

POSITION PAPER



ESBG position paper on the regulatory treatment of Initial Coin Offerings and crypto-assets

ESBG (European Savings and Retail Banking Group)

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This position paper aims to raise European Savings and Retail Banking Group (ESBG)'s views on the need for a regulatory treatment of Initial Coin Offerings (ICOs) and crypto-assets considering both the work at international level by CPMI-IOSCO and FSB and at EU level by EBA and ESMA.

Albeit small when compared to financial markets, the development of crypto-assets markets and of the related ICOs has attracted a lot of attention from businesses looking for an access to alternative sources of finance and investors drawn by the promises of quick gains. As savings and retail banks caring for both our corporate and retail clients, ESBG welcomes that policy makers are taking an interest in the regulation of these new assets and activities.

Indeed, ESBG is concerned by the numerous reports of abuses of retail investors' trust on innovative services providers, as well as the emergence of highways circumventing policy frameworks carefully crafted over the last decades, accompanied by the use of blockchain technology.

In particular, regulatory uncertainty on ICOs leaves room for a growing part of the economy that remains in regulatory limbo, helping new firms flourish at the expense of heavily regulated competitors and investors' protection. Cryptocurrencies and stablecoins lack a clear regulatory approach from EU authorities. As with ICOs, this implies increasing investor protection challenges.

- The growing risks stemming from the impact cyber-attacks can have on the ICO market needs to be addressed. For instance when a crypto exchange has their crypto-currencies stolen. The lack of clarity on which 'white papers' must be applied (e.g. in some cases the Prospectus Regulation may apply and in others it may not, while sometimes even applying the Regulation might need an adaptation to the different technological environment). This lack of clarity often provokes inexistence of due diligence performed by investors, attracted by quick gain promises, and may result in scams and relevant financial losses for retail investors.
- The lack of identification of investors, as well as the non-application of market abuse regulations to crypto exchanges, allow a high degree of speculation and market manipulation through techniques such as, dumping, spoofing, front running or whales¹.
- The anonymity of the wallet holders and the existence of blockchains specifically designed to ensure secrecy over the sender, the receiver and the amount transferred, create virtually risk-free ways of laundering money originating from criminal activities or hiding the financing of terrorist organisations.
- The uncertainty on the value of tokens pre- and post-sale increases risks of price volatility, which could cause financial instability issues in the future.
- There is a significant lack of clarity regarding the fiscal rules applying to tokens raised through ICOs and other crypto-assets.

For these reasons, while ESBG welcomes the continuous development of crypto-assets and ICOs, decisions need to be made with regard to the application of the EU financial markets regulatory

¹ For examples of glaring market abuses that would result in jail time if it would take place in financial markets: <https://www.wsj.com/graphics/cryptocurrency-schemes-generate-big-coin/>



framework to these new assets or services without undue delay. Because of their similarities on many aspects of traditional assets or services (financial instruments and Initial Public Offerings), it is paramount that, on the one hand, investors benefit from an equally high level of protection, and, on the other hand, a regulatory level playing field is ensured.

ESBG welcomes the work done by international and European policy makers in order to monitor the risks raising from crypto assets' market. ESGB believes that EBA and ESMA reports² on crypto-assets properly assessed the conditions for the application of the current regulatory framework to different types of cryptoassets. However, following the work from the supervisory authorities, legislators need to take action and regulate the areas where the policy framework is still not clear or inexistent, or where it needs some sort of adaptation. As a first step, EU legislators need to define a proper classification of the categories of cryptoassets.

In order to tackle the risks mentioned above, ESGB would like to make the following recommendations.

1. Market venues for virtual currencies and tokens must be organised

In particular, there needs to be guarantees in terms of:

- Price transparency;
- Fight against money laundering by submitting traders, platforms or issuer of crypto-tokens to AML regulations;
- Applying rules on market abuse/manipulation to cryptocurrency trading platforms; and
- Information disclosure.

ESGB welcomes the extension of the AML Directive scope of obliged entities to exchange services between virtual currencies and fiat currencies and custodian wallet providers, requiring them to be registered. However, this does not cover the entities providing exchange services between virtual currencies only. ESGB considers that they also should be specifically regulated, and subject to a licence in order to apply AML regulations. Protecting the traditional financial system should not be the only point of view of policy-makers while crypto-assets allow direct purchase of goods and services, therefore providing a way for criminals to profit from revenues originating from illicit activities.

