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

`

**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 publicly 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**

|  |  |
| --- | --- |
| Name of the company / organisation | Global Blockchain Business Council (GBBC) |
| Activity | Non-financial counterparty |
| Are you representing an association? | ☒ |
| Country/Region | Europe |



**About us:**

**GBBC** is the largest leading industry association for the blockchain technology and digital assets community. Launched in Davos in 2017, GBBC is a Swiss-based non-profit, with more than 500 institutional members, and 301 Ambassadors across 117 jurisdictions and disciplines. The organisation is dedicated to furthering adoption of blockchain technology by convening regulators, business leaders, and global changemakers to foster collaboration and advance dialogue to create more secure, equitable, and functional societies.

**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 conditions and criteria?**

<ESMA\_QUESTION\_MIC3\_1>

We welcome the work of ESMA in providing its suggestions. We recognise the difficulty to establish clear criteria in a space where 27 member-states have different definitions of what a financial instrument or security is. We understand that this multiplicity of definitions is a major challenge and we believe that it is time for the Union to adopt a uniform definition.

The principle of “negotiability” is very broad to provide a basis for what qualifies as a security because many non-financial assets are “negotiable” but they are not financial instruments. We also recognise the potential complexities that certain types of tokens under MiCA, especially Title 2 (other tokens) and Title 3 (ARTs) are at high risk of falling under the scope of financial regulations in some member-states. We need to stress though, that this is not a “MiCA problem” or a “crypto-assets” problem per se. It is a Financial Regulation problem and we strongly believe that it should be solved there, and not here. Here, ESMA needs just to provide very clear and very simple guidelines to NCAs.

Choosing between concrete vs. wide criteria is a strategic choice, each one with its benefits and risks. We believe that a rather general approach is welcome to the extent that it does not compromise the need for regulatory clarity and legal certainty. In the Recast of MiFID-2 when the EU adopted the broad principle of “Negotiability” as a foundational element of what qualifies as transferable security, the choice was rather in the end of general conditions rather than concrete ones. It seems this did not create significant problems in the EU’s financial markets.

***Recommendation:*** *GBBC believes that ESMA should have one clear guideline: the substance of the token should determine its classification. Other than the principle of negotiability, there is a very clear consensus that if an asset represents a claim to the issuer’s future cash flow or promises of a stake in capital gains, then this asset is substantially a security. Broadly speaking, if a token does not represent such a claim, then it should not qualify as a security.*

*The substance of a token should be clearly determined by the content of its White Paper or the promise the issuer of the token makes to the consumers. This promise should be articulated very clearly. Clarity is beneficial for both the issuers of tokens and the NCAs that will evaluate and classify the tokens. This also means that the NCAs must be open to discuss, clarify and exchange views with the issuers of tokens seeking authorisation. A working and trust-based relationship between the Supervisors and the entrepreneurs is sine qua non for the successful implementation of MiCA.*

*The complexity and rapidly evolving nature of financial instruments and crypto-assets, as well as regulatory goals and objectives, indicates that this kind of approach acknowledges the diverse nature of these assets and avoids stifling innovation by imposing overly rigid regulations that may quickly become outdated. On the other hand, establishing more concrete conditions and criteria can provide clearer guidance and certainty for market participants, investors, and regulators. It can help reduce ambiguity and enhance regulatory compliance, particularly in areas where risks are well understood or where there's a need for heightened investor protection. However, overly prescriptive regulations run the risk of being overly restrictive and may hinder innovation and the development of new financial products and services. The tension between flexibility and clarity in regulation is indeed a challenge. Striking the right balance is crucial to foster innovation while also ensuring investor protection and financial stability.*

*However, we recognise that there is a significant risk of regulatory arbitrage that we cannot avoid as the existing multiplicity of the definitions of transferable securities may result in discrepancies in the treatment of tokens between the NCAs. We expect the NCAs to find a way to deal with divergent views and interpretations.*

<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>

In principle, we welcome the functional approach of ESMA to classify a token based on its substance and not its form. We also agree that shares, bonds, UCITS and any other type of security defined by MiFID2 should be treated as a “MiFID instrument”. This ensures a uniform approach to the regulatory treatment of security-type tokens in the EU as well as investor protection and market integrity. We recognise though, that this may affect the proportionality of the treatment of some tokens with hybrid characteristics. For example, one area where there was uniformity was a utility token, surveyed as Case 5, in ESMA’s 2019 survey (ESMA50-157-1384 Annex 1), finding that “no NCA labelled case 5 as a transferable security and/or financial instrument….” We contribute more about this topic in Q7 of this consultation, addressing hybrid tokens with utility.

Guidelines 2 and 3, we believe are heading towards a good direction. We are concerned, nevertheless, with the broadness of the notions of negotiability and transferability. We have seen before that the width of interpretations of these principles from the NCAs can be beneficial, however, given that MiCA grants cross-border passports, we are concerned that this very space to interpretation may be problematic.

We also recognise the discrepancies of the definitions in securities we see between the member states, and it is true, that the 2019 ESMA Survey, after its publication created a wave of “token optimization” where entrepreneurs worked closely with law firms to design tokens that comply with applicable law such that they would not be considered a “security,” in the relevant jurisdictions within the member states, or adjusting their tokens accordingly.

After these optimizations, many NCAs granted authorizations and licences. We predict that a similar behaviour will occur when MiCA is in place, especially for smaller jurisdictions that would like to attract entrepreneurs issuing Title 2 tokens. Given the systemic riskiness of those tokens is very low, this creativity is rather welcome, to the extent that the issuance of tokens takes place in the jurisdiction where the vast majority of the issuer’s customers reside. We believe that some sort of flexibility is necessary and beneficial for startups and SMEs employing Title 2 tokens. This flexibility should not be penalised in the passporting process.

With the rise of digital assets like cryptocurrencies and tokenized securities, there may be discussions or proposals to amend MiFID, or alternatively, a dedicated section to MiCA 2, to specifically address the regulation of these assets. This could involve defining new asset classes, establishing regulatory frameworks for digital asset exchanges, and addressing investor protection and market integrity issues unique to digital assets.

