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European Securities and Markets Authority
201-203 Rue de Bercy, 75012 Paris
France

Re: Socios.com response to ESMA consultation on the draft Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments

1. Background Information

1.1. What is Socios.com?

Socios.com appreciates the chance to offer insights regarding ESMA's draft Guidelines on the conditions and criteria for the qualification of cryptoassets as financial instruments.

Socios.com was founded in 2018 and is headquartered in Malta. We are a blockchain-based Fan Engagement platform (the "Platform") that brings fans closer to their favourite teams while rewarding them for their loyalty. We are partners with over 70 of the biggest sports teams from around the world, and fans can now engage with their team wherever they are.

Socios.com Platform is a gamified ecosystem which provides sports fans the opportunity to purchase "Fan Tokens" and benefit from the utility rights attached thereto (see below paragraph for Fan Token utility). The Platform is powered by Chiliz Chain being the layer-1 permissionless blockchain, the go-to protocol for sports and entertainment, where the boldest and most innovative startups and developers are building web2 and web3 products and solutions that will shape the future of the industry. Chiliz tokens ("$CHZ") are the exclusive pairing of all Fan Tokens on the Platform. Therefore, any Platform user wanting to purchase or sell Fan Tokens can do so by exchanging such Fan Tokens on the Platform from or to $CHZ.

1.2. What are $CHZ?

$CHZ are digital assets issued, registered, stored and transferred on the blockchain, specifically the Chiliz Chain. $CHZ is the native token of the Chiliz Chain and is the governance and network token of the Chiliz Chain, authenticating transactions (including transactions involving Fan Tokens), and ensuring any on-chain activity is verified. When any transaction is conducted on the Chiliz Chain, $CHZ is used as a gas token to pay the relative transaction fees.
Holders of $CHZ do not acquire the right to receive any return, dividend or any right to participate in any voting related to the management, corporate or strategic matters of the issuer or any entities within the Socios.com group.

1.3. What are Fan Tokens?

Fan Tokens are utility tokens that are reshaping fan engagement across the global sports industry by enabling fans and brands to connect in unprecedented ways. They are minted on the Chiliz

Chain. Socios.com has launched a branded Fan Token for each of its partners, which Fan Tokens bear the IP and brand of the respective partner.

Fan Tokens holders are eligible to participate in several fan engagement token-gated features on the Platform and predominantly constitute tokenized voting rights on survey polls launched on the Platform in relation to partners (for instance choosing the goal celebration song, kit design, player of the match etc.). Fan Token holders are also eligible to participate in campaigns and other features enabling users to win exclusive merchandise and rewards and participate in gamified in-app features. Fan Token holders are rewarded loyalty points depending on their level of engagement which are then redeemable for various prizes and rewards. Holders of Fan Tokens do not acquire the right to receive any return, dividend, or any right to participate in any voting related to the management, corporate or strategic matters of the partners nor the issuer.

The management of the Platform (including provision of related crypto asset services and fan engagement activities), as well as issuance of Fan Tokens, are handled by different group entities including EU and non-EU (Swiss) entities.

1.4. **Our intention to participate in the consultation process**

At Socios.com we stand at the forefront of web3, recognising the impact that crypto assets can have for bringing together fan communities in sports and entertainment. Crypto assets can deliver greater belonging, participation and recognition for communities and we aim to bring this to sports fans and communities. As a crypto-asset service provider (CASP) operating within the EU, we prioritise regulatory compliance as a cornerstone of our operations.

Our commitment to compliance is unwavering. We have obtained national authorizations across several EU member states as well as outside the EU, demonstrating our dedication to operating within legal frameworks. Additionally, we have proactively initiated discussions with national competent authorities (NCAs) regarding the necessary licensing procedures under the Markets in Crypto-Assets (MiCA) Regulation.

Please find our feedback for consideration below.

2. General Comments

ESMA's clarification of the difference between cryptoassets governed by the Markets in Cryptoassets Regulation (MiCA) and those meeting the requirements for financial instruments under the Markets in Financial Instruments Directive (MiFID II) is crucial for maintaining clear regulations and effective oversight in the evolving cryptoasset ecosystem. $CHZ, serving as our native governance token, as well as Fan Tokens being utility tokens, will of course largely be out of scope of any determination on financial instruments, but we are of the view that any

requirements or obligations should remain clear and transparent, with a consistent approach throughout member states.

