has far-reaching regulatory consequences for the operator, who would be subject to licencing requirements under KWG.

BaFin is of the opinion that the listing of tokens from German token issuers to an unregulated foreign crypto exchange may lead to the German token issuer being included in the exchange activities which would require a BaFin licence.

In our opinion, this understanding is not correct. The listing of a token from a German token issuer who is actively seeking to list on a foreign crypto exchange cannot be actively targeting the German market by the relevant foreign crypto exchange, but is rather regarded as freedom to provide a passive service (e.g. reverse enquiry).

#### 4.1.2 GERMAN SECURITIES TRADING ACT/MAR REQUIREMENTS

The German Securities Trading Act and the WpHG covers the MAR provisions on market abuse in exchange and over-the-counter trading in financial instruments. Pursuant to Sec. 1 para. 2 s. 1 WpHG, the territorial scope of application also includes acts and omissions abroad if they relate to a token issuer domiciled in Germany, financial instruments traded on a domestic MTF or a domestic organised trading system or investment services or ancillary securities services offered on the domestic market.

With respect to market abuse monitoring, the WpHG extends the scope of MAR (Sec. 25 WpHG, Art. 15 in connection with Art. 12 para. 1 to 4 MAR) to:

- goods within the meaning of Sec. 2 para. 5 WpHG; and
- foreign means of payment within the meaning of Sec. 51 of the Stock Exchange Act,

which are traded on a domestic stock exchange or comparable market in other EEA member states.

The definition of "goods" in Sec. 2 para. 5 WpHG corresponds to the above definition of MAR and, therefore, does not include any services, copyrights and rights of use. The meaning of "fungible goods" and the example regulations do not include services, copyrights, etc. In our opinion, the sole purpose of Sec. 25 WpHG to include the scope of protection of commodity derivatives as regards the manipulation of the underlying assets, is not sufficient to extend them to other value categories.

Therefore, national legislators may consider extending the scope of secondary market regulation, i.e. the rules for post-issuance trading (so-called "secondary market"), to include (i) token rights traded on crypto exchanges, such as use rights, services and copyrights typically contained in utility tokens, and/or (ii) utility tokens themselves.

## 5. REGULATION OF TOKEN-RELATED SERVICES

In order to assess the licencing requirements of business models relating to tokens, we assume the following qualification of tokens, reflecting BaFin's practice:

Security tokens: the qualification as financial instruments according to the German Banking Act (KWG), as securities (and thus also as financial instruments) according to the German Securities Trading Act (WpHG), but not as securities according to the KWG for the purpose of securities custody as defined in Sec. 1 para. 1 s. 2 No. 5 KWG.

Utility tokens: in our opinion, it is possible that utility tokens are designed in such a way that they are not to be classified as financial instruments within the meaning of the KWG and the WpHG even though BaFin seems to be of the opinion that utility tokens may qualify as units of account and, thus, as financial instruments under the KWG. BaFin considers tokens that have a payment function as units of account, which means that the majority of all utility tokens would also be financial instruments. Clarification by BaFin is needed to create a clear legal understanding.

Crypto currencies can generally be qualified as financial instruments (units of account) within the meaning of the KWG, but not mandatory as financial instruments within the meaning of the WpHG.

In the following, the facts according to the KWG are discussed first. In a later section, the obligations relevant for investment services companies ("**WpDIU**") are then presented, which may apply to the framework of token business models. These are in particular the duties according to Sec. 63 et seq. WpHG. Thus, not all institutions providing investment services or ancillary services are included, but – apart from credit institutions – only those institutions which are to be classified as financial services institutions within the meaning of Sec. 1 para. 1a of the KWG and the branches of companies domiciled abroad which are regarded as credit or financial services institutions pursuant to Sec. 53 para. 1 s. 1 KWG.

### 5.1 INVESTMENT ADVICE (SEC. 1 PARA. 1A S. 2 NO. 1A KWG, SEC. 2 PARA. 8 S. 1 NO. 10 WPHG)

Under the KWG, anyone offering investment advice in relation to financial instruments requires a permit from BaFin. Investment advice in relation to security tokens or cryptocurrency tokens is, therefore, qualified as a regulated activity and requires prior approval by BaFin.

Investment advice with regard to utility tokens that do not qualify as financial instruments is basically not a regulated activity within the meaning of the KWG. In most cases, however, the investment advice refers to the purchase of utility tokens in exchange for crypto currencies.

In such cases, the investment recommendation for the purchase of the utility token in exchange for a cryptocurrency (e.g. Bitcoin) consists of two recommendations. The first in the form of buying the utility token and the second in the form of selling the cryptocurrency. As the second recommendation refers to a financial instrument, the entire activity would be considered as investment advice within the meaning of the KWG, since the recommendation also refers to a financial instrument. Regardless of the current uncertainty regarding the regulatory qualification of utility tokens, the investment recommendation regarding the acquisition of utility tokens in exchange for crypto currencies qualifies as activity subject to authorisation under the KWG. Only in cases where the investment advice relates to a transaction in which no financial instrument is involved (such as the acquisition of a utility token in exchange for fiat money) does the activity not qualify as investment advice requiring authorization.

## 5.2 FINANCIAL PORTFOLIO MANAGEMENT (SEC. 1 PARA. 1A S. 2 NO. 4 KWG, SEC. 2 PARA. 8 S. 1 NO. 7 WPHG)

The same principles also apply to the provision of financial portfolio management in accordance with Sec. 1 para. 1a s. 2 No. 4 KWG.

## 5.3 INVESTMENT BROKERAGE (SEC. 1 PARA. 1A S. 2 NO. 1 KWG, SEC. 2 PARA. 8 S. 1 NO. 4 WPHG)

Based on BaFin's administrative practice, investment brokerage comprises (i) the transmission of orders for the purchase or sale of a financial instrument from the buyer or seller to the other person or (ii) the promotion of a person's willingness to acquire a specific financial instrument.

Transmission may also take the form of an electronic platform which transmits offers to purchase or sell a financial instrument from one member to another member of the platform.

Just like investment advice, investment brokerage also requires prior written approval by BaFin. Thus, anyone operating a (electronic) platform that transmits orders for the purchase of crypto currencies, security, utility tokens that qualify as a financial instrument from one participant to another participant requires prior approval by BaFin.

Investment brokerage in relation to utility tokens that are not qualified as financial instruments (note, however, that BaFin tends also to qualify certain utility tokens as financial instruments under KWG) is not an activity requiring authorisation within the meaning of the KWG, unless the utility token is acquired or sold in exchange for security tokens or cryptocurrency tokens. In the latter case, the activity would be classified as investment brokerage in relation to the cryptocurrency or the security token.

#### 5.4 MULTILATERAL TRADING SYSTEMS PURSUANT TO SEC. 1 PARA. 1A S. 2 NO. 1B KWG, SEC. 2 PARA. 8 S. 1 NO. 9 WPHG (74 WPHG)

The same principles also apply to the operation of a multilateral trading system, as which the common crypto exchanges qualify, pursuant to Sec. 1 para. 1a s. 2 No. 1b KWG, the operation of which requires a licence under the KWG if the tokens traded on such a multilateral trading system qualify as financial instruments within the meaning of the same law.

In the case of multilateral trading platforms that are not domiciled in Germany, a question arises as to the applicability of the KWG. Only banking and financial services provided in Germany are subject to a licencing requirement according to Sec. 32 KWG. In the case of electronic trading platforms, it is controversially discussed which domestic reference is required. The prevailing view requires either a physical presence in Germany or active solicitation/marketing of the German market. The mere possibility for German customers to use an electronic trading platform (“reverse solicitation”) that is not domiciled in Germany is not sufficient to trigger a German licencing obligation.

However, BaFin has indicated that it may consider an issuer of tokens addressing the German market even if the issuer is only actively trading its tokens on a multilateral trading system abroad, when the issuer has offered its tokens for purchase also in Germany as part of an ICO.

In practice, such administrative practice would mean that the targeted distribution of tokens in Germany would exclude the trading of these tokens on a crypto exchange, as this would mean that the crypto exchange would address the German market in a targeted manner and, thus, require a licence to operate a multilateral trading system in Germany.

According to BaFin's previous administrative practice on cross-border financial services, foreign providers must take into account the activities of persons operating in Germany and targeting the German market, if the foreign provider uses these as a distribution network for its services in Germany. In this respect, it seems to be more appropriate to question whether the operator of the crypto exchange actively offers its services in Germany, to focus on whether the token issuer advertises or makes known the trading possibility of its tokens in Germany in coordination with the crypto exchange, than on the operation of the commencement of trading of the tokens by the token issuer. By merely accepting the tokens for trading, the operator of the crypto exchange does not yet offer its services to German customers in a targeted manner, as there is no communication between the crypto exchange or token issuer and German investors that is necessary for distribution.

In connection with BaFin's understanding, there is also the problem that crypto exchanges admitted in other European countries as multilateral trading systems cannot offer their activities in Germany under the EU passport regime due to the different definitions of the

financial instrument in the KWG and MiFID II, even by way of cross-border trade in services under Sec. 53b KWG. A prerequisite for the EU passport regime is that the business in question is approved by the company in its home country. For activity authorisation in other EU Member States under the EU passport regime, the relevant company must indicate which financial services are to be provided under MiFID II in the other EU Member State and in relation to which financial instruments. However, companies from EU Member States that have designed the licencing requirement for multilateral trading systems in accordance with MiFID II, do not require a licence to operate a multilateral trading system with regards to the trading of units of account. This is to say that, in principle, this activity cannot be provided under the EU passport regime.

Hence, BaFin should clarify that companies offering a multilateral trading system for other financial instruments in Germany by way of cross-border trade in services in accordance with Sec. 53b KWG are also entitled to offer this multilateral trading system in Germany under the EU passport regime for units of account.

Furthermore, the operation of a crypto exchange in Germany would have to deal with the restriction under Sec. 74 para 1 German Securities Trading Act together with Sec. 19 para 2 and 4 German Stock Exchange Act (*Börsengesetz*), whereby only professional market participants are allowed to act as a market participant of a multilateral trading system. Almost every crypto exchange has not limited its access to such professional market participants but also allows consumers to directly trade on the exchange without requiring an intermediary.

The purpose of Sec. 74 WpHG together with Sec. 19 para. 2 and 4 German Stock Exchange is to ensure – because of the high trade volume – the proper operational capability of the relevant exchange in multilateral trading facility by only allowing professional experienced participants with sufficient financial liquidity that trade in a professional way.<sup>79</sup> In particular all market participants should rely on the fact that the other market participants have sufficient financial means to fulfil the obligations from the concluded trades as the settlement takes place a few days later.<sup>80</sup>

The aforementioned considerations for the restriction of the access to stock exchanges do not apply to crypto exchanges. The participants of crypto exchanges are in most cases only allowed to trade tokens at the crypto exchange they used before and in particular where a wallet is already held. Therefore, the counterparty risk at stock exchanges (in case of a central counterparty, it takes such risk) does not exist in a same way at crypto exchanges. Furthermore, the trading volume at crypto exchanges is currently not comparable to the

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<sup>79</sup> Beck, Schwark/Zimmermann, Capital Market Law, BörsG, § 19 marginal 1.

<sup>80</sup> Beck, Schwark/Zimmermann, Capital Market Law, BörsG, § 19 marginal 2.



trading volume on stock exchanges, limiting their importance vis-à-vis the economic system as compared with that of the stock exchanges.

## 5.5 CUSTODY BUSINESS (SEC. 1 PARA. 1 S. 2 NO. 5 KWG)

Custody business is the safekeeping and administration of securities for third parties. In this context, the securities are only securities within the meaning of Sec. 1 para 1 of the German Securities Accounts Act. These include documents which certify a right in such a way that only the holder of the document can exercise this right.<sup>81</sup> The tokens discussed here are not represented by a certificate and therefore do not qualify as securities within the meaning of the Custody Act. The safekeeping of tokens for third parties is, therefore, not regarded as custody business within the meaning of the KWG.

Custody business is also an ancillary securities service within the meaning of Sec. 2 para. 9 No. 1 WpHG. The definition of custody business under the WpHG differs from the definition in the KWG. The custody business within the meaning of the WpHG comprises the safekeeping and administration of financial instruments (within the meaning of the WpHG) for others, including related services.

According to Sec. 84 WpHG, a WpDIU must take measures to protect the ownership rights of its customers in financial instruments held by the investment service provider. Such an investment service provider is obliged to pass on securities which it receives from clients in the course of providing investment services to a credit institution which is authorised to conduct custody business (in accordance with the KWG). If this provision were to directly apply to tokens that qualify as securities within the meaning of the WpHG but not within the meaning of the KWG or the German Securities Deposit Act (DepotG), the investment services company would be faced with the problem that such tokens are not currently accepted for safekeeping by credit institutions. Nor do we recognise the need to keep tokens in safe custody at banks that are specially authorised for the custody business. Therefore, with regard to tokens, we are of the opinion that Sec. 84 para. 3 WpHG requires that the relevant investment services company must take measures to ensure that the economic control over the tokens remains with the respective customer. It is not necessary to transfer the tokens to a credit institution for safekeeping, as the tokens do not qualify as securities within the meaning of Sec. 1 para. 1 of the DepotG.

Furthermore, it should be noted that according to the WpHG, WpDIU are only credit institutions or financial service providers that provide securities services according to WpHG exclusively or together with ancillary securities services. The sole provision of ancillary securities services, therefore, does not lead to a qualification as WpDIU according to WpHG.

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<sup>81</sup> Scherer, Securities Accounts Act, 1st version 2012, Sec. 1 marginal 2.

As a result, companies that only offer the storage of tokens do not require permission under the KWG and do not qualify as WpDIU under WpHG. They are, therefore, not required to comply with the duties of conduct and organisation set out in the WpHG, which includes Sec. 84 WpHG.

Companies that also provide other investment services, such as investment advice, investment brokerage or financial portfolio management in relation to tokens and are licenced as financial services institutions under the KWG, qualify as investment services companies and must, therefore, comply with the duties of conduct and organisation under the WpHG. In our opinion, however, this only means that, with regard to the safekeeping of tokens, they must take measures to ensure that the economic control over the tokens remains with the respective customer. However, it is not necessary to transfer the tokens to a credit institution for safekeeping purposes, as tokens do not qualify as securities within the meaning of Sec. 1 para. 1 of the DepotG.

Companies that provide wallet storage services for tokens will, from January 2020 at the latest, fall into the scope of the German Anti-Money Laundering Regulations. Until 10th of January 2020 the fifth European Anti-Money Laundering Directive (Directive (EU) 2018/843, 5 AMLD) must be transposed into the relevant national law. The 5 AMLD expands its scope to custodian wallet providers, which are defined as an entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer virtual currencies. The Directive defines virtual currencies as a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically. Based on such definitions entities that offer the safekeeping of tokens in form of wallets will (together with providers that are engaged in the exchange services between virtual currencies and fiat currencies) fall within the scope of the AML regulations.

## 5.6 TRADING ON OWN ACCOUNT (SEC. 1 PARA. 1A S. 3 KWG)

A proprietary transaction is the purchase and sale of financial instruments on own account, which is not proprietary trading. Own-account transactions only require prior approval in accordance with the KWG under certain conditions. Under Sec. 32 para. 1a s. 2 KWG, a licence is required if the proprietary transaction is operated as a member or participant of a regulated market or a multilateral trading system. Crypto exchanges generally meet the definition of a multilateral trading system. In addition, the users of such crypto exchanges place their orders directly on the respective exchange and, unlike securities exchanges, not via a financial intermediary. Therefore, the users of crypto exchanges act as members or participants of a multilateral trading system. This means that on the basis of the wording of Sec. 32 para. 1a s. 2 KWG, a person domiciled in Germany who buys or sells tokens commercially on a crypto exchange would require prior permission under the KWG.

The obligation to obtain a licence for own-account transactions as a member or participant of a regulated market or a multilateral trading system was incorporated into the KWG within the framework of the Second Financial Market Amendment Act and implemented Art. 2 para. 1 lit. d (ii) of MiFID into national law. According to Art. 2 para. 1 lit. d (ii) of MiFID, Member States should take measures to require prior authorisation for persons acting on their own account as members or participants of a regulated market or multilateral trading system in financial instruments as defined in Section C of Annex I to MiFID.

The definition of financial instruments in Section C of Annex I to MiFID differs from the definition of financial instruments under the KWG and does not include units of account. The German legislature has, therefore, extended the licencing requirement for own-account transactions to activities not covered by Directive 2014/65/EC.

The legislature has stated in the legislative documents that it intends to transpose MiFID 1:1 into national law.<sup>82</sup> Where the legislator has introduced additional requirements or stricter provisions in national law than in MiFID, these are clearly mentioned in the legislative documents. These do not indicate that the legislator intended to extend the licencing requirement of Sec. 32 para. 1a s. 2 KWG to constellations that do not fall within the scope of MiFID. There are strong signs that the legislator has unintentionally introduced a licencing obligation for the proprietary transaction of tokens as a member or participant of a multilateral trading system. This requires that the scope of the licencing obligation be limited to cases that are covered by the requirements of MiFID for such a licencing obligation.

Therefore, we consider that, currently, only own transactions in security tokens as a member or participant of a regulated market or multilateral trading system are subject to an authorisation under the KWG. But as set out before, the considerations to restrict the possibility to act as a market participant of a stock exchange to professional market participants do not apply to crypto exchange and the market participants of a crypto exchanges in the same way. Therefore, from a regulatory perspective it seems doubtful that market participants of a crypto exchange trading at in security tokens should be subject to a licence requirement under the KWG.

## 5.7 DUTY OF CONDUCT FOR INVESTMENT SERVICE PROVIDERS

Where financial services are carried out with regard to tokens that also qualify as securities under the WpHG, certain WpHG provisions, including organisational and conduct rules, must be complied with.

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<sup>82</sup> BT-Drucksache 18/10936, P. 3.

In addition to the general rules of conduct listed in Sec. 63 WpHG, which must always be complied with when providing investment services, there are also a number of obligations which apply to certain categories of securities' transactions, depending on the particularities of the concrete case. For example, the existence of investment advice or financial portfolio management offers the highest level of protection – including requiring a suitability test to be carried out, whilst for non-advisory business, only an adequacy check is needed.

WpDIUs are obliged to comply with certain general and special rules of conduct. These include, for example:

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### GENERAL RULES OF CONDUCT

- *Obligation to protect interests.* For example, to provide securities (ancillary) services with the necessary expertise, diligence and conscientiousness in the best possible interest of its clients.
- *Obligation to avoid conflicts of interests.* However, if conflicts of interest are unavoidable, the investor must be informed of the nature and origin of these and of steps taken to limit associated risks.
- *Obligations relating to design and distribution.* For example, determining the target market.
- *Duty to provide information to clients,* and that this be accurate and not misleading. Clients must be informed in a timely and comprehensible manner so that they can reasonably understand the nature and risks of the tokens and the associated investment services and make their investment decisions on this basis.<sup>83</sup>

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### SPECIAL RULES OF CONDUCT

The WpHG (Sec. 64) also regulates special rules of conduct. In particular, various rules regarding the provision of information prior to any investment and as part as any provision of investment advice and financial portfolio management. These include, for example:

- suitability of the product.
- a short and easily comprehensible information leaflet on the relevant financial instrument must be made available to a private customer in good time before the conclusion of a transaction ("*package insert*").
- Customer exploration and a suitability tests.

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<sup>83</sup> Sec. 63 para. 7 s. 1 WpHG [Sec. 31 para. 3 s. 1 WpHG]

- must provide the private client with a so-called "*declaration of suitability*" prior to conclusion of the contract.

Other material obligations in individual cases relate to the prohibition of the acceptance of donations and recording obligations with regard to telephone conversations and electronic communication.<sup>84</sup>

## 5.8 VOTING RIGHT DISCLOSURE OBLIGATIONS

Pursuant to Sec. 33 WpHG, anyone holding more than 3 per cent of the voting rights of an issuer's shares, registered in Germany, is obliged to disclose such holding to the issuer, to BaFin and the public. As such disclosure obligation only applies to shares, the provision does not apply to security tokens which do not have a link to shares, even if these tokens have specific voting rights.

Additionally, however, pursuant to Sec. 38 WpHG also the holding of 5 per cent of specific instruments that either give a right to acquire shares or have a similar economic effect as instruments that provide a right to acquire shares, even if the instruments do not provide for a physical settlement of shares, will have to be disclosed. Instruments of the latter category would be contract for differences for example.

With regard to tokens that represent shares, depending on the token structure, BaFin usually considers such tokens will have a similar effect to instruments that give the right to acquire shares if the issuer of the relevant token representing a share holds such share to hedge itself against any potential claims against the token. In such cases holdings of tokens representing 5 per cent of the underlying shares will have to be disclosed pursuant to Sec. 38 WpHG.

## 5.9 CONCLUSIONS AND RECOMMENDATIONS ON GERMAN LAW

With regard to investment advice, investment brokerage and portfolio management, in most cases there is an obligation to obtain a licence under the KWG and, as a result, the conduct of business rules of the WpHG must be complied with. Even tokens that cannot be classified as financial instruments within the meaning of the KWG are usually provided simultaneously with respect to tokens that qualify as financial instruments. We do not see any need for additional regulation of the provision of these activities with regard to tokens, other than that we recommend supplementing the relevant BaFin circulars, such as the so-called "*Minimum Requirements for Compliance*" (MaComp), in particular as concerns the provisions regarding investor's information.

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<sup>84</sup> Sec. 70 WpHG) and Sec. 83 para. 3 et seq. WpHG.

We note, however, the demand from professional investors for the safekeeping of tokens as a service and applying familiar professional standards. However, beyond that, we currently see no immediate need for additional regulation of the safekeeping of tokens on behalf of others due to the significant differences between the safekeeping of tokens and the safekeeping of securities. It is not necessary for token holders to use a provider to store their tokens – each token holder can store their tokens in an individual wallet for which only the token holder has the private key. On the other hand, for most securities the holder of the securities is not in a position to hold the relevant securities themselves and, therefore, needs a service provider to hold the securities on his behalf.

With regard to licencing requirements for own transactions, whether as a member or participant of a regulated market or a multilateral trading system, it would be desirable for BaFin or the German legislator to clarify that such licencing requirements.

V.  
GIBRALTAR

## V. GIBRALTAR

### 1. INTRODUCTION

It should be noted that Gibraltar forms part of the European Union (“EU”) by virtue of section 355(3) TEU, as a European territory for whose external relations a Member State (the UK) is responsible. While Gibraltar is exempt from several aspects of the EU legal order (e.g. it is outside the Customs Area, Common Commercial Policy, Common Agricultural and Fisheries Policies and the requirement to levy VAT), EU law applying to securities, money laundering, prospectus requirements, consumer rights, and other matters referred to below have full effect in Gibraltar. This will remain the case until at least 31 October 2019, the day that the UK is scheduled to leave the EU, and probably until at least the end of 2020, given Gibraltar’s provisional inclusion within the territorial scope of the EU-UK draft Withdrawal Agreement and the draft transitional provisions contained therein.

Her Majesty’s Government of Gibraltar (“HMGOG”) has consistently positioned itself as a global leader in the distributed ledger technology (“DLT”) space. On 1 January 2018, HMGOG brought into effect the DLT regulatory framework (“DLT Regulations”) defined on a principles basis with the ability to be applied proportionately to the business in question, providing businesses with the regulatory certainty that has been pursued by so many for so long. The intention is not to exclude certain activity from the existing regulatory frameworks but, rather, to create a specific framework for businesses that use DLT to “store or transmit value belonging to others” that may not have been subject to regulation under another existing framework in Gibraltar. Similarly, the purpose is to build a framework that can continue to evolve and allow for the Gibraltar Financial Services Commission (“GFSC”) to set appropriate and proportionate conditions or restrictions (for further detail on the DLT Framework see <https://www.fsc.gi/dlt>).

In regards to the issue of token sales, Gibraltar is similarly at the forefront. The GFSC released a public statement on 22 September 2017 (the “GFSC Statement”) noting the increasing use of tokens based on DLT as a means of raising finance, especially by early stage start-ups. The GFSC also noted that these new ventures were highly speculative and risky, that early-stage financing is often best undertaken by experienced investors, and set out matters that ought to be considered by anyone thinking of investing in tokens. In addition, the statement set out an intention to regulate the “promotion and sale of tokens.” HMGOG has publicly announced its intention to introduce regulations relating to, amongst other things, the promotion and sale of tokens in and from Gibraltar and set out its proposals in a document issued on 12 February 2018 (the “Token Framework Proposal”). This document sets out proposals for the regulation of token sales, secondary token market platforms, authorised sponsors of public token offerings and investment and ancillary services relating



to tokens. HMGOG hopes to have the legislation in place imminently. The Token Framework Proposal can be read here: <http://gibraltarfinance.gi/20180309-token-regulation---policy-document-v2.1-final.pdf>.

HMGOG indicated the legislation is not, however, intended to regulate the underlying technology, tokens, smart contracts or their functioning, individual public token offerings or persons involved in the promotion, sale and distribution of tokens.

## 2. SECURITIES UNDER GIBRALTAR LAW

In cases where tokens meet the necessary criteria to make them securities, various regulatory consequences will be triggered, such as the Prospectuses Act 2005 and/or the Financial Services (Markets in Financial Instruments) Act 2006. This legislation transposes the EU's Prospectus Directive and Markets in Financial Instruments Directive ("MiFID") respectively. Even though considered unlikely at present, there may also be an additional layer of requirements under the legislation bringing into effect the Token Framework Proposal, for any security that is 'tokenised'.

### 2.1 TRANSFERABLE SECURITIES

Transferable securities are defined at section 2(1) of the Financial Services (Markets in Financial Instruments) Act 2006: "*transferable securities*" means those classes of securities which are negotiable on the capital market, other than instruments of payment, such as –

- (i) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
- (ii) bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
- (iii) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

This definition implements the MiFID standard. It is therefore not materially different to the standard that applies in other EU states.

## 2.2 PROSPECTUS LEGISLATION

Under the Prospectuses Act 2005, “securities” means transferable securities as follows:

- a) shares in companies and other securities equivalent to shares in companies which are negotiable on the capital market;
- b) bonds and other forms of securitised debt which are negotiable on the capital market;
- c) any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement,
- d) excluding money market instruments having a maturity of less than 12 months.

The classification as a “security” triggers various consequences, the requirement to issue a prospectus when offering securities publicly, is only one example of such a requirement, to the extent the issuer of securities is unable to benefit from any exemptions. The most relevant ones in the context of a token sale would be as follows:

- where the offer is addressed only to qualified investors;
- where the offer is addressed to fewer than 150 persons per Member State, other than qualified investors;
- where the minimum consideration which may be paid by any person for securities acquired by him pursuant to the offer is at least 100,000 Euros (or an equivalent amount);
- where the securities being offered are denominated in amounts of at least 100,000 Euros (or an equivalent amount); and
- where the total consideration payable in the European Union for the securities being offered is less than 100,000 Euros (or an equivalent amount), which limit is calculated over a period of 12 months.

## 2.3 CONCLUSION ON “SECURITIES” UNDER GIBRALTAR LAW

The GFSC Statement sets out the GFSC’s general position in this regard. The GFSC stated, inter alia :

“tokens vary widely in design and purpose. In some cases, tokens represent securities, such as shares in a company, and their promotion and sale are regulated as such. More often, tokens serve some cryptocurrency or functional use that is unregulated, such as prepayment for access to a product or service that is to be developed using funds raised in the ICO.”

As the GFSC Statement suggests, in most cases tokens are currently bought and sold in an unregulated space. The focus of the GFSC's statement is on warning inexperienced investors of the risks associated with ICOs, rather than asserting that certain types of tokens are caught within the GFSC's current regulatory remit.

The reality is that "securities" is an imprecise term which takes its colour from its setting. Accordingly, the classification of a token as a "security" will ultimately depend on what the role, purpose and features of the token are and it also is necessary to consider what market participants themselves consider to be a 'capital market'. Generally, one main difference between capital markets and other parts of the financial markets is the ongoing relationship between the issuer and the investor based on the traded instruments. For instance, it is highly unlikely that under Gibraltar law, a token will constitute either shares in a company or securities equivalent to shares in a company if they do not confer on the holder any form of right to participate in, or benefit from, the capital, assets or financial returns of any entity, or confer any voting rights with respect to any entity or any other rights to participate in decision making in relation to company assets or strategy. Similarly, it is also highly unlikely that a token will be deemed to constitute debt security if it does not create or acknowledge any indebtedness and does not entitle holders to any interest payment or other benefits usually associated with such debt securities.

A distinction must also be drawn between the concept of a "security" on the one hand and a "financial instrument" (within the meaning in MiFID) on the other, with the latter being the broader term. "Securities" are one of several sub-categories of "financial instruments". Regulatory requirements may therefore also arise for non-securities that are classified as "financial instruments". This includes the requirements arising under the Financial Services (Markets in Financial Instruments) Act 2006 which, in addition to applying to businesses providing certain investment services or engaging in certain activities with clients in relation to financial instruments, also defines "financial instruments" in a wide form, including forms of commodity derivative contracts and arrangements that may apply to any asset or right of a fungible nature (under certain conditions).

Whilst the definition of "securities" will not change, the way the sale of tokens qualifying as "securities" is undertaken, or the requirements around the 'tokenisation' of such instruments may change, as and when the legislative proposals set out in the Token Framework Proposal are implemented.

## 2.4 INVESTMENT LAW

Similarly, collective investment scheme ("CIS") law such as the Financial Services (Collective Investment Schemes) Act 2011 is another relevant legal consideration.

Under the Financial Services (Collective Investment Schemes) Act 2011, a "collective investment scheme" means:

*“any arrangement with respect to property, the purpose or effect of which is to enable persons taking part in the arrangement, whether by becoming owners of the property or any part of it or otherwise, to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”.*

There can be many scenarios where tokens may not be defined as “securities” but may still be deemed to represent units in a CIS. In this case, a number of points would need to be considered, including the relevant exemptions and carve outs that may, under certain circumstances, be relevant.

In addition to the above, the definition of an alternative investment fund (“AIF”) under the Financial Services (Alternative Investment Fund Managers) Regulations 2013, which transposes the E.U. Directive relating to alternative investment funds, needs to be considered. An AIF is deemed to be any collective investment undertaking that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. If the arrangement is considered to form an AIF, or a token is deemed to represent a unit in an AIF, there are multiple considerations that become relevant, both in terms of the sale, promotion, and management of that scheme as well as the depositary arrangements for those units.