ESBG believes that at the minimum a clear regulatory framework is needed on these issues. All national regulators in the EU already require authorisation for a virtual currency exchange to be established, however there needs to be a harmonised framework, in particular with regard to the rules attached to this authorisation.

If not, consumers of utility tokens and investors in security tokens may find it particularly challenging to bring any revenues into the ordinary financial system. Specifically, ESGB feels that regulators should thoroughly review the AML risks associated with the various stages in a crypto-asset lifecycle, and related activities, and provide clear direction as to their treatment. For example, within the KYC processes, promoting a safe adoption by all players.

Moreover, crypto-assets often remain today on the exchanges that ensure 'conservation' without 'official' rules being defined. We would encourage regulators to put in place some measures that protect investors (e.g. provision for an optional license for digital assets).

2. Crypto assets should be properly legally defined and classified among existing or new categories

² <https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf>



The associated consumer protection issues primarily stem from the lack of a globally consistent view on how these novel products should be classified, whether they fall under an existing financial instrument category or require an ad hoc classification. As a result, consumers suffer from the lack of consistent protection. Fragmented regulation, even at the regional level, complicates this issue further. To address this issue adequately, global coordination and alignment is needed. The “case-by-case” approach of national supervisors can only be temporary while a global coordination on the application of the existing regulations takes place. Actions from authorities at EU level is also paramount.

It seems also important to be able to categorise the nature of tokens. Depending on this nature, different regulations could apply. For example, the Autorité des Marchés Financiers (AMF) published a [report](#) classifying the tokens in three major functional categories:

- Coins: crypto-assets as an exchange currency and unit of value;
- Security tokens: crypto-assets resembling financial instruments which are a type of investment in the company, in the form of rights to participate in the company governance or profit-sharing schemes;
- Utility tokens: crypto-assets having a utilitarian function which give the holder the right to access future products and services offered by the issuer;

In this context, the need for regulation has been identified mainly for the category of utility tokens. ESBG believes that sharing a common taxonomy of tokens could help all stakeholders to have a better understanding of the necessary diligence. However it should be kept in mind that tokens have their own lifecycle and can change from one category to another while the project they support evolves. Some degree of flexibility is required in this respect.

ESBG also supports the ESMA’s SMSG Own Initiative Report on Initial Coin Offerings and Crypto-Assets published on 19 October. In particular, it welcomes the advice given to ESMA to provide level three guidelines on the interpretation of the MiFID definition of “transferable securities”, “commodities”, and the concepts of MTF and OTF, with respects to crypto-assets and market venues for virtual currencies.

3. Adapting the regulatory framework for ICOs

ESBG is particularly in favour of adapting the EU regulatory framework for its application to ICOs. ESBG believes that developing an EU framework for ICOs, and the secondary markets and platforms where cryptoassets are exchanged, is of great importance. ESBG would support a comprehensive analysis by EU regulators on the necessary adaptations that the regulatory framework needs in order to integrate ICOs on the diverse set of rules applying to other forms of raising capital. In addition, once the regulatory approach is defined and implemented, it will be necessary to ensure a single supervisory approach on ICOs. Indeed, ESBG considers that there are existing opportunities for regulatory arbitrage, even within the EU, that cannot be tolerated and need to be tackled. ESBG supports that a specific legislative proposal following a comprehensive impact assessment should be put forward by the European Commission.

ESBG advocates for the setting up of an external audit of the requirements for firms issuing tokens through ICOs, as well as initiatives regarding education and digital skills, both for investors and regulatory authorities. In addition, the accountancy aspect of ICOs should be explored further and ESBG supports EFRAG’s work on clarifying the treatment of cryptocurrencies under IFRS Standards. In this context, ESBG also calls on Member States to provide legal certainty on the taxation of crypto-assets.



As stated previously, ESBG supports the innovation brought by the development of crypto-assets and ICOs. However, ESBG believes that this innovation should not allow a new era of fraud, deception, money laundering, tax evasion and financial instability, which are the very reasons why the banking sector is exceptionally regulated nowadays.



About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 1,000 banks, which together employ 780,000 people driven to innovate at 56,000 outlets. ESBG members have total assets of €6.2 trillion, provide €500 billion in SME loans, and serve 150 million Europeans seeking retail-banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.



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