Socios.com believes that harmonising the classification criteria between MiCA and MiFID II throughout the EU will promote consistency across jurisdictions, simplify cross-border regulatory cooperation, and reduce the risks associated with regulatory arbitrage. The absence of such alignment could impede passporting and the introduction of various products across multiple member states. This scenario may arise if an asset is categorised as a cryptoasset in one member state but labeled as a financial instrument in another, thus complicating cross-border operations and efforts to ensure regulatory compliance.

Given the array of regulatory frameworks overseeing these unique asset categories and the differing methods of handling financial instruments among EU member states, accurate classification with a standardised approach is essential. It serves to reduce the risk of regulatory arbitrage, operational inefficiencies, market fragmentation, and systemic vulnerabilities. Improving clarity on distinguishing between financial instruments and cryptoassets is vital for establishing clear guidelines, fostering transparency, and ensuring regulatory compliance among both market participants and regulators. Similarly, in case of for example considering uniqueness of NFTs (which is decisive to determine whether or not an NFT falls within the scope of MiCA) by the national competent authorities ("NCA"), it would lead to serious consequences if various NCAs classify the same assets differently.

While classification may appear straightforward in many instances, certain tokens, particularly those in edge cases, require a consistent interpretation and efficient classification process for the long-term sustainability of the EU's cryptoasset economy. This could include permitting self-attestation of tokens based on a thorough legal and industry perspective and engaging in dialogues with NCAs. However, ensuring a uniform application and interpretation of classification among member states' NCAs, especially in more complex cases, is crucial.

Therefore, Socios.com advocates for ESMA to provide more comprehensive elaboration on these general conditions and criteria. This will assist firms and NCAs in gaining a clearer understanding of how tokens should be classified. Additionally, ESMA should consider providing training to NCAs to ensure consistent implementation of the guidelines and to enhance clarity.

3. Responses to the Consultation Questions

Question 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 cryptoassets or would you support the establishment of more concrete conditions and criteria?

Socios.com's Response:

Acknowledging the limitations of applying a one-size-fits-all approach to classifying financial instruments and cryptoassets, Socios.com has concerns regarding the uniform interpretation of draft guidelines across NCAs, particularly when different member states may view a cryptoasset differently. The draft guidelines advocate for a nuanced approach to asset classification, prioritising high-level criteria and general principles over standardised tests. To effectively address these concerns, Socios.com advocates for the establishment of a standardized "Financial Instrument Test" alongside clear guidance notes on the applicability and conduct of such test[1]. While not a novel concept, this approach has already been embraced by certain NCAs and is widely favored by the industry for engaging with regulators worldwide. For instance, the MFSA (the NCA in Malta) has developed a similar test known as the "Financial Instrument Test".

One significant aspect of the guidelines is the hierarchical framework where MiFID II's criteria are initially used to determine if a cryptoasset aligns with the definition of a financial instrument. If it fails to meet these criteria, MiCA becomes applicable, provided the cryptoassets are fungible, thereby excluding those beyond these parameters from the EU's regulatory scope. Despite this clear distinction, NCAs may encounter significant challenges in effectively implementing this framework. To mitigate these challenges, the implementation of a substance-based test (the above mentioned Financial Instrument Test) across all NCAs would provide a unified approach that aligns more closely with the practical realities of the market and would be a truly technological neutral proposition that could be used for any new technology still to be developed that could also be used to issue financial instruments.

Moreover, the dynamic nature of cryptoassets and their underlying technologies poses additional obstacles to aligning them with traditional financial regulatory frameworks. While ESMA acknowledges that the technological infrastructure of these assets should not determine their classification, the practical application of this principle is fraught with difficulties. There is a pressing need for clear, standardised guidelines to ensure consistent classification of cryptoassets, particularly those issued via distributed ledger technology (DLT) or tokenised assets, across all regulatory contexts.

Given these challenges, Socios.com advocates for enhanced coordination among NCAs to establish a comprehensive and streamlined classification framework for cryptoassets in the EU, preferably in the form of a standardized test to determine the nature of the cryptoassets at play. Such a framework is essential for providing the legal clarity and certainty that market participants need to confidently conduct their activities. By integrating a standardized test into this framework, NCAs can create a level playing field, bolster investor confidence, and foster innovation in the rapidly evolving digital assets sector. This collaborative effort will not only facilitate regulatory compliance but also contribute to a more resilient and transparent ecosystem conducive to the sustainable growth of the EU's cryptoasset markets.