Under MiFID-2, transferable security must be part of a “class of securities,” though “class' ' is not defined, providing MiCA with an opportunity to provide more clarity. We agree with ESMA’s assessment that “For crypto-assets to form a class, they should confer similar rights to investors,” such as “ownership position in a company’s capital” or “right to vote on matters of corporate policymaking.” (¶32, ¶63) Importantly, as ESMA recognized in its discussion of utility tokens in Question 4, “tokens may be accompanied by governance rights,” which must be distinguished from the rights to participate in the issuer’s corporate decision-making process. Governance is critical for decentralised tokens, and should not be discouraged by unclarity on the factors.

We also agree with ESMA that the notion of ‘expectation of profit’ is not a concept that is defined or even used to qualify a financial instrument under MiFID II” and has no clear legal basis within Union law. Consequently, unless the investor's intention were to become a qualifying criterion, the ‘only investment’ component would not be self-sufficient to qualify a crypto-asset as a transferable security.

***Recommendation****: We call on ESMA to recognise that the definitional and interpretation differences between NCAs may occur and encourage NCAs to be open in receiving guidance to resolve those discrepancies and in communicating with each other to resolve differences when they emerge for the benefit of the ecosystem, and especially the SMEs and startups operating in the Web3. We also call upon ESMA to recommend against the notion that the investor's intention should transform into a qualifying criterion.*

*Furthermore, we call on ESMA to clarify, with examples, that tokens must provide rights that match securities, and that the ability to participate in governance processes for the protocol does not match voting rights on the issuer's corporate decision-making process offered by securities. We also call upon ESMA to recommend against the notion that the investor's intention should transform into a qualifying criterion.*

*We also strongly believe that a more operational definition of the notion of negotiability and transferability is paramount for the success of the cross-border implementation of MiCA. ESMA can enrich these more functional definitions with clear examples that can frame the concepts and support the work of the NCAs.*

<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>

TYPE YOUR TEXT HERE

<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>

It is important to recognize the distinct characteristics of different types of assets when crafting regulatory frameworks. Emission allowances, such as those related to carbon trading, indeed have unique features compared to many crypto-assets. Emission allowances are typically issued by governments or international bodies as part of efforts to mitigate climate change. They represent the right to emit a certain amount of greenhouse gases and are often traded on specialised exchanges. These allowances serve as a mechanism to incentivize companies to reduce their carbon footprint and transition to cleaner technologies.

On the other hand, many crypto-assets function primarily as digital representations of value or as utility tokens within specific ecosystems. While some may have investment or speculative characteristics, others are designed for use in decentralised applications or as a means of accessing services within a particular platform. Given these differences, it's crucial for regulators to tailor their approach to each type of asset accordingly. This may involve developing specific criteria and regulatory requirements that address the unique risks and characteristics associated with emission allowances, while also considering the broader objectives of environmental sustainability and carbon reduction. By acknowledging the distinct nature of emission allowances and other assets, regulators can ensure that regulatory frameworks are effective, proportionate, and capable of fostering innovation while safeguarding investor protection and market integrity. Considering these factors, it's essential for investors, regulators, and stakeholders to assess the environmental implications of different crypto-assets and consider them alongside other factors when evaluating their potential risks and benefits. Additionally, promoting transparency and encouraging sustainable practices within the crypto industry can help mitigate environmental concerns associated with crypto-assets.

We agree with ESMA that “For the issuer of a crypto-asset to be classified as a collective investment undertaking, the purpose of the crypto-asset project should not be a general commercial or industrial purpose” (¶47), pursuant to the exclusion of commercial or industrial purposes under the definition of “collective investment undertaking,” in accord with the ESMA Guidelines on key concepts of the AIFMD.

It will be useful for future clarity for ESMA to use examples to help blockchain projects understand the regulatory landscape. For utility tokens, or hybrid tokens with utility, a key characteristic of that utility is a general commercial or industrial purpose, the utility of the token is not part of a pooled return on the purchase price, and the token holders have no day-to-day discretion or control over the issuer, even if they may have some protocol governance rights.

***Recommendation****: We call on ESMA to explicitly recognize that utility tokens and hybrid tokens with utility have a general commercial or industrial purpose, and therefore should not qualify as a financial instrument under the collective investment undertaking definition. Moreover, we urge ESMA and EU co-legislative bodies to adopt a forward-looking perspective facilitated by collaboration with industry stakeholders, devising regulatory solutions which recognize the economic utilities of hybrid tokens. This is crucial to recognize that existing asset taxonomies may not encapsulate current and future technological advancements in the sphere of hybrid tokens and their applications. This alignment is crucial for the continued growth and integration of hybrid tokens into the broader financial ecosystem.*

.<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>

We welcome the approach of ESMA to create a safe space for crypto-assets that do not behave as transferable securities to enjoy a lighter compliance and supervision regime. From an economic point of view, this reflects the acceptance that the risk profile of crypto-assets, especially the “other tokens” of Title 2 of MiCA, is lower. It is also in line with the EU’s general policy that regulation should not stifle innovation. Again, an approach that focuses on the inherent characteristics of the token, its substance, is the best criterion.

In consideration of the potential regulatory discrepancies, we encourage the endorsement of globally recognized ISO benchmarks, which provide comprehensive criteria for crypto-asset categorization. The amalgamation of the ISO 24165 DTI, which details the technical aspects of tokens and DLT, combined with the economic particulars outlined in ISO 6166 ISIN, as well as the classification framework of ISO 10962 CFI, offers a substantial knowledge base to both regulatory bodies and market actors. It is noteworthy that the current CFI codes encompass crypto-assets that are classified as financial instruments, including equity and debt. In parallel, a dedicated subgroup within ISO is endeavouring to refine the CFI code structure to include a broader spectrum of crypto-assets, such as stablecoins and cryptocurrencies, which, as of now, remain uncategorized. In the interim, such assets, not recognized as financial instruments, are assigned as referential instruments.

Following on from our note in the first question, we need to elaborate at this point on the possibility of regulatory arbitrage. This possibility comes from the fact that there is no one definition of transferable securities across the 27 member states. This, very practically, means that a token that the NCA in, say Germany, qualifies as a Title 2 token, in another jurisdiction, say France, is qualified as an equity claim. The complexity of this situation creates a fundamental issue when it comes to the passporting that MiCA provides across the EU member states.

Our observation is that there is no consensus between the NCAs on how they will resolve this problem effectively and efficiently without destroying value for the firms, especially startups and SMEs employing Title 2 tokens in their business model. Hence, it is practically more efficient for the NCAs to commit to a principled solution ex-ante, instead of letting the emerging disputes and conflicts in interpretation between the NCAs result in lengthy dispute settlement procedures or European Court of Justice rulings.