In many cases, tokens should not normally risk being a CIS. However, a token that acts as a vehicle through which profits or income are shared or pooled, or where the investment is managed as a whole by a market participant, for instance the issuer of tokens, is likely to be a CIS.

## 3. REGULATION OF THE OUTPUT OF TOKENS

### 3.1 DUTY TO PUBLISH A PROSPECTUS

Due to the impending exit of the UK and Gibraltar from the EU, there is uncertainty as to the applicability of the EU Prospectus Regulation (EU) 2017/1129 in Gibraltar when the Regulation comes into force on 21 July 2019. Assuming Gibraltar is included within the territorial scope of the transitional provisions of the EU-UK Withdrawal Agreement, the Prospectus Regulation will apply in Gibraltar and will remain in force until at least 2020. HMGOG has not signalled a desire to diverge from this legislation, even if at some point in the future this becomes a legal possibility. Irrespective of what the UK’s departure from the European Union looks like, arrangements have been put in place between the UK and Gibraltar for access of each other’s markets. These arrangements will be through deemed ‘passporting’ rights and ensure that that Gibraltar licensed financial services firms continue to have access to UK markets, once the UK leaves the EU, even in a no deal scenario. This

provides the only guaranteed access point into the United Kingdom market, which places Gibraltar in a unique position in the backdrop of the current Brexit uncertainty.

### 3.2 CIVIL LAW

The law of contract in Gibraltar is similar to the law in England and Wales. English common law applies in Gibraltar in accordance with the English Law (Application) Act 1962. Unlike certain civil law jurisdictions, there is no general duty of disclosure in pre-contractual negotiations. Such a duty only exists when there are particular reasons for disclosure. These can be based on a pre-existing relationship between the parties, such as a fiduciary or confidential relationship<sup>85</sup>, or when the nature of the contract carries specific duties of disclosure.

Investors dealing with each other at arm's length are therefore expected to do their due diligence. Unless one party's mistake of fact is due to misrepresentation by the other party (or some other vitiating factor, such as duress) the parties will usually be held to their contractual commitments under Gibraltar law.

In short, a token issuer in Gibraltar is under no general duty of pre-contractual disclosure, but is prevented from inducing a purchase of tokens by misrepresenting (whether fraudulently or negligently) the nature of the arrangement.

### 3.3 IMPLEMENTATION OF E-COMMERCE AND CONSUMER PROTECTION REGULATIONS INTO GIBRALTAR LAW

All the relevant EU legislation on e-commerce and consumer protection has been transposed into Gibraltar law via various Acts of Parliament or Regulations. The EU e-commerce and consumer protection rules (E-Commerce Directive, Consumer Rights Directive, Directive on Distance Marketing of Consumer Financial Services) all specify the information that should be disclosed. The relevant provisions applicable under Gibraltar law are detailed below.

If the token is offered online, it falls within the scope of the EU's e-commerce Directive which has been transposed into Gibraltar law through the Electronic Commerce Act 2001. Regarding the type of information that must be provided when concluding electronic contracts, section 6(1) states: a service provider shall ensure (unless agreed otherwise with a prospective party to the contract who is not a consumer) that the following information is available clearly and in full before conclusion of the contract:

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<sup>85</sup> Tate v Williamson (1866) LR 2 Ch App 55.

- a) the steps to follow to conclude the contract;
- b) whether the contract, when concluded, will be accessible and, if so, where;
- c) the steps to follow to correct any errors made in input by the recipient of the service; further, such steps must be effective and accessible allowing the recipient to identify and correct any errors without difficulty;
- d) any general terms and conditions imposed by the service provider, further, such general terms and conditions must be accessible to the recipient of the service for him to store and retrieve them.

If the contract on which a token sale is based constitutes a consumer contract, further consumer protection rules apply, as set out in the Consumer Rights on Contracts Regulations 2013 (which transposes, inter alia, the Consumer Rights Directive).

### 3.4 MONEY LAUNDERING REGULATIONS

The EU Anti Money Laundering Directive has been transposed into Gibraltar law by the Proceeds of Crime Act 2015 (“POCA”). It should be noted that Section 9(1)(p) of the POCA now includes within the definition of “*relevant financial business*” any “undertakings that receive, whether on their own account or on behalf of another person, proceeds in any form from the sale of tokenized digital assets involving the use of distributed ledger technology or a similar means of recording a digital representation of an asset.” POCA also requires reporting (by businesses and by the GFSC) when there is a suspicion (rather than actual knowledge) of money laundering. Essentially, the addition of the new definition of “*relevant financial business*” specifically brings the sale of a token within existing AML laws, which in turn have been very well received by other service providers in the industry. Amongst other things, customer due diligence is required before a business may receive proceeds from the sale of tokens. These businesses would also be required to appoint a money-laundering reporting officer (“MLRO”), as well as apply certain record keeping requirements. The business must also maintain an AML compliance program and report suspicious activity.

In essence, any entity issuing tokens, whether security, utility, cryptocurrency, hybrid or otherwise, would be subject to POCA requirements in full, from the moment it invites expressions of interest.

The Regulatory Principles set out at Schedule 2 to the Financial Services (Distributed Ledger Technology Provider) Regulations 2017 also state that a “*A DLT Provider must have systems in place to prevent, detect and disclose financial crime risks such as money laundering and terrorist financing.*”

## 4. REGULATION IN RELATION TO TRADE IN TOKENS ON SECONDARY MARKETS

The DLT Regulations establish a licensing regime for individuals and firms that engage in activities that, for business purposes, use DLT for the transmission or storage of customers' assets. It is generally accepted that the DLT Regulations do not extend to the generation and sale of tokens. This is in line with public statements made by various bodies, including HMGOG, and is consistent with the Token Framework Proposal. However, there may be instances where a token issuer may fall within the scope of the DLT Regulations, although this should be considered separately from the actual token sale, which may remain unregulated until the new legislation referred to above comes into effect.

The DLT Regulations state that the provision of DLT services is a '*controlled activity*' for which a license is required from the GFSC. The activity is defined in section 3 of the underlying Financial Services (Investment and Fiduciary Services) Act as "*carrying on by way of business, in or from Gibraltar, the use of distributed ledger technology for storing or transmitting value belonging to others.*"

Entities that qualify as DLT Providers under the DLT Regulations are required to abide by the regulatory principles that are set out in Schedule 2 of the Regulations, namely a DLT Provider must

1. conduct its business with honesty and integrity.
2. pay due regard to the interests and needs of each and all its customers and must communicate with them in a way that is fair, clear and not misleading.
3. maintain adequate financial and non-financial resources.
4. manage and control its business effectively, and conduct its business with due skill, care and diligence; including having proper regard to risks to its business and customers.
5. have effective arrangements in place for the protection of customer assets and money when it is responsible for them.
6. have effective corporate governance arrangements.
7. ensure that all of its systems and security access protocols are maintained to appropriate high standards.
8. have systems in place to prevent, detect and disclose financial crime risks such as money laundering and terrorist financing.
9. be resilient and have contingency arrangements for the orderly and solvent wind down of its business.

Persons who are not DLT Providers but who are otherwise licensed by the GFSC may provide DLT services if they are doing so in order to improve their controls, procedures and processes. Like all GFSC licensees they are required to comply with conduct of business rules that the regulatory principles above are broadly designed to reflect.

The application process under the DLT Regulations requires applicants to be able to demonstrate a clear focus on the nine core principles that the DLT Regulations are built around, and a high standard of regulatory adherence is expected. As part of demonstrating adherence with the nine principles, secondary market operators must clearly illustrate the processes they have in place relating to amongst other things, custody of assets and the security measures underpinning this, best execution of transactions and market abuse, therefore outlining the checks that are in place to ensure the protection of client assets and their fair treatment as clients.

Operating a secondary market platform for trading tokens is regulated in Gibraltar under the DLT Regulations.

The Token Framework Proposal covers the regulation of secondary market platforms, operated in or from Gibraltar as an additional layer to the DLT Regulations and, to the extent not covered by other regulations, their derivatives, with the aim to ensure that such markets are fair, transparent, and efficient.

At this stage, the Token Framework Proposal does not elaborate on the specific regulatory obligations that will be imposed. However, it does highlight the introduction of further transaction reporting and disclosure requirements, as well as extending its application to cover trading of derivative token products. Ultimately, whether any form of structured, derivative or related instrument falls within MiFID II and/or the DLT Regulations would be the subject of detailed analysis of the product, its intended design and use within the DLT system.

The Token Framework Proposal also mentions modeling the proposed regulations on market platform provisions under MiFID II and the Markets in Financial Instruments Regulation (MiFIR), so far as is appropriate, proportionate, and relevant.



#### 4.1 CAPITAL MARKET LAW

Tokens serving some cryptocurrency or functional use, such as the advance sale of products that entitle holders to access future networks or consume future services, or virtual currency, serving principally as a medium of exchange within an ecosystem (or marketplace) of consumers and service providers, should not fall under the securities concept of MiFID II as transposed into Gibraltar law. These tokens should generally not be considered financial instruments under Gibraltar law.

However, with respect to futures contracts, where the ‘underlying’ is a token of the type mentioned immediately above, may nevertheless be considered derivative instruments under the relevant financial services legislation.

Ultimately, whether or not a token will fall within a currently existing financial services framework will be determined by a token’s intended design, use and the rights it intends to provide.

#### 4.2 GIBRALTAR CRIMINAL LAW REGARDING THE MANIPULATION OF MARKETS

Market abuse is punishable under the criminal law of Gibraltar. Under section 20(1)(j) of the Market Abuse Act 2016, the GFSC may refer a matter for criminal prosecution. Whilst there is no equivalent law applying to DLT Providers, they are still required to monitor market manipulation techniques in relation to the markets operated. Market manipulation is likely to become an additional regulatory “principle” under which DLT Providers must operate.

### 5. REGULATION OF TOKEN-RELATED SERVICES

Tokens, which are not “securities”, do not generally qualify as financial instruments (of any kind) under Gibraltar law, subject of course to their intended design, use and the rights that intend to provide being consistent with this.

As and when the legislative proposals outlined in the Token Framework Proposal are implemented, specific provision will be made for the regulation of token-related services. Although the details of this are still unknown, HMGOG has stated that investment and ancillary services relating to tokens ‘will be modelled, so far as is appropriate, proportionate and relevant, on similar provisions under MiFID 2’.

Providing investment and ancillary services relating to tokens is not currently regulated in Gibraltar. HMGOG has proposed to regulate the provision of investment and ancillary services in or from Gibraltar and, to the extent not otherwise caught by regulations, their

derivatives. These regulations aim to ensure that such services are provided fairly, transparently, and professionally. This limb of the proposals will intend to cover advice on investment in tokens, virtual currencies, and central bank-issued digital currencies, including:

- generic advice (setting out fairly and in a neutral manner the facts relating to token investments and services);
- product-related advice (setting out in a selective and judgmental manner the advantages and disadvantages of a particular token investment and service); and
- personal recommendations (based on the particular needs and circumstances of the individual investor).

This limb of the proposals will be proportionately modeled on provisions that currently exist under MiFID II with the aim of ensuring that such services are provided fairly, transparently, and professionally. However, at this stage, little guidance has been given on the specific types of advisors involved in a token distribution process that will be caught by the proposals (e.g., introducers, marketing professionals, technical developers and smart contract auditors, economic, legal and tax advisors, cybersecurity firms, escrow agents).

## CONCLUSIONS AND RECOMMENDATIONS ON GIBRALTAR LAW

The legislative position in Gibraltar is currently in a state of flux insofar as tokens are concerned. However, HMGOG is clearly committed to creating a regulatory environment for token sales (and for DLT business more generally) that is attractive to businesses and safe for customers.

The small size of the jurisdiction means that the Government and legislators can adapt quickly to developments in the token space.

As of May 2019, the full extent of the Government's legislative proposals for the regulation of token sales is still uncertain, although the Token Framework Proposal gives us a 'high-level' outline of what lies in store.

# VI. IRELAND

## VI. IRELAND

### 1. INTRODUCTION

There is currently<sup>86</sup> no specific legislation or regulation in relation to tokens in Ireland, and to date there has been relatively little guidance from the Irish authorities and no decisions from the Irish courts regarding the applicable regulatory treatment. That said, the Central Bank of Ireland (**CBI**), which is the financial services regulator for most categories of financial firms in Ireland, has issued statements echoing the guidance that has been issued from EU regulatory authorities on the legal and regulatory issues impacting token regulation.

The Central Bank Reform Act 2010, which commenced on 1 October 2010, created the CBI as a new single body with responsibility for both central banking and financial regulation. The CBI is responsible for protecting the best interests of consumers of financial services, and the Competition and Consumer Protection Commission (**CCPC**) provides information to consumers on the costs, risks and benefits of different financial products.

Similar to the European Securities and Markets Authority (**ESMA**), the CBI issued warnings to consumers and investors regarding the risks of investing in virtual currencies in February 2018<sup>87</sup>. The CBI emphasised that virtual currencies are a form of unregulated digital money that can be used as a means of payment, noting that they do not have legal tender status in Ireland, and are not guaranteed or regulated by the CBI. The CBI highlighted the extreme volatility, the absence of protection due to the lack of regulation under Irish or EU law, as well as the propensity for misleading information associated with investments in virtual currencies.

The CBI also reiterated ESMA's warnings on initial coin offerings (**ICOs**) in its "*Alert on Initial Coin Offerings*" published in November 2017<sup>88</sup>. The Director of Policy and Risk of the CBI indicated that the CBI supports ESMA's position that "*depending on how they are structured ICOs may fall outside the regulatory space*", but cautioned that firms which are "*involved in ICOs must consider whether their activities fall within the perimeter of regulated activities*".<sup>89</sup>

In the absence of a specific regime, the regulatory environment for tokens in Ireland is primarily based on an analysis and interpretation of the existing framework of laws related to

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<sup>86</sup> This section related to Ireland is up-to-date up to 1 July 2018.

<sup>87</sup> Consumer warning on Virtual Currencies published by the Central Bank of Ireland in February 2018.

<sup>88</sup> Alert on Initial Coin Offerings published by the Central Bank of Ireland in November 2017.

<sup>89</sup> 'Financial regulation, technological innovation and change' – Speech given by Gerry Cross, Director of Policy and Risk to Association of Compliance Officers in Ireland Event: Are you Fit for FinTech?

securities, anti-money laundering, tax and investment funds. In interpreting this regulatory framework, Irish regulatory authorities and courts are likely to pay regard to any guidance issued by EU regulators (ESMA, the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Central Bank and the European Commission), as well as the UK Financial Conduct Authority (FCA).

## 2. FINANCIAL REGULATION

### 2.1 CLASSIFYING TOKENS UNDER IRISH LAW

There are no Irish laws or regulations addressing how tokens would be classified under Irish law. ESMA has stated<sup>90</sup> that "where coins or tokens qualify as financial instruments it is likely that the firms involved in ICOs conduct regulated investment activities, such as placing, dealing in or advising on financial instruments or managing or marketing collective investment schemes." Moreover, ESMA has indicated that firms involved in ICOs "may be involved in offering transferable securities to the public".

Neither ESMA nor any Irish regulator or supervisory authority, has issued substantive guidance on what type of tokens would qualify as "financial instruments" or "transferable securities" for the purposes of the applicable EU and/or Irish rules. That being the case, determining whether a particular token is covered by this definition requires a case-by-case analysis of the characteristics and features of the token in question. Similar to ESMA, the CBI has indicated that where the features of an ICO are consistent with a financial instrument, then financial regulations apply.

#### 2.1.1 THE CONCEPT OF "FINANCIAL INSTRUMENTS" UNDER IRISH LAW

For Irish financial regulatory purposes, the concept of "financial instruments" is defined in the European Union (Markets in Financial Instruments) Regulations 2017 (the **MiFID II Regulations**). The MiFID II Regulations give effect to the Markets in Financial Instruments Directive 2014/65/EU, EU Commission Directive 2017/593 and EU Regulation 600/2014 (together, being **MiFID II**).

The MiFID II Regulations, at Schedule 1 Part 3, directly transpose the broad definition of "financial instruments" set out in Section C of Annex 1 to MiFID II, which includes the following:

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<sup>90</sup> Alert on ICOs, published by ESMA in November 2017.

- transferable securities;
- money-market instruments;
- units in collective investment undertakings;
- options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;
- options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;
- options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled;
- options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in paragraph 6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments;
- derivative instruments for the transfer of credit risk;
- financial contracts for differences;
- options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Part, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, an OTF or an MTF; and
- emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC.

Neither the CBI nor the Irish courts have considered what types of tokens would be classified as "financial instruments" for Irish legal purposes. However, the CBI has commented<sup>91</sup> on

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<sup>91</sup> 'Tomorrow's yesterday: financial regulation and technological change' – speech given by Gerry Cross, Director of Policy and Risk at the CBI at Joint Session: Banknotes/Identity High Meeting 2018

tokens in the context of an ICO, noting that "where the features of any given ICO match those of financial instrument issuance, then financial regulation applies, and issuers and others must, subject to legal penalty, ensure that they comply with the relevant rules". Determining whether a particular offering involves a financial instrument issuance would require a case-by-case analysis of the particular token in question and the structure of the offering, having regard to the above broad definition.

Where a token is classified as a "financial instrument" within the meaning of the MiFID II Regulations, firms involved in ICOs potentially fall within the scope of a wide range of Irish financial regulation, in particular:

- European Union (Markets in Financial Instruments) Regulations 2017 (the **MiFID II Regulations**);
- European Union (Alternative Investment Fund Managers) Regulations 2013 (the **AIFM Regulations**);
- Prospectus (Directive 2003/71/EC) Regulations (the **Prospectus Regulations**);
- the Irish anti-money laundering regime under the Criminal Justice Act 2010 (**CJA 2010**); and
- the Irish Market Abuse Regulations (**MAR**).

### 2.1.2 THE CONCEPT OF "TRANSFERABLE SECURITIES" UNDER IRISH LAW

The key Irish legislation in relation to the definition of "transferable securities" is the MiFID II Regulations. The MiFID II Regulations directly transposed the definition of "transferable securities" from MIFID II, being as follows:

"transferable securities" means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:

- a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares,
- b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities, or
- c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

Similar to ESMA, neither the CBI nor Irish courts have issued guidance on what kind of tokens would be classified as "transferable securities" for the purposes of the above

definition; however the CBI has indicated that "if the token issued is deemed to be a "transferable security" then a range of financial services legislation will apply".<sup>92</sup>

The individual categories of tokens were broadly identified in the main paper as follows:

- *Cryptocurrency tokens* – tokens used as a means of payment within a network for transactions between users or also between the network operator and users.
- *Utility tokens* – tokens which carry a right to usage or access (i.e. are redeemable against a current or future product or service) or voting rights.
- *Security tokens* – a broad range of token products that are each comparable to one or more conventional equity or debt instruments. Many tokens are hybrid in nature and will combine characteristics of more than one of these categories.

A 'pure' cryptocurrency token, i.e. a token that will be used only as a means of payment, may be interpreted by an Irish regulator or court as falling outside the scope of the definition of "transferable securities" under the MiFID II Regulations. The Irish legislation, which was directly transposed from the definition under MiFID II, provides for "*the exception of instruments of payment*", which comparable to the discussion at section 3.1.1.4 of the main paper. In that context, it is possible that the CBI might adopt a similar approach to other European regulators, such as the German and Swiss regulators, who have both taken the view that these types of tokens fall outside the scope of MiFID II.

Utility tokens typically confer the right on token holders to access or use a digital service. It is possible that the CBI or an Irish court would also take the view that a pure utility token does not amount to a transferable security for the purposes of the MiFID II Regulations. However, this would require analysis on a case-by-case basis. For example, the main paper refers to the possibility of certain voting rights attaching to utility tokens. Since voting rights are typically the type of rights that are attached to traditional equity or shares, an Irish court or regulator might be more inclined to treat them as "transferable securities".

In relation to security tokens which are closer to conventional debt instruments and equity instruments, it is also likely that an Irish regulator or court would interpret security tokens as "transferable securities" for the purposes of the MiFID II Regulations. Unfortunately, in the absence of a specific regulatory regime at present, there is simply no 'one size fits all' approach, and a case-by-case analysis is unavoidable.

If a token is classified as a "transferable security" for the purposes of the MiFID II Regulations, it would also fall within the definition of "financial instruments" outlined above, and the broad range of financial regulation outlined from sections 6.7 of this paper may

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<sup>92</sup> See footnote 90 above.



apply. In particular, where there is an offer of transferable securities to the public, the requirements under the Prospectus Regulations (discussed at section 4) may apply.

## 2.2 THE MIFID II REGULATIONS

The MiFID II Regulations apply broadly in relation to the placing, dealing in or advising on "financial instruments". If the token or coin being offered in an ICO qualifies as a "financial instrument", the process by which the token or coin is created, distributed or traded is likely to involve some MiFID II activities or services and accordingly be subject to its regulatory regime.

MiFID II, as implemented in Ireland under the MiFID II Regulations, established a regulatory regime that governs "financial instruments irrespective of the trading methods used".<sup>93</sup> The impact of a token being classified as a "financial instrument" would mean that any firm in Ireland that provides investment services or related activities in relation to tokens classified as financial instruments must ensure compliance with MiFID II requirements. Activities regulated under the MiFID II Regulations include placing, dealing in or advising on financial instruments, which can apply broadly; and could include, for example, the distribution of tokens to the public through professional investment agents, or the hosting of platforms for offering tokens through ICOs. The organisational requirements, the conduct of business rules and the transparency requirements as set out in MiFID II could then apply, depending on the services being provided, to the token/token issuer in question, which would require a case-by-case analysis of the services provided in each instance.

## 2.3 ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (AIFMD)

The Alternative Investment Fund Managers Directive (**AIFMD**) was implemented into Irish law under the AIFM Regulations, and may apply if the token is part of a fund. To the extent that an ICO is structured to raise capital from a number of investors with a view to investing in accordance with a "defined investment policy", the ICO may qualify as an alternative investment fund (**AIF**) and be subject to the capital, organisational and transparency requirements set out in AIFMD.

In its guidelines released on August 2013<sup>94</sup>, ESMA sought to define the key elements of an AIF, noting that an entity will only be considered as an AIF where all of the prescribed elements are present. For this purpose, ESMA considers that various concepts in the AIFMD definition require further guidance, with the key elements of the ESMA guidance being as follows:

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<sup>93</sup> Recital 13, MiFID II.

<sup>94</sup> Guidelines on key concept of AIFMD, published by ESMA on 13 August 2013.

### 2.3.1 COLLECTIVE INVESTMENT UNDERTAKING

ESMA has specified that one of the characteristics of a collective investment undertaking is that it “pools together capital raised from investors for the purpose of investment with a view to generating a pooled return for those investors”. Holders of the undertaking as a collective group should have no day-to-day discretion or control over the undertaking.

### 2.3.2 RAISING CAPITAL

The criterion of raising capital would be fulfilled if there are direct or indirect steps taken by an undertaking or a person or entity acting on its behalf to procure the transfer or commitment of capital by one or more investors to an undertaking for the purpose of investing it in accordance with a defined investment policy.

### 2.3.3 NUMBER OF INVESTORS

Whether an undertaking raises capital from a number of investors or not should be determined by looking at the rules or instruments of incorporation of such undertaking, national law, or any other provision or arrangement of binding legal effect. If such provisions do not contain an enforceable obligation which restricts the sale of units/shares to a single investor, then such undertaking should be considered to be raising capital from a number of investors, regardless of whether the undertaking in fact only has a sole investor.

### 2.3.4 DEFINED INVESTMENT POLICY

A defined investment policy should be understood as being a “policy about how the pooled capital in the undertaking is to be managed to generate a pooled return for the investors from whom it has been raised”. The following factors are indicative of a defined investment policy but the absence of all or any one of them would not conclusively demonstrate that no such policy exists:

- the investment policy is determined and fixed, at the latest by the time that investors’ commitments to the undertaking become binding on them;
- the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking;
- the undertaking or the legal person managing the undertaking has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it, and
- the investment policy specifies investment guidelines, with reference to criteria.

The CBI has not issued any guidance in relation to the applicability of the AIFMD rules to ICOs or tokens generally. Regulated Investment Funds in Ireland may be established as UCITS, pursuant to the European framework for UCITS funds as implemented in Ireland, or

Retail Investor Alternative Investment Funds (**RIAIFs**) or Qualifying Investor Alternative Investment Funds (**QIAIFs**) both pursuant the AIFM Regulations.

It is likely that an ICO, if it were an AIF, would fall outside the regulated fund framework in Ireland and accordingly would be classed an "unauthorised AIF" in Ireland. An unauthorised AIF is one which is not authorised by the CBI under domestic investment funds legislation.

The legal person whose business it is to manage that AIF (for example the token issuer) would be deemed to be an Alternative Investment Fund Manager (**AIFM**). An AIFM of an unauthorised AIF must be authorised pursuant to AIFMD and is subject to the marketing requirements of the Central Bank in relation to the AIF it manages.

The AIFM of an unauthorised AIF must be authorised pursuant to AIFMD and is subject to the marketing requirements of the CBI in relation to the AIF it manages. The CBI's AIFMD Q&A<sup>95</sup> does provide that retail investors can trade, on the secondary market, in unauthorised AIFs. Such secondary market trades will usually occur through investment intermediary firms and, therefore, the protections of the MIFID II regime will apply.

## 2.4 THE PROSPECTUS REGULATIONS

Under the Irish prospectus regime, a prospectus is required to be prepared and published in the following circumstances:

- When there is an offer of transferable securities; and
- When this offer of securities is made to the public.

The primary source of prospectus law in Ireland is the Prospectus Regulations (which implement the Prospectus Directive (2003/71/EC)), the Prospectus Rules issued by the CBI and the EU Prospectus Regulation (Regulation (EU) 2017/1129), which will be fully and directly applicable in Ireland from 2019 onwards.

The CBI will also take into account any relevant guidance or guidelines issued by ESMA in respect of prospectus regulation, such as the ESMA Alternative Performance Measures Guidelines published in October 2015<sup>96</sup>, which are aimed at promoting the usefulness and transparency of Alternative Performance Measures included in prospectuses.

Where a token is found to be a "transferable security", an offer of tokens to the public could potentially be subject to the requirements set out in the Prospectus Regulations. Where that is the case, a prospectus must be prepared before the offer to the public or the admission to

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<sup>95</sup> [AIFMD Questions and Answers](#), 29th Edition published in March 2018.

<sup>96</sup> Guidelines on Alternative Performance Measures (APMs) for listed issuers published by ESMA in October 2015.

trading of such securities on a regulated market located or operating within Ireland, unless a prospectus exemption is applicable.

Detailed information requirements are attached to the preparation of a prospectus, designed to enable investors to make an informed assessment of the financial position, profits and losses and prospects of the token, as well as the rights attached to the tokens in question, and all prospectuses must be approved by the CBI which reviews the information contained therein in line with the Irish Prospectus Rules.<sup>97</sup>

An offer is exempt from the requirement to publish a prospectus in a number of circumstances, including:

- the monetary threshold of the capital raising does not exceed €5,000,000<sup>98</sup>;
- the offer of securities is addressed solely to qualified investors; or
- an offer of securities is addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors.

#### 2.4.1 MONETARY THRESHOLD EXEMPTION

This exemption may be available if the proceeds of the token generation event will be less than €5,000,000 (or €1,000,000 from 2019 after the EU Prospectus Regulation comes into force). It should be noted that this monetary amount is calculated in total over a period of 12 months, meaning that all monetary amounts raised over the course of a 12 month period will be calculated together for the purposes of qualifying for this exemption.

#### 2.4.2 QUALIFIED INVESTORS EXEMPTION

A "qualified investor" under Irish law includes authorised and regulated legal entities such as investment firms or credit institutions, national and regional governments and other supranational institutions, and natural or small to medium sized enterprises provided that they are authorised by the CBI. This is narrower than the category of "accredited investors" in the US and may not be appropriate for many token sales where the intention is to make tokens available to as broad a category of investors as possible.

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<sup>97</sup> The Prospectus Rules are contained in the Prospectus Handbook, most recently published by the Central Bank of Ireland in September 2016, which set out procedural and administrative requirements and guidance in respect of the Prospectus (Directive 2003/71/EC) Regulations 2005, as amended (the Regulations).

<sup>98</sup> Note this threshold is reduced to 1,000,000 under the Prospectus Regulation 2017 which will incrementally change the EU prospectus regime.

### 2.4.3 EXEMPTION FOR 150 OR FEWER INVESTORS

The availability of this exemption would be dependent on a case-by-case analysis of the issuance in question. It may not be appropriate in many cases if the intention is to reach as many investors as possible.

## 2.5 ANTI-MONEY-LAUNDERING LEGISLATION IN IRELAND

### 2.5.1 CURRENT REGIME

The principal anti-money laundering and terrorist financing legislation in Ireland is the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (**CJA 2010**), as amended by Part 2 of the Criminal Justice Act 2018 (which implemented the provisions of the Third Anti-Money Laundering Directive (**3AMLD**)) and the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Act 2018 (which implemented the Fourth Anti-Money Laundering Directive (**4AMLD**)). Ireland has not yet implemented the Fifth or Sixth Anti-Money Laundering Directives.

Designated persons under the CJA 2010, including all financial institutions authorised by the CBI or business conducting certain regulated activities, have certain statutory obligations.

These obligations include compliance with provisions involving a combination of risk-based and rules-based approaches to the prevention of money laundering and terrorist financing. Designated persons for the purposes of the CJA 2010 must apply customer due diligence, report suspicious transactions and have specific procedures in place to prevent money laundering and terrorist financing, with failure to comply with the CJA 2010 being a criminal offence.

Designated persons under the CJA 2010 include credit institutions, financial institutions and a broad category of professional services providers such as legal or accountancy professionals.

The Irish Department of Finance (**DoF**) and the Irish Department of Justice (**DoJ**) produced a Joint Risk Assessment for Ireland on Money Laundering and Terrorist Financing<sup>99</sup> where they identified the use of cryptocurrencies to launder the proceeds of computer-enabled financial crime as a concern for the Irish government. The risk assessment acknowledged that this may allow some foreign financial crimes to pass through the Irish financial system without coming to the attention of Irish credit or financial institutions.