[1] https://www.mfsa.mt/wp-content/uploads/2019/05/VFAG_FITest_1.02.pdf

Question 5: Do you agree with the suggested conditions and criteria to differentiate between MiFID II financial instruments and MiCA crypto-assets? Do you have concrete condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

Socios.com's Response:

ESMA's initiative to delineate utility tokens from financial instruments marks a positive step towards regulatory clarity. However, the effective application of these guidelines requires careful consideration, comprehensive guidance, and potential iterative revisions to keep pace with the evolving nature of digital assets. For these guidelines to be effective, they must be sufficiently clear to be consistently understood and enforced by NCAs across the EU's diverse regulatory landscapes.

Socios.com agrees with ESMA's view that utility tokens should primarily facilitate practical or functional use within a DLT ecosystem. We also appreciate the clarification that the mere expectation of profit does not automatically categorise a token as a financial instrument. Nonetheless, this clarification introduces a potential for significant interpretative variability among NCAs. Differences in how NCAs interpret 'utility' or 'profit expectations' could result in uneven classifications and regulatory treatments across member states, which may undermine the stability and predictability of regulatory landscapes within the EU. Additionally, the mention that the expectation of profit, while not a sole qualifier for financial instruments, could contribute to a token being covered by MiCA along with other criteria, requires further elucidation. What these "other coexisting criteria" entail needs to be clearly defined to ensure uniform application and understanding across all member states. Furthermore, it is crucial that the classification considers the intended purpose as articulated through the issuer's marketing, development efforts, and disclosures, emphasizing that this original intention should not be easily affected by the activities of third parties, as a matter of legal certainty for the operators to rely upon. And even more so having in mind that the definition of crypto-asset under MiCA does not make any references to expectations of profits or any other returns.

The issue of governance rights associated with utility tokens further complicates their classification. Although ESMA advises that governance rights accompanying utility tokens should not replicate those rights attached to traditional financial instruments, the practical implications of such governance functions, such as voting on pivotal operational decisions, may resemble those of financial instruments. This similarity introduces additional complexity to the regulatory process, potentially complicating the accurate determination of a token's true nature and the appropriate regulatory framework.

Moreover, ESMA recognises that while the expectation of profit alone is insufficient for classifying a cryptoasset as a financial instrument, it could, along with other factors, place a token within the scope of MiCA. This acknowledgment calls for a clearer definition of what these additional criteria entail to ensure consistent application and understanding across all member states. Without

precise guidelines, there is a risk of disparate interpretations, which could undermine the harmonisation efforts of the regulatory framework.

In relation to the definition of a utility token, it should be considered and clarified within the guidelines that the intended purpose of the token by its issuer i.e. that the token is to act as a utility token granting access to goods or services, which hence the issuer promotes and markets the token as a utility token should be the main criteria to determine whether it classifies as a utility token or otherwise. In our view it should be primarily the issuer's intention for the respective assets' nature to be issued as utility tokens that should be decisive for such classification, since there might be different use cases on the secondary market which in our view however should not influence respective asset classification. So if an asset is designed in its very nature to serve as a utility token and is not granting any rights associated with any financial instrument, then it should be classified as utility token regardless of possible other use cases on the secondary market or subjective expectations of the holders of such assets. Our response to Question 7 hereunder expands further on this topic. It also needs to be highlighted that in company organisational structures comprising various group entities having the same ultimate shareholding structure, the entity providing the goods or services attached to the utility token should not be restricted to the issuing entity but should extend to other affiliates within the organisational group structure. This in turn should not be diminishing the nature of an asset as a utility token and should not prevent its classification as such.

To achieve a uniform application of ESMA's guidelines, extensive training and the development of detailed operational guidelines will be necessary. Such measures are crucial to provide the NCAs with the tools and knowledge needed for consistent implementation of these guidelines. This approach will help in minimising enforcement variability and ensure that the digital asset market operates smoothly across the EU.

Question 6: 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 condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

Socios.com's Response

Socios.com acknowledges that the primary text of MiCA does not delve into the specifics of NFTs, and we hold significant concerns regarding the potential implications of enforcing the proposed conditions and criteria. We fear that if implemented, these measures could unintentionally extend the regulatory reach of MiCA, thereby hindering innovation within the EU.

