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| Reply form  on the Consultation Paper on guidelines on conditions and criteria for the classification of crypto-assets as financial instruments for MiCA implementation |
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**Responding to this paper**

ESMA invites comments on all matters in this consultation paper and in particular on the specific questions. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 April 2024.**

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Use this form and send your responses in Word format (**pdf documents will not be considered except for annexes**);
3. Please do not remove tags of the type <ESMA\_QUESTION \_MIC3\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
4. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
5. When you have drafted your response, name your response form according to the following convention: ESMA\_MIC3\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_MIC3\_ABCD\_RESPONSEFORM.
6. Upload the form containing your responses, **in Word format**, to ESMA’s website (www.esma.europa.eu under the heading “Your input – Open Consultations” -> Consultation Paper on guidelines on conditions and criteria for the classification of crypto-assets as financial instruments”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/legal-notice).

**Who should read this paper**

# All interested stakeholders are invited to respond to this consultation paper. In particular, ESMA invites crypto-assets issuers, crypto-asset service providers and financial entities dealing with crypto-assets as well as all stakeholders that have an interest in crypto-assets.

**General information about respondent**

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| Name of the company / organisation | Ripple Labs Inc. |
| Activity | Non-financial counterparty |
| Are you representing an association? | ☐ |
| Country/Region | Europe |

**Questions**

1. **Do you agree with the suggested approach on providing general conditions and criteria by avoiding establishing a one-size-fits-all guidance on the concepts of financial instruments and crypto-assets or would you support the establishment of more concrete condition and criteria?**

<ESMA\_QUESTION\_MIC3\_1>

Ripple Labs Inc. (“Ripple”) appreciates ESMA’s consultation on Guidelines regarding the classification of crypto-assets. We appreciate this is a nuanced area with sensitivities regarding Member State law, the interaction between a Directive (MiFID) and Regulation (MiCA), and issues regarding form vs substance of new assets. Ripple’s guiding line is that as envisaged under the MiCA Level 1 text, market outcomes should be as harmonised across the EU as possible to ensure all EU citizens’ equal protection and a level playing-field between Member States, and market certainty should be established to support innovation and growth in the EU within the MiCA framework.

The Guidelines as proposed go some way to achieving these aims, while managing competing sensitivities, but we would welcome greater granularity of explanation to help guide National Competent Authorities (“NCAs”) to come to the same outcomes. This would mitigate the risk of fragmenting interpretations, reduce the tension of a Directive taking precedence over a Regulation, and reduce the uncertainty surrounding the potential for NCAs to change established facts in the market.

Ripple would therefore support greater clarity around the assessment criteria in order to prevent scenarios in which NCAs are able to come to different conclusions in relation to the classification of crypto-assets - different either between NCAs or from previous established fact in the market.

We commend the certainty that is provided for crypto-assets under the MiCA level 1 Regulation. As proposed, however, these guidelines could unintentionally create uncertainty for industry participants and NCAs alike through undermining this clarity. Without clearer guidance, we believe that there is an increased risk that NCAs take different stances on what is and what is not considered a financial instrument. Our suggestion would be to offer a series of case studies of ‘indicative scenarios’ or ‘guiding examples’ in the final guidelines, which will help NCAs interpret new cases. This would be preferable to having overly strong line-by-line assessment criteria which may not keep up with technological or market innovation and which could end up having unintended consequences.

ESMA’s 2019 survey to NCAs on the legal qualification of crypto-assets demonstrates how differently NCAs can view certain crypto-assets or definitions. Even in cases where the vast majority of NCAs agreed on a certain scenario for the classification of a crypto-asset, rarely was there unanimous agreement. The potential for outliers would not only mean an inconsistent approach applied throughout the EU, but also create opportunities for arbitrage that could be exploited to undermine the objectives of MiCA.

Ripple acknowledges that the classification of a crypto-asset as a financial instrument has long been the responsibility of the individual NCA and has depended on the specific national implementation of EU law. Across this period, we note that the vast majority of crypto-assets have not been classified as financial instruments under MIFID or national laws. There should be no reason for these guidelines to prompt NCAs to reevaluate these decisions.

Our concern is that these proposed guidelines, in their current form, prompt NCAs to re-examine previously established judgements and make assessments based on such a broad mandate that allows them to operate separately from each other. Such practices have been detrimental to industry participants and to the principle of passporting under EU Directives such as MiFID or PSD2.

Therefore, it is our view that these guidelines should not present NCAs with the opportunity to reopen areas of MiCA already established, but rather serve to provide further clarity and weight to the regulations in order to foster an environment of legal certainty for future developments in the sector. At present, we do not believe that these guidelines succeed in what should be the objective of delineating between MiFID and MiCA because it overly defers to MiFID.

We also believe that there is a heightened risk that, because of a lack of resources, capacity, or expertise, the broad mandate given to NCAs in these guidelines could result in some NCAs choosing to classify crypto-assets under the more familiar financial instruments categories of MiFID, for ease, thereby undermining the MiCA regulations.

<ESMA\_QUESTION\_MIC3\_1>

1. **Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as transferable securities? Do you have any additional conditions and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.**

<ESMA\_QUESTION\_MIC3\_2>

Ripple respectfully requests that ESMA offer greater clarity in relation to the conditions and criteria for classifying crypto-assets as transferable securities.

Paragraph 26 of ESMA’s consultation notes that an expectation of profit, without governance or ownership rights, seems to be considered sufficient for some NCAs to qualify crypto-assets as transferable securities.