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<sup>99</sup> [Department of Finance and Department of Justice Joint National Risk Assessment for Ireland on Money Laundering and Terrorist Financing](#), published in October 2016.

## 2.5.2 APPLICATION OF CURRENT REGIME TO TOKENS IN IRELAND

Token issuers are not per se designated as "designated persons" under the current Irish anti-money laundering regime. However, depending on (i) the underlying activities of the blockchain platform and (ii) the nature of the tokens and the manner in which they are made available in the context of a token offering, certain token issuers may constitute "designated persons" for the purposes of the CJA 2010.

For example, if the underlying platform provides traditional payment or banking services, bringing it within the definition, the token issuer is likely to be regarded as a "*financial institution*" within the meaning of "designated persons" under the CJA 2010.

The resulting obligations on a token issuer that meets the definition of designated persons would require, inter alia, that the token issuer conduct customer due diligence, subject to certain exemptions.

## 2.5.3 5AMLD REGIME IMPACT ON TOKENS

The European Union recently announced the publication of the Fifth Anti-Money Laundering Directive (5AMLD), which for the first time will see fiat-to-cryptocurrency exchange platforms, as well as custodian wallet providers, brought within the scope of EU anti-money laundering rules. Once implemented into Irish law, cryptocurrency exchanges and wallet providers covered by 5AMLD will be subject to the anti-money laundering requirements set out in 4AMLD.

In particular, they will be subject to the requirement to carry out identity checks on their customers, as well as their customers' beneficial owners (where applicable), the aim being to help reduce the anonymity associated with cryptocurrency transactions. They will also be subject to specific obligations around the reporting of suspicious transactions.

5AMLD extends EU anti-money laundering requirements to "providers engaged in exchange services between virtual currencies and fiat currencies". Depending on how these provisions are implemented under Irish law, this may be broad enough to impact token issuers, where they issue tokens in exchange for fiat currencies. In these circumstances, a token issuer would potentially be an obliged entity for the purposes of 5AMLD and would therefore be subject to the obligations set out above. This is discussed in further detail in the main paper.

## 2.6 THE MARKET ABUSE REGULATIONS (MAR)

MAR gives effect to Regulation (EU) No 596/2014 of the European Parliament and Directive 2014/57/EU of the European Parliament. MAR came into effect in July 2016, replacing the previous rules implementing the EU Market Abuse Regulation which sets out certain disclosure requirements for Irish companies to release 'inside information' to the market without delay, and to prevent insider dealing and market manipulation/market abuse.

Where tokens are classified as "financial instruments" in Ireland, MAR may apply in connection with tokens being placed on trading platforms, meaning that token issuers would have to comply with obligations under MAR and would be subject to the certain restrictions. MAR places a significant compliance burden on entities that fall within its scope, including significant record-keeping and reporting obligations where market disclosure has been delayed. It also lays down certain prohibitions and/or restrictions, for example market manipulation, insider trading and manager transactions

"Financial instruments" for the purposes of MAR incorporate financial instruments within the meaning of the MiFID II Regulations which are:

- admitted to trading on a regulated market or for which a request for admission to trading on a regulated market has been made;
- traded on, admitted to trading on, or for which a request for admission to trading on a multilateral trading facility has been made;
- traded on an organised trading facility; or
- not falling within any of subparagraphs (8.3.1 to 8.3.3), the price or value of which depends on, or has an effect on, the price or value of a financial instrument referred to in any of those subparagraphs, including, but not limited to, a credit default swap and a contract for difference.

## 2.7 CROWDFUNDING LEGALISATION IN IRELAND

Ireland does not currently have a bespoke regulatory regime in relation to crowdfunding. In January 2018, the DoF published a Feedback Paper on a consultation process it previously conducted in April 2017 regarding the regulation of crowdfunding. It indicated that domestic legislation will not be introduced regarding crowdfunding, but that the approach of the Irish government would be to monitor the progress of the European Commission and that any such European regulation introduced would be implemented in Ireland once confirmed.

The European Commission has since published a proposal for an EU Crowdfunding Regulation, which includes a comprehensive authorisation and passporting regime for crowdfunding platforms across Europe. Once this has been passed at EU level it will form part of Irish law.

The proposed EU Crowdfunding Regulation could potentially be relevant to certain token sales carried out in Ireland, insofar as token issuers may be able to avail of certain exemptions that are provided to crowdfunding under the legislation once it is enacted.

## 3. OTHER LEGAL AND REGULATORY ISSUES

### 3.1 E-MONEY LEGISLATION IN IRELAND

E-money is regulated under the European Communities (Electronic Money) Regulations 2011 (**E-Money Regulations**), which transpose the E-Money Directive 2009/110/EC into Irish law, without any significant additional national measures. Under the E-Money Regulations, "e-money" is defined as "electronically (including magnetically) stored monetary value as represented by a claim on the electronic money issuer, which is issued on receipt of funds for the purpose of making payment transactions, or is accepted by a person other than the electronic money issuer."

Electronic money is therefore an electronic payment product that is prefunded. Value is subsequently issued and held electronically or magnetically on an instrument (either locally or remotely) with a view to making payments using the instrument. Monetary value stored on a token could potentially be caught by this definition, subject to an evaluation of the nature of the rights and obligations of the token holder and the issuer of the token and the functionality of the token (for example, whether it can be used in order to make payments to third parties). Where a token cannot be used in order to make payments or does not store pre-paid value, it is unlikely to fall within the definition of e-money for the purposes of the E-Money Regulations.

In the event that a token qualifies as "e-money", the E-Money Regulations would require that the token issuer be authorised as an e-money institution by the CBI. In order to be authorised as an e-money institution, a token issuer would be required to meet strict authorisation requirements including: (i) meet minimum capital requirements (currently €350,000), (ii) supply accounting information including information for activities other than the issuance of e-money, and (iii) be subject to the Irish anti-money laundering regime (see above).

### 3.2 PAYMENTS LEGISLATION IN IRELAND

Payment service providers in Ireland are regulated under the European Union (Payment Services) Regulations 2018 (**Payment Services Regulations**), which transpose the Payment Services Directive 2015/2366 (**PSDII**) into Irish law, again without any significant national measures.

Payment services that typically require authorization under the Payment Services Regulations include services relating to the operation of payment accounts (for example, cash deposits and withdrawals), execution of payment transactions, issuing payment instruments, merchant acquiring, and money remittance. The Payment Services Regulations focus on electronic



means of payment rather than cash-only transactions or paper cheque-based transfers. The Payment Services Regulations also create an authorisation and registration regimes for firms who provide holders of online payment accounts with payment initiation services and account information services

Whether an issuer of a token will be subject to the Payment Services Regulations will depend on the functionality of the token itself and also any related services carried on by the token issuer. For example, the token issuer may need to consider whether the token could potentially be considered a payment instrument and/or whether it is operating any payment accounts.

In any event, a case-by-case analysis will be necessary to determine if a token issuer is subject to the Payment Service Regulations. If a token issuer carries on regulated payment services in connection with the token, it would need to be authorized as a payment institution by the CBI. In order to be authorized as a payment institution, the issuer would be required to meet strict authorization requirements including: (i) meet minimum capital requirements; (ii) meet certain reporting and transparency requirements (iii) supply accounting information and (iv) be subject to the Irish anti-money laundering regime.

### 3.3 IMPLEMENTATION OF EU E-COMMERCE, DISTANCE SELLING AND CONSUMER PROTECTION REGULATIONS IN IRELAND

An offer for the sale of tokens may be subject to the various relevant European e-commerce legislation as implemented in Ireland, including the corresponding consumer protection rules that are applicable for sales of tokens to consumers. In these circumstances, there are also certain information obligations in accordance with the distance selling regulations and the rules for electronic transactions that may also be applicable. The key regulations governing the European e-commerce, distance selling and consumer protection provisions in Ireland are as follows:

#### 3.3.1 E-COMMERCE

The key regulations governing e-commerce that may be applicable to tokens in Ireland are:

- The European Union (Consumer Information, Cancellation and Other Rights) Regulations 2013 (S.I. 484 of 2013) (the **Distance Selling Regulations**).
- The European Communities (Directive 2000/31/EC) Regulations 2003, (S.I. 68 of 2003) (the **E-Commerce Regulations**).
- EC (Electronic Communications Networks and Services) (Privacy and Electronic Communications) Regulations 2011 (the **e-Privacy Regulations**).

### 3.3.2 THE DISTANCE SELLING REGULATIONS

The Distance Selling Regulations apply to contracts concluded on or after 14 June 2014. They transposed Directive 2011/83/EU on Consumer Rights into Irish law and revoked previous related legislation. There are a number of contracts outside the scope of the Distance Selling Regulations including contracts for financial services and certain construction contracts. The Distance Selling Regulations apply to businesses which sell goods or services to consumers by means of on-premises, off-premises (e.g. when a trader visits a consumer's home) or distance contracts.

Tokens are unlikely to be covered by the Irish definition of "goods", which is defined as "any tangible movable items". However, it is not clear if the issuance of tokens (or an underlying utility) would constitute a "service" for the purpose of the Distance Selling Regulations. The main paper at section 4.1.3.1 appears to argue that the underlying Directive in relation to the Distance Selling Regulations may be applicable to token issuers in general; however this has yet to be considered by any Irish regulatory authority or court.

If applicable, the Distance Selling Regulations would require token issuers in Ireland to:

- (i) provide certain general information to consumers;
- (ii) provide the consumer with confirmation of the concluded contract on a durable medium; and
- (iii) provide for a 'cooling off period' of fourteen days for consumer after a distance or off-premises contract has been concluded.

### 3.3.3 THE E-COMMERCE REGULATIONS

The E-Commerce Regulations apply to businesses operating online when engaging with both consumers and other businesses. The concept of services is defined broadly in the E-Commerce Regulations and may be broad enough to cover a token issuance (or the utility/service provided by the underlying blockchain platform); however this has yet to be considered by any Irish regulatory authority or court. The main paper highlights at section 4.1.4 how both token issuers and token buyers would benefit significantly from a clearer regulatory framework that sets out which investor and consumer protection rules apply to what type of tokens.

If applicable, the E-Commerce Regulations would require token issuers in Ireland to:

- (i) provide certain general information to customers on their website;
- (ii) ensure commercial communications are clearly identified as such;
- (iii) ensure any unsolicited commercial communications are clearly identified as such;
- (iv) supply certain information prior to an sale being concluded electronically; and

- (v) provide a receipt of the sale without undue delay and by electronic means.

### 3.3.4 THE E-PRIVACY REGULATIONS

The e-Privacy Regulations impose strict legal obligations on the use of personal data for direct marketing (including direct marketing by electronic means), in addition to penalties for unsolicited communications for direct marketing purposes, which could impact token issuers' dealings with Irish participants in a token issuance. These Regulations are due to be replaced by the new EU e-Privacy Regulation which will enhance the confidentiality of communications, and simplify the rules on cookies and unsolicited electronic marketing.

The EU General Data Protection Regulation (**GDPR**) may also be relevant to token issuers to the extent that:

- (i) token issuers process personal data as part of the activities of one of its branches established in the EU, regardless of where the data is processed; or
- (ii) if the token issuer is established outside the EU and are offering goods/services (paid for or for free) or monitoring the behaviour of individuals in the EU.

Token issuers will be required to be fully transparent about how they are using and safeguarding personal data, and to be able to demonstrate accountability for their data processing activities.

## 3.4 IRELAND'S FOREIGN INVESTMENT REGIME

Ireland does not have a single overarching body responsible for regulating investment into Ireland by foreign investors (e.g. in the context of a token sale) or a general regime regarding the protection of foreign investment per se, with investors from outside the EU and those from inside the EU receiving the same treatment as domestic investors under Irish law. Furthermore, Ireland does not have any applicable foreign reporting regime for payments over a certain threshold made in or out of Ireland like other jurisdictions in Europe such as Germany.

However, various protections are contained within statutory frameworks in relation to:

- Mergers, joint ventures and acquisitions being subject to an Irish antitrust regime contained within the Competition Act 2002 to 2012, providing certain types of transaction being notifiable to the Irish Competition Authority.
- Public takeovers being subject to regulation by the Irish Takeover Panel Act 1997 (as amended), the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 and the Irish Takeover Rules.

- Certain regulated industries being subject to supervision by various regulatory bodies.

The EU announced a proposal for a new voluntary mechanism to screen foreign direct investment in the EU in May 2018.<sup>100</sup> The aim of this proposal is to ensure that "*foreign investments do not pose a threat to critical infrastructure, key technologies or access sensitive information*". On the basis of the text endorsed by EU ambassadors in June 2018<sup>101</sup>, the Presidency will start negotiations with the Parliament with a view to reaching an agreement within the current legislature.

This proposed EU screening mechanism could potentially be relevant to certain token sales, insofar as foreign participants are involved, once it is enacted into Irish legislation. This will depend on the terms of the final text of the legislation once adopted, and on how its provisions are implemented in Irish law. Pending that, there is currently no Irish foreign investment protection regime that would be applicable to token issuances in Ireland.

## 4. TAX ANALYSIS

### 4.1 IRELAND'S TAXATION REGIME

The Irish revenue authority, the Office of the Revenue Commissioners (**Irish Revenue**), has issued very limited guidance about the application of domestic tax rules to token transactions. The extent of the guidance is limited to a brief statement<sup>102</sup> issued by Irish Revenue in May 2018 (the **Guidelines**). The Guidelines only address the direct tax and Value Added Tax (**VAT**) implications of transactions involving cryptocurrency tokens (as described in Section 6.11 of this paper).

No tax rules specific to tokens have been enacted to date and Irish Revenue's view is that existing tax laws deal sufficiently with cryptocurrencies. The Guidelines do not consider other taxes (e.g. stamp duty) or the issuance or secondary trade of other forms of tokens (e.g. utility tokens or security tokens). Accordingly, the tax treatment of these types of tokens remains unclear. In the absence of specific rules and Irish Revenue guidance, Irish resident issuers and investors must use a principle-based approach to comply with the existing tax rules.

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<sup>100</sup> [European Parliament Press Release](#), dated 28 May 2018.

<sup>101</sup> [European Council Press Release](#), dated 13 June 2018.

<sup>102</sup> Revenue eBrief No. 88/18 regarding an update of Part 02-01-03 "The tax treatment of cryptocurrency transactions" of the Tax and Duty Manual, dated 15 May 2018. Available at: <https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-02/02-01-03.pdf>.

The Irish taxation analysis in this section outlines the potential Irish profit taxes (capital gains tax (CGT), income tax and corporation tax) and VAT consequences of token transactions for Irish tax residents only. This area of taxation is uncertain and the tax implications may evolve over time. Further, the lack of standardisation in token products means that a uniform approach is not practicable from a tax perspective.

In addition to profit and VAT implications, a written agreement (such as a smart contract) that documents a token transaction (if any) could potentially trigger stamp duty consequences. This will likely only be applicable to the extent that the agreement between token issuer and customer is a natural language document (e.g. a contract or a memorandum etc.) or the contract is split between code and a written document. However, except for in limited circumstances, the stamp duty rules have not yet been extended to capture transactions that occur in the absence of written documents (i.e. many token transactions).

## 4.2 CHARACTERISATION OF TOKENS AND TAX IMPLICATIONS

Tokens represent asset claims or rights. Tokens can embody any combination of claims and these claims can change over the life of the token. The designation of tokens as "transferable securities" or "financial instruments" for regulatory purposes (as detailed above in section 7 above) will be a relevant factor in determining how a token is treated under the tax rules. In the absence of (or in addition to) this designation, the tax outcomes for Irish issuers and investors should generally reflect the particulars of each token in terms of economic substance. Given the lack of standardisation, a one-size fits all approach for assessing tax implications is not practicable. As such, a case-by-case analysis is required.

Practically, token holder/issuer taxpayers adopt the rules and precedents relevant to the most analogous traditional instrument. However, perfect analogies are unlikely to exist. For simplicity, the comments below draw on the classifications set out in the main paper – summarised as follows:

- **Cryptocurrency tokens** – tokens which serve as a means of payment (e.g. Bitcoin).
- **Utility tokens** – tokens which carry a right to usage or access (i.e. are redeemable against a current or future product or service) or voting rights.
- **Security token** – a broad range of token products that are each comparable to one or more conventional equity or debt instruments.

## 4.3 CRYPTOCURRENCY TOKENS

### 4.3.1 DIRECT TAXES

None of the Irish tax provisions apply specifically to transactions involving cryptocurrency tokens. Irish Revenue's Guidelines (the **Guidelines**) merely state that the ordinary income tax,

corporation tax and CGT rules apply. Tax outcomes will therefore depend on the nature of the transaction (particularly whether it is on capital or revenue account) and the parties involved. Whether a taxpayer is deemed to be transacting cryptocurrency tokens in a trading (revenue) or investing (capital) capacity is heavily fact dependent.

Taxpayers who receive cryptocurrency tokens in place of a recognised currency simply treat the receipt in the same manner as ordinary currency. In this regard, active trading profits, such as profits derived from the sale of goods or services in exchange for cryptocurrency tokens, are subject to income tax or corporation tax (as relevant). Similarly, gains and losses arising on the realisation of capital assets for crypto-consideration are chargeable or allowable in accordance with the corporate tax or CGT provisions (as relevant).

Taxpayers that provide cryptocurrency tokens as payment for goods (including other tokens), services or rights will also realise a taxable gain/loss or chargeable gain/loss on disposal. The time of recognition, quantum of the gain/loss and the applicable tax rate will depend on the nature of the transaction, as well as the taxpayer's activities and tax attributes (e.g. losses).

For the calculation of tax liabilities, the value of any crypto-consideration is determined using an "appropriate" exchange rate for the relevant token at the time of the transaction. Further, reporting entities must represent crypto transactions in their accounts in the functional currency elected – which cannot be a cryptocurrency.

The Guidelines also confirm that, for payroll tax purposes, the value of any employee payments made in the form of cryptocurrency tokens should be reported and remitted to Irish Revenue in Euro.

In 2014, the UK HM Revenue and Customs (**HMRC**) issued guidance (later supplemented) that contains similar views to those expressed in the Guidelines.<sup>103</sup> Interestingly, HMRC stated that in some circumstances (e.g. where a transaction is "highly speculative") a token transaction may be akin to a gamble. This characterization would mean that profits arising as a result of the investment are not taxable, but equally any resulting losses would not be available to offset other items of taxable income. Irish Revenue chose not to include this particular view in their analysis, suggesting that Irish Revenue may differ with the HMRC's interpretation.

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<sup>103</sup> HM Revenue & Customs policy paper "Revenue and Customs Brief 9 (2014): Bitcoin and other cryptocurrencies", dated 3 March 2014. Available at: <https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies>.

### 4.3.2 VAT

In line with the Court of Justice of the European Union and the position taken in other tax jurisdictions, Irish Revenue has taken the view that tokens that are comparable to Bitcoin (essentially cryptocurrency tokens) are VAT-exempt "negotiable instruments". Therefore, the exchange of fiat currency for cryptocurrency tokens should not attract VAT.

However, subject to exemptions and satisfaction of certain conditions, the supply of goods or services by a taxable person (including traders) in exchange for consideration in the form of cryptocurrency tokens would be taxable. In this case, VAT must be charged by reference to the consideration received, translated at the appropriate exchange rate at the time of the supply.

Suppliers of VAT-exempt cryptocurrency tokens to customers in the EU would not ordinarily be entitled to recover VAT payable on expenses incurred in connection with those supplies (exceptions apply). However, input VAT may be recoverable where the supply is made to customers outside of the EU (i.e. the supply is an export).

Irish Revenue does not regard digital mining as an "economic activity" for VAT purposes. As such, the acquisition of cryptocurrency tokens falls outside the scope of the VAT regime where it results from mining (rather than transacting).

## 4.4 UTILITY TOKENS

### 4.4.1 DIRECT TAXES

Following the description set out in the main paper, a utility token may confer a right to:

- access or redeem against a future or current service or product (i.e. a prepayment for a supply); or
- vote (e.g. on the functionality of a service or product under development).

A utility token that entitles the holder to a future usage right would likely be treated as a prepayment for tax purposes. In this base case, the issuer would likely be subject to direct tax on sale receipts in the tax year in which the issue took place. The token purchaser should be able to deduct the cost of the token to the extent that the expense would have been deductible if it had been paid in fiat currency. This would be the case if, amongst other factors, the underlying goods/services were acquired in connection with a taxable undertaking. Specific rules limiting deductions for prepaid expenditure may also apply.

In some circumstances, tokens that confer voting rights may be classified as security tokens – this can only be assessed on a token-by-token basis. Likewise, a utility token may be classified as a security token if it is issued before a product/service/network exists. The tax

treatment surrounding the issue and transfer of more complex utility tokens and security tokens remains unclear at present (as detailed further from section 21 below).

#### 4.4.2 VAT

The issue of a utility token by a taxable person in exchange for a right to receive a non-exempted good or service within Ireland should, in principle, constitute a taxable supply for VAT purposes.

A clear link can be drawn between supply and consideration where a utility token simply acts as a prepayment. The supply will be deemed to occur at the time of payment (and VAT should be charged) to the extent that the goods and services are identifiable (even if the actual supply takes place at a later time). Typically, VAT should be charged on the higher of the full (VAT exclusive) consideration and the market value of the usage rights attached to the utility token.

In limited circumstances, there may be scope for a utility token issuer to delay accounting for VAT on consideration (up to the redeemable value of the usage rights attached to the token) until the goods/services are supplied (the "voucher" exception). This will depend on the facts and in any case could only be relied on where the purchaser did not acquire the token for resale in the furtherance of business.

It may be arguable that a payment should be treated as a VAT exempt donation where the rights conferred by the token are negligible in comparison to the cost of the token and the rights are unrelated to the issuer's business offering.

## 4.5 SECURITY TOKENS

### 4.5.1 DIRECT TAXES

Security token products are not standardised. However, Irish Revenue has provided no guidance on the tax treatment of tokens that are issued as a digital means to raise finance (through an ICO or otherwise), related returns, or the secondary trade of such tokens.

Among other rights, security tokens may provide investors with one or more of the following:

- right to a return; and/or
- right to participate in profit.

Given the lack of consistency in the entitlements attached to security tokens no uniform tax analysis can be undertaken. From a principles based assessment, the receipts from a token issue may be assessable to the issuer as either a capital or trading receipt. This distinction is important because under Irish tax law, capital receipts are usually subject to tax at a rate of



33 per cent, whereas trading receipts are taxed at the lower corporate tax rate of 12.5 per cent. Further, returns paid to a security token holder may be deductible to the issuer and assessable (as either a capital or trading receipt) to the holder.

In contrast, finance obtained through a loan or share issue is generally not taxable. A share issue is not treated as a "disposal" for CGT purposes because a share only comes into existence as a consequence of an issue (i.e. the issuing company does not hold an asset which is capable of being disposed of prior to the issue). Accordingly, there may be scope to argue that CGT does not apply to a receipt arising from the issue of a security token where that token is brought into existence as a result of the issue. The circumstances under which a receipt on issue or a return from a token should be treated as an income or a capital receipt will depend on the particular facts.

There are specific direct and indirect tax rules (including exemptions) that govern the issuance, returns derived from and sale of certain instruments. The creation of a separate asset class with tax rules specifically designed for the various features and uses of tokens has been proposed by advocates in other jurisdictions. This could include, for example, rules that operate to disregard the issue of a security token for CGT purposes where the token is, in substance, comparable to either a share (albeit not conferring an equity interest) or a loan (or similar instruments). We are not currently aware of plans to adopt such an approach in Ireland.

#### 4.5.2 WITHHOLDING TAX

Withholding tax applies to certain payments made by an Irish entity (such as payments of interest, royalties and amounts treated as annual payments). Whether the payment of a return to a security token holder will give rise to any withholding tax obligations will depend on the particular circumstances.

Token issuers must characterise returns in the context of the domestic withholding tax rules and any applicable double tax agreements. In practice, this may be difficult as the information required to assess whether:

- withholding tax applies – e.g. the legal form of the security token holder (pension fund etc.); or
- an exemption or reduction applies – e.g. the residency of the investor for treaty relief purposes,

may not be readily available to the issuer.

### 4.5.3 VAT

In principle, the supply (issue or secondary trade) of a security token that confers on the holder a taxable intangible right (e.g. the right to a return or profits) for consideration could constitute a taxable supply.

However, VAT may not apply if the intangible right(s) that are attached to the security token would ordinarily be exempt from VAT. This might be the case, where the security token is considered the issue of a new stock, new share, new debenture or new security for VAT purposes, is convertible for equity interests in the issuing entity (i.e. a convertible note) or takes the form of a bond. Likewise, if a taxable person issues a security token that carries a right to receive interest payments, there may be scope for that token to be treated as an exempt grant of credit.

The recoverability of input VAT will ultimately depend on the characterization of the supply that the issuer or trader is deemed to have made for VAT purposes.

### 4.5.4 EXCHANGE OF INFORMATION REQUIREMENTS

A series of EU Council Directives have been issued to impose mandatory exchange of information obligations on revenue authorities in the EU in relation to cross-border arrangements. Broadly, the Directives dealing with reportable cross-border arrangements provide for the exchange of any information that has foreseeable relevance to the administration and the enforcement of Member States' tax laws (excluding VAT, customs duties, excise duties and compulsory social contributions). Information exchange takes place in three forms: spontaneous, automatic and on request.

Additionally, Ireland has a network of Double Tax Agreements (**DTAs**) and Tax Information Exchange Agreements (**TIEAs**) which also provide for the exchange of certain types of information on request. While not specifically addressed by the exchange regime, token transactions may fall within the scope of exchange requirements (including automatic exchange). This might apply, for example, where a cross-border token transaction is subject to an Irish Revenue ruling which Irish Revenue is required to exchange under Directive 2016/881/EU.

The most recent Council Directive (EU) 2018/822 (issued on 25 May 2018) amending Directive 2011/16/EU (**DAC6**) obliges intermediaries to report details of potentially aggressive cross-border tax planning arrangements to their revenue authorities (being Irish Revenue in Ireland). Irish Revenue will share these details with other relevant tax authorities and the Commission.

For the purposes of this Directive:

- an intermediary includes a party that is involved in the "*design, market, organise or make available for implementation or manage the implementation*" of the arrangement. This includes tax advisers, lawyers (subject to privilege) and other parties (e.g. accountants).
- a cross-border arrangement is reportable if it involves a Member State, not all of the participants are tax resident in the same jurisdiction and a tax "hallmark" applies.
- there are five "hallmarks" of potential tax avoidance. Only three contain a tax benefit motivation requirement. Therefore, a broad range of transactions are reportable.

This Directive does not need to be transposed into domestic law until December 2019 but transactions from 25 June 2018 are reportable. The due date for disclosing reportable cross-border arrangements that take place between 25 June 2018 and 30 June 2020 is 31 August 2020. After this date, in-scope arrangements will generally need to be reported within 30 days from the start of implementation.

## 5. FUTURE REFORM

It is clear that there is a need for greater regulatory certainty on the application of the wide-ranging EU and Irish financial regulatory regime with respect to tokens in Ireland. To-date, the CBI has maintained a 'wait and see' approach with regard to implementing regulation, taking guidance from the other regulators, most notably the EU.

The CBI has indicated that the recent publication of the European Commission's Action Plan on FinTech<sup>104</sup> was "*very welcomed*", however they cautioned that the challenge for regulators is "*to facilitate good innovation, to seek to prevent or limit innovations that are detrimental to the goal of well-functioning financial services and markets, and to ensure that the associated risks are well managed*".

It is clear that the approach of the CBI in the longer term will be to move forward with a balanced view on regulating financial innovation, with the approach being firmly rooted in protecting Irish consumers. The CBI highlighted that its role in regulating emerging financial technology will be "*to protect against the risks raised by innovation while still allowing it to develop for the benefit of consumers*".<sup>105</sup> The CBI has confirmed that they will continue to look to Europe for guidance on how to proceed with regulating tokens and token issuers,

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<sup>104</sup> [EU Commission Action Plan on FinTech](#), published 8 March 2018.

<sup>105</sup> '[Tomorrow's yesterday: financial regulation and technological change](#)' – speech given by Gerry Cross, Director of Policy and Risk at the CBI at Joint Session: Banknotes/Identity High Meeting 2018.

emphasising that financial regulation should respond to and regulators best engage with innovations in this space "*at a coordinated European level*".

In terms of reform in the short term, with the enactment of 5AMLD at European level, the Irish legislature is now under pressure to introduce new legislation in the anti-money laundering space, to bring cryptocurrency exchanges and wallet providers within scope of Irish anti-money laundering requirements.

The EU Crowdfunding Regulation discussed above will also form part of Irish law once enacted, and may potentially be relevant to certain token sales carried out in Ireland.

In the meantime, the DoF have recently published a Discussion Paper on Virtual Currencies and Blockchain Technology<sup>106</sup>, in which it proposed the creation of an intra-departmental working group that will draw on the expertise of multiple state agencies – including the DoF, the Irish Revenue, the Data Protection Commissioner and the Department of Business, Enterprise and Innovation – to explore and oversee developments in virtual currencies and blockchain. The Working Group's stated mandate will include "*monitoring developments*" at EU and global level in relation to virtual currencies and blockchain, identifying economic opportunities for Ireland in this area, and "*considering whether suitable policy recommendations*" are required.

The CBI has also indicated that it will remain "*actively engaged with other European and international policy makers*" in relation to developments in tokens and ICO regulation. Moving forward, the Irish regulatory environment is likely to closely mirror the European regime as it continues to develop and evolve in this space.

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<sup>106</sup> [Discussion Paper on Virtual Currencies and Blockchain Technology](#), published by the DoF in March 2018.

