

Banking and Finance

The EBA's report on crypto-assets and the possible regulatory and practical developments

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On 9 January 2019 the European Banking Authority ("EBA") published a Report addressed to the European Commission which analyses, in view of possible amendments, the regulations applicable to crypto-assets.

The EBA focused on the urgency of a wide-ranging analysis assessing whether the use of crypto-assets may already fall within the regulatory framework applicable in EU countries in relation to Directive 2009/110/EC ("EMD2" or second directive on electronic money institutions) and Directive 2015/2366/EU ("PSD2" or second directive on payment services).

The importance of such analysis is confirmed, according to the EBA, by the findings set out in the **Fintech Action Plan** of the European Commission (March 2018). For the Commission it is of the utmost importance to understand how the current European regulation applies to crypto-assets in order to ensure the stability of the markets, the protection of investors, consumers

and personal data, as well as the prevention of the use of the financial system for money laundering.

At a first level, the EBA defines crypto-assets as:

- i. based on cryptography and Distributed Ledger Technology ("DLT") or similar technologies;
- ii. not issued or guaranteed by a central bank or by a public authority; and
- iii. usable as a medium of exchanges (payments), for investment purposes and/or to access goods and services.

The Report restates the lack of a clear cut definition of crypto-assets but, in general, it provides a distinction in categories which reflects the purposes listed above under point iii:

- a) **payment tokens**, among which virtual currencies (e.g., Bitcoins, Lite-coins etc.);
- b) **investment tokens**, which are issued within the frame-

work of transactions for the raising of capital through ICOs (Initial Coin Offerings) against fiat currency or other crypto-assets;

- c) **utility tokens**, used as a means to access goods and services or projects based on the future provision of services, goods or particular digital features.

Furthermore, this division, although with some differences, is similar to other classifications already made by other Supervisory Authorities of non-EU countries, among which the US **SEC** and the Swiss **Finma**.

The main aim of the Report is to understand whether some of the rules of the PSD2 on payment services and of the EMD2 on the prudential supervision of the activities of electronic money institutions could apply to crypto-assets.

In order to understand if crypto-assets could qualify as electronic money, from the **EMD2** perspective, it is necessary to analyze,

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from time to time, whether the crypto-asset complies with the **general definition of electronic money** pursuant to art. 2 of the EMD2 (and namely an «*electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions [...] and which is accepted by a natural or legal person other than the electronic money issuer*»).

It is worth noting that, according to the Report, five Supervisory Authorities of five EU countries have already reported to the EBA cases in which crypto-assets fell within the definition of “*electronic money*”.

However, the issue of electronic money is reserved for “*electronic money issuers*”, as defined by art. 2, no. 3 of the EMD2 (e.g., credit institutions, electronic money institutions and some public entities or institutions).

With regard to the **PSD2**, the Report shows how crypto-assets are not banknotes, coins or scriptural money.

The EBA clarifies that they cannot automatically fall under the definition of “*funds*”, pursuant to art. 4, paragraph 25, of the PSD2, **unless they fall into the defini-**

tion of “electronic money” according to the EMD2.

As a result, if a fintech operator intends to provide a payment service (such as the execution of payment transactions, including the issue of payment instruments, or money remittances) through a crypto-asset that qualifies as “*electronic money*”, and thus “*funds*”, such activity will certainly fall within the scope of the PSD2.

Therefore, crypto-assets are not easily and directly ascribable to a well-defined category.

As for the importance of crypto-assets within the framework of activities consisting in **investment services**, the Report concludes that they can fall, in some cases, within the **definition of “financial instruments”** pursuant to MiFID regulations (this conclusion is in line with what is reported in the ESMA document “*Advice on Initial Coin Offerings and Crypto-assets*”), within the definition of “*electronic money*” or in any of the previous categories.

The importance of the EBA Report also lies in the fact that it has provided the very first classification of the various activities on crypto-assets in light of the supervisory and monitoring activities conducted by many Euro-

pean Supervisory Authorities (see table in **Annex**).

A further aspect subject to analysis in the Report, which is likely to have significant operational implications in the next years, is the **protection of consumers**.

The EBA Report confirms the warnings already expressed in previous years for the dangers for consumers, in particular in relation to two activities, i.e. **trading** on crypto-assets and **custody/wallet services**.

From a practical standpoint, the importance of the Report is two-fold. From the perspective of the Supervisory Authorities, the Report underlines the need for an interpretation constantly aimed at assessing whether certain activities on crypto-assets fall within regulated fields or not.

From the perspective of fintech operators, the need for an accurate interpretative classification is even more important because, given the multitude of matters and regulations, **the preliminary classification of the activities is essential in order to avoid subsequent potential claims by the Supervisory Authorities** which might consider specific activities on crypto-assets as reserved.

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Annex – Table of the Report with a list of crypto-asset activities classified on the basis of the type of regulated entities (in brackets the number of national Supervisory Authorities which have already reported/monitored that activity):

| Type of regulated entity | Observed activity/number of competent authorities reporting that activity |
|---|---|
| Institution (credit institution/investment firm as defined in Article 4 of the Regulation (EU) No. 575/2013, Capital Requirements Regulation, "CRR") | Owning crypto-assets directly (1) |
| | Making-markets (1) |
| | Lending against crypto-asset collateral (1) |
| | Clearing or trading derivatives with crypto-asset underlying (3) |
| | Investing in products with crypto-assets underlyings (1) |
| | Lending to entities dealing directly or indirectly with crypto-assets (4) |
| | Providing custody/wallet services (1) |
| | Providing exchange services for crypto-assets to fiat currency or for other crypto-assets (1) |
| | Other crypto-asset activity (1) |
| Payment institution | Owning crypto-assets directly (1) |
| | Providing custody/wallet services for crypto-assets (1) |
| | Providing exchange services for crypto-assets to fiat currency or to other crypto-assets (1) |
| | Other crypto-asset activity (1) |
| Electronic money institution | Owning crypto-assets directly (1) |
| | Crypto-asset liabilities (1) |