As currently formulated, the proposed guidelines lack sufficient specificity for businesses and NCAs to reliably and uniformly decide whether a particular cryptoasset qualifies as an NFT and thus falls under MiCA.

Our main concern arises from ESMA's introduction of the new concept of '***genuine uniqueness***' as a criterion for differentiating between fungible and non-fungible cryptoassets, and consequently determining their inclusion under MiCA, as outlined in paragraph 67. Reading through Paragraph 68, the consultation touches on the core issue of what should be considered an NFT within MiCA's context. It clarifies that technical characteristics alone should not be the primary determinant of a token's classification. Instead, the emphasis on "uniqueness" and its perceived "non-fungibility," as established in Paragraph 67, are critical in defining the regulatory nature of a token recognized as an NFT. We concur that the value of NFTs often stems from a collective recognition of their uniqueness, which transcends technical specifications through either coded attributes or societal acknowledgment. This "uniqueness", we believe, can be defined as a social consensus-based distinctiveness.

Public perception of NFTs often associates them more with uniqueness, as defined above (either programmed or contextual) and utility, influencing their distinct status. A case in point is **Adidas Originals'** use of the ERC-1155 standard in their project, blurring the lines between fungible and non-fungible tokens. Here, Phase 0 tokens (pre-redemption) are fungible among themselves, as are Phase 1 tokens (post-redemption for a physical item)[2]. The process involves burning a Phase 0 token to receive a physical item and the minting of a new, corresponding Phase 1 token to the user's blockchain address. This example illustrates the complexity and variable nature of NFTs, underscoring the need for a nuanced understanding and categorization.

By transforming the definition of ***'fungible'*** into a quantitative assessment, the proposed guidelines overlook the fact that a significant portion of art derives its value from its interconnectedness with other artistic and cultural objects. Furthermore, it is important to acknowledge instances where tokens might qualify as NFTs for the regulatory exemption under MiCA for NFTs, yet are technically fungible. An example is Colored Coins[3] on the Bitcoin protocol, where differentiation depends on user consensus rather than inherent features of the blockchain code. Here, it is the haecceitas—the essence that makes an item uniquely identifiable due to its unique historical and social context—that matters. The dynamic nature of NFTs necessitates a comprehensive classification framework that considers their contextual use, functionalities, and defining characteristics. Such a holistic approach is critical for accurately understanding the rights and values associated with these digital assets.

Additionally, the classification process under MiCA hinges on the concept of ***interchangeability***, or lack thereof, as a crucial factor in determining the uniqueness of cryptoassets. This criterion raises concerns from a practical perspective. As suggested in paragraphs 70 and 71, NFTs that are issued as part of a series are more inclined to be classified as fungible, necessitating individual scrutiny by NCAs on a case-by-case basis. Without further clarification, this approach is likely to

[2] D. J. Kappos, L. A. Schneider, D. M. Barabander, & C. A. F. Sproule, Fuzzy Tokens: Thinking Carefully About Technical Classification Versus Legal Classification of Cryptoassets. 2023

[3] Rosenfeld, M. (2012, December 4). Overview of Colored Coins. Retrieved from https://bitcoil.co.il/BitcoinX.pdf

mistakenly lead to the majority of serialised NFTs being deemed fungible, resulting in a notable lack of consistency across EU member states. We also believe it is crucial for ESMA to define what exactly is meant by a 'series of NFTs'. It is not clear if there is a limit to how many NFTs can be in a series, and if there is, what that limit should be.

Consider the scenario of event organisers issuing tickets for a major event, say 7,000 tickets, in the form of NFTs where each NFT grants access to the event just like a traditional paper ticket would. Although these NFTs are part of a large series and can be transferred, they don't fit the criteria of EMTs, ARTs, utility tokens, or any other fungible crypto-assets regulated by MiCA.

However, if MiCA were to apply solely based on the scale of the ticket issuance, event organisers who choose blockchain technology for ticket issuance and tracking would find themselves obligated to create a white paper detailing the NFTs which risk being reclassified as utility tokens. Meanwhile, issuers of tickets in the traditional paper or electronic format with QR codes or barcodes for tracking would not face such a requirement – this would seriously undermine the technology neutrality concept reiterated by ESMA.