# VII. ITALY

## VII. ITALY

### 1. OVERVIEW OF THE POSITION OF THE ITALIAN REGULATORS

The Banca d'Italia, in an official Statement dated 30th January 2015, has expressly defined Bitcoin, Litecoin and Ripple as "Virtual Currencies" i.e. "a digital representation of value, used as a medium of exchange, used also for investment purpose which may be traded, transferred and stored electronically". As such, Bitcoin and other Cryptocurrencies, as well as most tokens, should not be falling under the application of the PSD directive as implemented in Italy. However the situation is unclear at best since in the same Statement the Banca d'Italia further expresses "caution" since "the activities of issuing, exchanging (FIAT into crypto and vice versa) as well as the managing of payment systems based on cryptocurrencies may well fall under the application of the MiFIDII, PSD and AMLD Directives as implemented in Italy. "

on November 29th, 2017 the Italian Stock Exchange Commission (CONSOB) has issued an informal press release stating that Bitcoin and other Cryptocurrencies cannot be considered, as of today, a Financial Product falling under the application of the MiFIDII for the purposes of issuing a Prospectus. "The Financial Stability Board is currently evaluating whether Bitcoin and/or other Cryptocurrencies may be considered as "currencies". On that issue we must wait and see what the FSB decides."

the Italian Stock Exchange Commission (CONSOB) on December 4th, 2017 has issued a "warning" based on the recent ESMA opinion that ICO's " depending on the characteristics of the offer, may constitute a regulated activity that must be carried out according to regulations on financial investments" (the Prospectus Directive, MiFIDII, AIFMD and the AMLD).

## 2. APPLICATION OF EU DIRECTIVES (PSD, EMD, VAT, AMLD, MIFID II AND AIFMD) TO TOKENS AND CRYPTOCURRENCIES

### 2.1 APPLICATION OF PSD (PAYMENT SERVICES DIRECTIVE) TO TOKENS AND CRYPTOCURRENCIES

See 1 (a) above.

### 2.2 APPLICATION OF EMD (E-MONEY DIRECTIVE) TO TOKENS AND CRYPTOCURRENCIES

Cryptocurrencies and Tokens do not fall under the definition of e-money under the EMD Directive as implemented in Italy.

### 2.3 APPLICATION OF VAT DIRECTIVE TO TOKENS AND CRYPTOCURRENCIES

Following the European Court of Justice (ECJ) 2015 Ruling, it is now a consolidated approach at EU level not to apply VAT (IVA) to Bitcoin transactions as this is considered money when buying and selling. This will also apply to other Cryptocurrencies. As far as tokens are concerned, there is no official position yet. The concerns regarding the applicability of the ECJ ruling also to tokens – and not only to Bitcoin – are a consequence of the recent growth of tokens which do not only serve as “Money” within the chain, but represent also “*non digital assets or rights*” off-chain. However, the deciding factor in future decisions on that matter, shall likely remain whether those tokens are used, at least in prevalence, as “money” and as a means of payment, independently of whether there are also rights or assets attached to it.

### 2.4 APPLICATION OF AMLD (ANTI-MONEY LAUNDERING DIRECTIVE) TO TOKENS AND CRYPTOCURRENCIES

Recently Art. 2 of the 4th Anti-Money Laundering Directive was amended as to include virtual currency exchange platforms and custodian wallet providers within the scope of the directive. Although the modification was not yet implemented at national level this is now an established fact that every new issuer should start to comply with.

### 2.5 APPLICATION OF MIFIDII AND PROSPECTUS REGULATION TO TOKENS AND CRYPTOCURRENCIES

Please also see below para 3.2. In summary this appears to be the position: (a) if an ICO selling equity tokens qualifies within the strict parameters of the Crowdfunding Law (see

below para 3.4), then it is covered by the Crowdfunding Law and the MiFID II does not apply; (b) if an ICO sells non-equity tokens, MiFID II should also in principle not apply; (c) by default it can be reasonably assumed that MiFID II shall apply to an equity token ICO not falling within the strict parameters of the Crowdfunding Law. As far as the implementation of the new Prospectus Regulation (EU) 2017/1129 is concerned, the threshold under which the drafting of a prospectus is not required will be hopefully raised to €8 million, as permitted by Article 3(2), point b of the Prospectus Regulation.

## 2.6 APPLICATION OF AIFMD (ALTERNATIVE INVESTMENT FUND MANAGER DIRECTIVE) TO TOKENS AND CRYPTOCURRENCIES

At the moment the only official position is that of the Italian Stock Exchange Commission (CONSOB) which on December 4th, 2017 has issued a “warning” based on the recent ESMA opinion that ICO’s “ depending on the characteristics of the offer, may constitute a regulated activity that must be carried out according to regulations on financial investments therefore including also the AIFMD Directive which was implemented in Italy in March, 2014.

## 3. INTERNAL SOURCES OF LAWS WHICH MAY AFFECT TOKEN ISSUES

In addition to the common sources of EU Law referred to in para 2 above, there are a number of provisions in the Italian Civil Code, as well as internal regulations such as the TUF (*Testo Unico Finanziario*) and the Crowdfunding Law, which may apply to token issuers in Italy:

### 3.1 CIVIL CODE

The Italian Civil Code lists a number of provisions in the area of General Obligations and Contracts which may also apply to token sales. The purpose here is not to evaluate the effect of such provisions on token sales (which can only be done with regard to specific cases) but to simply enlist those civil code provisions which may become relevant in the case of token sales in Italy.

- According to Art. 1343 and 1418, a contract (therefore also a contract for the sale of tokens) may be null and void and the issuer may be liable for damages for breaching mandatory law provisions.
- According to Art. 1375 a contract (therefore also the contract for the sale of tokens) must be performed in good faith between the parties.
- According to Art. 1175 the parties must perform their contractual obligations with fairness and appropriate diligence.



- According to Art 1218 the breach of contractual obligations generates a liability for damages.
- According to Art. 1427 and 1439 and 1440 a contract (therefore also the contract for the sale of tokens) is null or voidable when a party has "fraudulently" induced the other party into contracting. That party is always liable for damages.
- According to Articles 1469 bis and followings, as replaced by the Consumers' Code Law nr 206 of 2005, there are a number of cases which may determine the nullity of the Contract as well as the liability for damages. In addition, art 140 bis introduces Class Action lawsuits for consumers.

### 3.2 THE LAW NR. 58/1998 – CONSOLIDATED LAW ON FINANCIAL INTERMEDIATION (TESTO UNICO FINANZIARIO – TUF)

This Law regulates investment services to the public, which are reserved to investment firms, banks and authorized financial intermediaries. This Law is the backbone of the Italian regulations on financial markets and it has been constantly amended and integrated as to incorporate also the MiFID II Directive 2014/65/EU . Leaving aside the provisions of the MiFID II, which are extensively dealt with in the EU section of this paper and which are also generally applicable in Italy, some of the extra provisions of the TUF which may become applicable to token issues are the following:

- Art. 21 of TUF indicates the general criteria that the authorized professionals shall fulfil in selling investment services such as (i) the duty to act diligently and transparently in the interests of customers and the integrity of the market, (ii) a duty to inform and (iii) a duty to avoid conflict of interest and act transparently.
- Art 23 of TUF states that in case of claims for damages from the private investor against the professional, it is the latter who has to duty to prove to have acted diligently and transparently in compliance with the obligations set out in Art 21.
- Art 166 of TUF provides for fines and prison terms up to 8 years for carrying out investment services activities in Italy without being authorized.
- Art 184 of TUF provides for heavy fines and prison terms up to 6 years for market manipulations such as in the case of the fairly common "pump and dump" practices in ICOs.

### 3.3 PROFIT PARTICIPATIONS

Article 2459 of the Italian Civil Code defines the "Profit Participation" as the contract between two parties in which the associated party contributes services or money to the other party's business venture in consideration for a future share of the profits generated. As far as

taxation is concerned, when the associated party has contributed money to the business venture and receives back a payment from the business, this is treated and taxed as a dividend. Theoretically, also this legal framework could be applied to different types of tokens, which in fact may represent a Profit Participation with additional Rights or Assets connected to the token.

### 3.4 CROWDFUNDING LAW

This Law was approved in 2012 (DL 179/2012). The Italian Crowdfunding Law applies to so called “Innovative Start-ups” as well as existing “Innovative SME’s” under which definition most of ICO issuers appear to be falling (Art 25). However, the Crowdfunding Law does have additional strict admission criteria such as:

- the Crowdfunding shall not exceed 5M €uro
- only Equity Crowdfunding is possible.
- at least 5 % of the equity raised in the Crowdfunding shall be allocated to a professional investor, bank or incubator.
- should the terms of the Crowdfunding offer substantially change, then the investor shall be granted an option right to resell its shares back to the issuer.
- should the majority of the shares in the Issuer be sold to third party investors after the Crowdfunding sale, the investors shall be allowed the right to sell also their shares to the third party buyer (Tag-along rights).

Clearly the intention of the Italian legislator with this Law was to limit the cumbersome application of the MiFID II/Prospectus Regulations to the Crowdfunding. As a consequence, it can be assumed that should an ICO (selling “equity tokens”) not fulfil the above mentioned criteria, it will not benefit from the less strict requirements of the Crowdfunding Law and it will be therefore likely – by default – to fall within the application of the MiFID II/Prospectus directive. Any ICO selling tokens different from “Equity Tokens” may, as a consequence, also be exempt from the MiFID II Directive.

# VIII. LIECHTEN- STEIN

## VIII. LIECHTENSTEIN

### 1. GENERAL STATE OF FINTECH INNOVATION, NOTABLE TRENDS AND FUTURE PROSPECTS

Many reputable players on the blockchain scene have come to Liechtenstein to start their businesses. For example, Yanislav Malahov (who was closely involved in the creation of Ethereum) has founded Aeternity – the first blockchain-based project in Liechtenstein with a market capitalization of over \$1 billion (on May 08, 2018, making it the first Liechtenstein blockchain “unicorn”). Ultimately, Aeternity is a project focused on smart contracts, allowing for the execution of credible transactions through the use of blockchain technology without the help of third-party intermediaries.

Communications with the local regulator – the Financial Market Authority (FMA) – are very efficient, as the FMA established its own fintech department (*Gruppe Finanzinnovation*) in June 2018. Further, a so-called regulation laboratory has been established to further the proliferation of fintech businesses.

In addition to these local projects and advancements in favour of fintech innovation, the so-called Blockchain Law (Token & Trusted Technologies Law, TTTL; Gesetz über Token und VT-Dienstleister; Token- und VT-Dienstleister-Gesetz; TVTG)), which is anticipated to come into force in Liechtenstein in 2019.<sup>107</sup> In general, the government – along with the prime minister, and even the prince – is very open minded to fintech projects. In addition, the Crypto Country Association has been founded, dealing with various topics relating to the Liechtenstein crypto ecosystem.

The success of established and young companies is furthered by general state conditions, which are especially favourable to blockchain-based projects. The Ministry of Presidential and Finance has created innovation clubs, serving as a tool enabling companies to contribute their ideas for improving the framework of conditions in an unbureaucratic manner. Moreover, the Ministry of Presidential and Finance offers all market participants from Liechtenstein and abroad the ability to engage in a transparent process for implementing their ideas to improve the conditions of the local framework. Ultimately, successfully tested ideas are supported in direct contact with the ministry until they are implemented.

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<sup>107</sup> The Government of the Principality of Liechtenstein accepted the TTTL bill for review on May 07, 2019.

The ability to build new disruptive business models is crucial to the strategic competence of an economy. At the same time, while financing start-ups always poses great challenges, so does the question of what exactly constitutes an optimal level of support. Through favorable business conditions and state support, the Liechtenstein government has created an incubator in cooperation with private partners, leading to the successful establishment of start-ups in Liechtenstein.

## 1.1 TOKEN & TRUSTED TECHNOLOGIES LAW, TOKEN ECONOMY AND TOKEN INFRASTRUCTURE

On the regulatory front, it is the intention of the Liechtenstein government to enact the Token & Trusted Technologies Law, or TTTL, which will regulate certain business projects based on ‘trusted technologies’ such as distributed ledger technology, of which the blockchain technology is the most prominent use case. Through this regulation, the government is aiming to support and monitor through minimal regulation that creates legal certainty; ensuring assistance while also avoiding uncontrollable growth. This legal certainty is reached by creating a transfer regime applicable to token transactions analogous to the system of the law of property and its transfer of rights in rem. Ultimately, the TTTL is targeted at creating a friendly regulatory environment for entrepreneurs and consumers alike.

Adapting pre-existing legislation, the TTTL avoids pigeonhole definitions by remaining technologically neutral. For example, as opposed to breaking down tokens into pre-existing classifications such as utility or security, the law defines a token as information on a TT system, that can represent rights, which are assigned to a TT identification tool. In other words, this definition makes it clear that a token can embody a right to something, such as property, which is already defined in the pre-existing legal framework; or, a token can embody a right to nothing, in the physical sense, which is not defined within the pre-existing legal framework.

TT systems are transaction systems, which ensure secure transmission and retention of tokens by use of trusted technologies. These technologies ensure the integrity of tokens, association of tokens with their TT identifier (eg. public key) and the user’s disposal of tokens on TT systems.

This need for a technologically neutral definition led to the coinage of what we like to call the “Token Container Model,” or TCM. This model described how any right may be tokenized, stating that the respective token will serve as a technical container holding the right represented therein. Within this framework, a token serves as a container with the ability to hold rights of all kinds, whether that be the right to something underlying – examples including real estate, stocks, bonds, and gold; or the right to nothing underlying – encompassing digital code, the most notable example being Bitcoin. Consequently, this progressive model provides legal certainty surrounding the rights to digital information on blockchain based systems.

Although trying to avoid pre-existing token classifications the Liechtenstein legislature realized a need to define payment tokens due to the presence of due diligence requirements upon exchange of these tokens. This led to the TTTL defining a payment token as a means of payment which is accepted for the effective performance of a contractual obligation and thus replaces legal tender in its function as such

Further defining elements of the token economy, the TTTL puts forth various roles and requirements such as the following:

- TT Identifier: A unique identifier enabling allocation of tokens (eg. a public key).
- TT Key: A key enabling disposal of tokens (eg. a private key).
- Basic Information: A requirement to put forth basic information on tokens offered to the public, allowing a user to develop an informed opinion in regards to the rights and risks associated with the tokens, as well as the rights and risks related to the involved TT Service providers.
- TT Service Provider: A person or entity carrying out functions within a token economy.
- Token Issuer: A person or entity offering tokens to the public on its own behalf or that of another person or entity
- Token Generator: A person or entity generating tokens.
- TT Key Holder: A person or entity acting as a custodian, holding the keys on behalf of the principal.
- TT Token Depository: A person or entity who holds tokens on behalf of another person or on another person or entity's account.
- Physical Validator: A person or entity who ensures the existence and enforcement of contractually obligatory rights to property represented on a TT system – in the sense of property law.
- TT Protector: A person or entity holding tokens in their own name on a TT system for the benefit of a 3<sup>rd</sup> party.
- TT Exchange Service Provider: a person or entity who exchanges fiat (legal tender) for payment tokens (or vice versa), as well as payment tokens for other payment tokens.
- TT Verifier: A person who verifies the legal capacity and requirements for token disposal.
- TT Price Service Provider: A person or entity providing TT system users with aggregated price information based on buy and sell offers or completed transactions.

- TT Identity Service Provider: A person who identifies the person authorized to dispose of a token on a TT system, and enters or registers this person in a directory.

Not only providing basic definitions, the intuition of this law is witnessed by the creation of roles such as that of the physical validator. Recognizing that these decentralized systems are operating in a world traditionally subject to centralized and regulated intermediaries, this particular role provides licensed intermediaries with an opportunity to assist with bridging the gap between the online and offline worlds. This is accomplished by the physical validator ensuring that the physical object and associated rights to be tokenized on the TT system actually exist.

Furthermore, the law provides guidelines in the event that a user holding a token embodying a right loses access to their token, such as the loss of a private key, highlighting the existence of court proceedings for proof of ownership, as well as prescribing mechanisms for the burning of tokens that are rendered invalid.

At its core, the TTTL is focused on adapting pre-existing laws to foster legal certainty within a token economy, including adaptations of the Liechtenstein Persons and Companies Act, Trade Act, Due Diligence Act, and Financial Market Authority Act.

Several companies engaged in tokenization projects have launched within the country, with services ranging from creation of utility tokens for use on platforms to security tokens representing a wide range of rights. Especially in the realm of security tokens, the Liechtenstein regulatory environment has proved incredibly friendly, due to the pre-existing law looking directly to the underlying, and the fact that Liechtenstein law has recognized dematerialized securities for almost 100 years. This particular advantage allows for the tokenization and transfer of rights on blockchain based systems with relative ease.

There are several banks in Liechtenstein which have expanded from the realm of traditional banking to include trading and custodial services for cryptoassets, including the allowance of crypto 'cold storage' solutions. Further, over-the-counter trading desks have formed within the country, allowing for high-volume transfers of cryptocurrencies for investors seeking to avoid the volatile nature of traditional online exchanges.

Since Liechtenstein is a member of the European Economic Area (EEA) the financial market, along with the licensed financial intermediaries is, in general, fully harmonized; enabling "passporting" (notification) throughout the EU/EEA, further making it feasible to make use of the freedom of services and the freedom of establishment within the European single market.

## 1.2 LIECHTENSTEIN SUPERVISORY AUTHORITY

Communication with the Liechtenstein Financial Market Authority (FMA) is excellent. Therefore, new projects may be introduced in personal meetings with the FMA. Usually a legal opinion examining the business model and the token functionality (if a token is issued) will be filed with the FMA in order to receive a preliminary evaluation. If no regulation applies, the FMA will issue a statement indicating that the intended business does not fall under its jurisdiction if it is exercised in the way presented to the FMA in the set of facts of a legal opinion. Due to the FMA having a department wholly dedicated to analysis of fintech projects, the FMA has amassed an extensive knowledge in this field and can operate in a time-efficient manner.

The Financial Market Authority of Liechtenstein (*Finanzmarktaufsicht, FMA*) has issued a factsheet on virtual currencies like bitcoin, which was published on February 16, 2018, stating that virtual currencies are generally defined as a “digital representation of a (cash equivalent) value that is neither issued by a central bank or a public authority.” Further, the fact sheet stated that these tokens do not constitute fiat currency (legal tender). However, it is pointed out that virtual currencies are similar to fiat currencies when they are used as a means of payment or traded on an exchange.

The production and the use of virtual currencies as a means of payment is not currently subject to any licensing requirement governed by specialized legislation. However, depending on the specific design of the business model and token structure, licensing requirements might apply. Business models are assessed on a case-by-case basis. In particular, due diligence requirements according to the Due Diligence Act may apply. Seeing that these kinds of tokens have an inherent function as a means of payment, they are defined as “payment tokens” in the TTTL, and TT\_Service Providers rendering services with regard to these tokens are required to register with the FMA, and are thus subject to due diligence duties.

The FMA also issued a factsheet on ICOs on September 10, 2017 (last update on October 01, 2018). Depending on the specific design and the function of the tokens, the guidance explained that tokens may constitute financial instruments if they have characteristics of securities or other investments. Furthermore, activities relating to financial instruments are subject to licensing by the FMA, and the FMA assesses Token Offerings (ICOs, TGEs, or STOs) on a case-by-case basis.

In general, a negative definition is employed when describing utility tokens. In that sense, utility tokens are tokens which are neither security tokens (tokens which represent classical financial instruments) nor tokens which represent e-money. For the sake of the nationally regulated exchange office/bureau de change (Wechselstube) in Liechtenstein, there is a further distinction made between utility tokens which may serve as a substitute to legal



tender or have a similar payment function, and tokens with other utilities (e.g.: access to a software-platform, discounts on certain products, etc.).

### 1.3 PRE-EXISTING REGULATIONS

Currently, various pre-existing laws and regulations may apply. Potentially applicable regulations may include (*among others*):

- the Banking Act (Bankengesetz);
- the Asset Management Act (Vermögensverwaltungsgesetz);
- the Payment Services Act (Zahlungsdienstegesetz);
- the E-money Act (E-Geld-Gesetz);
- the Prospectus Act (Wertpapierprospektgesetz);
- the Act on Alternative Investment Funds (AIFMG);
- The Act on Undertakings for Collective Investment in Transferable Securities (UCITS);
- the Insurance Act (Versicherungsvertragsgesetz);
- the Due Diligence Act (Sorgfaltspflichtgesetz);
- the Persons and Companies Act (Personen- und Gesellschaftsrecht);
- the Gambling Act (Geldspielgesetz);
- the Consumer Protection Act (Konsumentenschutzgesetz);
- the Remote Financial Services Act (Fern-Finanzdienstleistungs-Gesetz);
- the Distance and Foreign Trade Act (Fern- und Auswärtsgeschäfte-Gesetz).

Additionally, the anticipated Blockchain Law will further shape the governance of fintech businesses within Liechtenstein.

## 2. INVESTMENT, ASSET AND WEALTH MANAGEMENT

These areas are widely harmonized within the European Union and the European Economic Area under the EU Markets in Financial Instruments Directive and Regulation, as well as the Capital Requirements Directive regime. Activities of such financial institutions, as well as required prospectuses for security tokens, may be notified (ie, 'passport') within the European Union and the European Economic Area pursuant to the "Euro-Pass-System". Aside from CRR Credit-Institutions (banking institutions) CRD IV provides three types of investment firms with different rights with MiFID II regulating trading venues like the

Multilateral and Organised Trading Facilities (MTF/OTF) and similar infrastructures like Systematic Internalizers (SI). MiFID II has not formally been enacted in the EEA due to the lack of a Joint Committee Decision, however Liechtenstein has transformed national laws to be fully MiFID II compliant, which is accepted by all European Supervisory Authorities.

All three investment firm licenses, the small investment firm license (in Liechtenstein known as the Asset Management license; Vermögensverwaltung), the middle investment firm (investment firm with administration rights – suitable for acting as a broker-dealer), as well as the full investment firm license (may operate an MTF or OTF) are fully MiFID II compliant and passportable.

## 2.1 ROBO-ADVISORY AND AI

Depending on the designated business plan, robo-advisory and/or artificial intelligence (AI) may be qualified as a form of asset management (ancillary securities service).

Ultimately, the regulation surrounding any automated platform depends on the type of token being traded. To illustrate, Bitcoin itself is not a security, but the Liechtenstein government is moving in the direction of classifying Token Offerings that meet certain requirements as securities, thus subjecting certain tokens to regulation.

Therefore, any kind of AI applied to the trading of officially recognized transferable securities is subject to regulation by the authorities. Conversely, any AI applied to the trading of utility or commodity tokens does not require a license from the FMA.

## 2.2 EXCHANGES

Given the various forms of crypto-exchanges, varying regulations are applicable in certain cases. Exchanges which are matching the buying and selling interests (Matched-Principal-Trading; multilateral) with regard to utility tokens against fiat and/or crypto are deemed unregulated and only require a trade license with the Office of Economic Affairs (Amt für Volkswirtschaft) for conducting an operating business. The settlement in fiat is however considered a regulated payment service (especially since the commercial broker exemption is no longer applicable under PSD II when acting both on the buy- and sell side).

However, if these tokens are traded against the own book for fiat payments, this might be deemed a so called Wechselstube (exchange office; bilateral) pursuant to the Liechtenstein SPG (Due Diligence Act; Sorgfaltspflichtgesetz). This is not a licensed activity, but rather, the FMA needs to be notified of this kind of undertaking, and due diligence duties are applicable. If only crypto/crypto pairs are traded against the own order book, this is again deemed an unregulated business activity. Under the TTTL this type of exchange will be required to register with the FMA though if payment tokens are being traded.

Then, there are security token exchanges. These kinds of exchanges are fully regulated pursuant to MiFID II and require an investment firm with an MTF (Multilateral Trading Facility) or OTF (Organised Trading Facility) on top. The main differences between MTF and OTF are that all financial instruments may be traded on an MTF whereas only certain debt instruments may be traded on an OTF (the OTF may also act on a bilateral basis regarding government bonds). The MTF therefore has participants while an OTF has customers (also due to the discretionary execution). The third difference between the two trading facilities is that an OTF allows discretionary trading/matching rules as compared to the non-discretionary nature of an MTF.

Lastly, it is possible to set up fully decentralized peer-to-peer security exchanges without any regulation requirements. With a decentral network operating an exchange there is no entity to be regulated and the exchange itself does also not fall under the definition of an MTF or OTF (trading venues). Depending on the services rendered in connection with such a P2P-Exchange certain license requirements may apply. In any event, prospectus requirements have to be adhered to. Some of the most renown example of such exchanges are EtherDelta, the Stellar DEX (Stellar Decentral Exchange), IDEX, and OasisDex amongst others. Usually both matching and settlement are carried out in a decentralized manner on such exchanges, and associated aspects like the orderbook and custodial/escrow services (smart contracts) are also decentralized.

## 2.3 CRYPTO FUNDS

With funds it is crucial to distinguish between the investment portfolio and the shares of the fund. Since a fund pursuant to the UCITS regime may only invest in specific types of financial products a true crypto fund is not feasible pursuant to the UCITS Directive but only the shares of the fund may be tokenized. A true crypto fund in that sense may only be achieved under the AIFM Directive, as this is primarily a fund manager and not an investment fund regulation as such.

Hence, a fund pursuant to the AIFMD may both invest in a crypto portfolio and its shares may be tokenized. Central aspect of an AIF is the pooling of capital or assets. These criteria have to be broadly construed to mean any assets. Thus, a fund may potentially be holding yachts in its portfolio or other commodities – such as tokens.

## 2.4 OTHER TECHNOLOGIES

A plethora of other business models are possible and plausible due to recent technological development. Peer-to-peer lending, to name but one, is easily feasible with blockchain technologies. However, while easy to implement, such a business might be illegal if executed without the corresponding licenses.

Further, the regulatory environment in Liechtenstein can be viewed as favorable to start-ups focused on alternative blockchain applications such as smart contracts and blockchain-based voting. In that sense it is possible to keep the share register of a legal entity electronically (no certificate required) and the transfer and distribution is also possibly by electronic means pursuant to the Liechtenstein Persons and Companies Act (PGR) – directly on the blockchain.

### 3. E-MONEY

E-money is defined as any electronically or magnetically stored monetary value in the form of a claim against the issuer of electronic money issued against payment of a sum of money in order to effect payment transactions within the meaning of the Payment Service Act, and which is accepted by natural or legal persons other than the issuer of electronic money. In that sense there are five characteristics or attributes of e-money, being: electronic or magnetic monetary value, claim against the issuer (central issuance), obtained by money (legal tender and e-money itself), suitable for conducting payments, and acceptance by third parties.

Since certain cryptocurrencies like Bitcoin are mined, they cannot be classified as e-money, because there is no claim against the issuer. Also, if tokens – for example in an ICO – may only be obtained by using other cryptocurrencies (non-regulated tokens), then the E-Money Act is not applicable. With regard to the payment function and acceptance by third parties two major exemptions may be relevant. If only a very limited product range or range of services may be obtained with a newly generated and issued token, then an exemption from the e-money regime applies. The same applies if only a restricted service provider network actually accepts the tokens as a means of payment (especially relevant for franchises).

Although, in general, it must be noted that the e-money regime is not particularly suitable for blockchain and crypto technology. Most of the stablecoins (coins pegged to fiat) probably have to be deemed as e-money which has been implemented incorrectly, since certain restrictions apply to e-money and its distribution (although the territorial scope of the E-Money Directive may not be applicable to jurisdictions outside of the EU/EEA). For example, e-money has to be exchanged back to fiat at all times at par value<sup>108</sup> and no or only minimal fees may apply for this service (also this is not a criterion for e-money to come into existence but the re-exchange is merely the logical and legal consequence of e-money). E-money may also not be used for savings purposes and no interest may be granted. In addition, problems may arise with token holders storing their e-money token on a wallet to which they have access to the private key. Lastly, the money collected in exchange for e-money must be placed in deposit protected accounts, which means, contrary to popular

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<sup>108</sup> Cp. EFTA Court Decision in Case E-9/17 Falkenhahn AG v Liechtenstein FMA.

belief, these funds may not be used by the entity which collected them for their operating business.

With regard to the variety of business models in the sector, the Payment Service Directive may also be applicable, and therefore, it might be necessary to apply for a payment service license.

## 4. VARIA

### 4.1 VIRTUAL CURRENCIES

Liechtenstein has included “virtual currencies” in the latest amendment of its Due Diligence Act pursuant to the European Anti-Money-Laundering Directives. The due diligence obligations codified in the Act serve to combat money laundering, organised crime, and terrorist financing; applying to providers of exchange services, among others. An exchange office (bureau de change) is defined as any natural or legal person whose activities consist in the exchange of legal tender at the official exchange rate or of virtual currencies against legal tender, and vice versa. Virtual currencies are defined as “digital monetary units, which can be exchanged for legal tender, used to purchase goods or services or to preserve value and thus assume the function of legal tender.” Pursuant to the Report and Motion 2016/159, 31, the most notorious example of such a virtual currency being Bitcoin.

This also means that crypto-to-crypto trading is fully unregulated and may be conducted with a simple trading license. In theory, not even KYC/AML duties apply since the trading of such utility tokens would be the same as trading commodities like sugar and salt. However, due diligence duties apply indirectly as banking institutions usually will not exchange these cryptoassets to legal tender if no KYC has been conducted, since the banking institution has to be fully compliant.

In general, crypto-fiat trading is also unregulated with regard to utility tokens if it is not conducted against the own order book, but instead serves as matched principal trading. Although, in the event of clearing services, a payment service provider may be required.

### 4.2 CONSUMER PROTECTION AND DISTANCE TRADING

Since, as mentioned above, utility tokens are treated similar to commodities, consumers generally have the right to withdraw from the agreement within 14 days. Consumers may expressly waive this right if they have been fully informed about their rights and instantly receive the product. In other words, waiving the right to withdrawal of contract is not possible for ECAs (Early Contribution Agreements) or SAFTs (Simple Agreements for Future

Tokens) where no consideration (token) is given upon entering into the agreement and transfer of monetary assets by the purchaser.

In general, the Remote Financial Services Act applies for security tokens, however there is an exemption regarding the possibility of withdrawal of contract when securities are involved. Therefore, this act only plays a minor practical role.

#### 4.3 PROSPECTUS REQUIREMENT

As security tokens commonly follow the rights and obligations of their underlying asset, they are deemed themselves deemed transferable securities (financial instruments). Any classical equity, equity-like, or debt instrument may be represented by tokens. As such, if a public offering is carried out, (for example by means of a security token offering; STO) drawing up a prospectus pursuant to the European Prospectus Directive and getting it approved by the FMA may be necessary if no exemptions apply.