Traditionally, financial instruments such as stocks, bonds, derivatives, and investment funds have been subject to regulatory oversight and classified according to established frameworks like the Markets in Financial Instruments Directive (MiFID) in the European Union or the Securities Acts in the United States. These regulatory frameworks aim to achieve various objectives, including investor protection, market integrity, and systemic stability. They establish criteria for determining whether a particular asset qualifies as a financial instrument and outline the obligations and requirements for market participants dealing with these instruments. With the emergence of crypto-assets, which encompass a wide range of digital tokens and cryptocurrencies, regulators have faced the challenge of applying existing regulatory frameworks to these novel assets. This challenge arises from the unique characteristics of crypto-assets, such as decentralisation, programmability, and global accessibility, which may not fit neatly into traditional regulatory categories. The importance of considering **the substance and technological characteristics of crypto-assets is well-founded**, especially in the context of distinguishing between MiFID II and MiCA classifications. **Assessing the substance of a crypto-asset** **involves understanding its underlying purpose, whether it represents a digital representation of value, rights, or other assets**. This assessment is crucial for determining the regulatory treatment of the asset and ensuring alignment with the objectives of relevant regulatory frameworks. By focusing on both substance and technological characteristics, National Competent Authorities (NCA) can effectively differentiate between different classes of crypto-assets and apply appropriate regulatory standards. This approach facilitates regulatory clarity, enhances investor confidence, and supports the development of a vibrant and responsible digital finance ecosystem.

Following up on issues raised in responses to previous questions, we stress the necessity for precise criteria that distinctly separate MiFID II financial instruments from MiCA crypto-assets. These criteria should be grounded in tangible features, rather than on the speculative intentions of investors for profit. Echoing our response to Question 2, we emphasise that rights similar to those granted to securities are very relevant for this classification and must not be confused with the governance rights within blockchain protocols, which differ substantially from corporate shareholder voting rights found in traditional securities.

Moreover, as we discussed in response to Question 1, the concept of 'investor intent' is not anchored in EU law and therefore doesn’t provide a good ground for classifying a crypto-asset as a security as it risks arbitrariness. We maintain our recommendation to exclude capital gains considerations from the guidelines and focus on the actual rights conferred by the asset.

As we discussed in response to Questions 4 and 7, a clear distinction is needed between utility tokens or hybrid tokens with utility functions, on the one hand, and collective investment undertakings on the other hand. Such tokens generally serve specific commercial or industrial functions and do not fit within the financial instrument category, this distinction should be acknowledged to avoid misclassification of assets.

***Recommendation:*** *We call on ESMA to explicitly state, and the NCAs to explicitly commit to the principle that there is no hierarchy between MiCA and MiFID2 and that the passport granted by one NCA will be automatically respected by every other EU and EEA jurisdiction.*

<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>

We welcome the effort of ESMA to bring clarity to the space of NFTs. NFTs embody a natively digital expression of creativity and culture, offering new platforms and tools for creators and the opportunity for creators to reach audiences and build communities for their works never before imaginable. NFTs also empower the ability for collectors to truly own creative works in the form of NFTs, with indisputable provenance and blockchain-based proof against counterfeiting, bots and AI.

In addition, as a technology, NFTs embody natively digital property rights for the internet of value, recorded on the blockchain, for the broad universe of things (including but not limited to intangible things) that are non-fungible. Although NFTs are referenced or implemented as an intangible yet identifiable digital thing, it must also be emphasised that NFTs are a new technology. Any “one size fits all” approach to this nascent technology must be avoided at this early stage.

We expect that over time NFTs will form an integral part of many new digital business models, and legal certainty is sine qua non for allowing innovative value propositions to flourish.

We welcome the decision of the EU co-legislative bodies to refrain from over-regulating an emerging technology option like NFTs. The decision to exclude NFTs from the remit of MiCA was a pragmatic decision at this stage of market and technology maturity. We understand that after the 30th of December 2024, a new recommendation may come from the European Commission. However, until further legislative initiatives arise, we strongly recommend that ESMA ensure that its guidelines to the National Competent Authorities (NCAs) will promote legal clarity and regulatory certainty across the 27 Member States, avoiding undue complications, piecemeal interpretations or premature line-drawing.

Ensuring that NCAs will have clear guidelines is of paramount importance. A fragmented regulatory environment and divergent cross-border interpretations of the regulation can only harm artists and creators in the emerging NFT space, impairing the scope for artists and creators in the visual and other arts to produce and distribute their works and connect with their collectors and communities. This fragmentation and divergence would also harm the overall market, especially smaller start-ups and SMEs employing NFTs in their business models. In that light, a case-by-case approach is welcome only to the extent that it does not generate different interpretations between the Member States. Any approach that would confer different regulatory status upon NFTs within the same collection would cause widespread confusion.

**A. Focus on substance over form**

GBBC agrees with the view of ESMA that the substance of the NFT is the dominant criterion and that if an NFT in its substance qualifies as a financial security, it must fall under the remit of the pertinent financial regulations. We also agree that if an NFT in its substance qualifies as an Other Crypto-asset, Asset Referenced Token, or E-money Token, then it should fall under MiCA in that capacity.

**Substance over form**. In principle, the classification of crypto assets should be considered on a case-by-case assessment, taking into consideration the nature of the underlying asset (substance over form). In other areas of Union law such as treatment for VAT purposes, a working paper was recently circulated by the Commission and analysis is still ongoing as use cases continue to be identified and those with relevant expertise start to apply their analysis.[[1]](#footnote-1)

*Recommendation: GBBC concurs that the substance of the NFT’s function determines the classification of the NFT.*