Based on this understanding that defines what an NFT has to be to be exempted under MiCA as expressed in paragraph 65, we have come up with the below arguments and points that we think would constitute a sensible guideline for the industry on this topic, a good portion of these are directly or indirectly connected to the principle of "***technology neutrality***" and "***same activities, same risks, same rules***" as rightly identified and described in paragraph 7 of this Consultation.

Before delving into into further arguments, a general example has been presented below (vide 'General Example' section below) to exemplify the many cases (that we will later discuss) in which a normal activity can be equally executed using traditional methods or blockchain-based methods, with possible different regulatory results, when they remain equal in nature. Having this in mind can facilitate the understanding of our proposals and arguments.

General Example:

> Consider the scenario where a company chooses to recognize the participation of its customers in a special corporate event. To commemorate this occasion, the company produces 1,000 identical postal cards, each distributed to every customer who attended the event. These postal cards are simple tokens of appreciation and carry no intrinsic financial value; they are valued purely for their sentimental significance. Under current regulations, such simple tokens—tangible and intangible—are not subject to regulations as they do not constitute regulated instruments.
>
> Now, let us transpose this scenario into the digital realm. Suppose the same company decides to use modern technology for a similar purpose and produces 1,000 identical Non-Fungible Tokens (NFTs) instead of physical postal cards to commemorate the event. These digital tokens are issued to customers who participated in the same event, serving

an identical commemorative function as the postal cards[4]. Each NFT, like its physical counterpart, carries no inherent value and is merely a digital representation of appreciation for the customers' participation.

With this General Example in mind, we would like to provide a more detailed breakdown of the arguments supporting our suggested approach in analysing and classifying digital tokens whilst maintaining the underpinning concept of 'technology neutrality'. In order to contextualise further, other examples and analogies shall be discussed further below:

Argument 1: Identical Functionality and Intent – Same activities, same risks, same rules

I. Function and Intent:

The reality is that there are many examples of items and issuance and placing of such items, that are traditionally not regulated, but that an expansive understanding of the regulation would cover and thus, would produce a non-warranted burden on the market participant if it was to decide to use a blockchain-based product instead of a physical and traditional one.

Referring back to the General Example previously discussed, both the NFTs and physical postal cards (commemorative cards) serve an identical purpose: to acknowledge participation in an event. The fundamental intent behind issuing these tokens is to provide a token of appreciation, not to function as a transferable asset nor any other type of riskier instruments rightly regulated under the scope of MiCA. By focusing on their function and intent, it becomes evident that whether a token is digital or physical does not change its use as a commemorative item.

Regulations for products carrying minimal risk and merely serving as digital counterparts to existing, unregulated items should not be overly stringent. Under MiCA, tokens still face regulations requiring extensive disclosures and Know Your Customer (KYC) and Anti-Money Laundering (AML) checks by Crypto Asset Service Providers (CASPs). These requirements, designed to mitigate information asymmetries and risks, appear excessive for low-risk tokens especially when considering that the physical counterparts of such tokens do not attract the same requirements. We propose that future regulations should avoid imposing disproportionate burdens on NFTs, focusing instead on the intent, representations, and goals of their issuance and placement to clearly understand the nature of the token itself.

II. Consumer Perception:

[4] Market participants are already implementing similar practices, as evidenced by the activities of POAPs. For further details, see https://poap.xyz/.

The perception and representations made to consumers should more prominently define the perceived "uniqueness" of an NFT, thereby influencing its regulatory classification more than any technical characteristic of the token itself.

As illustrated by the previous General Example, recipients view both digital and physical tokens as memorabilia or keepsakes. These items are generally not traded, lack significant inherent value, and are retained as souvenirs. This perspective is similarly applicable to other real-life items such as medals for achievements or corporate merchandise.

Therefore, we advocate for a clear stance on the perceived fungibility of these or similar tokens. In our view, the fact that an asset is tradable, and that this trait is marketed, should not dictate its regulatory assessment if trading is not its primary advertised feature but merely a characteristic of the token itself. Market dynamics, based on the asset's characteristics, should evolve naturally without regulatory imposition, as observed in traditional markets. For example, collectibles like Panini stickers, Pokémon cards, or Magic: The Gathering cards, are inherently tradable and have fostered a vibrant secondary market, both in physical stores and online. The latter's primary purpose, however, is not for trading but for collection; therefore, they are not deemed high-risk and remain unregulated by financial regulations. This principle and stance of regulators should also extend to their digital equivalents. If a digital or physical token is primarily regarded as memorabilia, part of a collection, or a keepsake, and not intended for substantial monetary transactions or speculative purposes, its potential as a tradable asset should not singularly influence its regulatory status.