# IX.

# LUXEMBOURG

# IX. LUXEMBOURG

## 1. INTRODUCTION

Luxembourg is known for its pragmatic approach to laws and regulation. This approach has continued to ensure the attractiveness of Luxembourg as a preeminent hub within the EU for financial services activities. Historically this has focused largely on the investment funds and banking sectors, with today Luxembourg emerging as a hub also for newer variations such as FinTech and RegTech. Luxembourg has a very international population with a large percentage of foreigners as a part of the workforce. As a result of this diverse workforce and the international nature of its businesses, English has increasingly become the dominant business language.

Although the current Luxembourg legal and regulatory framework does not specifically deal with the question of ICOs and the legal treatment of digital tokens, many of the existing rules already apply. As many of these rules are based on EU Directives, the situation in Luxembourg is largely aligned to the EU analysis, albeit with certain country-specific particularities and interpretations.

Where there is no specific legal regime, existing rules and regulations will apply. These include, amongst others, financial sector, capital markets and investment funds laws, AML/CTF<sup>109</sup> rules, and consumer protection requirements. These should be assessed on a case-by-case basis, based on factors such as the features and purpose of the tokens, the services provided by the relevant actors, and the form of the token issuer.

Luxembourg's financial sector regulator *Commission de Surveillance du Secteur Financier* ("CSSF") was, however, one of the first European regulators to take a stance on the regulation of virtual currencies in February 2014. Since already in 2014 the CSSF has authorised several cryptocurrency exchanges as payment institutions in Luxembourg.

Guidance from the Luxembourg regulator has largely remained in line with EU positions. The Luxembourg legislator and regulator have also been keen to stress that their approach is to remain *technology agnostic* in order to ensure the rules work for multiple situations and continue to be relevant as technologies change over time. As a result, they tend not to legislate for a particular technology unless absolutely necessary – preferring to interpret existing rule to encompass technologies evolutions. An example, however, was the amendment was passed in 2018 to modify Law of 1 August 2001 on the circulation of

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<sup>109</sup> "AML/CTF" means anti-money laundering and counter terrorism financing.



securities to include distributed ledger technologies – proactively ensuring old laws adequately support these new technologies and new business models by enhancing legal certainty.

In order to increase investors' awareness of the risks related to ICOs, the CSSF has also endorsed the ESMA and IOSCO statements on ICOs by way of a press release.<sup>110</sup> Similarly, in March 2018 the CSSF issued two separate warnings on ICOs and digital tokens<sup>111</sup> and on virtual currencies<sup>112</sup>, whereby the CSSF provides some regulatory guidance as to the Luxembourg legal treatment of virtual currencies and ICOs (cf. sections 0. and **Fehler! Verweisquelle konnte nicht gefunden werden.** below for further details).

It is also worth noting that the CSSF stresses that its warnings are limited to fundraising activities by way of ICOs, and do not question the usefulness and benefits of the use of blockchain technologies in general, which the CSSF states may bring about benefits through its use in financial sector activities and in various innovative projects.

It should finally be noted that the Luxembourg tax administration *Administration des contributions directes* (the "ACD") also clarified in a circular dated 26 July 2018 the tax treatment of virtual currencies under Luxembourg tax law<sup>113</sup> (cf. section 0. below).

## 2. TOKEN QUALIFICATION

From a Luxembourg law perspective, there is a possibility that a digital token may fall within the definition of financial instruments, electronic money or units of an investment fund under Luxembourg law (as set out in several laws, including, amongst others, the law of 5 April 1993 on the financial sector, as amended (the "**Financial Sector Law**") and the law of 10 July 2005 on prospectuses for securities, as amended (the "**Prospectus Law**"), or, as the case may be, the Prospectus Regulation directly applicable in Luxembourg as of 21 July 2019).

For further discussion on this topic, please also refer to the papers issued by the LHoFT (the Luxembourg House of FinTech):

- "*Understanding Initial Coin Offerings: Technology, benefits, risks and regulations*"<sup>114</sup> (2017)

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<sup>110</sup> Cf. [CSSF Press release 17/38](#) dated 16 November 2017 in relation to ESMA statements, and [CSSF Press Release](#) dated 19 January 2018 on the IOSCO's statement.

<sup>111</sup> [CSSF Warning on ICOs and tokens](#) dated 14 March 2018 (the "CSSF ICO Warning").

<sup>112</sup> [CSSF Warning on virtual currencies](#) dated 14 March 2018 (the "CSSF VC Warning").

<sup>113</sup> [ACD Circular L.I.R. n°14/5 – 99/3 – 99bis/3](#) dated 26 July 2018 (the "Tax Circular"), only available in French.

<sup>114</sup> September 2017. Available at: <https://www.lhoft.com/en/the-future-of-fintech-lies-here/understanding-initial-coin-offerings-technology-benefits-risks-and-regulation>

- “A Guide Through the Common Features of Digital Asset Generating Events: How currently regulations apply, and how to characterize digital assets” (2019)<sup>115</sup>

## 2.1 FINANCIAL INSTRUMENTS/TRANSFERABLE SECURITIES

The question arises whether a digital token may qualify as a financial instrument and in particular as a “transferable security” as a sub-type of a financial instrument as referenced in Annex II, Section B Financial Sector Law, which implements Annex I, Section C MiFID II.

Luxembourg law does not set-out additional types of financial instruments and is as such aligned with European law. The same goes for the definition of “transferable securities” as set-out in Article 1(33) Financial Sector Law.

The criteria set-out in the European law section also apply in Luxembourg, i.e. (i) transferability, (ii) negotiability on a capital market, (iii) no payment instrument, and (iv) comparability to equity and shares.

However, it is useful to note that the Luxembourg State Council expressed the view in the parliamentary documents to the law of 1 August 2001 on circulation of securities that there is no clear definition of the concept of securities under Luxembourg law, presumably intentionally in order to capture any new financial instrument which may appear on the market.

Luxembourg legal writing on the broader notion of security (*titre*), also comprising transferable securities (*valeurs mobilières*) within the meaning of the Prospectus Law/Financial Sector Law and financial instruments within the meaning of the Financial Sector Law, considers that securities (*titres*) generally designate the rights (i) resulting from a legal act (*negotium*) vis-à-vis an issuer (or any other person having obligations under the security), materialised or, as the case may be, ascertained by a (documentary) support in the broadest sense of the term (*instrumentum*), and (ii) corresponding to certain essential characteristics making them fungible and allowing their circulation on the capital markets.

In light of the above, to the extent that the digital token fulfils the criteria above it would be considered as a transferable security under Luxembourg law.

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<sup>115</sup> <https://www.lhoft.com/en/insights/a-guide-through-the-common-features-of-digital-asset-generating-events>

## 2.2 ELECTRONIC MONEY

Where digital platform tokens allow users to purchase and obtain digital goods and services either from the issuer itself or third-party participants, these may as a means of exchange be regulated as electronic money.

There are no specific additional Luxembourg requirements incorporated in the law of 10 November 2009 ("*Payment Services law*") and the main determining criteria is whether the digital token represents a claim against the issuer. The latter criteria is often fulfilled in case of digital platform tokens which allow the users to pay with digital tokens and receive in return a service.

The CSSF highlighted in its CSSF VC Warning that in its view virtual currencies are not to be seen as currencies, but rather as means of exchange or digital representations of non-guaranteed values, which are not issued or controlled by central banks (without a legal tender), and whose value is solely based on the trust that holders and users have in their acceptance by other natural or legal persons as a means of exchange.<sup>116</sup> Such guidance should however not preclude virtual currencies to still be qualified as payment instruments under the Payment Services Law.

## 2.3 UNITS OF FUNDS

In line with the European regulatory investment funds framework, there is in Luxembourg a general distinction between alternative investment funds and UCITS funds. The latter are also suitable for retail investors and hence have more stringent rules.

Luxembourg provides for a flexible alternative investment funds framework and does contrary to other member states not impose stricter rules but allows for different set-ups depending on the needs of the initiators or investors.

Whether an investment fund may issue digital tokens depends largely on its corporate form and whether it is supervised by the CSSF and as such approval of the latter is required.

All investment funds targeting retail investors but also specialised investment funds set-up under the Luxembourg specialised investment funds regime (SIF Law) require approval of the CSSF.

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<sup>116</sup> CSSF VC Warning, p. 1.

## TOKENS MAY BE RE-CHARACTERISED AS UNITS OF FUNDS AND/OR AS SECURITIES

ICOs are often used as a way to raise funds in order to finance a current or future activity. Depending on their characteristics and rights, tokens issued by way of an ICO may therefore fall within the definitions of the various investment funds laws. If so, they will be subject to their requirements – including the requirement for regulatory authorisations for the issuer and of various service providers.

Pursuant to Article 1(39) of the AIFM Law, an AIF is an undertaking for collective investment that:

- raises capital from multiple investors,
- with a view to investing that capital for the benefit of those investors,
- in accordance with a defined investment policy, and
- does not fall within the UCITS regime.

As a result, a digital token issuance by way of an ICO may qualify as the issuance of units of an alternative investment fund if it falls within the AIF definition.

There are various regulatory restrictions in the European Union – including in Luxembourg – regarding the marketing of participation rights in collective investment vehicles and/or the types of investors who may be approached for a particular type of vehicle or asset class, and which should be taken into account.

### 3. REGULATORY CONSEQUENCES

As a result of the qualification of the digital tokens as financial instrument, electronic money or units of investment funds the digital token issuer is required to obtain a licence or approval from the respective Luxembourg authority.

The Luxembourg financial regulator (CSSF) also pointed out that persons envisaging exercising an activity associated with virtual currencies (such as the issuing of means of payment in the form of virtual or other currencies, the offer of payment services using virtual currencies or other, or the provision of virtual currency exchange services) are invited by the CSSF to submit their draft documentation to the CS+SF beforehand.<sup>117</sup>

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<sup>117</sup> Op. cit., p. 4.

The CSSF has further stressed that in determining whether or not an activity is a regulated financial sector activity, it will not hesitate to assess ICOs by the objectives pursued (applying a substance over form approach).<sup>118</sup>

### 3.1 PROSPECTUS LAW

Pursuant to Article 5(1) of the Prospectus Law, no offer of securities may be made to the public within the territory of Luxembourg without prior publication of a prospectus. Guidance as to the elements to be taken into account to identify an "offer to the public" "on the territory of Luxembourg" is set out in the CSSF Circular 05/225.

If an ICO would enter into the scope of the Prospectus Law, prior publication of a prospectus may be required, to the extent not benefitting from any of the exemptions set out under the Prospectus Law.<sup>119</sup>

### 3.2 FINANCIAL SECTOR LAW AND PAYMENT SERVICES LAW

An entity dealing with digital tokens (e.g., crypto exchange) which qualify as financial instruments most likely require a licence under the Financial Sector Law.

Similarly, if a digital token would qualify as electronic money, a license under the Payment Services Law would be required.

### 3.3 AML/CTF

ICOs issuers, initiators and other involved parties are, to the extent falling within the scope of the Luxembourg AML/CTF legal framework, required to, amongst others establish appropriate AML/CFT procedures and comply with the relevant requirements.<sup>120</sup> The CSSF ICO Warning expressly reminds initiators of ICOs that they are required to establish AML/CFT procedures.

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<sup>118</sup> CSSF ICO Warning, p. 4.

<sup>119</sup> the most relevant ones in the context of an ICO being:  
securities included in an offer to the public where the total consideration of the offer in all Member States is less than EUR 5,000,000 over a period of 12 months (Part II of the Prospectus Law only);  
an offer of securities addressed solely to qualified investors;  
an offer of securities addressed to fewer than 150 natural or legal persons per Member State, other than qualified investors;  
an offer of securities addressed to investors who acquire securities for at least the total amount of EUR 100,000 per investor, for each separate offer; and  
an offer of securities whose denomination per unit amounts to at least EUR 100,000.

<sup>120</sup> CSSF ICO Warning, p. 4.

Like any professional in the banking and financial sector, the law of 5 April 1993 on the financial sector makes these professionals subject to compliance with regulations regarding client identification and the fight against money laundering and terrorist financing. In addition, the provisions of the *Grand-Ducal Regulation of 1 February 2010* clarifies the amended law of 12 November 2004 on the fight against money laundering and terrorist financing. Finally, there are of course the various circulars from the regulator CSSF from which the token framework does not deviate, in that sense that a person who can be qualified as a professional of the financial service will be expected to abide by the same rules regardless of whether or not a token is used. Since 2012, remote clients' identification can be carried out if professionals put in place rigorous procedures and processes to verify the identity, rights and powers of access of the client or his representative to the services offered by the financial sector professional.

Outside the current framework relating to AML /CTF, there are no specific provisions other than those that should be implemented these upcoming months such as the 5th Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing<sup>121</sup> and the FATF Risk Based Approach to Virtual Assets and Virtual Asset Service Providers<sup>122</sup>.

### 3.4 CONSUMER PROTECTION LEGISLATION

Where ICOs are open for retail investors/consumers, Luxembourg consumer protection laws, such as on transparent and clear consumer information or on distance contracts and services, may be applicable.

## 4. INVESTING INTO DIGITAL TOKENS IN LUXEMBOURG

The CSSF has no general restrictions regarding investments into digital tokens (including virtual currencies), but has taken the approach to warn investors and regulated entities of the risks of this new asset class through the CSSF ICO Warning.

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<sup>121</sup> Directive (UE) 2018/843 du Parlement européen et du Conseil du 30 mai 2018 modifiant la directive (UE) 2015/849 relative à la prévention de l'utilisation du système financier aux fins du blanchiment de capitaux ou du financement du terrorisme ainsi que les directives 2009/138/CE et 2013/36/UE.

<sup>122</sup> FATF (2019), Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, FATF, Paris.

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## GENERAL GUIDANCE FROM THE CSSF ON INVESTING INTO DIGITAL TOKENS

The CSSF recommends that investors be prudent and not risk money one cannot afford to lose, as well as giving practical tips such as recommending investors do basic research on ICO initiators, such as finding out basic company information such as the registered office, the legal form, the persons involved in the project, and details about any account(s) on which investment amounts should be transferred.<sup>123</sup> The CSSF ICO Warning sets out various risks associated with ICO fundraising activities.

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## FUNDS INVESTING INTO VIRTUAL CURRENCIES

Funds investing into virtual currencies through ICOs is not suitable for all investors, nor for all investment objectives. As a result, the CSSF has stated that Luxembourg based UCITS funds<sup>124</sup> marketed to non-professional customers and pension funds may not invest directly or indirectly into virtual currencies.

*However*, as the CSSF has not distinguished between different characteristics of digital tokens and uses the term “*virtual currencies*” it remains unclear whether a UCITS fund would be also prohibited to invest in digital tokens qualifying as transferable securities.

Alternative investment funds or “**AIFs**” (funds which do not fall within the definition of a UCITS fund) should in principle be able to invest into digital tokens, but as for any other investment may do so only where this would fall within the remit of their investment objectives and regulatory licences, and those of their service providers. For example, AIF managers would, as for any other investment, need to check a proposed investment was within their stated investment objectives and within the asset classes covered by their regulatory licences and that their policies and procedures were appropriate.

A major outstanding barrier for most AIFs remains the requirement to appoint a depositary to take custody of the fund’s assets (including the digital tokens) should the fund size exceed certain thresholds.<sup>125</sup> As a result, funds launched recently in Luxembourg to invest into digital tokens take care to remain below these legal thresholds. Depositary solutions have been announced, and are expected to start becoming available in 2019.

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<sup>123</sup> Ibid.; CSSF VC Warning, pp. 3 – 4.

<sup>124</sup> An undertaking for collective investment in transferable securities (or UCITS) is a collective investment vehicle that raises capital from the public and invests it, with due regard to specific restrictions on investments and diversification requirements. UCITS are defined in the UCITS Directive (2009/65/EC), as amended.

<sup>125</sup> For example, maximum of either (i) EUR 100 million, or of (ii) EUR 500 million for unleveraged AIFs which are also closed-ended for a minimum period of five years.

## 5. LUXEMBOURG TAX CONSIDERATIONS

The Luxembourg tax authorities (direct tax and VAT) have so far issued limited guidance (i.e. two circulars) about the application of domestic tax rules to cryptoasset transactions. These address some, but not all, of the direct tax and VAT implications of transactions involving cryptocurrencies. Other types of token (e.g. utility tokens, securities tokens) are not referred in such circulars.

The main outcome of these circulars could be summarized as below:

- Cryptocurrencies (cryptoassets used as a form of payment means) should be treated as *intangible assets* for corporate income tax and net wealth tax purposes
- Cryptocurrencies (cryptoassets used as a form of payment) should *not affect the nature of the income* (e.g. rent paid in cryptocurrency will remain a rental income), and the taxability of income related to such assets will depend on whether it falls under one of the income categories determined in Luxembourg Income Tax Law (e.g. commercial activity or miscellaneous activity). To be noted that all income generated by limited liability entities (e.g. Sarl, SA) fall under the commercial activity category automatically.
- The VAT exemption applicable to transactions (including negotiation) concerning currency used as legal tender was extended to cryptocurrencies (e.g. Bitcoin), to the extent that they are regarded as a method of payment and are accepted for this purpose by some operators. That position was taken following the judgment regarding *Skatteverket v David Hedqvist* (Case C-264/14) of 22 October 2015.

In this context, in the absence of more specific rules, Luxembourg taxpayers must use a principle and substance over form approach to comply with the existing Luxembourg tax rules.

The Luxembourg taxation analysis in this section outlines the potential Luxembourg income tax and VAT consequences of token transactions. It needs to be reminded that this area of taxation remains unclear and the below represent a preliminary analysis of the possible tax treatment that might apply and is subject to confirmation by the Luxembourg tax authorities. Furthermore, the lack of standardisation in token products means that a uniform approach is not practicable from a tax perspective and a case by case analysis is always recommended.

## 6. CHARACTERISATION OF TOKENS AND TAX IMPLICATIONS

Tokens represent assets with an infinite combination of claims and rights that can even change over the life of the tokens. It is therefore difficult to establish standard and



classification. Despite such difficulties the following categories seem to emerge in the cryptoecosystem:

- **Cryptocurrency tokens** – tokens which serve as a means of payment (e.g. Bitcoin).
- **Utility tokens** – tokens which carry a right to usage or access (i.e. are redeemable against a current or future product or service).
- **Security tokens** – tokens that are comparable to equity or debt instruments.

A high-level preliminary analysis of the Luxembourg tax consequences for transactions related to the different type of token at the level of Luxembourg taxpayers is outlined in the following section

## 7. CRYPTOCURRENCY TOKENS

### 7.1 INCOME TAX

#### 7.1.1 CORPORATE INCOME TAX

Based on the above-mentioned Luxembourg circular on direct tax, cryptocurrency tokens are considered as intangible assets in Luxembourg and should be subject to tax accordingly.

Exchange of cryptocurrency (against another cryptocurrency tokens or against FIAT) shall therefore trigger a taxable event at the level of the holder of such asset, subject to corporate income tax. It is to be noted that any payment made with cryptocurrency token shall not alter the type of Income generated by the said transactions and thus the tax rules to apply.

#### 7.1.2 PERSONAL INCOME TAX

For Luxembourg tax individuals, capital gains generated assets – including from cryptocurrency tokens – are *tax exempt* provided:

- (i) the assets were held for more than 6 months, and
- (ii) such activity is not considered as a commercial activity at the level of the taxpayer.

In case the above conditions are not met, such gain should be fully subject to tax at their progressive tax rate of the token holder.

### 7.2 VAT

Based on the above-mentioned circular on VAT, it was clearly stated that transactions using cryptocurrency tokens shall be exempt from VAT.

## 8. UTILITY TOKEN

### 8.1. INCOME TAX

#### 8.1.1 AT THE LEVEL OF LUXEMBOURG TOKEN ISSUER

Utility tokens can be viewed as a sale of goods or services, in which case their issuance should be subject to corporate income tax as an ordinary income at the level of the token issuer.

Utility tokens may also have the characteristics of a future sale of goods or services that could span over several fiscal years, in which case they should qualify as a deferred income for accounting and tax purposes.

#### 8.1.2 AT THE LEVEL OF LUXEMBOURG CORPORATE TOKEN HOLDER

Utility tokens viewed as a sale of goods or services should be tax deductible expense or deferred expenses at the level of the token holder. In certain cases, it could be treated as an intangible asset at the level of the token holder.

#### 8.1.3 AT THE LEVEL OF LUXEMBOURG INDIVIDUAL TOKEN HOLDER

For Luxembourg tax resident individuals, utility tokens exchanged against the goods or services to which they give right should not trigger the recognition of any income. However, it cannot be excluded that a gain should be recognized if the value of the goods or services to which the tokens give right has increased since the acquisition of the token. This will have to be confirmed by the Luxembourg tax authorities.

### 8.2 VAT

In line with the EU Directives regarding VAT, the issuance to a third party of any token qualifying as a present or future sale of goods or services should be subject to VAT where the transaction is carried out by a taxable person acting as such (unless the type of services or goods is VAT exempt). Also, the determination of the basis of the VAT computation and the event triggering the payment of the VAT should be analysed on a case by case basis.

## 9. SECURITY TOKENS

### 9.1. INCOME TAX

Security tokens, if viewed as debt or quasi-equity, should have the same tax treatment as the security it is most similar to (i.e. substance over form principle) at the level of token Issuer and token holder.

#### 9.1.1 AT THE LEVEL OF A LUXEMBOURG CORPORATE TOKEN ISSUER

Security tokens qualifying as equity for Luxembourg tax purposes shall not be net wealth tax deductible and financial transfer paid to security holder (qualifying as dividends for tax purposes) shall not be tax deductible and might suffer Luxembourg withholding tax (unless reduced or exempt by domestic law or applicable double tax treaties).

Security tokens qualifying as debt for Luxembourg tax purposes shall benefit from a net wealth tax deduction and financial transfer to security holder (qualifying as interest for tax purposes) should be tax deductible from the taxable basis of the token issuer.

#### 9.1.2 AT THE LEVEL OF A LUXEMBOURG CORPORATE TOKEN HOLDER

The substance over form principle should be applied on security tokens held by Luxembourg corporate entities. In this context the qualification of specific security token would either be debt or equity and the Luxembourg tax treatment should apply accordingly.

It is, however, unlikely that security tokens and the deriving financial income/capital gain should benefit from net wealth tax, capital gain and dividend exemption as applied for qualifying participation based on the so-called "*Luxembourg participation exemption regime*". This should be further confirmed by the Luxembourg tax authorities.

To some extent it is possible that income qualifying as dividends could benefit from a 50 % exemption provided the token issuer is a qualifying entity.

Capital gains and interest should be fully taxable at the level of the token holder.

#### 9.1.3 AT THE LEVEL OF LUXEMBOURG INDIVIDUAL TOKEN HOLDER (NOT QUALIFYING AS COMMERCIAL ACTIVITY)

For Luxembourg tax resident Individuals, capital gains deriving from security tokens (representing less than 10 % of the fund of the token Issuer) should be tax exempt provided:

- (i) the assets were held for more than 6 months, and
- (ii) such activity is not considered as a commercial activity at the level of the taxpayer.

If such capital gains derive from security tokens representing more than 10 % of the fund of the token issuer and were held for more than 6 months, half income tax rate should be applied, resulting in a 50 % exemption. In other cases, it should be fully taxable at the respective progressive tax rate of the Individual.

Income generated from security tokens that qualify as dividends should benefit from a 50 % exemption at the level of the token holder provided the token issuer is a qualifying entity. In other cases, it should be fully taxable at the respective progressive tax rate of the Individual.

Income generated from security tokens that qualifies as interest should be fully taxable at the level of the token holder at the respective progressive tax rate.

Any other income not specified by the law shall usually not be subject to tax.

## 5.2. VAT

The issuance of security tokens should be exempt from VAT in most cases (assuming they are similar to debt or quasi-equity instruments).

## 6. CONCLUSION – LUXEMBOURG

Many existing Luxembourg legal and regulatory rules already apply to virtual currencies or digital tokens, with the situation in Luxembourg largely aligned to the EU analysis.

Already since 2014 the CSSF has shown itself to be open to new technologies and techniques related to virtual currencies, but remains mindful to ensure they are deployed appropriately and with due respect and compliance for existing laws and regulations.

Like ESMA and IOSCO, the CSSF has used warnings to try to ensure investors' awareness of the risks related to ICOs, stressing that investors be prudent and careful, as well as stressing the highly speculative nature of investing into early stage start up projects.

Luxembourg being an adherent to the view that laws should be technology agnostic, most efforts focus on supplementing guidance and interpretation of laws with respect to new technologies rather than new regimes which may quickly become outdated or include loopholes as the technologies advance and change.

X.

MALTA

## X. MALTA

### 1. INTRODUCTION

The Virtual Financial Assets Act, 2018 (the “VFA Act”), which came into force on the 1<sup>st</sup> of November 2018, regulates the field of Initial Virtual Financial Asset Offerings carried out in and from within Malta as well as the provision of a number of services in relation to Virtual Financial Assets (“VFAs”).

In order for the VFA Act to be applicable, a token must be classified as a VFA, and the Act provides a comprehensive *Financial Instrument Test* to determine such classification. Should the token be considered a VFA, the Act provides for a broad set of processes and regulations that aim to provide a significant level of investor protection, whilst encouraging growth in the industry.

The VFA Act defines a VFA as, “any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not electronic money, a financial instrument, or a virtual token.” The VFA shall also be generated through the use of Digital Ledger Technology (“DLT”), which is defined as, “a database system in which information is recorded, consensually shared, and synchronised across a network of multiple nodes...”

The Act delineates the necessary regulatory framework for VFA offerings, which must be made through a whitepaper (which is compliant with the VFA Act) to be registered with the Malta Financial Services Authority (“MFSA”) through a licensed VFA Agent. The VFA Act also sets out particular sanctions for non-compliant issuers, with the aim of increasing investor protection.

The VFA Act creates a regulatory environment that will provide much sought-after legal certainty for issuers of tokens. With the establishment of a robust compliance and enforcement regime whilst encouraging innovation and promotion of all industry stakeholders, Malta is a well-suited jurisdiction for the offering of tokens.

#### 1.1 FINANCIAL INSTRUMENT TEST

In order to determine whether or not the token will fall under the purview of the VFA Act, an issuer must complete the *Financial Instrument Test*. An issuer shall enlist a VFA Agent to complete the test and register their findings, along with a compliant whitepaper, with the MFSA.

The test will determine the nature of the token and the applicable regulatory regime which it will fall under. The test takes a negative approach, in that if the DLT token (“DLT asset”) is not a virtual token, transferable security, money market instrument, a unit in a collective investment scheme, a financial derivative, an emissions allowance, or electronic money, it shall be classified as a VFA and will fall under the purview of the VFA Act.

## 1.2 VIRTUAL TOKEN

In order for a token to be considered a virtual token, it must fulfil the *non/limited-exchangeability* and *purpose* criteria:

### 1.2.1 EXCHANGEABILITY

The virtual token should remain exchangeable either solely within the DLT platform on or in relation to which it was issued or within only a limited network of DLT platforms;

### 1.2.2 CONVERTIBILITY

The virtual token should not allow for convertibility into another DLT asset type; and

### 1.2.3 PURPOSE

The virtual token should be a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services.<sup>126</sup>

Should, after completing the Financial Instrument Test, the token be considered a virtual token, it shall fall outside the purview of the VFA Act and remain unregulated – of course the general principles of contract law and consumer protection (where applicable) would still apply.

## 1.3 TRANSFERABLE SECURITY

A token will be considered a Transferable Security, if it falls within the definition provided by Annex I, Section C of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance (“MiFID II”). The guidance note on the Financial Instrument Test provides for the following to be considered:

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<sup>126</sup> Malta Financial Services Authority, A Guidance Note to the Financial Instrument Test. (2019). Available at: <https://www.mfsa.com.mt/fintech/virtual-financial-assets/guidance/financial-instrument-test/>.

### 1.3.1 EXCHANGEABILITY

The first criterion to be assessed is the negotiability of a DLT asset on the capital markets. It has been established that such a feature is a *sine qua non* for a DLT asset's classification as a Transferable Security. In this respect, the Financial Instrument Test also considers whether the transferability of the DLT asset is restricted solely to the issuer, given that only under such a scenario would the DLT asset be considered as non-transferable. For the purposes of this determination, the negotiability feature shall also apply to DLT assets which have not yet been issued, should such assets be designed to be negotiable on the capital market upon issuance.

### 1.3.2 RIGHTS

A DLT asset's qualification as a Transferable Security is further subject to the assessment of the rights attached to it in order to determine whether these effectively render such DLT asset akin to a share in a company, partnership or other entity, and depository receipt in respect of share/s, or bond or other form of securitized debt or gives the right to acquire or sell any such Transferable Securities or gives rise to a cash settlement determined by reference to, inter alia, Transferable Securities.

### 1.3.3 INSTRUMENT OF PAYMENT

The definition of Transferable Securities under MiFID excludes instruments of payment; therefore a DLT asset qualifying as such shall not be deemed to be a Financial Instrument under MiFID.<sup>127</sup>

Should the token be considered a Transferable Security, it will fall under EU Prospectus Regulations. So-called 'security tokens' would in all likelihood be considered Transferable Securities and the issuer would be required to comply with the aforementioned EU Prospectus Regulations.

## 1.4 MONEY MARKET INSTRUMENT

Various EU legislation has set out the criteria for what qualifies as a money market instrument.<sup>128</sup> In order for a DLT asset to be considered as such, issuers shall contemplate the following:

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<sup>127</sup> Ibid.

<sup>128</sup> Article 3 of Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions, MiFID II, Commission Delegated Regulation 2017/565.



### 1.4.1 MATURITY

Qualification as a money market instrument would be based on whether the DLT asset has a maturity at issuance of up to 397 days or less.<sup>129</sup>

### 1.4.2 RIGHTS

In accordance with the definition under Article 4 of the Markets in Financial Instruments Directive II and the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (“Commission Delegated Regulation (EU) 2017/565”) the DLT asset should have features that are similar to those of other instruments falling within the definition’s scope, including inter alia treasury bills, certificates of deposit and commercial papers and other instruments with substantively equivalent features. This is subject to the condition that the DLT asset does not qualify as a derivative.<sup>130</sup>

### 1.4.3 ACCURATE VALUATION

The Commission Delegated Regulation (EU) 2017/565 stipulates that such instruments should have a value that can be determined at any point in time.