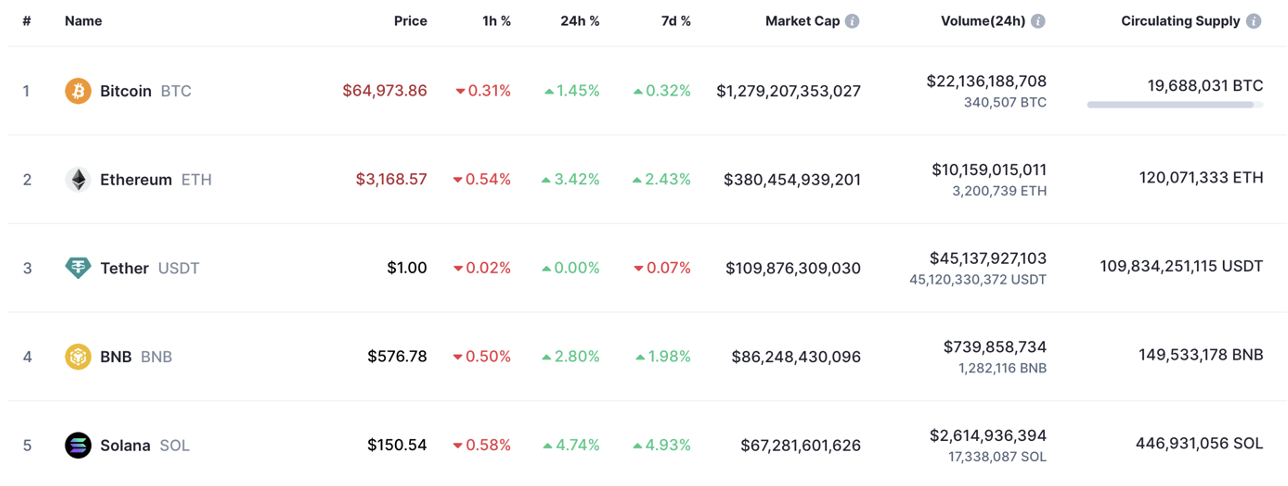
**B. NFTs as part of a “large series or collection” in relation to “uniqueness” and “non-fungibility”**

None of the terms “large”, “series” nor “collection” is defined anywhere in MiCA, nor is it even clear whether the word “large” modifies " both"series " and collection” or just “series”.

We believe that the language of MiCA recital 11 as to whether an NFT is part of a “large series or collection” is highly ambiguous and must be considered in light of proportionality and available data and metrics – including typical metrics for number of tokens for recognized fungible crypto asset tokens. Whether or not an NFT is part of a collection or series or not must not be in and of itself the sole indicator of uniqueness or fungibility. Available data is persuasive that this alone is among the poorest possible indicators.

**6.B.1 – Metrics of fungible tokens**:

Before addressing NFT metrics it is helpful to recognize the vast number of tokens in fungible crypto assets. This table reflects the top five crypto assets by “market capitalization” as of 21 April, 2024, and we draw your attention to the column on the right titled “circulating supply”.



*(Source – coinmarketcap.com 21 April 2024)*

First is Bitcoin (BTC), whose algorithm limits it to 21 million tokens. Of these, the current circulating supply is approximately 19.68 million. Each bitcoin is divisible into 100 million “satoshis” or “sats”, so the current circulating supply is approximately 1.968 quadrillion satoshis. Second is Ethereum (ETH), whose algorithm does not cap the number of potential tokens. Each Ethereum token is divisible into 1 billion “gwei”. Current circulating supply is over 120 million ETH, so total circulating supply based on divisible sub tokens is 120 quadrillion gwei. Third is tether (USDT) with over 109 billion fungible units; fourth is BNB with 149 million fungible tokens; and fifth is Solana (SOL) with over 446 million fungible tokens, each divisible into 1 trillion “lamports” so there are 446 quintillion “lamport” tokens.

*Recommendation: Because fungible tokens commonly number in the hundreds of millions, billions, trillions, even quadrillions or quintillions, this scale for fungible tokens should be the benchmark against which whether an NFT is part of a “large series or collection is understood.*

**6.B.2 – Metrics of Non-Fungible Tokens**

Today, by contrast, many popular NFTs are released in collection sizes of 10,000. Others may be in smaller or larger collection sizes.

We believe this analysis will help ESMA and NCAs appreciate that this new technology makes mathematically provable uniqueness and nonfungibility achievable at a larger scale for creators than previously possible while ensuring the distinctness and individuality of the creative outputs.

These collection sizes are “ant-sized” in number compared to the number of tokens of fungible crypto assets. Fungible tokens can typically be subdivided– for example, there are 1 billion sub tokens in a single ETH or SOL – whereas a collectible NFT is characteristically integral and indivisible.

This table shows the number of NFTs in certain of the most popular NFT collections:

|  |  |
| --- | --- |
| **Collection Name** | **Number of NFTs** |
| CryptoPunks | 10,000 |
| Pudgy Penguins | 10,000 |
| BoredApeYachtClub (BAYC) | 10,000 |
| Chromie Squiggles | 10,000 |
| Fidenzas | 1,000 |

**6.B.2.1 - CryptoPunks**

CryptoPunks comprise 10,000 unique collectible characters with proof of ownership stored transparently and visible on the Ethereum blockchain. While there are 10,000 CryptoPunks, based on the parameters of the algorithm this represents 0.00000011% of the total number of CryptoPunks (over 922 million) that could have been created if one of every permutation of the traits and attributes had been minted. Thus, while 10,000 understandably sounds initially large for any set of anything to be unique and non-fungible, this is actually, in context, a provably minute number relative to the population of 922,453,598 that could have existed.

All of this information is transparent, visible and verifiable on the blockchain. Please find in Appendix A calculations which illustrate how the number of all possible combinations was found.

While there is no such thing as an image of a fungible token such as a Bitcoin, Ethereum or Solana token, images of all 10,000 CryptoPunks NFT tokens can readily be viewed on the blockchain.

**Appendix B** includes images of some CryptoPunks listed as recent sales in April 2024.

**Appendix C** elaborates on this topic through the case study of the Pudgy Penguins Collection.

It would be an absurd outcome for an NCA to determine that of a collection of 10,000, some meet a standard of being sufficiently unique and non-fungible, thus falling outside MiCA, while others do not meet the standard and thus fall within MiCA. Inconsistency within particular collections would be an unworkable standard for creators, collectors and market participants.