Argument 2: Technological Neutrality

I. Consistency Across Mediums:

The principle of technological neutrality, as covered in MiCA's recital 9, mandates that regulatory decisions should not favour or penalise a particular technology, but rather should be based on the functionality and intent of the item. Applying disparate regulatory standards to digital tokens (NFTs) and physical tokens (commemorative cards, Panini cards, etc.) when both serve similar commemorative or consumptive purposes (such as being collectible) would breach this principle.

Discriminating between technologies (digital vs. physical) introduces unnecessary complexity and could hinder the adoption of innovative digital solutions for non-commercial purposes. If physical tokens such as postal cards are not subject to regulation under similar conditions, then digital tokens, specifically NFTs, should not fall under stringent regulatory frameworks like MiCA when utilized in an identical manner.

Consistent with our earlier remarks, a token's inherent characteristics should not determine its regulatory classification. This is in line with ESMA's directive in Paragraph 68, asserting that technical specifications of tokens should not be the basis for classification. Even though the ERC 721 standard is mentioned, the logic should consistently apply to any standard, including those

similar to ERC 20, which renders a token fungible. According to the reasoning outlined in the Guidelines, if technical characteristics, such as fungibility determined by code, are not to be used to define or classify a token, it logically follows that the context of its issuance, placement, and use (perception) must be the decisive factors. Thus, the technical 'fungibility' of a token should be considered a secondary cue for classification, not the primary one. Placing an additional burden on market players who opt to use this technology would be overly restrictive.

This logic was also taken into account during the drafting of MiCA as Recital 10 clearly clarifies that: “This Regulation should not apply to crypto-assets that are unique and not fungible with other crypto-assets, including digital art and collectibles. (...)”. As many collectibles are technically fungible, but they gain their distinctiveness, from pure social consensus and circumstances surrounding them.

Argument 3: Avoidance of Unnecessary Regulatory Burden

I. Administrative and Cost Burden:

Imposing regulatory requirements such as AML, KYC, and risk assessments on entities issuing commemorative NFTs would place an undue burden on these entities, especially when such measures are disproportionate to the risks involved.

Regulation should adhere to a clear risk-based approach. For instance, while the issuance, placement, and sale of collectible cards are not regulated, transactions involving fine art are - due to the heightened risks of money laundering associated with high-value art.

Delving deeper into this point, MiCA provides a regulatory framework for crypto assets and sets baseline goals and generic requirements for issuing or dealing with crypto assets under certain circumstances. Among these obligations are AML checks. The rationale for exempting NFTs from certain regulations likely stems from their market dynamics and risk profile, which do not necessitate burdensome requirements. AML regulations and checks, fundamentally, were not designed with specific assets in mind but rather around the risk of facilitating, whether knowingly or unknowingly, the laundering of illicit funds.

In alignment with Recital 26 of MiCA, which exempts certain crypto-assets from stringent regulatory requirements, such as those offered for free or those that function within a limited network, our position is that most NFTs such as those used for commemorative purposes should similarly be exempt, regardless of their apparent technical fungibility. This recital supports our assertion that the regulatory approach must be proportionate and sensitive to the actual use and risk profile of the crypto-asset. Just as the regulation exempts utility tokens providing access to goods and services from undue regulatory burdens, so too should NFTs that serve a similar low-risk, non-financial function.

We propose that any guidelines concerning how to manage NFTs should follow the same asset-agnostic approach and regulate only those activities, issuers, professionals, or service providers that, regardless of the asset involved, are found to be at risk of facilitating the laundering of illicit funds. Therefore, we advocate for a contextual approach, opposing the indiscriminate imposition of burdens and obligations on issuers intending to produce an NFT (regardless of its technical characteristics, including a certain level of fungibility) that does not meet the basic minimum contextual criteria for being at risk of such activities.

This principle should consistently apply within this context as well. Such regulatory burdens could deter organisations from utilising blockchain technology for benign purposes, thereby stifling innovation and curtailing the creative use of new technologies in traditional settings, as demonstrated in the example provided above.