### 1.4.4 INSTRUMENT OF PAYMENT

The definition of money market instruments excludes instruments of payment; hence, a DLT asset which qualifies as such shall be excluded from MiFID II’s scope.

Tokens which are considered to be a money-market instrument shall fall outside the purview of the VFA Act and will subsequently fall within the confines of MiFID II and the Malta Investment Services Act.

## 1.5 UNIT IN COLLECTIVE INVESTMENT SCHEME

What constitutes a unit in a collective investment scheme is defined by Malta Subsidiary Legislation 123.51 and Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. In

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<sup>129</sup> Article 3 of Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions.

<sup>130</sup> Directive 2014/65/EU (MiFID II).

order to determine whether or not a DLT asset will be considered a unit in a collective investment scheme (“CIS”), an issuer must consider its purpose and arrangement.

### 1.5.1 PURPOSE

The DLT asset in issue should enable investors to participate in or receive profits or income arising from the acquisition, holding, management or disposal of such DLT asset and the objective of the issue should be the collective investment of capital.

### 1.5.2 ARRANGEMENTS

The undertaking should also have one of the necessary arrangements which equate the DLT platform to a CIS.<sup>131</sup>

Should a token be determined to be a unit in a collective investment scheme, the VFA Act would not apply and the token would fall within the confines of the Malta Investment Services Act.

## 1.6 FINANCIAL DERIVATIVE

Annex 1, Section C (4) to (10) of MiFID sets out what shall qualify as a financial derivative. In order to determine if the token in question falls within such definition, the following criteria shall be considered:

### 1.6.1 CONTRACT TYPE

The DLT asset should be equivalent to an option, future, swap, forward rate agreement or any other derivative contracts currently available in the markets.

### 1.6.2 UNDERLYING

The DLT asset should have an underlying asset which falls within MiFID’s scope.

### 1.6.3 SETTLEMENT

The DLT asset should be settled in accordance with the settlement conditions applicable in terms of MiFID and the Commission Delegated Regulation (EU) 2017/565.

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<sup>131</sup> Ibid. No. 1.

#### 1.6.4 PURPOSE

The DLT asset should have an underlying purpose either in terms of a financial instrument for the purposes of the transfer of credit risk or equivalent to a contract for difference.

Should a token be considered a financial derivative, it will not be subject to the VFA Act and will fall under MiFID II and the Malta Investment Services Act. The dealing of derivatives is a regulated activity which requires an appropriate license.

### 1.7 EMISSIONS ALLOWANCE

If a DLT asset is issued by a national competent authority<sup>132</sup> in terms of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, it shall be considered an emissions allowance and fall under the purview of the said Directive.

### 1.8 ELECTRONIC MONEY

Where the DLT asset allows users to purchase and obtain goods and services, and is considered to be a widely-used means of exchange, it may be regulated as electronic money. In order to determine whether or not the token will be considered electronic money, the issuer must contemplate the following criteria:

#### 1.8.1 ISSUANCE AND REDEMPTION

The DLT asset should be issued at par value on the receipt of funds by an issuer and be redeemable solely by the said issuer. Redemption should be possible at any time, at par value and without any possibility to agree a minimum threshold for redemption.

#### 1.8.2 CLAIM ON THE ISSUER

The DLT asset should represent a claim on the issuer arising from the funds originally placed against the issuance of such DLT assets.

#### 1.8.3 PURPOSE

The DLT asset should be used for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive (EU) 2015/2366 of the European Parliament and of the Council

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<sup>132</sup> As defined by Article 18 of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC.

of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC and should be accepted by a natural or legal person other than the issuer of the said DLT asset as a payment.<sup>133</sup>

However, should the payment or the DLT asset itself fall under the exemption stated in Article 3(k) of Directive 2015/2366, it shall not be considered electronic money.<sup>134</sup>

Electronic money will not fall under the VFA Act.

## VIRTUAL FINANCIAL ASSET

If a DLT asset, after completing the Financial Instrument Test, is determined not to be any of the above instruments, it will be considered a VFA, and thus fall within the purview of the VFA Act. The relevant regulations apply in relation to both the whitepaper and the issuer itself. The issuer must fulfil a fit and proper test, and meet certain specifications – the determination of which will be initially made by the VFA Agent. Furthermore, the whitepaper shall be compliant and contain the matters stated in the First Schedule of the Virtual Financial Assets Act.

Along with a VFA Agent, the Virtual Financial Assets Rulebook, Chapter 2, Virtual Financial Assets Rules for Issuers of Virtual Financial Assets states that an issuer must have, at all times, the following functionaries: a systems auditor, a custodian, an auditor, and a money laundering reporting officer. Each functionary must have sufficient knowledge and experience and adhere to the regulations set forth by the MFSA.

The VFA Act has required issuers to state in detail many aspects of the VFA offerings. From risks, milestones and financial disclosures to the technical aspects of the token – the VFA Act places a high level of obligatory disclosure on the issuer. It is clear that investor protection is a very important aspect of the VFA Act, and the legislator has used the Prospectus Directive as a model when drafting the requirements for what constitutes a compliant whitepaper.

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<sup>133</sup> Ibid. No. 1

<sup>134</sup> Services based on specific payment instruments that can be used only in a limited way, that meet one of the following conditions:

instruments allowing the holder to acquire goods or services only in the premises of the issuer or within a limited network of service providers under direct commercial agreement with a professional issuer;

instruments which can be used only to acquire a very limited range of goods or services;

instruments valid only in a single Member State provided at the request of an undertaking or a public sector entity and regulated by a national or regional public authority for specific social or tax purposes to acquire specific goods or services from suppliers having a commercial agreement with the issuer.

## 2. REGULATORY CONSEQUENCES

### 2.1 AML/KYC

Issuers of VFAs are subject to the Prevention of Money Laundering Act and related legislation. The 5<sup>th</sup> Anti-Money Laundering Directive<sup>135</sup> which was passed by the European Parliament specifically addresses cryptocurrencies and how anti-money laundering provisions will become applicable. This Directive will enter in force in Malta prior to the 30<sup>th</sup> May 2020.

One of the notable requirements is to adopt white-listing and anti-money laundering and counter financing of terrorism procedures in terms of the aforementioned anti-money laundering Act.<sup>136</sup>

Additionally, the Malta Financial Intelligence Analysis Unit (“FIAU”) has provided VFA Agents, issuers and licence holders with sector-specific guidance as to how they can meet their AML/CFT obligations through a consultation document entitled “Application of Anti-money Laundering and Countering the Funding of Terrorism Obligations to the Virtual Financial Assets Sector”. The document is not yet final, however it aims to assist VFA operators in achieving a better understanding of the money laundering and financing of terrorism risks that they may face due to the nature of the VFAs, and related products, services and activities.

### 2.2 CONSUMER PROTECTION LEGISLATION

Where VFA offerings are open for retail investors, Maltese consumer protection laws may be applicable.

## 3. INVESTING INTO DIGITAL TOKENS

Through the Virtual Financial Assets Rulebook, Chapter 2, Virtual Financial Assets Rules for Issuers of Virtual Financial Assets, the MFSA imposed on issuers the obligation to ensure that an investor does not invest more than EUR 5,000 in its initial VFA offerings over a 12-month period. Having said so, this rule does not apply to experienced investors.<sup>137</sup>

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<sup>135</sup> Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

<sup>136</sup> First Schedule Sec. 7(aj), Chapter 590, Virtual Financial Assets Act 2018.

<sup>137</sup> An experienced investor is one who declares to the Issuer that:

## 4. CONCLUSION

The VFA Act is a progressive and investor-protection-conscious piece of legislation. It attempts to classify tokens into either being virtual financial assets, instruments under the current regulatory regime, or virtual tokens which remain unregulated. It would seem as though the definition of a VFA has been purposely left incredibly broad so as to act as a net, and catch all that does not fall within the current regulatory regime. The definition is of such breath that very few tokens will be classified as virtual tokens and hence be unregulated.

The legislation and subsequent regulations are designed to be comprehensive but not overly onerous – ensuring that Malta remains one of the most attractive jurisdictions, allowing it to live up to its epithet, “Blockchain Island”.

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he is capable of providing evidence that he has already participated in other Initial VFA Offerings and his initial investment exceeded EUR 10,000 or its equivalent;  
he is aware of the risks involved; and  
the funds he is contributing to the specific Initial VFA Offerings do not exceed one per cent of his net worth excluding his main residential home.

# XI.

# POLAND

## XI. POLAND

### 1. INTRODUCTION: THE POLISH FINANCIAL REGULATOR'S APPROACH TOWARDS TOKEN-RELATED ACTIVITIES

KNF (*Komisja Nadzoru Finansowego*), the Polish Financial Supervisory Authority, has thus far provided a limited guidance on its approach towards regulatory aspects of token-related activities, including token sales. At the same time KNF remains quite critical and restrictive towards cryptocurrencies, and this approach spills over other applications of permissionless blockchains, such as tokens. Therefore most of the Polish token sales organisers conduct their ICOs in other countries, such as Switzerland, Estonia, or Gibraltar.

In mid-2017, KNF and the Poland's central bank, NBP, have issued a joint statement on virtual currencies. Although it primarily related to cryptocurrencies and not directly to tokens, the statement had a chilling effect on the country's blockchain space. In November 2017, KNF has followed ESMA<sup>138</sup> and its peer institutions from other countries and issued a statement concerning specifically token sales<sup>139</sup>. It did not, however, provided more guidance than ESMA's statements. Consequently, there is e.g. still no bright line between non-security tokens and security tokens, and the interpretation of the term "transferable security" in the context of tokens is still unclear (see the part "**Security tokens under the Polish regulations**" below).

KNF, which since the beginning of 2018 has a new fintech department, has also launched a program called Innovation Hub, which is designed to support innovative fintech and blockchain initiatives. It has been announced that 35 entities, including token sales organisers, have benefited from this program in the first half of 2017, however no further details have been provided to the market and still a general guidance is missing.

One of the most recent developments is an appointment of the blockchain working group at the KNF in June 2018 with a wide participation from the market actors, which was welcomed by the Polish blockchain community. Large part of the working group's activities will be devoted to tokens and token sales, but it remains to be seen whether this effort will lead to more regulatory certainty with regard to tokens and token sales in Poland. It was stated by

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<sup>138</sup> ESMA, ESMA alerts investors to the high risks of Initial Coin Offerings (ICOs), ESMA50-157-829, 13.11.2017. Available at: <https://www.esma.europa.eu/file/23910/download?token=PMCCNzcd>.

<sup>139</sup> KNF, The KNF's statement on selling so-called coins or tokens (Initial Token Offerings – ITOs or Initial Coin Offerings – ICOs), 22 November 2017. Available at: [https://www.knf.gov.pl/o\\_nas/komunikaty?articleId=60178&p\\_id=18](https://www.knf.gov.pl/o_nas/komunikaty?articleId=60178&p_id=18) (Polish) and [https://www.knf.gov.pl/en/news?articleId=60239&p\\_id=19](https://www.knf.gov.pl/en/news?articleId=60239&p_id=19) (English).



the KNF that the works are aimed to develop the proposal of the new law aimed to stabilize the regulatory qualification of tokens and ICOs.

## 2. TOKEN CLASSIFICATION UNDER THE POLISH LAW

### 2.1 GENERAL REMARKS

The Polish capital market law (understood broadly as law of market for financial instruments) does not give clear answer as to the legal status of certain categories of tokens (e.g. carrying some participation rights, debt/receivable or other transferable legal claim/title, to which this part is discussion is limited) vis-à-vis the notion of financial security as defined in art. 2 of Polish Act on Trading in Financial Instruments of 2005140. As mentioned above, KNF has not yet taken a unequivocal stand on that matter. In an already-mentioned Statement of 22 November 2017 KNF did not exclude, however, such possibility. KNF underlined that “activities concerning ICOs may potentially be subject to numerous legal requirements, including drawing up a prospectus and a public offer, establishing and managing alternative investment funds and investor protection. However, each case shall be assessed on an individual basis.” Very general and vague statement by KNF does not help Polish market participants of token transaction since it does not reduce the uncertainty as to the application of the whole capital market law regime to them.

The KNF’s statement followed ESMA’s alerts investors to the high risks of Initial Coin Offerings (ICOs), and in the same manner focuses on risks associated with investments in ICOs. Those risks will not be enumerated here as they are described thoroughly in the documents cited above as well as the others<sup>141</sup>. Without any doubt one of the most direct risk for the token transactions’ participants is the lack of regulation and clear understanding as to which exactly provisions apply to them. Another is a still relatively new model of its creation and distribution. However, several other categories of risks associated with certain categories of tokens do not seem too different from these inherent to investing in the financial instruments on the capital market.

At the same time, it seems that dominant legal interpretations in Poland follow the categorization of tokens as presented in the main part of this report, that is: security tokens, utility tokens, cryptocurrency tokens and hybrid tokens. What still remains unclear is the

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<sup>140</sup> Act on Trading in Financial Instruments of 29.07.2005 (O.J. No. 183, item 1538), consolidated text of 15 September 2017 (O.J. 2017 item 1768).

<sup>141</sup> See, instead of many, ESMA, Discussion Paper on The Distributed Ledger Technology Applied to Securities Markets, ESMA/2016/773, 2 June 2016 and Credit Suisse report Blockchain 2.0 from 1 January 2018. Available at: [https://research-doc.credit-suisse.com/docView?language=ENG&format=PDF&sourceid=csplusresearchcp&document\\_id=1080109971&serialid=pTkp8RFIoVyHegdqm8EILLNi1z%2Fk8mlnqoBSQ5KDZG4%3D](https://research-doc.credit-suisse.com/docView?language=ENG&format=PDF&sourceid=csplusresearchcp&document_id=1080109971&serialid=pTkp8RFIoVyHegdqm8EILLNi1z%2Fk8mlnqoBSQ5KDZG4%3D).

precise legal boundaries of each of those categories, and in particular the answer to the question of what constitutes a security token (or, to be more precise, which tokens should qualify as financial instruments, and transferable securities in particular).

## 2.2 SECURITY TOKENS UNDER THE POLISH REGULATIONS

As briefly mentioned above, the key practical issue of what conditions need to be fulfilled in order to classify a given token as a security token are still open. In general, the conclusions relating to the EU law reached in the main part of this report also apply in Poland. In light of no specific guidance from the regulator (see the part **“Introduction: the Polish financial regulator’s approach towards token-related activities”** above), general principles apply. The relevant Polish legal act (the Trade in Financial Instruments Act of 29 July 2005), which implements the MiFID II, provides a definition of a “security” (*papier wartościowy*) that obviously does not specifically refer to tokens, and thus legal interpretation of the term is needed.

In general, it is rather clear that tokens functionally comparable with e.g. shares or other securitised debt instruments, especially those that are connected with financial payments to their holders, are very close to the statutory definition of securities. There is however an important Poland-specific aspect of the issue. A very influential concept of securities under the Polish law assumes a closed catalogue of securities under the Polish law (so called *numerus clausus*). In line with this theory, there can exist no security types other than those specifically mentioned by the lawmaker in the law. There are certain aspects of the mentioned definition of a “security” in the Polish law that supports that view. It is also being supported by some key legal scholars in Poland. This is at odds with the EU concept of securities and a non-exhaustive, indicative list of examples of securities in Art. 4 para. 1 No. 44 MiFID II, but in practice plays a great role in legal considerations relating to tokens and token sales in Poland. It remains to be seen whether in the legal practice that concept will be applied to tokens. If so, the consequence would probably be that many tokens that at the EU level are deemed security tokens, in Poland will not be considered financial instruments due to the *numerus clausus* principle.

## 2.3 EQUITY TOKENS IN THE SIMPLE JOINT-STOCK COMPANY

The Polish joint-stock companies law, regulated i.a. by the Code of Commercial Companies of 2000<sup>142</sup>, does not refer and does not regulate tokens or distributed ledger technology. This, however, might be subject to change in the non-distant future if the Polish Parliament adopts an amendment to the Code aimed at introducing so-called Simple Joint-Stock

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<sup>142</sup> Act of 15 September 2000, consolidated text of 20 July 2017 (OJ 2017 item 1577).

Company<sup>143</sup>. The legislative process in that matter is currently on-going and is in the stage of providing comments by interested parties. Pursuant to the projected art. 300(29) of the Code, the shares in the Simple Joint-Stock Company shall not have a form of a document and shall be registered in the share register in accordance with the provisions of the Code. According to art. 300(32) of Code, the register may be kept also in a distributed and decentralized database, which ensures the security of data contained therein and proper performance of duties of an entity keeping the register.<sup>144</sup> Whether the distributed ledger technology could be employed for the share register keeping in the new type of the company is currently under the analysis of the experts.

It is possible that the aforementioned new legislative developments will lead to emergence of “share tokens” or “equity tokens”, since it cannot be excluded that if the projected act is adopted, it would be possible to keep the share registers of simple joint-stock companies as tokens on public blockchains. However, that does not solve the general issue as to whether a token that is not explicitly a share might constitute a security.

It is difficult to predict to what extent the adoption of the new law would constitute a breakthrough legal development with respect to equity tokens. The legislative proposal sets forth that shares in the Simple Joint-Stock Companies may not be subject to organised trade in the meaning of the Trade in Financial Instruments Act of 29 July 2005, which may significantly limit the practical advantages of the blockchain technology such as the possibility of decentralized, peer-to-peer trade.

### 3. CIVIL LAW

For the purposes of this document a simplified categorization of tokens was used according to the proposition in point 2.7 Bundesblock Report.

There is a discussion going on under the Polish law whether cryptocurrency tokens (e.g. Bitcoin), as well as other types of tokens, can be regarded as an object of the subjective right; in other words, if the holder of the tokens is legally “entitled” to the token.

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<sup>143</sup> Project of 15 May 2018 on amendment of the Code of Code of Commercial Companies, document no. UD154. Available at: <http://legislacja.rcl.gov.pl/projekt/12311555/katalog/12507990#12507990>.

<sup>144</sup> The list of entities entitled to keep the register includes: National Depository of Securities S.A. (Krajowy Depozyt Papierów Wartościowych S.A.), a company to which National Depository of Securities S.A. handed over the activities related to the tasks referred to in art. 48 par. 1 point 1 of the Act of 29 July 2005 on Trading in Financial Instruments; an investment company; a foreign credit institution conducting brokerage activities on the territory of the Republic of Poland; a domestic bank; a credit institution conducting banking activity on the territory of the Republic of Poland; a notary. (art. 30031 § 2).

Under the Polish law only tangibles could be objects of ownership. A common view is that tokens are intangibles. As a consequence, a token does not constitute the object of the ownership.

According to one of representing views<sup>145</sup>, cryptocurrency tokens are a subjective right and, as such, constitute assets (art. 44 Civil Code). The right to which token's holders would be entitled is an obligation. The reason for the above statement is the fact that tokens have an economic value.

According to the second approach<sup>146</sup>, a pure cryptocurrency token, in the opposition to utility or security token, cannot be regarded as a (property, personal, exclusive, transferable, effective *erga omnes* (absolute) or *inter partes* (chose in action)) right. Such a token does not represent any claims: neither against issuer (if exist) nor against anyone else. Hence, such a token neither documents nor represents any contractual relation (obligations). The economic value of a token does not constitute the legal basis that would give the token's holder any rights/titles to the token. The cryptocurrency token is not recognized by the civil law as an intangible object of proprietary rights (like e.g. copyright). It should be emphasized that in Poland the traditional rule of *numerus clausus* (the exhaustive list) of proprietary rights is still accepted, what, as the consequence, determines also a *numerus clausus* of legal objects of proprietary rights. There is no legal basis which would give a token's holder any proprietary rights to this token. The "possession" of a pure cryptocurrency token is only a factual situation. However, the legal rules protecting the possession would not apply to tokens' holders because these rules protect only the physical custody of tangible things. Hence, under this approach, the protection of tokens' holders by law against violations is very limited, e.g. by using the tort law.

There exists yet no case law that would determine which of the mentioned approaches finds more judiciary support. The issue however has strong tax consequences (see the part "**Tax considerations**") below.

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<sup>145</sup> K. Zacharzewski, Bitcoin jako przedmiot stosunków prawa prywatnego, "Monitor Prawniczy", 2014, nr 21/2014, Wydawnictwo C.H.Beck, s. 1132–1139; K. Zacharzewski, K. Piech, przegląd polskiego prawa w kontekście zastosowań technologii rozproszonych rejestrów oraz walut cyfrowych, 2017, s. 13; K. Wojdyło, M. Pietkiewicz, Czym są wirtualne waluty? [w:] Raport: wirtualne waluty, Wardyński i Wspólnicy, 2014, pp. 15 – 18 [http://www.wardynski.com.pl/w\\_publication/wirtualne-waluty/](http://www.wardynski.com.pl/w_publication/wirtualne-waluty/) (access 04.07.2018); S. Bala, T. Kopyściański, W. Srokosz, Cryptocurrencies as electronic means of payment without the issuer. Computer science, economic, and legal aspects, Wrocław 2016, p. 113. Available at: [https://www.gov.pl/documents/31305/52168/przegląd\\_polskiego\\_prawa\\_w\\_kontekście\\_zastosowan\\_technologii\\_rozproszonych\\_rejestrow\\_oraz\\_walut\\_cyfrowych.pdf/f6e74ce0-09e5-776d-bd3b-c21fca96cce2](https://www.gov.pl/documents/31305/52168/przegląd_polskiego_prawa_w_kontekście_zastosowan_technologii_rozproszonych_rejestrow_oraz_walut_cyfrowych.pdf/f6e74ce0-09e5-776d-bd3b-c21fca96cce2) (access 04.07.2018)

<sup>146</sup> J. Szewczyk, O cywilnoprawnych aspektach Bitcoina, MoP 2018/5; A. Kotucha Bitcoin nie jest prawem, 2018, <https://www.linkedin.com/pulse/bitcoin-nie-jest-prawem-adam-kotucha/> (access 04.07.2018); M. Michna, Bitcoin jako przedmiot stosunków cywilnoprawnych, Warszawa 2018, pp. 45 – 47.

## 4. TOKENS AND PAYMENT SERVICES REGULATIONS

Similarly, as at the EU level, the payment services regulations (the Polish Act on Payment Services) implementing the PSD2 will not apply to most of the tokens in their current form. It cannot be excluded, however, that certain types of tokens can qualify as electronic money pursuant to point 2 of Art. 2 of EMD.

PSD 2 (and hence also the Polish Act on Payment Services) will also not apply to other types of tokens due to the wording of point (25) of Article 4 of PSD2. Tokens are not funds, defined by art. 4 item 25 PSD2 ('funds' means banknotes and coins, scriptural money or electronic money). Obviously, tokens are not banknotes and coins. Tokens are not scriptural money, either. The term 'scriptural money' has been associated in Polish law with the term 'bank money' (demand deposit).

According to the KNF, bank money in its essence is a record in the bank's books (in the depositor's bank account), stating the existence of a bank's obligation to pay a certain amount of money (i.e. cash notes). Undoubtedly, the term 'scriptural money' may also be applied to funds recorded on the accounts of payment institutions. However, at the moment pursuant to Polish law, the term 'scriptural money' cannot apply to blockchain entries, including those regarding tokens. Currently, tokens are not 'cash funds' referred to in the Polish Act on payment services. It seems that it is also not possible to state that the scope of the term 'scriptural money' includes blockchain entries in the meaning of the PSD2. Such an important change in the understanding of 'scriptural money' would need to be confirmed clearly by the EU legislator or by a court judgements (preferably by the judgments of the Court of Justice).

According to the KNF, the provisions of the directive PSD 2 and the Act on Payment Services may be applied to cryptocurrency exchanges in the situation when they accept payments from their clients to bank accounts, operating among others so-called "virtual wallets".<sup>147</sup> For these entities, according to the KNF, there may arise an obligation to obtain a license to "perform payment services in the scope of operating payment accounts (so-called virtual wallets) and performing payment transactions specified in the Act on Payment Services". This is a consequence of accepting by Commission the idea that cryptocurrency exchanges "control" funds of their clients accumulated on the bank account of the exchange and they cannot be subject to the application of the exemption from the scope of the directive PSD 2.

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<sup>147</sup> [https://www.knf.gov.pl/knf/pl/komponenty/img/Komunikat\\_ws\\_funkcjonowania\\_gield\\_i\\_kantorow\\_kryptowalut\\_61993.pdf](https://www.knf.gov.pl/knf/pl/komponenty/img/Komunikat_ws_funkcjonowania_gield_i_kantorow_kryptowalut_61993.pdf) (access on 8.07.2018).

## 5. NEW AML REGULATORY FRAMEWORK AND CONSEQUENCES FOR TOKENS

The amendments to the new AML directive (so called AMLD5) that cover some aspects of cryptocurrency-related activities (and may impact tokens as well) have been already taken into account in the new Polish AML legislation, the Act of 1 March 2018 on anti-money laundering and counter-terrorist financing.

It is important to note that the new Polish AML act's scope extends beyond the EU regulations. The AMLD5 only covers entities engaged in exchange between 'virtual currencies' and traditional ones (crypto-to-fiat and fiat-to-crypto). The Polish AML act, in force since 13 July 2018, also applies to entities which conduct "exchanges between virtual currencies" (crypto-to-crypto). This extended approach may be justified by the desire to improve the effectiveness of anti-money laundering efforts by covering transactions which involve e.g. exchanging illicitly obtained funds from bitcoins into cryptocurrencies (such as Monero or Zcash) which provide an even higher degree of user anonymity. However, this proposal may have undesirable effects on the market and while its practical effectiveness is questionable.

As mentioned in the main part of the report, the newly introduced definition of 'virtual currency' is quite imprecise and broad-ranging. As a result, we can expect that the term 'virtual currency' will apply not only to well-known cryptocurrencies (e.g. Bitcoin) but will also cover a wide variety of tokens. This would mean that many token-to-token exchanges would also be covered under the new regulations. Within this context, token sales represent a particularly important scenario. Most token sales involve the exchange of ETH for newly introduced tokens. If these tokens fall under the new definition of 'virtual currency,' all token sales would potentially be classified as "exchanges between virtual currencies" under the Polish AML Act. Additionally, the entity conducting the token sale would have to be considered an "entity engaged in providing [or facilitating] exchange between virtual currencies."

This provision would certainly also raise a lot of doubts regarding proper interpretation, increasing the general uncertainty with regard to tax and regulatory aspects of tokens and token sales. To our knowledge this is the only such regulation in the EU. Meanwhile, crypto-to-crypto exchanges are provided by entities across the world and can be accessed through any internet connection. As a result, there are serious doubts whether the proposed provisions would have any practical impact on money laundering operations.

## 6. CONSUMER LAW ASPECTS

Consumer aspects are present in token sales to the same extent as in any other area of economy. Consumers may enter into the token transactions the same as with any other goods or services, e.g. financial instruments and other financial products as well as acquire financial services like investment services. This raises the issue of applying the consumer acquis to the relatively new field of the market. From the legal point of view it is, however, no different than in the case of other innovative sectors of the financial market.

Polish consumer law in its current state constitutes a rather close implementation of the EU consumer law, including i.a. the Directive 93/13/EEA of 1993 on unfair contractual terms<sup>148</sup>, Directive 2002/65/EC of 2002 on distance marketing of consumer financial services<sup>149</sup>, Directive 2005/29/EC on unfair business-to-consumer commercial practices<sup>150</sup> and Directive 2011/83/EU on consumer rights. The definition of a consumer in the Polish civil law is laid down in article 22.1 of the Civil Code<sup>151</sup>, which provides that “a consumer is a natural person performing a legal transaction other than directly related to his or her business or professional activity with an entrepreneur”. This definition applies universally to the whole system of private law. Therefore, whenever one of the parties to a legal transaction is a consumer, the consumer provisions of the Civil Code may be applied (for instance as regards unfair contractual terms – article 3851 in conjunction with article 221 of the Civil Code). The view that a person engaging in transactions in a field where they lack expertise, including fintech sector and capital market transactions, is a consumer insofar as unfair contractual terms (abusive clauses) are concerned is widely accepted throughout the EU.<sup>152</sup>

Polish Consumer Rights Acts of 30 May 2014<sup>153</sup> implements the EU Directive 2011/83/EU on consumer rights. The directive does not apply to contracts on financial services (article 3(3)(d) of the directive). The financial service is defined in art. 2(12) of the Directive as “any service of a banking, credit, insurance, personal pension, investment or payment nature”. A similar exemption can be found in article 4(2) of the Polish Act, pursuant to which the provisions of the Act shall not apply to contracts regarding financial services, in particular such as: banking

<sup>148</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21.4.1993, p. 29–34.

<sup>149</sup> Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ L 271, 9.10.2002, p. 16–24.

<sup>150</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive'), OJ L 149, 11.6.2005, p. 22–39.

<sup>151</sup> Civil Code of 23 April 1964, consolidated text of 10 May 2018 (OJ 2018 item 1025).

<sup>152</sup> See J. Dybiński, The notion of a consumer on the capital market in Polish and EU law, *Allerhand Working Paper 23/2017*. Available at: [http://www.allerhand.pl/images/allerhand/pdf/wp/WP\\_IA\\_23\\_2017\\_JD\\_2018\\_04\\_23.pdf](http://www.allerhand.pl/images/allerhand/pdf/wp/WP_IA_23_2017_JD_2018_04_23.pdf).

<sup>153</sup> Consumer Rights Act of 30 May 2014, consolidated text of 9 March 2017 (OJ 2017 item 683).

operations, consumer credit agreements, insurance operations, purchase or repurchase agreements of an open-end investment fund or an open-end specialized investment fund and acquisition or subscription of investment fund investment certificates closed payment services. The enumeration is only exemplary and the term “financial service” should be interpreted broadly in the spirit of art. 2(12) of the Consumer Rights Directive.

The exclusion of financial services from the Polish Consumer Rights Act set out in art. 4(2) is of limited scope, though. First, since it pertains to contracts, it does not extend to unilateral acts, i.e. act performed solely by one party outside the contract. Second, the exemption of the financial contracts from the Act does not include the contracts relating to financial services concluded remotely, to which the provisions of chapters 1 and 5 apply. In consequence, articles 1-7a and articles 39-43 of the Act are directly applicable to distance contracts for financial services which are established remotely, without simultaneous physical presence of the parties, based on the exclusive use of one or more distance communication measures until and inclusive of the time of contract execution (Article 2(1) of the Act).