Furthermore, in the spirit of advancing clarity and precision within this domain, we anticipate the evolution of the ISO DTI standard, which currently encompasses fungible tokens on distributed ledger technology. Forecasts indicate an extension to include NFTs by the end of the current year, which will enable the application of the same principles of identification as set forth above. In line with this expectation, we advocate for the incorporation of the ISO 24165 DTI code as a reference mechanism for crypto-assets in our discourse. Such use would offer unequivocal distinction.[[2]](#footnote-2)

*Recommendation: GBBC believes associating fungibility and uniqueness with an NFT’s collection or series instead of its individual substance lacks proportionality in relation to the size of NFT collections relative to that of fungible token collections, as well as to the provable uniqueness and scarcity of NFTs within the collection. We believe such an approach would generate unnecessary and unjustified divergence in the views of different NCAs, harming the ecosystem unnecessarily.*

*We also strongly recommend against any approach that could bifurcate an NFT collection by allocating some to meet a standard of being sufficiently unique and non-fungible, thus falling outside MiCA, while others do not meet the standard and thus fall within MiCA. An example of this would be determining that some CryptoPunks are unique and non-fungible, but others are not, or that some Penguins are unique and non-fungible while others are not.* ***This would literally be determining that “some animals are more equal than others' '*** *– which we believe would be an inadvisable standard for ESMA to promulgate and would be unworkable for NCAs to apply. How for example would Sothebys or Christies know which category a work fell into, and whether they needed to comply with MiCA requirements on some digital art sales but not others?*

**C. Interdependence of value and Fungibility**

ESMA suggests the “interdependency” of the value of NFTs that are part of a collection is an indicator of a lack of fungibility.

GBBC believes that this criterion is regulatory not robust and methodologically very weak to provide the NCA with a reliable criterion or to provide creators and market participants with predictability, regulatory certainty and convergence.

It is not uncommon for heterogeneous (e.g. non-fungible) artworks such as individual paintings or other creative works by a particular artist, school of artists or similar categorization to increase or decrease in light of overall market conditions, currency exchange variations and market trends, as well as general economic conditions. This applies to all manner of collectibles and other items - watches, baseball or football cards, Warhol prints, Picasso paintings, Rodin sculptures, or collectible stamps and coins with varying degrees of scarcity or rarity. Movements up or down in any artist’s work often reset expectations of where the market might value their outputs for subsequent purchase or sale. Such movements are not regarded as diminishing the individuality and uniqueness of any particular work in non-NFT contexts.

It is evidenced that crypto-assets and other types of consumer activities follow similar pricing and cyclical patterns. When the economy is in difficulties, people may spend less on art, jewellery, expensive watches, or restaurant meals, yet this is not considered to render any of the foregoing as lacking uniqueness or individuality. It should not be necessary to establish that there are no “countercyclical NFTs” and that NFTs are somehow immune to economic or other cycles. Consequently, it is extremely problematic to establish causality in the price of two NFTs and link this causality with non-fungibility.

Moreover, these types of market movements do not bring the above referenced collectible assets within the remit of NCAs. Not only is it outside their general area of competence but would also initiate a tremendous misallocation of scarce regulatory and supervisory resources.

*Recommendation: GBBC believes that linking the uniqueness and fungibility of NFTs that are part of a collection with the interdependence of their value is a methodologically mistaken approach because correlation does not establish causality. Applying a requirement to NFTs that they, alone among all intangible and tangible goods and services, be immune from economic cycles in order to demonstrate “uniqueness” and “non-fungibility” would be arbitrary and unrealistic.*

*We advocate for robust methodologies that can only increase the uniform approach between the Member States, and the value of interdependence cannot qualify as an indicator or criterion of the lack of fungibility. Moreover, any guideline on this basis can only unnecessarily increase the complexity of the evaluation of fungibility, harming thus the ecosystem, and especially creators, collectors, their communities, and SMEs and startups.*

**D. Market view and Fungibility**

ESMA suggests that the “market view” of an NFT that is part of a collection can lose its uniqueness and non-fungibility despite the different attributes between the NFTs. Similarly to the case of “interdependence of value” specified above, “market view” is also methodologically weak and analytically not a useful criterion to be linked with NFT’s uniqueness. Market view is an elusive concept, and the only way to capture it is in the pricing of an NFT. The existence of algorithmically unique attributes visible to all, enduring immutably and provably on the blockchain, persists in perpetuity to ensure uniqueness and non-fungibility, whereas the price of an NFT is evolving and lacks permanence.

**Appendix D** illustrates the issue with the concept of the market view on the example of floor penguins.

This proposed approach by ESMA would also run into the same problem as discussed above, in the event that some percentage of NFTs are priced or traded at or close to the market “floor” while others are priced or traded at different levels, like the $16 million CryptoPunk 3100. It would be an absurd outcome for an NCA to determine that of a collection of 10,000, some meet a standard of being sufficiently unique and non-fungible, thus falling outside MiCA, while others do not meet the standard and thus fall within MiCA. Inconsistency within particular collections would be an unworkable standard for creators, collectors and market participants.

*Recommendation: GBBC believes that linking the uniqueness and fungibility of NFTs that are part of a collection with the “market view” of those NFTs despite the different attributes of the NFTs is a mistaken approach lacking robustness and analytical value, that only adds unnecessary complexity in the classification of an NFT. A potential outcome of this approach could be determining that some CryptoPunks are unique and non-fungible, but others are not, or that some Penguins are unique and non-fungible while others are not. This would literally be determining that “some animals are more equal than others” – which we believe would be an inadvisable standard for ESMA to promulgate and would be unworkable for NCAs to apply. Again, we recommend simplicity and clarity focusing on the substance of the NFT as the only safe approach for its classification independent of subjective considerations like “market view” and independently of the size of the collection.*

**E. Additional rights granted to NFT holders**

ESMA suggests that the utility function of NFTs may affect their interchangeability. The reasoning of ESMA is that if an NFT confers access rights or grants exclusive benefits, then this is an indicator that the utility of the NFT is rather replicating the function of a utility token and thus falls under Title 2 of MiCA. We believe that it is possible for some NFTs to grant similar benefits or access rights to their holders. However, the existence of those additional benefits does not alter the substance of the NFT.

We believe the presence of various types of utility does not and should not alter the status of an NFT to bring it within the remit of NCAs under MiCA. (Unless the additional features fundamentally alter its status in terms of whether it becomes for example a financial instrument or regulated security.)

An analogy to highlight this point is that purchases of in-game assets in the Roblox ecosystem total billions of Euros per year.[[3]](#footnote-3) These in-game assets are valued by the market within the Roblox ecosystem, some may be relatively equivalent in value (or “fungible” even if not identical) while others are not. A sword or other weapons or costumes or disguises may confer utility to the purchaser or owner. Yet it would not be a good use of scarce regulatory or supervisory resources for NCAs to regulate these under MiCA. Ownership of an NFT may allow its holder to attend events with other aficionados of that collection - a brunch for CryptoPunk owners or a drinks event with other Penguin owners - or an advance opportunity to buy new work from the same artist or collection, the same way an art gallery today provides priority for openings and access to new works for their top collectors.