While ESMA clarifies that an expectation of profit is not sufficient to make such classifications and that this has no clear basis within Union law, the way in which NCAs have previously interpreted legislation suggests that, without further clarification, these NCAs could continue to interpret and implement the legislation differently. We would request greater clarification by ESMA for NCAs on this point.

We note that Guideline 2 of the consultation attempts to set out criteria, noting that crypto-assets might be recognised as transferable securities if they grant rights similar to shares, bonds, and other securities. We believe it is important for ESMA to explicitly distinguish between share-like rights and other types of rights granted by certain crypto-assets, such as governance or rewards rights that may allow holders to participate in profits. Further guidance on this will make it less likely that NCAs differ in their interpretations of when crypto-assets qualify as transferable securities and greater legal certainty to industry participants. As noted above, we would recommend that ESMA produce a series of illustrative examples to help guide NCAs’ assessment.

<ESMA\_QUESTION\_MIC3\_2>

1. **Based on your experience, how is the settlement process for derivatives conducted using crypto-assets or stablecoins? Please illustrate, if possible, your response with concrete examples**

<ESMA\_QUESTION\_MIC3\_3>

For centralised crypto-asset derivative products and services (e.g. Coinbase perpetuals), settlement occurs in much the same way as it would at a traditional financial markets CFD/spread-betting firm - on the entity’s internal database or ledger.

This is regardless of whether settlement occurs in fiat, crypto-assets or stablecoins. Once a client exits or closes a derivatives position, or it expires (in the case of dated futures) or is exercised (in the case of options), the entity simply records the client’s new balance in the settlement asset on their internal system and to the client on the front-end platform.

This will occur in an automated manner courtesy of the software used at the entity. Settlement to the underlying DLT protocol only happens when a client makes a withdrawal request of their crypto-asset. Settlement time here should be near-instant, unless the centralised entity imposes some sort of delay to check certain items (which it may do at an expiry of a quarterly futures contract, for example).

For decentralised crypto-asset derivative products and services (e.g. dYdX, Synthetix), settlement occurs instantly on the underlying DLT protocol (e.g. the Ethereum blockchain) following closure of a position, or the expiry or the exercising of a derivative contract.

The smart-contract(s) involved in the trade at the DeFi protocol will send the relevant crypto-asset (settlement asset) to the user’s wallet, based on the result of the trade. Settlement time will therefore be dependent on the underlying DLT protocol’s transaction time - the time it takes to send an asset from the smart contract to the user’s wallet. Given the on-chain nature of these services, settlement will be in crypto-assets or stablecoins (there is no potential for fiat settlement, unlike in centralised offerings).

<ESMA\_QUESTION\_MIC3\_3>

1. **Do you agree with the conditions and criteria to help the identification of crypto-assets qualifying as another financial instrument (i.e. a money market instrument, a unit in collective investment undertakings, a derivative or an emission allowance instrument)? Do you have any additional conditions, criteria and/or concrete examples to suggest?**

<ESMA\_QUESTION\_MIC3\_4>

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<ESMA\_QUESTION\_MIC3\_4>

1. **Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete conditions and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.**

<ESMA\_QUESTION\_MIC3\_5>

As already stated, Ripple believes that it would be beneficial to both industry and NCAs if ESMA were to better define some of the terms attached to financial instruments, e.g. governance and profit, to ensure greater clarity and to avoid differing interpretations between NCAs.

The proposed guidelines in their current form are not sufficient for the clear delineation between MiFID and MiCA and we do not believe they effectively achieve ESMA’s objective of assisting “stakeholders engaged in activities relating to crypto-asset services in determining which legal regime will apply to them.”

Ripple believes that by giving NCAs the option to make assessments on a case-by-case basis, many factors could be interpreted differently and it is very possible that NCAs could form contrasting opinions thus undermining the objective of the Level 1 MiCA text to create a harmonised EU crypto-asset market.

<ESMA\_QUESTION\_MIC3\_5>

1. **Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional conditions and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.**

<ESMA\_QUESTION\_MIC3\_6>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_MIC3\_6>

1. **Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional conditions and/or criteria to suggest that could be used in the Guidelines?  Please illustrate, if possible, your response with concrete examples.**

<ESMA\_QUESTION\_MIC3\_7>

We believe that further guidance would be beneficial in providing clarity to certain scenarios.

The proposed guidelines imply that any characteristics that are like a financial instrument are automatically the “predominant elements” of a crypto-asset and should take precedence in any classification. This does not seem appropriate. If a given asset does not have sufficient characteristics on its own to be determined a ‘financial instrument’ it is unclear why it should then be so determined purely to differentiate the legal regime it falls under between MiCA and MiFID. The very purpose of these Guidelines is to help NCAs decide, on the basis of ‘substance over form’ and technological neutrality, whether the inherent rights and design of a given asset are such as to require it to be treated under MiCA as a crypto-asset or MiFID as a financial instrument. A blanket decision that ‘if in doubt, assume it is a financial instrument’ is as incorrect as an interpretation of MiFID as it is as an assessment under MiCA.

Ripple therefore does not believe that if a hybrid crypto-asset displays just any feature of a financial instrument, this should take precedence in its classification to make it a financial instrument. Instead, we believe that any analysis should look to consider the primary function and design of the hybrid token and any characteristics in a proportional manner, as envisaged by the MiCA level 1 text.

<ESMA\_QUESTION\_MIC3\_7>