Taking above into consideration, the legal status of token transactions requires an analysis and verification vis-à-vis their falling under the scope of the Polish Consumer Rights Act, provided that the Polish jurisdiction applies. This answer would be similar in case of the question whether the Directive 2002/65/EC on Distance Marketing of Financial Services applies to token transactions. Preliminary analysis suggests that this could be the case.

Last few months witnessed developments in the financial consumer protection education in Poland. On 1 June 2018 Polish Financial Supervision Authority (Komisja Nadzoru Finansowego, hereinafter referred to as “KNF”) launched a media campaign “Who will you be when the bubble bursts?” According to official information from KNF, the aim of the campaign is to draw public attention to the risks associated with investing in cryptocurrencies and the Forex market, as well as underlining that entities and individuals offering “fast, reliable and high profit” cannot be trusted on the financial market. The campaign’s partners are the Ministry of Finance, the National Bank of Poland and the Police. The means of the campaign include i.a. two warning videos showed on internet channels. KNF introduced also a mobile application “KNF Alert” allowing to check if the company offering service in the financial market is a supervised entity and whether it is enlisted on the “List of Public Warnings of the KNF”.

The campaign has been criticized by the fintech community for presenting a one-sided and largely negative picture of cryptocurrencies which have been listed next to the risky Forex investments. The comments were indicating that instead of providing an objective view and starting a constructive debate on the benefits, risks and challenges of the token market growth, KNF started off with a severe critique which may forgo the Poland’s chances for



taking advantage of the currently most innovative part of the modern economy. It should be noted that while that data indicate that already for the several past years the Forex investments were bringing losses to ca 80 % of Polish investors<sup>154</sup>, the author did not encounter such data available with respect to the token transactions with participation of the Polish investors.

Several aspects of consumer protection agenda in the financial market connected with the token transaction are overlapping with the issues of investor protection and were mentioned above.

## 7. TAX CONSIDERATIONS

One of the most discussed issues in Poland related to digital assets, such as tokens and cryptocurrencies, is the taxation of the income derived therefrom. Organising the ICO through Polish entities is not so popular (mainly due to tax reasons), therefore, the tax implications are not on the official agenda of the tax authorities as often as simple token or cryptocurrency transactions. The Ministry of Finance is working on changing the current tax regulation in order to facilitate the tax settlements of the cryptocurrency transactions. We should assume that new law will cover also other digital assets such as tokens. On August 24, 2018 the Ministry of Finance has published the draft of bill concerning, among others, the taxation of virtual currencies (as defined in the Polish AML law). The draft is subject to public consultation. It is most probable that the new rules of taxation are to be in force starting from January 1, 2019.

On April 4, 2018, the Ministry of Finance has issued the letter – information on its standpoint towards taxation of the cryptocurrency transitions. Once the letter was published, the taxation of cryptocurrency became subject number one in Poland as many of the cryptocurrency enthusiast have not been aware of certain tax implications. The letter itself did not directly refer to tokens, but it should be assumed that many of the issues determined thereof apply also to token transaction.

As it was mentioned above, there is no legal definition of the cryptocurrencies (apart from the new one established for the purposes of AML regulation to be in force from July 13,

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<sup>154</sup> According to cyclical reports from the Supreme Audit Office (Najwyższa Izba Kontroli, “NIK”) on average about 75 – 82 % of retail clients investing in the Forex market incur losses, while this highly speculative market has legal loopholes in the system of legal protection of its participants, with the presence of entities operating without authorization, in the absence of cooperation between supervisory authorities. See NIK, Information on results of audit on protection of rights of non-professional market participants of the currency market (forex, on-line currency exchange offices and virtual currency market), KBF.430.011.2016, ref. no. 199/2016/P/16/007/KBF, 14.02.2017; KNF, Statement on clients’ results in the Forex market in 2016-2017, 7 September 2017. Available at: [https://www.knf.gov.pl/knf/pl/komponenty/img/Forex\\_wyniki\\_58546.pdf](https://www.knf.gov.pl/knf/pl/komponenty/img/Forex_wyniki_58546.pdf).

2018) or for the token under the civil law. There is also no such definition for a tax purposes. Therefore, the main difficulty and issue related to determining the tax aspects of the cryptocurrency and the token transaction is of a legal nature. In practice, this issue is limited to the not so simple question *What is the legal nature of the token and the cryptocurrency?*

In this context it should be noted that the tax authorities do not exactly recognize the differences between tokens and the cryptocurrencies and therefore, tend to qualify tokens as a type of cryptocurrency. Consequently, tokens are considered as 'material rights' and the tax aspects are determined based on such supposition.

Irrespective of the above, it seems that starting from 2019, this situation will differ in relation to so called security tokens. It seems that based on the draft of regulation, the tokens being considered as financial instrument will fall under the rules of taxation for this kind of instruments. Still however, there is no final wording of the law.

It must be stated, however, that as regards the VAT, the Polish tax authorities have fully adopted the standpoint of the European Court of Justice regards the cryptocurrencies presented in the 2015 Hedqvist ruling (C-264/14). In this context, the tax authority verifies the nature of the token (mainly whether the token is to be accepted by third parties as a means of payments) and determine the VAT consequences based on it. The cryptocurrency transactions are considered as VAT-exempted.

There were several cases of the Polish ICOs (i.e. organised under the Polish jurisdiction) recently analysed by the Director of the National Tax Information – the authority responsible for issuing the individual tax ruling. What is surprising, is that some of the applicants for the tax ruling avoided the phrase 'ICO' and replace it with the words such as "innovative crowdfunding proceeding" or 'innovative project'.

Apart from the above, it is extremely crucial to understand one of the tax implications of classifying the tokens and cryptocurrency as type of 'material right'. If the acquisition of exchange of such right is done i) outside of the business activity of a token/cryptocurrency holder and acquirer and ii) is done in Poland or iii) is done outside Poland, but the rights associated with a transferred tokens/cryptocurrencies are executed in Poland, such transaction is subject to transfer tax (to be paid by acquirer). The tax equals 1 % of the value of the transaction (value of the token/cryptocurrency). Taking into account the turnover a single token holder can achieve the transfer tax may be significant. At the same time, this tax does not depend on the net income recognised on a transaction (if any) but is a turnover tax. The transfer tax does not correspond to the reality of the cryptocurrency transactions and its collection may lead to the bankruptcy of a given trader. The Ministry of Finance suspended this tax for the transactions concerning virtual currencies (as determined in AML law) from the transactions made between July 13, 2018 and June 30, 2019. However, there is no official standpoint regards the past transactions.

# XII.

# SLOVENIA

## XII. SLOVENIA

### 1. INTRODUCTORY REMARKS

Even though Slovenia is home (both in terms of physical location of development teams and in terms of company incorporation) to a number of blockchain companies, Slovenia has not yet passed a lot of blockchain specific regulation. The stance so far has been rather to provide sufficient clarification to current regulation in force, mostly by way of clarifications by the Slovenian Securities Market Agency (ATVP) and Slovenian Tax Authority (FURS). As a small country, Slovenia will most likely follow the regulatory developments on the EU level and try not to deviate from that.

### 2. SECURITIES UNDER SLOVENIAN LAW

Under Slovenian law, the term "securities" is defined in several statutory laws, namely Market in Financial Instruments Act<sup>155</sup> (ZTFI-1), Book-entry Securities Act<sup>156</sup> (ZNVP-1), Alternative Investment Fund Managers Act<sup>157</sup> (ZUAIS) and Investment Funds and Management Companies Act<sup>158</sup> (ZISDU-3). In addition to the financial regulation, Slovenian Obligations Code<sup>159</sup> (OZ) also defines and regulates securities from a civil law perspective.

#### 2.1 SECURITIES UNDER MARKET IN FINANCIAL INSTRUMENTS ACT AND BOOK-ENTRY SECURITIES ACT

ZTFI-1 Article 7 classifies financial instruments as transferable securities, money-market instruments, units in collective investment undertakings and derivative financial instruments.

Paragraph 3 in Article 7 (in connection with Article 49) in essence matches the definition of transferable securities in MIFID II, referring to transferable securities as "*those classes of securities which are negotiable on the capital market, with the exception of instruments of payment. Transferable securities are:*

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<sup>155</sup> Zakon o trgu finančnih instrumentov (Official Gazette of RS, no. 77/2018).

<sup>156</sup> Zakon o nematerializiranih vrednostnih papirjih (Official Gazette of RS, no. 75/15, 74/16 – ORZNV48, 5/17 and 15/18).

<sup>157</sup> Zakon o upravljavcih alternativnih investicijskih skladov (Official Gazette of RS, no. 32/15).

<sup>158</sup> Zakon o investicijskih skladih in družbah za upravljanje (Official Gazette of RS, no. 31/15, 81/15 and 77/16).

<sup>159</sup> Obligacijski zakonik (Official Gazette of RS, no. 97/07, 64/16 and 20/18).

1. *shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;*
2. *bonds or other forms of securitized debt, including depositary receipts in respect of such securities;*
3. *any other securities which include:*
  - *a unilaterally defined entitlement of the holder to acquire or sell the transferable security, or*
  - *a right of the holder to request cash payment, which is determined on the basis of the value of transferable securities, currencies, interest rates or yields, commodities or other indices or measures.”*

As evident from the description above, ZTFI-1 does not give a substantive definition of securities, but rather deals with the notions of transferability and tradability.

When such instruments fall under the definition of securities, they are bound in case of public offering by the obligation imposed by the ZTFI-1 to publish a prospectus. There are currently several views in Slovenian legal theory on how to approach the question whether or not tokens fall under definition of a security.

The prevalent position confirmed also by the ATVP<sup>160</sup>, is based on the fact that ZTFI-1 does not provide a substantive civil law definition of a security (this is stipulated by OZ, as is presented below). To be deemed a security, ZTFI-1 in principle relies on key elements of i) transferability, ii) negotiability and iii) formality of a security.<sup>161</sup> With regard to the latter, an instrument must be acknowledged as having also the formal (i.e. shape, form, type of medium) and not only substantive characteristics of a security, before it can actually be deemed as such.<sup>162</sup>

A contrary position seems to support a more restrictive interpretation where all tokens which have the nature of a security, should also be issued with the needed formality (medium); and those issuers failing to do so, should be found in breach of the OZ and ZTFI-1 requirements.<sup>163</sup>

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<sup>160</sup> See Positions of ATVP in connection to the consultative document ICO (“Stališča ATVP v zvezi s posvetovalnim dokumentom ICO»), published in June 2018, p. 7 – 8, 20 (hereinafter as “ATVP Position Paper”).

<sup>161</sup> T. Prevodnik, When crypto universe crashes into the financial market regulation (“Ko kripto svet trči v regulacijo finančnih trgov”), Bančni Vestnik 10/2017, p. 4 (the author is a sectoral secretary with the ATVP).

<sup>162</sup> Ibid, p. 5.

<sup>163</sup> Ibid, p. 6.

Another position revolves around a more substantive test of a security, which may be derived from the ZTFI-1 itself, disregarding the formality requirements set in the civil code.<sup>164</sup> Under this approach the substance of the rights embedded in the token should be examined in order to come to a final decision whether or not the token is a security, regardless of the form of issuance.

ZNVP-1 on the other hand regulates book-entry (“non-material”) securities, which are defined in a more formalistic (or technical) way. In paragraph 1 of Article 4 ZNVP-1 book-entry securities are defined as a “*statement by the issuer entered in the central register of book-entry securities whereby the issuer undertakes to meet obligations arising from the book-entry security.*” Such securities however only incur upon its first entry in the account of the holder in the central register and continue to exist until its deletion from the central register.

## 2.2 OTHER FINANCIAL INSTRUMENTS

Paragraph 4 in Article 7 ZTFI-1 defines money-market instruments as “all types of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers, with the exception of payment instruments.”

Slovenian Euro Adoption Act<sup>165</sup> prescribes Euro notes and coins as a lawful payment tender in Article 3. Slovenian Foreign Exchange Act<sup>166</sup> in Article 4 defines foreign legal tender as notes and coins in a foreign currency issued by a central bank or a country.

Since tokens are not issued as a Euro or foreign legal currency, they cannot be deemed as a money-market instrument, which has also been the opinion of the Bank of Slovenia.<sup>167</sup>

Further, it seems also that tokens could not be deemed as derivative financial instruments for the transfer of credit risk, financial contracts for differences or other derivatives, such as options, futures, swaps etc. The types of tokens currently prevalent in the blockchain industry normally do not have the functionality and do not serve the purpose of the mentioned instruments. Moreover, many of the options and other derivative financial instruments are contingent on the underlying values of securities, which in case of ICO tokens is usually not the case.

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<sup>164</sup> A. Butala, Brave new world of distributed ledger technology, tokens and autonomous organizations (Krasni novi svet tehnologije razpršenih evidence, žetonov in avtonomnih organizacij), Pravna Praksa 11/2017, p. 3 (the author is a sectoral secretary with the ATVP).

<sup>165</sup> Zakon o uvedbi eura (Official Gazette of RS, no. 114/06).

<sup>166</sup> Zakon o deviznem poslovanju (Official Gazette of RS, no. 16/08, 85/09 and 109/12).

<sup>167</sup> Statement of Bank of Slovenia no. 29.00-0817/17-ARU, entitled View towards different forms of cryptographic tokens from the aspect of legislation in scope of the Bank of Slovenia (“Obravnava različnih oblik kriptografskih žetonov z vidika zakonodaje v pristojnosti Banke Slovenije), p.2.

ATVP in its position paper<sup>168</sup> indicated that in case of tokens which do not have a clear substance, they could not be classified as money-market instruments or a derivative financial instrument. However, ATVP also argued that tokens which function as a part of a smart contract, defining the clear obligations of a money-market or a derivative instrument, could potentially be deemed as such instrument.

## 2.3 INVESTMENT LAW

ZUAIS and ZISDU-3 are implementing the UCITS and AIFM Directives, respectively, and explicitly define and establish specific types of securities.

Under Article 34 ZISDU-3 the shares of the Management Companies have to be issued as book-entry securities, registered with the central register.

And under ZUAIS Article 34, units of an alternative investment funds (AIF) must be issued as securities, where such units of AIF should be:

1. a proportional share of the portfolio of an AIF where the AIF constitutes a separate portfolio of assets;
2. a proportional share of the capital of an AIF where the AIF is a company.

Alternatively, it is not necessary to issue units of AIFs as securities in case where they are kept in a register that complies with the requirements of AIFMD, or where holders of units are entered in the court register as holders of shareholdings.

The key question is whether an ICO may be deemed as an investment fund, and tokens as units of an investment fund. To answer these questions, the issuer of tokens will have to undergo a test, defining whether i) there is a collective undertaking, ii) the purpose of such undertaking is raising funds of investors, iii) the funds are invested in accordance with the investment strategy and iv) whether the funds are invested exclusively to the benefit of holders of units of the investment fund. One of the key matters is also the possibility (or lack thereof) of the daily management or supervision of the management of the collective undertaking by the owners as unit holders.<sup>169</sup>

Accordingly, under Slovenian law an ICO might be regarded as an investment fund and the issuers of tokens as investment managers, where the issuers have the exclusive right to manage the funds.<sup>170</sup> The issued tokens could also potentially be deemed as units of an

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<sup>168</sup> ATVP Position Paper, point 4.3., p. 9.

<sup>169</sup> As stipulated by Article 5 of the Decision on types and categories and key elements of investment funds (Sklep o ključnih elementih investicijskega sklada ter tipih in vrstah investicijskih skladov; Official Gazette of RS, no. 100/15 and 16/17).

<sup>170</sup> T. Prevodnik, When crypto universe crashes into the financial market regulation, p. 7.

investment fund, where the units are designed as a proportional unit in the separately collected funds.

Should an ICO be deemed as an investment fund and tokens as units of a fund, then the licensing obligations and restrictions regarding the sale of such fund and its units are applied. Under Article 31 ZUAIS only professional investors or investors investing more than 150.000,00 EUR can participate, whereby the offer is also limited to the territory of the Republic of Slovenia (in case where sale of units is granted also to non-professional investors).

## 2.4 CIVIL LAW

A general definition of securities is stipulated by OZ, which defines securities in Article 212 as a *“written document, with which the issuer is obliged to fulfil the obligation written in the document, to the lawful holder.* It further stipulates that securities may also be issued on a [digital] medium, but only if a special act (for instance the ZNVP-1) defines so.

From the text in the previous paragraph it is evident that the standard of an instrument being a security is twofold: substantive (a promise to fulfil the obligation) and formal (a written document or statutory designated medium). Under Slovenian civil law the lack of prescribed formality has the effect of rendering the contract, transaction or instrument as null and void. Which is in line with the prevalent opinion that a cryptographic token could be deemed a security only if it satisfies the formality requirements.<sup>171</sup>

## 2.5 CONCLUSION

According to ATVP Position Paper on the topic of ICO and token classification, ATVP currently examines each ICO individually, analysing whether or not it could fall under the scope of ZTFI-1.

However, a principal opinion of the ATVP is that the types of ICOs and tokens known so far cannot be covered by the scope of ZTFI-1 as they lack the crucial components of securities: a clearly defined obligation of the instrument and a definite designation of the instrument issuer (besides the earlier discussed missing formality requirements of securities).<sup>172</sup>

ATVP also principally declined the possibility of ICO falling under the scope of ZISDU-3. The reasoning is firstly that normally the purpose of an ICO is to support an individual project and not to jointly invest in liquid financial investment. And secondly, in such case the tokens

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<sup>171</sup> See point 2.1 Securities under Market in Financial Instruments Act and Book-entry Securities Act.

<sup>172</sup> ATVP Position Paper, point 4.1., p. 7 – 8.



should either not be transferrable or need to be issued as book-entry securities, in order to be classified as investment coupons, representing the units of an UCITS fund.<sup>173</sup>

However, in case of an AIF, ATVP left the option open that, although most token issuances are not promising or promoting a joint return on investment, this might still be the case, and such ICO might fall under the AIF regulation.<sup>174</sup> This reasoning is also based on the fact that there are no formality obligations for the AIF units (regardless of the transferability). In other words, a token could be deemed as an AIF unit, if purchasing such token would mean supporting a project, which fulfils the criteria for an AIF.

With regard to classifying tokens as money-market instruments or derivative financial instruments ATVP took the position that the content of such token or given promise needs to be observed, since the definition of these financial instruments does not depend on the medium of issuance.<sup>175</sup>

In conclusion, ATVP argues that the ICO and cryptographic tokens are a new phenomenon and a new type of instruments and thus very different from the existing financial instruments. For this reason, ATVP proposes a *sui generis* regulation, which would be separate, but comparable, to the principles in the field of financial instruments<sup>176</sup>, bearing in mind the principle of technological neutrality.

ATVP also touches upon the classification of tokens as cryptocurrencies, security tokens and utility tokens; a similar classification has been proposed by the Blockchain Think Thank Slovenia.<sup>177</sup>

### 3. REGULATION IN RELATION TO TRADE IN TOKENS ON SECONDARY MARKETS

ATVP is in favour of regulating the secondary marketplaces (exchanges) as well as potential abusive behaviours, in a similar manner as the financial markets are currently regulated.

In its opinion ATVP distinguishes between “centralized” exchanges, where the funds of clients (traders) are held in custody on the exchange platform and “decentralized” exchanges, where the clients hold their funds in their wallets and make trades using smart contracts. ATVP supports the idea to regulate both types of exchanges, bearing in mind the

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<sup>173</sup> Ibid., point 4.2.1., p. 8.

<sup>174</sup> Ibid., point 4.2.2., p. 9.

<sup>175</sup> Ibid., point 4.3., p. 9.

<sup>176</sup> Ibid., point 6., p. 20.

<sup>177</sup> Guidelines for raising funds through initial coin offerings (Smernice za zbiranje sredstev s primarno izdajo in prodajo kripto žetonov), April 2018, p. 18.

principles of trading system reliability, simultaneous trade execution, non-discriminatory rules of execution, trade transparency etc. The question of custody of client funds should also be specifically addressed in any future regulation.<sup>178</sup>

## 4. ANTI-MONEY LAUNDERING REGULATIONS

Prevention of Money Laundering and Terrorist Financing Act (ZPPDFT-1) governs the AML related issues in Slovenia, which implements the directive no. 2015/849.

Additionally, the ZPPDFT-1 has, even though it came in force on 19th November 2016, already also included a definition of “virtual currency” and imposed the exercise of anti-money laundering and counter terrorism financing (AML) measures on certain services related to virtual currencies such as exchange platforms and providers of custodial wallets for cryptocurrencies.

Slovenia was therefore ahead of time because the definition of “virtual currency” is set out in the revised AML directive no. Directive (EU) 2018/843, which the member states have to transpose by 10 January 2020. Slovenia also hasn’t transposed the revised Directive yet, but has included several elements in respect of the virtual currencies in its law already based on the draft of the revised directive.

### 4.1 DEFINITION OF A “VIRTUAL CURRENCY”

ZPPDFT-2 sets out the definition of a “virtual currency” in Article 3:

“virtual currency” is a digital representation of value, issued by a natural or legal person, which is not a central bank or a public authority, used as means of exchange, which can be electronically transferred, stored or traded and is not necessarily attached do a traditional (fiat) currency and can be used as means of exchange among entities, which accept it. 179

The definition, currently set out in ZPPDFT-1, is therefore slightly different from the one, set out in the revised EU directive<sup>180</sup>, whereas the biggest difference is in our opinion in the fact, that Slovenian version uses a positive definition of the issuer and the wording of the revised directive uses negative definition of the issuer. We believe that the current definition

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<sup>178</sup> ATVP position paper, p. 15.

<sup>179</sup> Our own, unofficial translation.

<sup>180</sup> “Virtual currencies” means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.

is slightly different from the one, proposed by the revised directive, and we expect that the legislator will adjust it to secure full compliance with the directive.

It is our understanding that the legislator in particular had in mind those cryptographic tokens, which are widely used for payment, and not all cryptographic tokens. Therefore, the definition most likely catches coins or tokens such as Bitcoin and Ether.

## 4.2 THE OBLIGED ENTITIES

ZPPDFT-1 sets out the obliged entities in Article 4, where it requires natural and legal entities, “which are offering services of issuance and management of virtual currencies, including exchange between virtual currencies and fiat currencies” to implement anti money-laundering and counter terrorism finance policies in full. This is a pretty serious burden as such a definition requires full and complete compliance with the law, even no thresholds are set. Namely, it does not matter what is the amount of virtual currencies in question, the entity needs to perform full KYC and AML process. This was probably not the intention of the legislator and happened due to last-minute addition of virtual currencies, as even e-money issuers are granted certain thresholds where KYC of the customers is not required or is simplified. According to our information, the regulator and the legislator are considering these issues to be rectified in the revised law in 2019.

It should be noted also that the law explicitly covers exchange of virtual currencies into fiat currencies, and it seems that the definition does not cover exchange between different virtual currencies, and that was also probably the legislator’s intent. The regulators are mostly concerned with money-laundering risks in respect of fiat money, and not (yet) so much concerned with money-laundering within the crypto world. This understanding might change in the future with wider adoption. Current concern is focused on a risk of laundering fiat money of illicit sources through its conversion into virtual currencies and then again conversion back into fiat currencies.

The term issuing virtual currencies is new to the legal system. There is no interpretation or explanation included in the preparatory documents of the law or in case law, and it can also not be found in the AML directive. Therefore, the intent of this term remains unclear. One could guess that the legislator had initial coin offerings in mind, but that would be rather surprising as ICOs only gained popularity in 2017. It is true that a number of ICOs already took place in 2016 (and also earlier), but it is difficult to imagine that Slovenian legislator would have already intended to cover those at such an early time. Also, in all correspondence “issuing and managing” is always used jointly so the legislator might have used issuing with an intent of issuing those virtual currencies, which are previously put in management (if management means custody). The law also uses term “issue” in respect of e-money, means of payments (travellers’ cheques and credit notes) and warranties. Therefore, it could also be argued that the “issuance of virtual currencies” also refers to ICOs, as creation and first sale (therefore meaning issuance) of virtual currencies. Incidentally,

in such case only those ICOs, whose token match the definition of virtual currencies, would have been caught by such definition. However, an ICO transaction could have also been understood as an exchange of one virtual currency for another virtual currency, which is, as explained above, not covered by the AML law. Therefore, there is a certain degree of ambiguity in respect of the term “issuing”. Neither the EU AML, nor the revised AML directive, use this term. We are yet to see if after the revised AML directive is adopted in Slovenia, this term will remain in the law.

The term managing is another term, which is not defined or explained more, than what we can understand from the word itself. We assert that the legislator had in mind “custody”, namely holding third parties’ assets or holding means to access third parties’ assets. We do not believe that the legislator only thought of investment asset management, but rather any holding of third-party assets, namely virtual currencies. Therefore, it does not really matter how the technology operates, but only matters that there is an entity offering such service.

The biggest peculiarity of the Slovenian AML law is that it sets out that the obliged entities are only those, who are in the business of providing services of issuing and managing of virtual currencies. That means, in our view, that any entity, who exchanges or issues virtual currencies, but such an execution is not a business of providing such services, does not fall within the scope of the AML law. We draw a comparison to a similar solution, already existing within the legal system, whereas granting a loan to a third party is not considered a regulated business. But when an entity starts offering loans as a service, then such an entity needs to secure a banking licence.

#### 4.3 RECOMMENDATION

The biggest issue of Slovenian AML law, in over view, is not so much blockchain specific. The law sets out also means of identifying the customers.

There are two digital means of identification available: i) qualified digital certificate, or ii) video identification. Identification via qualified digital certificate has practically the same powers as identification in person, whereas use of video identification is in our view too restricted and too complicated. To use video identification an entity firstly has to (among others): i) establish that there is no increased money-laundering risk, ii) that an additional safety measure needs to be put in place for a period of minimum one year, iii) cannot be used for transactions over 15.000,00 EUR, iv) audio needs to be recorded, v) video call has to be encrypted, vi) the customer has to read out serial number of the personal document, vii) the customer has to read out a unique number, which is sent to the customer via e-mail or SMS text.

All these measures need to be taken regardless of the amount of money transacted in a virtual currency transaction. We believe that this puts too much burden on the businesses and is not proportional to the risks.

## 5. TAXATION OF CRYPTOCURRENCIES IN SLOVENIA

The Financial Administration of Slovenia ("FURS") issued their latest explanations<sup>181</sup> regarding tax treatment of cryptocurrencies in June of 2018. It contains generalized guidance on taxation of business with cryptocurrencies. However, FURS stresses it is necessary to determine who actually generates an income (natural person, natural person doing business activities or legal person), and to classify what sort of income is being generated (payment for services or salary, mining fees, exchange fees etc) and other circumstances that can influence method of taxation. With that many options and combinations at hand it is rather important for FURS to conduct tax analysis for each case separately.

### 5.1 PERSONAL INCOME TAX

The income obtained by individual is not subject to personal income tax if it comes out of increase of value of cryptocurrency or when exchanging one cryptocurrency for another or for fiat. According to Personal Income Tax Act, capital gains are generally not taxable if they derive from exchange of movable property or disposal of derivative financial instruments. Taking into account that cryptocurrencies are not defined as movable property or financial instruments, they do not fall within the scope of capital gains taxation applicable to natural persons.

When individual obtains income in form of cryptocurrency (e.g., salary or other income), such income is taxable with personal income tax with tax basis being determined by exchange rate between the cryptocurrency and euro on the date of receipt. Also, mining is considered as so-called other income and it is taxable as such. Tax rate in case of other income is 25 %.

### 5.2 TAXATION OF SOLE TRADER AND OTHER NATURAL PERSONS CARRYING BUSINESS ACTIVITIES

Individuals who trade or mine cryptocurrencies in the course of their business activities (e.g., sole traders and consultants) are liable to pay income tax on profits derived from such activities. The respective profits are taxable either using tax scale (16 %, 27 %, 34 %, 39 % or 50 % tax rate which depends on height of yearly revenue) or using so called normative

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<sup>181</sup> Tax treatment of business with virtual currencies under the Personal Income Tax Act, Corporate Income Tax Act, Value Added Tax Act and Financial Services Tax Act ("Davčna obravnava poslovanja z virtualnimi valutami po ZDoh-2, ZDDPO-2, ZDDV-1 in ZDFS"); June 2018. Available at: [http://www.fu.gov.si/davki\\_in\\_druge\\_dajatve/podrocja/dohodnina/dohodnina\\_drugi\\_dohodki/novica/sprememba\\_dokumenta\\_davcna\\_obravnava\\_poslovanja\\_z\\_virtualnimi\\_valutami\\_po\\_zdoh\\_2\\_zddpo\\_2\\_8064/](http://www.fu.gov.si/davki_in_druge_dajatve/podrocja/dohodnina/dohodnina_drugi_dohodki/novica/sprememba_dokumenta_davcna_obravnava_poslovanja_z_virtualnimi_valutami_po_zdoh_2_zddpo_2_8064/).

taxation with 4 % tax rate on revenue which is limited to 300.000 euros average in two consecutive years (if exceeded taxation per tax scale is used).

### 5.3 CORPORATE TAX

Tax base for corporate tax is surplus of revenue over costs. Company's possession of bitcoins (or other similar cryptocurrencies) is registered in accounting books as financial investment. Their value has to be calculated or converted to euro at fair price on the last day of business (tax) year or on the day of receipt. Explanation on the chosen method has to be part of the tax report. In case of bigger difference in index value of cryptocurrencies between exchanges, the value or exchange rate has to be calculated according to the average.

Corporate tax rate is currently at 19 %.

### 5.4 VALUE ADDED TAX

Slovenia adopted same reasoning regarding VAT taxation as presented in CJEU Judgement C-264/14 (Hedquist). Therefore, fees for exchange of fiat currency for cryptocurrency and vice versa are exempt from VAT taxation in Slovenia.

Similar to other EU countries, mining of cryptocurrencies does not constitute a VAT transaction. However, mining can be taxable with VAT if mining is considered as payable service when miner is entitled to obligatory fee for every validation of transaction.