Example: An NFT that depicts “D. A. Maradona” confers access to the final of the Football World Cup game – VIP seat 622. Another NFT that depicts “Pele” confers access to the Final of the Football World Cup game – Regular Seat 1084. The very fact that the NFT grants a similar additional right of access benefit does not mean that the NFT loses its uniqueness or becomes interchangeable.

*Recommendation: The ownership of an NFT may grant additional utility to the holder. But this utility comes in addition to the utility of the NFT per se which derives from its uniqueness of attributes. GBBC believes that additional benefits are independent of the uniqueness of an NFT as they are added on top of something that is already non-fungible. Thus, it is not associated with the essence of the fungibility of the NFT. Consequently, we recommend that ESMA should clarify to NCA not to confuse the non-fungibility of a token with potential additional benefits.*

**G. Unique Identifiers and Fungibility**

We believe that the proposed approach of ESMA with respect to editions or series of NFTs that are identical defeats the purpose of exclusion from MiCA.

Let us start with the example of traditional art publishing. If for example, the Louvre publishes reproductions of the Mona Lisa as postcards, prints or otherwise, whether in a collection of 100, 50,000 or 500,000, no one would suggest that these are anything other than a collectible consumer product.

Should the Louvre do so in digital form, for example as NFTs, it seems absurd that these should fall within the regulatory perimeter of MiCA in its present form. Moreover, NCAs accustomed to the regulation of financial products and services lack the resources, expertise and mandate to oversee such products and services.

Several academic institutions in the union have begun issuing academic credentials such as diplomas and certificates in the form of NFTs. These may be identical except for the recipient’s name, which could be viewed under the proposed ESMA approach as just a unique identifier. Accordingly, these should clearly be excluded from the scope of MiCA.

*Recommendation: Collectible art NFTs, no matter whether unique and non-fungible, or in editions of small or large sizes, should be treated as excluded from MiCA, in accordance with the plain intent of the legislation. Diplomas and certificates in the form of NFTs should also be treated as excluded.*

In Appendix D you can find other comparative examples of data variations within leading NFT collections

<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>

It is true that the tokenization of value, smart contracts, oracles and artificial intelligence can generate business model opportunities that transcend the limits and the frameworks that regulators used to be comfortable with. This is apparent in the design of “smart assets” – assets that combine one or more digital technologies and create a space of possible uses and utilities that is much wider than the assets markets and regulators have experienced so far.

This new space of possibilities coming from smart assets is still in its infancy. The issuers are still experimenting with hybrid tokens, the consumers are still exploring their uses and the regulators are trying to understand the implications of these innovations in the areas of their regulatory treatment, financial stability, and consumer and investor protection.

Innovators and entrepreneurs ask the regulators to ensure proportionality. For example, a token that behaves 90% as a utility token and 10% as an equity is treated by the regulators as 100% transferable security. This may generate immense compliance costs for entrepreneurs exploring innovative business models in Web3.

As in the case of the classification of any other crypto-assets also in terms of hybrid-type tokens, the classification should be based following the principle of “**substance over form**”. In the context of crypto-assets, this principle is particularly relevant due to the unique nature of these assets and the challenges they pose for traditional accounting and regulatory frameworks. **Crypto-assets, such as cryptocurrencies and tokens issued through blockchain technology, often challenge traditional notions of ownership, control, and valuation**. The substance of a transaction involving crypto-assets may differ from its legal form, requiring careful consideration to accurately reflect the economic reality of the transaction.

For example, hybrid tokens that have utility, will exhibit features or characteristics that include the utility of providing access to a “good or service that exists or is in operation” (exempted by MiCA Article 4(3)(b) and shows the commercial or industrial purposes for the collective investment undertaking analysis), or have tokens issued as a reward for validating or maintaining their ledger (exempted by MiCA Article 4(3)(b)), and may operate in a fully decentralised manner, without any intermediaries, which Recital 22 exempts from MiCA regulation of crypto asset services. MiCA’s application to these hybrid tokens should be assessed proportionally, taking into account the materiality of the characteristics and features of the token.

GBBC is dedicated to one mission: innovation with responsibility. This mission is based on two principles: technological neutrality coupled with business model neutrality. However, innovation does not happen in an economic, financial, social and cultural vacuum. Consequently, we are open to new technological possibilities taking into consideration that the regulatory authorities always lag behind and need some time to adjust their thinking.

***Recommendation:*** *GBBC believes that the approach suggested by ESMA is the appropriate one, at least for the time being. We strongly encourage the Regulatory Authorities, though, to recognise explicitly that the treatment of hybrid tokens is rather disproportional and promise to keep working with the industry and the blockchain associations to solve this problem in a way that liberates innovation, without compromising consumer and investor protection, market integrity and financial stability.*

*A comprehensive evaluation of all characteristics of a token is essential, rather than relying solely on a methodological analysis. We recommend that the assessment process does not prematurely conclude based solely on a singular aspect, like the method of a token, especially if it constitutes a minor component. Instead, a holistic review should be adopted, where every intrinsic property and potential function of the token is considered.*

<ESMA\_QUESTION\_MIC3\_7>

*(To be submitted as separate PDF)*

**APPENDIXES:**

**APPENDIX A: All potential combinations of the CryptoPunks population[[4]](#footnote-4)**

|  |  |  |
| --- | --- | --- |
| **Collection: CryptoPunks** |  |  |
| **Trait** | **Number of properties** | **Options** |
| Type | 5 | Alien, Ape, Zombie, Female, Male |
| Facial Hair | 12 | Mustache, Long Beard, Goatee, Sideburns, etc. |
| Hair | 25 | Ponytail, Spiky, Mohawk, etc. |
| Headwear | 16 | Cap, Fedora, Beanie, etc. |
| Mouth | 6 | Smile, Frown, Open Mouth, etc. |
| Neckwear | 3 | Scarf, Chain, None |
| Smoking Device | 3 | Cigarette, Pipe, Vape |
| Other | 3 | Clown Nose, Earring, Medical Mask |
| **Results** |  |  |
| Min Properties: | 0 |  |
| Max Properties: | 7 |  |
| Size [0] : | 1 |  |
| Size [1] : | 87 |  |
| Size [2] : | 3,111 |  |
| Size [3] : | 59,771 |  |
| Size [4] : | 678,525 |  |
| Size [5] : | 4,743,645 |  |
| Size [6] : | 20,819,917 |  |
| Size [7] : | 57,554,361 |  |
| **Total number of combinations:** | 922,453,598 |  |

**APPENDIX B: Non-fungibility and collection size – CryptoPunks**

****

Although these represent only 48 NFTs from the entire collection, the variety of traits and attributes can readily be observed and one would be hard-pressed to describe these as “fungible”.