II. Proportionality

Assessing the Regulatory Need:

The principle of proportionality mandates that regulatory measures should be commensurate with the objectives they aim to achieve. For NFTs, such as those issued for commemorative purposes, the primary objective of any potential regulation should be to prevent their misuse for financial speculation. However, when these tokens are explicitly linked to non-commercial purposes, the likelihood of financial misuse is minimal. Thus, imposing stringent financial regulations would be disproportionate to the risks posed, failing the test of proportionality.

As noted previously in Argument 1, Section II on Consumer Perception, tokens should not be regulated based solely on their tradability if trading is not their primary function. Rather, regulation should focus on the token's principal advertised functions, allowing market dynamics to develop naturally without undue regulatory interference.

Reducing Regulatory Burden:

Applying stringent regulatory frameworks designed for higher-risk instruments and activities to commemorative NFTs would disproportionately burden issuers, particularly those from non-financial sectors such as artists, cultural organisations, and community groups. A proportional approach would tailor regulatory requirements to the actual risks and nature of the NFTs. Such an approach would exempt NFTs clearly intended and utilized for commemorative purposes or for entertainment purposes (such as ticket issuance) from burdensome financial regulations. This strategy would not only facilitate the innovative use of NFTs in various non-financial contexts but also encourage their adoption and broader integration of blockchain technology ensuring a wider audience can benefit from the advantages of this innovative technology.

Argument 4: Substance-Over-Form – Contextual Significance

I. **Uniqueness**:

As highlighted in the introduction of this response, we assert that the value of NFTs primarily stems from a collective acknowledgment of their uniqueness, which transcends mere technical specifications through either coded attributes or social recognition. This "uniqueness" can be defined as a social consensus-based distinctiveness.

Each NFT, even those identical in content and form, acquires a unique status from the consensus regarding its significance related to a specific event or communal experience. This characteristic, known as haecceitas—the essence that renders something unmistakably identifiable due to its unique historical and social placement—can be evidenced or represented by specific traits of the NFT (such as a serial number, recognition of limited supply, or social cues like issuance in commemoration of a particular event, previous ownership by a notable personality, or involvement in unique circumstances that subjectively differentiate it from others). This phenomenon mirrors typical social behaviour observed with traditional collectibles, where markets develop for seemingly identical objects that have acquired distinct reputations and differentiation from others solely due to their circumstances (such as collectible toys, watches, memorabilia, or skins of certain characters in video games).

Following this rationale, it is evident that these tokens are more than just digital artefacts; they are integral parts of a social fabric that endows them with a distinct identity, recognized and upheld by the community involved. This collective dimension of NFTs highlights their uniqueness based on social consensus, not merely their serial number or digital design. It is imperative that this understanding is acknowledged to avoid discriminatory considerations for these types of assets, ensuring they are not unjustly subjected to regulatory treatments that similar items created using different technological means traditionally do not face.

In conclusion, as currently formulated, and given the state of the market and its rapidly changing nature the proposed guidelines lack sufficient specificity for businesses and NCAs to reliably and uniformly decide whether a particular cryptoasset qualifies as an NFT and thus falls under MiCA. A more detailed analysis is included in our response to Question 7 hereunder.

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

Socios.com's Response

Socios.com acknowledges ESMA's effort to bring clarity to hybrid tokens, where some cryptoassets may possess traits of financial instruments.

Furthermore, Socios.com would like to highlight the challenges associated with token categorisation, particularly given the evolving nature of cryptoassets. Innovations such as the so-called ERC-404 token experiment introduces complexities, where tokens may shift between categories throughout their lifecycle. While we acknowledge that crafting an exhaustive and continually updated classification might be overly ambitious, it is important to note that ESMA's hierarchical approach could inadvertently subject all tokens to the existing financial services regulations rather than applying the intended MiCA framework. This misalignment risks undermining the very objectives of the MiCA framework, which aims to foster innovation while ensuring investor protection within the crypto market.

Under the proposed guidelines, a token initially classified as a utility token could risk reclassification if third parties unilaterally decide to ascribe to it features characteristic of financial instruments. This presents a critical issue: the original issuer, having created the token with a defined utility (or lack thereof) function following all pertinent regulatory guidelines, cannot foresee nor control subsequent uses by third parties. This aligns with the guidelines' recognition that "*Due to the evolving nature of crypto-asset arrangements in the market, making an exhaustive and up to date classification would be overly sweeping*" (paragraph 76). This lack of control should not penalize the issuer or alter the fundamental classification of the token.