VAT deductions are not permitted on purchases of software and hardware for cryptocurrency mining, except when mentioned software and hardware are exported outside of EU or when transactions are validated outside of EU.

### 5.5 TAX ON FINANCIAL SERVICES

Transactions, including negotiation, concerning currency (cryptocurrency included), bank notes and coins used as legal tender, are exempted from VAT, but are not tax free as they are subject to financial services tax. FURS advocates "cryptocurrency as a legal tender" in the same way as CJEU in the C-264/14 (Hedquist) judgement, saying that transaction of cryptocurrencies presents taxable financial service if cryptocurrency have a main feature or acts in a similar way to legal means of payment.

### 5.6 FISCAL VALIDATION OF RECEIPTS

Every transaction where the payment is not made by transfer from one bank account to another (including payment made by cryptocurrencies) is subject to fiscal validation. Latter presents an obligation for the seller or service provider to issue an invoice (receipt) and

instantly validates it fiscally using invoicing device which allows direct telecommunication connection between FURS and invoicing device.

## 5.7 TAX ON PROFIT FROM DISPOSAL OF DERIVATIVES

If the virtual currency is defined as derivative financial instrument, then trade profits can be taxed as stipulated by Law on Tax on Profit from Disposal of Derivatives. Currently slovenian legislature does not define any virtual currency as financial instrument.

## 5.8 ACCOUNTING TREATMENT OF RAISED CAPITAL IN ICO

The Slovenian Institute of Auditors ("SIA") has issued an explanation to Slovenian Accounting Standards in October of 2018. SIA presented two options for issuers of cryptocurrencies (within ICO or separately). First option is to measure and account received cryptocurrencies at fair value at the end of the business (tax) year, second alternative option is to measure and account received cryptocurrencies at the purchase value on the day of the purchase.

Issuers can also resort to use of the active and passive time deferrals, and thus divide the revenue generated in ICO to the following business years.

## 6. CONCLUDING REMARKS

We have not identified and red flags for blockchain commerce in Slovenian legislation. The regulators, in particular the Tax Authority and the Securities Markets Agency, have been very active in interpreting and clarifying existing regulation in respect of blockchain. It is evident from the clarifications that they are open minded and eager to facilitate the industry within the existing regulation. We have identified a practical weakness, namely a complex and rigid digital identification rules for the purposes of AML, which require an update to become easier to use by the consumers, and cheaper to provide by the businesses. It should also be noted that, until now, the government has not proposed any legislative changes to accommodate blockchain commerce, even though it can be concluded from public remarks of the governmental representatives that they are researching options. In any case, Slovenia as a small economy is most likely to follow regulatory developments on the EU level.

# XIII.

# SWITZERLAND



# XIII. SWITZERLAND

## 1. FINANCIAL MARKET LAW

### 1.1 "CRYPTO VALLEY" OVERVIEW

Since the Ethereum Token Generating Event in 2014, Switzerland and its "*crypto valley*" have attracted a substantial number of crypto projects. A clear regulatory framework, the Swiss federalism and "bottom-up" structure matching the decentralisation efforts of blockchain projects, the simple and favourable tax system and, last but not least, a lively crypto community have been some of the success factors for the fast growing Swiss blockchain ecosystem.

Swiss regulators and tax authorities had to gain blockchain knowledge to handle blockchain enquiries comparably early. To further expand fintech competences, the Swiss Financial Market Supervisory Authority FINMA has set up its fintech desk at the end of 2015, which bundles all enquiries relating to fintech. The aim of the fintech desk is to provide rapidly fintech-specific information to interested persons from the public, start-up companies and established financial service providers on questions of interpretation relating to financial market law. To this end, it has set up its own contact channels: a fintech website, fintech mailbox and fintech hotline. The possibility to receive a project-specific regulatory pre-ruling by FINMA is a highly valuable instrument, as it leads to both high legal and high business certainty for crypto projects.

In September 2017, FINMA published guidelines in which it indicated the points of contact between ICOs and applicable financial market law. In February 2018, FINMA published guidelines on the handling of enquiries from ICO organisers. The guidelines set out the specific information that FINMA needs to process such enquiries from market participants. At the same time, they indicate which principles FINMA uses to analyse and reply to corresponding enquiries. The principles in the guidelines were explained to groups of interested parties at several roundtables.

In December 2018, the Swiss Federal Council has published a detailed report on blockchain technology titled "Legal framework for distributed ledger technology and blockchain in Switzerland – An overview with a focus on the financial sector". The Federal Council wishes to exploit the opportunities offered by digitalisation for Switzerland. It wants to create the best possible framework conditions so that Switzerland can further establish itself and evolve as a leading, innovative and sustainable location for fintech and blockchain companies. The current report addresses several legal and regulatory questions and proposes specific

legislation amendments. The following information is mainly based on the content of and summarising the Federal Council report.

At the end of March 2019, the Federal Council submitted DLT-specific amendments to various federal laws for consultation. In the future, rights shall be displayed and transferred by law using DLT. The Federal Council emphasizes that the current law already offers a lot of flexibility and possibilities, but that selective adaptations are necessary for the implementation of promising DLT- and blockchain-based applications, in particular to increase legal certainty and to remove hurdles. In particular, the focus is on corresponding changes in general securities law with the introduction of the category of so-called DLT-registered uncertificated securities. In addition, a new "DLT Trading Facility" license will allow non-discretionary trading of native and security tokens for both financial intermediaries and retail clients. With the new license category, the same entity is also allowed to pursue trading and post-trading (clearing and settlement) activities.

## 1.2 FINMA TOKEN CLASSIFICATION MODEL

In its guidelines of February 2018, FINMA classified tokens issued in ICOs as asset, utility and payment tokens under financial market law. In general, the classification set out by FINMA in its guidelines is a suitable guide to deciding the implications of financial market law.<sup>182</sup> FINMA distinguishes between the following three token categories:

### ASSET TOKENS

Asset tokens *represent* assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the blockchain also fall into this category. The classification of asset tokens must take into account the issuing conditions and the specific legal positions related to the token.

### UTILITY TOKENS

Utility tokens give access to a digital application or service provided on or via a blockchain-based infrastructure. Depending on their form, they are comparable to vouchers, chips or keys that can be redeemed for contractually owed services. Depending on the

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<sup>182</sup> However, FINMA's classification model is a high-level approach. In many cases, tokens have hybrid forms. More detailed classification models as the "Blockchain Crypto Property (BCP) Framework" distinguish further categories showing the relevant regulatory implications. See: [https://www.mme.ch/en/magazine/magazine-detail/url\\_magazine/conceptual\\_framework\\_for\\_blockchain\\_crypto\\_property\\_bcp/](https://www.mme.ch/en/magazine/magazine-detail/url_magazine/conceptual_framework_for_blockchain_crypto_property_bcp/).

specific case, utility tokens may be based on a contractual relationship, but are also possible in completely decentralized ecosystems without any claim of its holder. Therefore, the category of utility tokens is the currently most vague. Because of the lack of a relationship to the capital market, utility tokens generally do not qualify as a security, even if the token holder has a direct claim against the issuer (for example to use its infrastructure).

## PAYMENT TOKENS

Payment tokens (synonymous with cryptocurrencies) are tokens which are intended to be used, now or in the future, as a *means of payment* for acquiring goods or services or as a means of money or value transfer. Those tokens are actually accepted or intended by the ICO organiser as a means of payment for acquiring goods or services or as a means of money or value transfer. Payment tokens include "cryptocurrencies" in the strict sense of the term, such as Bitcoin, Bitcoin Cash, Bitcoin Gold and Litecoin. Besides cryptocurrencies in a narrow sense, tokens may also be designed and used as means of payment by "securing" them with assets such as gold or state currencies ("stable coins").

### 1.3 TOKENS AS SECURITIES

According to the Swiss Financial Market Infrastructure Act (FMIA) entered into force on 1 January 2016, certificated and uncertificated securities, derivatives and intermediated securities that are standardised and suitable for mass trading are considered to be *securities*. They are standardised and suitable for mass trading if they are publicly offered for sale in the same structure and denomination or are placed with more than 20 clients, insofar as they have not been created especially for individual counterparties.

Asset tokens as intangible items may be classified as uncertificated securities, derivatives or, under certain circumstances, as intermediated securities. In contrast, payment tokens are intended as a means of payment and so they do not present any similarities to traditional securities based on their economic function. Likewise, utility tokens – even if transferring rights against a counterparty – are not securities because there is no connection to the capital market.

However, even with comparably clear guidance by FINMA, there are currently several questions regarding the security qualification of tokens in practice: Due to the flexible form of tokens, they cannot be classified in a uniform manner under financial market law in all circumstances. The FINMA token classifications are not mutually exclusive. For example, tokens could be classified for example as securities and payment means at the same time (*hybrid tokens*), which may result in a cumulative application of the corresponding requirements under financial market law. In addition, tokens usually have different *development stages* in time. Depending on the form of the ICO, tokens can be issued either on the raising of funds or after the raising of funds and may therefore be treated differently. In practice, functional, pre-functional and voucher tokens can be distinguished.

The *legal implications* of the classification of a token as a security are derived from the relevant financial market laws and apply above all to the *secondary market*. Hence, provisions about trading venues are only relevant for products that are classified as securities. If the token qualifies as a security, authorisation as a securities dealer (or securities firm) is needed for commercial trading with such tokens, and the trade of such securities-tokens on a platform is subject to specific requirements. The same applies for authorisation requirements and rules of conduct for securities. The term "securities" is also to be found in the market conduct rules: insider information must refer to securities, and the object of market and price manipulation must be a security.

In the opinion of the Federal Council, the current legal definitions for securities and derivatives have proved useful, and it is not essential to change them. Blockchain- and token-based applications specific to the financial sector should be able to develop in a framework that allows and fosters innovation. At the same time, fundamental goals under financial market law, such as the protection of investors, creditors and the integrity of the Swiss financial market, must be maintained. According to the Federal Council, challenges in the classification of tokens can mostly be clarified by means of forward planning and consultation, as well as by means of current tools as the FINMA no-action letters.

#### 1.4 SWISS PROSPECTUS REQUIREMENTS

According to the current law, the issuance of tokens that are analogous to equities or bonds can result in prospectus requirements under the Swiss Code of Obligations. However, these prospectus obligations are based on *civil law* provisions and do not require any approval. Therefore, FINMA has no direct responsibility. In contrast, the prospectus for funds as collective investment schemes is regulated and needs approval of FINMA.

Based on the future Federal Financial Services Act (FinSA) – which will enter into force in January 2020 – a (regulatory) prospectus requirement applies to providers of securities and to persons that request the admission of securities for trading at a trading venue. In case of an ICOs, if a company issues a notification to the public that contains sufficient information about the offer conditions and the token itself for a purchase or subscription of tokens qualifying as securities, this will constitute a public offer and hence be subject to the prospectus requirement. There will be several prospectus exemptions, especially if the investor group has a limited size or if the offer does not exceed CHF 8 million over a period of 12 months. Based on the same law, the issuer of a tokens qualifying as complex *financial instrument* must usually draw up a Key Information Document (KID) for offers to private clients.

## 1.5 BANKING ACT (BANKA), SANDBOX AND FINTECH AUTHORISATION

The professional acceptance of deposits from the public is subject to the Swiss Banking Act (BankA) and requires an authorisation from FINMA. Various fintech business models involve such acceptance of third-party money subject to authorisation. This may apply in particular to certain blockchain and DLT-based business models, e.g. the provision of account-like services that enable clients to hold tokens, provided that the service provider is obliged to make repayment. According to the FINMA practice and the Federal Council report, the *safekeeping of tokens* (token vault services) is *not* considered to be a deposit business subject to authorisation if the balance is transferred solely for secure safekeeping, is held (directly) on the blockchain and can be attributed to the individual client at any time. Moreover, the BankA includes a general list of exemptions in which a banking license is not mandatory.

Based on the *innovation area (sandbox)* introduced in 2017, there is no requirement for bank authorisation if the amount does not exceed CHF 1 million in total and if there are no interest operations. Furthermore, depositors must be notified before they make a deposit that the company in question is not subject to FINMA supervision and that the deposit is not covered by deposit insurance.

In addition to the sandbox, the Federal Council has proposed amending banking law to include a new authorisation category ("*fintech authorisation*"). Parliament adopted the necessary amendments to BankA on 15 June 2018. Many fintech business models, including blockchain- and DLT-based models, do not have the time limit transformation typical of banks and thus do not incur the related risks. With the new authorisation category, the authorisation requirements for business models that are limited to the deposit business and do not exceed CHF 100 million in deposits are lower compared with those for banks. The new authorisation category came into force on 1 January 2019.

## 1.6 CRYPTO FUNDS AS COLLECTIVE INVESTMENTS

Collective investment schemes within the meaning of the Collective Investment Schemes Act (CISA) are assets collected from investors for the purpose of collective investment, and which are managed (by third parties) for the account of such investors. The key characteristic of collective investment schemes are thus the presence of assets, the collective investment pool, third-party management and the equal satisfaction of investors' needs. Any party responsible for the management of a collective investment scheme, the safekeeping of the assets held in it or the distribution of the collective investment scheme to non-qualified investors must obtain FINMA authorization.

Regarding crypto tokens, CISA's fund type "other funds for traditional investments" is allowed to make investments in cryptoassets. However, the institutions responsible for

managing a collective investment scheme and the prescribed custodian bank should meet certain conditions based on the features of the specific asset class. In addition, it is possible for a crypto fund to record (tokenize) its fund units directly on the blockchain to improve the tradability.

## 1.7 REGULATION OF TOKEN-TRADING ON SECONDARY MARKETS

### OVERVIEW

In Switzerland, the FMIA governs the organisation and operations of financial market infrastructures and the rules of conduct of financial market participants in securities and derivatives trading. The purpose of FMIA is to guarantee the functioning and transparency of the securities and derivatives markets, the stability of the financial system, the protection of financial market participants and the equal treatment of investors. Trading institutions can be differentiated according to various criteria, for example, based on authorisation requirements (or on authorisation categories), on types of trade, on the financial instruments that can be traded at the trading institution, and permissible trade participants:

- Stock exchanges: institutions for multilateral securities trading where securities are listed; a stock exchange permits the simultaneous exchange of bids between several participants and the conclusion of contracts based on non-discretionary rules;
- Multilateral trading facilities (MTFs): institutions for multilateral securities trading whose purpose is also the simultaneous exchange of bids between several participants and the conclusion of contracts based on non-discretionary rules but without listing securities;
- Organised trading facilities (OTFs): institutions for multilateral or bilateral trading in securities and other financial instruments based on discretionary or non-discretionary rules.

### LICENSING REQUIREMENT FOR CRYPTO TRADING PLATFORMS

Stock exchanges and MTFs need financial market infrastructure authorisation from FINMA. No special authorisation is required to operate an OTF. However, OTFs can only be operated by authorised banks, securities dealers, trading venues and financial groups subject to consolidated supervision by FINMA. All of these financial market participants are supervised by FINMA.

In general, the operation of a trading platform for tokens classified as securities needs authorisation. By contrast, operation of a trading platform for non-securities (e.g. pure payment or utility tokens) does not require authorisation as a financial market infrastructure.

The operation of exchange platforms (e.g. crypto-brokers) and distributed peer-to-peer platforms must be distinguished from the operation of a centralised trading platform for tokens. In the current legal situation, according to the Federal Council there is no authorisation requirement for exchange platforms and distributed peer-to-peer platforms in accordance with FMIA.

For the operation of blockchain-based trading platforms for tokens classified as securities, the question arises as to *which type* of authorisation is appropriate for the following cases. Stock exchange or MTF authorisation is necessary for multilateral trade in securities in accordance with non-discretionary rules. In view of an automation via smart contracts, non-discretionary systems are the usual scenario for blockchain-based trading platforms. However, access to a stock exchange or MTF is currently limited to *authorised financial market institutions*. Therefore, retail clients, who usually are the main target group for current blockchain-based trading platforms, are excluded from such platforms. Business models directly targeting retail clients and intended for multilateral trade in securities in accordance with non-discretionary rules cannot be granted authorisation under current legislation, but they correspond to a need in practice, as the Federal Council stated.

Discretionary multilateral and bilateral trade in tokens classified as securities does not need separate FMIA authorisation. However, operation of an OTF for such trade is reserved to banks, securities dealers, trading venues and financial groups subject to consolidated FINMA supervision. In practice, problems arise today, if authorisation holder wishes to operate an OTF (e.g. for tokens classified as securities) and requests an authorisation from FINMA (e.g. as a securities dealer) *for this purpose only*. In accordance with current practice, the operator may in this case not be eligible for authorisation, as such a model does not fit into the existing authorisation framework and categories. This problem will be solved by the legislation amendments proposed in March 2019.

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## DUTIES OF TRADING FACILITIES

The FMIA sets out the duties to be met by financial market infrastructures, i.e. requirements regarding the organisation and management, risk management, fit and proper business conduct, outsourcing, business continuity, minimum capital requirements, operation of IT systems, documentation and storage duties and the avoidance of conflicts of interests. In general, the requirements for trading institutions applicable in the traditional financial are also applicable to blockchain projects, provided that such institutions are centrally organised – like traditional financial market infrastructures – and pursue similar business activities. However, according to the Federal Council, certain provisions are *not always suitable* for blockchain-based financial market infrastructures in practice. For example, the provisions to guarantee orderly trade currently state that trading venues must have the necessary systems and procedures to cancel, alter or rectify each transaction in exceptional cases. Considering the specific properties of blockchain and DLT systems nonetheless, approaches that are functionally equivalent but more flexible need to be found. The Federal Council suggests

giving FINMA the power to grant exemptions from this requirement, provided that such exemptions do not run counter to the purpose of the law.

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## NEW DLT TRADING FACILITY LICENSE

Based on the current lack of suitable authorisation types, the Federal Council proposes a new technology-specific authorisation category geared to blockchain and DLT applications (cf. proposed art. 73a ff. FMIA) with the following characteristics:

Art. 2a FMIA will contain the new licence category of the DLT Trading Facility. DLT Trading Facilities fall under the legal definition of financial market infrastructures. Most of the legal requirements that apply to the existing categories of trading venues shall also apply to this new trading system. Consequently, DLT Trading Facilities are subject to the general authorisation requirements and obligations pursuant to Art. 4 seq. FMIA. Furthermore, the rules concerning oversight and supervision pursuant to Art. 83 seq. FMIA, as well as the insolvency provisions pursuant to Art. 88 seq. FMIA, will analogously be applicable.

Art. 73a-f FMIA deals almost entirely with the DLT Trading Facility. This is regarded as an institution for the multilateral trading of DLT securities, the purpose of which is the simultaneous exchange of offers between several participants and the conclusion of a contract according to non-discretionary rules. This uniform financial market infrastructure also includes post-trading services such as central custody and the settlement and account of DLT securities. These functions are currently performed by central securities depositories (Art. 61 seq. FMIA) and payment systems (Art. 81 seq. FMIA).

Art. 73a para. 2 FMIA defines the concept of DLT securities, according to which securities entered in a DLT-based register are transferred by means of this register. DLT securities are always securities within the meaning of Art. 2 lit. b FMIA. According to the report on the consultation draft of the Federal Department of Finance, securities issued in the form of electronically registered uncertificated securities with securities character (cf. Art. 973d CO) are included in the scope of the consultation. Furthermore, relatively similar securities issued under foreign law are also considered DLT securities. Payment tokens and pure utility tokens do not fall under the concept of DLT securities. Nevertheless, payment and utility tokens can also be traded on a DLT Trading Facility.

Pursuant to Art. 73c para. 1 FMIA, a DLT Trading Facility issues regulations on the admission, obligations and exclusion of participants. In contrast to multilateral trading systems, retail clients are admitted to a DLT Trading Facility pursuant to Art. 73c para. 2 lit. e FMIA, if they trade in their own name and for their own account. Contrary to classic exchange trading, investors (retail and institutional clients) can participate directly in a DLT Trading Facility and are not forced to go through an intermediary such as a securities dealer or a bank. The advantage lies mainly in the fact that no more commissions are charged to the investor.



In addition, the Federal Council will be allowed to define specific facilitations for smaller DLT trading systems (cf. art. 73f FMIA).

## 1.8 GENERAL MARKET CONDUCT RULES

In addition to regulatory provisions on financial market infrastructures, FMIA also contains rules on derivatives trading, as well as provisions on the disclosure of shareholdings, public takeover offers as well as insider trading and market manipulation (market conduct rules).

### *DERIVATIVE TRADING DUTIES IN PARTICULAR*

Especially the derivative trading rules (consisting of i.e. the clearing, reporting, risk mitigation and platform trading duties) were not drafted to take account of novel derivatives in the form of tokens either inside or outside Switzerland, but instead are intended to regulate traditional OTC derivatives. The Swiss FMIA does not answer the question of whether derivative trading duties are applicable to tokens that have the form of derivatives. In any case, according to the Federal Council, it is clear that at present tokenised derivatives are not subject to either a clearing or a trading duty.

### *MARKET MANIPULATION AND INSIDER TRADING IN PARTICULAR*

Moreover, the FMIA contains regulatory bans on insider trading and market manipulation, which apply to all market participants. The regulatory offences of both insider dealing and market manipulation must involve securities that are admitted for trading on a stock exchange or multilateral trading facility in Switzerland. This also applies to *asset tokens* that take the form of securities. Other securities or tokens are not comprised and are thus treated equally. According to the Federal Council, there is no specific need for action with respect to tokens at present.

## 1.9 (FUTURE) CONDUCT RULES FOR CRYPTO SERVICE PROVIDERS

The new Federal Financial Services Act (FinSA) – which will enter into force in January 2020 – aims to guarantee client protection in the (general) financial services sector and create comparable conditions for the provision of financial services by financial service providers. In general, the conduct rules are applicable in the context of services of financial instruments. According to FinSA, securities that constitute equity securities or debt instruments are deemed to be financial instruments. Therefore, only those asset tokens (qualifying as security) are covered, which grant the holder participation rights, voting rights or rights to the repayment of debt. In its recent blockchain report of December 2018, the Federal Council evaluated the potential applicability of the FinSA conduct rules to different blockchain actors:

## **MINERS**

Mining of tokens does not constitute a financial service. It does not fulfil the requirement of an activity performed for clients with respect to the acquisition or the sale of financial instruments or the acceptance and brokering of orders involving financial instruments, at least in cases in which the mined tokens do not constitute financial instruments in accordance with FinSA. By contrast, the Federal Council states that if tokens were mined that constitute financial instruments within the meaning of FinSA, the classification of a miner as a financial service provider would depend on how close and concrete the client relationship is in terms of a contractual relationship (mandate). The mandate must focus in practical terms on the purchase or sale of financial instruments or the acceptance and brokering of orders that involve financial instruments.

## **WALLET APP DEVELOPERS**

The development of software that allows users to manage their tokens does not constitute a financial service, even if the tokens are financial instruments. It does not fulfil the requirement of an activity performed for clients with respect to the purchase or the sale of financial instruments or the acceptance and brokering of orders involving financial instruments. Hence, a pure wallet app developer is not a financial service provider and is not required to observe the duties set out in FinSA.

## **CRYPTO TRADING PLATFORMS**

Crypto trading platforms or crypto exchanges allow clients to buy and sell tokens directly without the involvement of an intermediary. If retail clients can purchase tokens via a crypto exchange from its holdings without pure matching, and these tokens are financial instruments in accordance with FinSA, the operator is generally considered to be a financial service provider. Accordingly, they will be subject to the conduct rules in Article 7 – 20 FinSA, especially the duty to provide information in accordance with Article 8 FinSA and the documentation and accountability duties in Article 15 and 16 FinSA. Possible exceptions apply if client orders are only executed or forwarded, that is, no advisory services or similar are provided (so-called execution-only transactions).

## **CUSTODY SERVICES**

The custody of assets, be it tokens or assets in the analogue world, does not in itself constitute a financial service, even if the tokens are financial instruments. It does not fulfil the requirement of an activity performed for clients with respect to the purchase or the sale of financial instruments or the acceptance and brokering of orders involving financial instruments. On the other hand, if the sale of tokens classified as financial instruments is only possible via the account of the provider of custody services, the Federal Council report considers such activity as a financial service. In any case, execution-only transactions are exempted.

## CRYPTO BROKERAGE

Companies that purchase or sell tokens in the secondary market on behalf of clients meet the conditions to be deemed financial service providers, provided that the tokens can be classified as financial instruments. The conditions are met in this case because the activity in question aims to purchase or sell financial instruments for clients or because orders are accepted and forwarded that involve financial instruments. If these services are provided professionally by companies in Switzerland or for clients in Switzerland, the crypto brokers in question are financial service providers. As a result, they are required to comply with the FinSA conduct rules. Accordingly, crypto brokers must divide their clients into segments, they are subject to the duty to provide information required to check the appropriateness and suitability. Execution-only transactions are exempted.

### 1.10 ANTI-MONEY LAUNDERING PROVISIONS IN A CRYPTO ECOSYSTEM

The current Federal Council report of December 2018 further evaluates further the applicability of anti-money laundering provisions to selected market participants. In general, as with other means of payments, the payment of goods and services in cryptocurrencies and the provision of services in return does *not* constitute a financial intermediary activity and is therefore not subject to the Anti Money Laundering Act (AMLA).

#### TOKEN ISSUER VIA ICO OR TGES

FINMA has published guidelines on ICOs, in which it defines different categories of tokens and indicates whether they are subject to AMLA. According to FINMA, the issuance of *payment tokens* constitutes the issuing of a "means of payment" subject to anti-money laundering provisions, if the tokens can be transferred technically on a blockchain infrastructure. In this case, the issuer must be either affiliated to a self-regulatory organisation (SRO) or directly subject to FINMA supervision. Alternatively, a financial intermediary subject to AMLA in Switzerland can act as the payment receiver. The issuance of (non-hybrid) utility and asset tokens does *not* constitute a financial intermediary activity according to the AMLA.

#### WALLET PROVIDERS

*Custodian* wallet providers hold clients' private keys in safekeeping and enable clients to send and receive cryptocurrencies. They have power of disposal over third-party assets, so that they can trigger transactions. If custodian wallet providers order the transfer of cryptocurrencies in the name and on behalf of contractual parties, they are providing a payments transaction service and must be affiliated to an SRO or directly subject to FINMA supervision. In contrast, providers of *non-custodian* wallets do not keep or have access to clients' private keys. Non-custodian wallet providers can neither view nor access clients' wallets. Providers merely make software available and are not involved in the transfer of assets. Clients can transfer cryptocurrencies without the involvement of their non-custodian

wallet providers. Such activities cannot be described as financial intermediary activities in accordance with applicable law and are not subject to the AMLA.

### **CRYPTO TRADING PLATFORMS**

Central trading platforms keep an order book and bring the supply and demand of their market participants together by means of matching. Trading platforms hold assets for their clients in their own wallets. They generally have access to clients' private keys and therefore also have power of disposal over third-party assets. As the trading platform accepts money or cryptocurrencies from clients and transfers them to other clients, thereby acting as an intermediary, it can be considered to be providing a service relating to payments. According to the Federal Council, such an activity can therefore be classified as a financial intermediary and must fulfil the due diligence duties set out in AMLA. In contrast, *decentralised* trading platforms do not have access to clients' private keys and do not have direct power of disposal over third-party assets. Usually, transactions are settled directly on the blockchain between clients with the help of smart contracts, which withhold the tokens transferred for trading purposes. If a trading platform bring buyers and sellers together and transactions are settled completely decentrally, the activity is not subject to the AMLA.

### **CURRENCY EXCHANGE OFFICES**

In currency trading, exchange offices sell and buy cryptocurrencies directly from their own holdings. There is a bilateral relationship between the exchange office and the client. The professional purchase and sale of cryptocurrencies in return for conventional currencies (e.g. CHF) or for other cryptocurrencies constitute exchange activities subject to AMLA. FINMA currently uses a limit of CHF 5,000 for its identification requirement for currency exchange offices.

### **CRYPTO FUNDS**

Crypto funds are generally understood to be collective investment schemes that invest their assets primarily or exclusively in cryptocurrencies or other crypto-based currencies. They are treated the same way as other collective investment schemes under anti-money laundering legislation. They are deemed to be financial intermediaries if they have authorisation as a fund management company, a SICAV, a limited partnership for collective investment or a SICAF.

## 2. SELECTED CIVIL LAW ASPECTS

### 2.1 PROPOSAL OF A NEW SECURITIES LAW PROVISION

Based on current law, the transfer of an *uncertificated* security – which is the widely-used legal instrument for the structuring of asset tokens – is only possible by a written cession. The ratio of this rule is the protection of the debtor. It should be clear, to whom the debt has to be paid. In practice, there are several valid options to avoid the written form requirement in regard to asset tokens, but all of them are at least unnecessarily complex in a token-ecosystem, where the creditor can easily be evaluated. Since an entry in a decentralized register accessible to interested parties can create publicity similar to the (physical or intermediated) ownership of a security, it seems justified to attach similar legal effects to this entry (or the actual control over it).

The Federal Council proposed an amendment to securities law (art. 973d ff. CO) to increase legal certainty and enhance the issuance of asset tokens. The proven principles of securities law will be retained as much as possible. Digital representation and transfer is therefore possible only for those rights which could also be represented by a security and which are freely transferable. The planned legislative amendment will enable the legally secure transfer of uncertificated securities by means of entries in decentralised registers and further enhance legal certainty.

### 2.2 PROPOSAL OF INSOLVENCY LAW AMENDMENT

The Federal Council also recognises the need for legislative action regarding insolvency law. In the course of bankruptcy proceedings, the assets of the bankrupt debtor are collected and realised.

In the process, it is regularly necessary to clarify what is to be included in the debtor's assets. This question arises particularly if assets to which the debtor is economically entitled are deposited with third parties and if the debtor has power of disposal over assets to which third parties assert their rights. In the latter case, it has not yet been conclusively clarified in Switzerland whether it is possible to segregate crypto tokens.

The Federal Council thus considers it necessary to provide for unambiguous rules regarding the segregation of crypto-based assets from the bankrupt's estate by analogy to the owner's right to segregation under current law. Two new provisions in the Federal Law on Debt Collection and Bankruptcy (art. 242a f. SchKG) expressly allow the segregation of crypto-based assets (as well as data in general) in the event of bankruptcy. Required is that the third party has control over the assets that they can be individually allocated to this party.