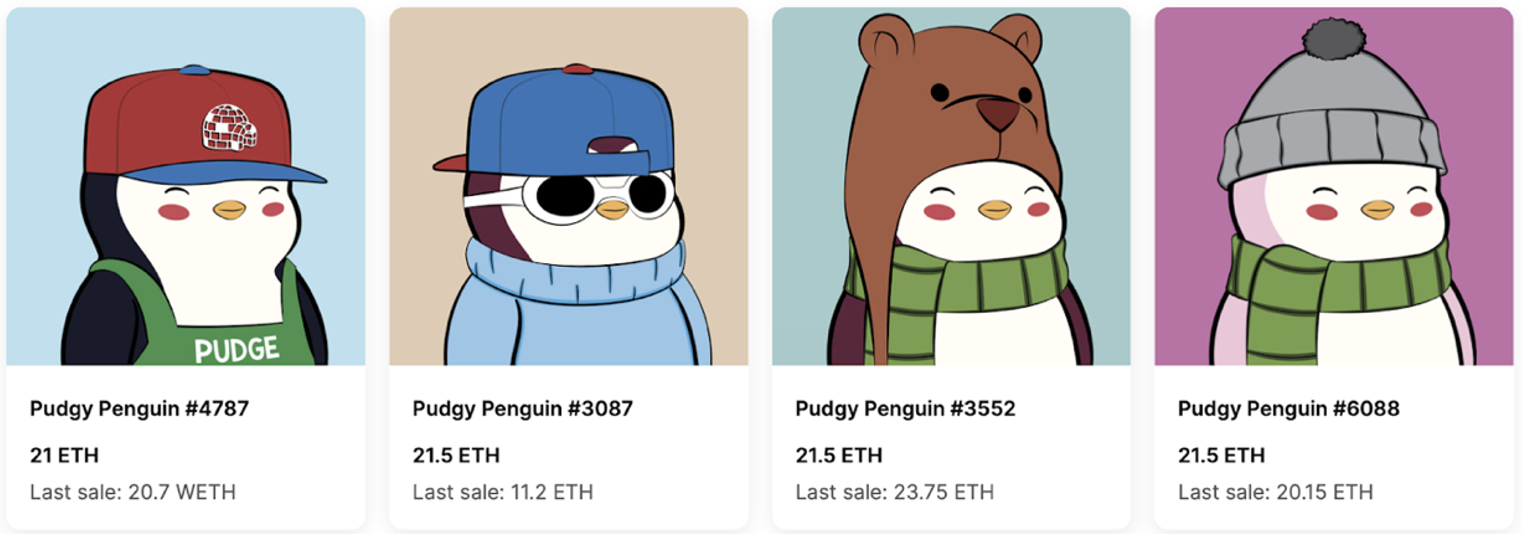
While some CryptoPunks may be purchased and sold, others tend to be prized by individual owners who utilise their CryptoPunk as the avatar or visual image for their digital identity in social media.

**APPENDIX C: Non-fungibility and collection size - “Pudgy Penguins”**

Pudgy Penguins (Penguins) are another series of 10,000 NFTs with proof of ownership stored on the Ethereum blockchain. Based on the parameters of the Penguin algorithm this represents 10,000 out of over 21 million potential permutations, or 0.0000046%.[[5]](#footnote-5)

|  |  |
| --- | --- |
| **Collection: Pudgy Penguins** |  |
| **Trait** | **Number of properties** |
| Skin | 15 |
| Background | 13 |
| Face | 27 |
| Body | 64 |
| Head | 53 |
| **Total number of combinations** | 21,700,677 |

Images – here are images of some Pudgy Penguins listed for sale at roughly equal prices in February 2024 (source – OpenSea). It is easily apparent that their appearance is quite different.



Moreover, the slogan of the Penguins community is “I am my Penguin and my Penguin is me”. This reflects that many Penguin community members utilise these as their avatars in their social media presence, and often extend elements of their Penguin’s appearance into their physical world presence.

It can further be observed that the uniqueness and non-fungibility of such Penguins often lies in the eyes of the beholder, who select Penguins that resonate with them based on their particular blend of characteristics.

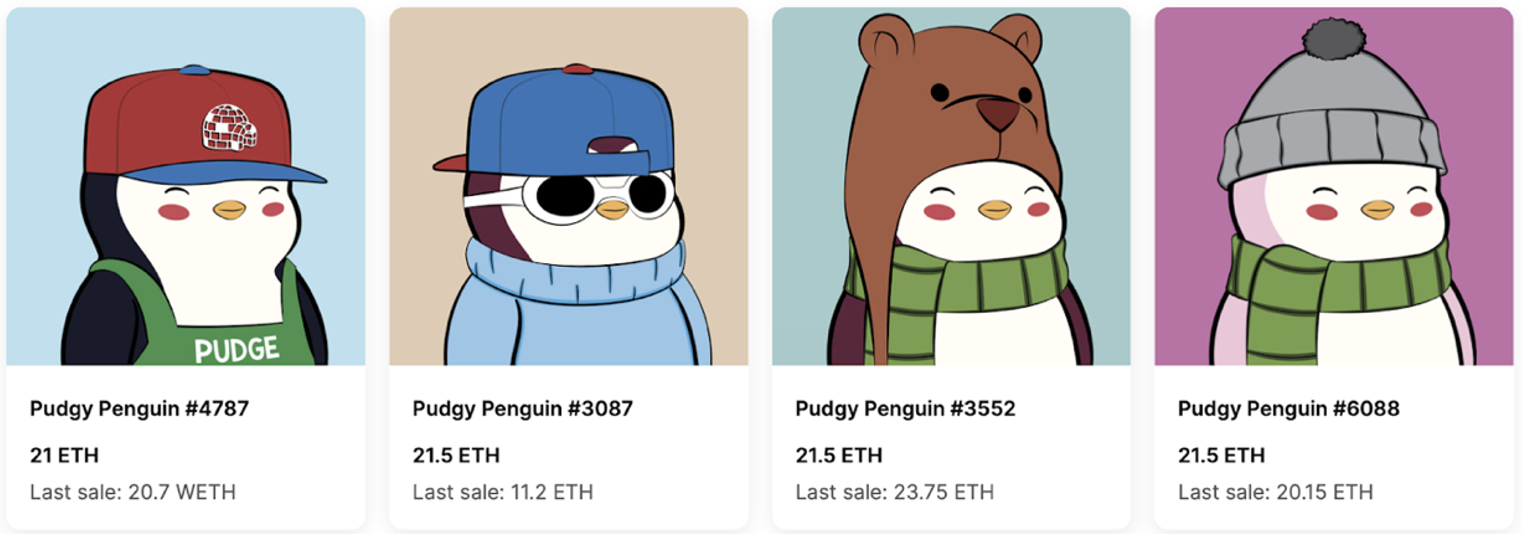
**Appendix D: Market view and Fungibility – example of pricing Floor Penguins**