A re-classification of a token based solely on unilateral third-party actions could cause significant disruption and impose substantial non-intended compliance costs on the original issuer for circumstances entirely beyond their control. Issuers would be forced to adapt their operations, systems, and processes to comply with an entirely different regulatory framework, even if their token's intended use and functionality remain unchanged. Furthermore, such a re-classification could make it impossible for the issuer to provide the originally intended utility to token holders, as the token's new classification may prohibit or severely restrict its marketed use case. This situation would not only undermine the principles of regulatory certainty and fairness but also stifle innovation and discourage legitimate utility-focused projects in the blockchain space. Crucially, it would also directly impact users who purchased or planned to utilise the token for its originally intended and marketed utility, potentially depriving them of the promised functionality and value proposition.

The Nature of Permissionless Systems

Many DLT systems, by design, use a form of permissionless technology allowing for innovation and interaction without the need for centralized control or oversight. Once tokens are issued on such a system, the original issuer has no effective means to govern how these tokens are used or transacted beyond their platform. To impose a regulatory expectation that issuers monitor and potentially be held accountable for every conceivable use of their tokens by third parties is not only impractical but also unprecedented in other fields of law. Typically, individuals or entities are

not held liable for actions that are beyond their control and that they have not authorized, encouraged, or facilitated.

Legal Precedents and Consistency

In most jurisdictions, the principle of liability hinges significantly on control or influence over the actions in question. For instance, a car manufacturer is not liable if a vehicle is used in a manner that contravenes its intended legal use, provided that the vehicle met all safety and operational standards at the point of sale. Similarly, if a utility token is issued with a specific function and meets all regulatory requirements at the time of issuance, changing its classification based on third-party actions would set a concerning legal precedent.

Proposed Criteria for Token Re-classification

Given the potential for third-party actions to modify the perceived function of a token, we propose that re-classification should only occur when the majority (+51%) of the token's measurable use shifts demonstrably and sustainably towards the functions characteristic of a different classification, such as financial instruments. This approach aligns with the guidelines' emphasis on a "substance over form approach" (paragraph 82) and also with the principle of proportionality but would also provide a clear and manageable criterion for issuers and regulators. It acknowledges the dynamic and evolving uses of crypto-assets while protecting issuers from undue liability for unforeseeable third-party actions.

Conclusion

Socios.com supports the efforts of ESMA to craft clear and practical guidelines for the classification of crypto-assets, particularly in distinguishing between financial instruments and utility tokens under MiCA and MiFID II. We appreciate the opportunity to participate in this consultation and offer our insights, given our unique position at the intersection of blockchain technology and fan engagement.

Our primary concern is the need for consistent application and interpretation of these classifications across member states to avoid regulatory discrepancies that could impair the seamless operation and growth of the blockchain-based fan engagement market in the European Union. The introduction of a standardised "Financial Instrument Test" is advocated as a means for NCAs to achieve this consistency, ensuring that all crypto-assets are evaluated under a uniform framework that reflects their actual use and economic reality rather than merely their technical characteristics.

Moreover, we emphasise the importance of regulatory adaptability to keep pace with the rapid innovation within the blockchain sector and hence highly specific characteristics and requirements for assessing digital tokens is very undesirable as it fails to keep up or promote innovation within

this unique sector. Additionally, addressing the issue of third-party activities impacting token re-classification, particularly within permissionless networks, remains crucial. Given the decentralised nature of these networks, actions by third parties, over which issuers have no control, should not lead to token re-classification. To ensure consistency and stability in token categorization, we propose that changes in classification only be considered when there is a significant and consistent shift in the token's primary use, not merely based on third-party behaviours. This approach will help prevent unnecessary regulatory burdens and support the predictable legal environment necessary for the thriving of the blockchain ecosystem.

Socios.com is committed to maintain continuous engagement with regulatory bodies to further refine these guidelines, ensuring they foster a conducive environment for the development of blockchain technologies while maintaining robust consumer protection and market integrity.

We look forward to further discussions and are eager to contribute to shaping a regulatory landscape that both supports innovation and addresses the complexities presented by the digital asset markets.