Example 1: We have earlier reviewed the metrics derived from the maths of algorithms, permutations and probabilities associated with NFT collections. For example, it is frequently observed that NFT collections may have 1000 or 10,000 (or a memetic number in between) instances of NFTs. Well known examples in the NFT space include the generative art collection known as “Fidenzas” by Tyler Hobbs (1000), “Chromie Squiggles” by Snowfro (1000), CryptoPunks (10,000), Bored Ape Yacht Club (10,000) and Pudgy Penguins (10,000).

At any given moment there may be some numbers that are listed for trading at prices at or near the lowest listing price – the market typically refers to these as “floor” Punks, floor Penguins, floor Squiggles etc.

It would be problematic to determine that all 10,000 NFTs in a collection should be deemed to be fungible and non-unique because some subsets were listed during a particular time window within a particular range. This in our view fails to comport because 1 – as discussed above an entire collection of 10,000 can be shown to be probably scarce, unique and non-fungible, for example in relation to the vastly larger fungible token sets. 2 – even if one took the view that market view rendered certain collection NFTs to be fungible and interdependent, it would be problematic for an NCA to determine that some NFTs within a single collection are unique and non fungible, while others are not, and then to apply that view statically in perpetuity.

It should be noted that these are “offer” prices from holders actually holding the NFT. The offer price is not necessarily indicative of the market price, which would involve the bid price and traded prices as well as comparability of recent sales and comparability of the actual NFTs transacted. In addition, prices are most typically quoted in Ethereum (ETH), which itself rapidly fluctuates to varying degrees in relation to the Euro, dollar or other fiat currency.

Revisiting the Floor Penguins:  


The sellers offering these NFTs implicitly view them as identical in price, however it must be remembered that the offer price is not necessarily the price a willing buyer is willing to pay. The offer price is not necessarily the market price.

Moreover these NFTs are unique and non-fungible; individual collectors might respond to them differently as if purchasing a household pet; our analytics tools would find numerous different traits and attributes. In the eye of the beholder, a Penguin enthusiast typically picks one they relate to in some way.

**Appendix E: Other Leading NFT Collections – collection size and non-fungibility[[6]](#footnote-6)**

|  |  |
| --- | --- |
| **Collection: Bored Ape Yacht Club** |  |
| **Trait** | **Number of properties** |
| Eyes | 23 |
| Mouth | 33 |
| Clothes | 43 |
| Background | 8 |
| Earring | 6 |
| Fur | 19 |
| Hat | 36 |
| **Results** |  |
| Min Properties: | 4 |
| Max Properties: | 7 |
| Size [4] | 8,251,003 |
| Size [5] | 90,959,214 |
| Size [6] | 502,672,536 |
| Size [7] | 1,071,537,984 |
| **Total number of combinations** | 1,673,420,737 |

|  |  |
| --- | --- |
| **Collection: Chromie Squiggle by Snowfro** |  |
| **Trait** | **Number of properties** |
| Type | 6 |
| Spectrum | 4 |
| Segments | 9 |
| Colour Direction | 2 |
| Height | 2 |
| Colour Spread | 47 |
| Steps Between | 3 |
| Start Colour | 256 |
| End Colour | 255 |
|  |  |
| **Results** |  |
| Min Properties: | 7 |
| Max Properties: | 9 |
| Size [7] : | 11,367,137,304 |
| Size [8] : | 15,032,261,664 |
| Size [9] : | 7,952,670,720 |
| **Total number of combinations:** | 34,352,069,688 |

|  |  |
| --- | --- |
| **Collection: Fidenza by Tyler Hobbs** |  |
| **Trait** | **Number of properties** |
| Have Margin | 2 properties |
| Turbulence | 3 properties |
| Soft Shapes | 2 properties |
| Outlined | 2 properties |
| Collision Check | 3 properties |
| Shape Angles | 2 properties |
| Spiral | 2 properties |
| Colours | 14 properties |
| Super Blocks | 2 properties |
| Scale | 7 properties |
| Density | 4 properties |
|  |  |
| **Results** |  |
| Min Properties: | 1 |
| Max Properties: | 11 |
| Size [10] : | 932,736 |
| Size [11] : | 225,792 |
| **Total number of combinations:** | 1,158,528 |

The above figures reflect that a collection of 1,000 or 10,000 NFTs is provably unique and non-fungible and represents only a small fraction of the potential outputs of an algorithm.

1. On 21 March 2023, the European Union's VAT Committee (the VAT Committee) published a working paper (<https://circabc.europa.eu/ui/group/cb1eaff7-eedd-413d-ab88-94f761f9773b/library/7d1ef2eb-b820-4866-a155-785e2373fb80/details>). Initial VAT reflections on non-fungible tokens (NFTs). The aim of the document is to address the value-added tax (VAT) consequences of NFT-related matters to generate meaningful discussions within the VAT Committee with the objective of reaching a common position. The VAT Committee does not take positions in the working paper. In summary, the working paper includes the following points in relation to the VAT treatment of the creation and supply of NFTs:

   1. The working paper considers NFTs to be services (and not goods) as a rule, with the possible exception of NFTs that can be redeemed for specific goods. If NFTs are understood as legal contracts, for example as in property title for a physical good, the transfer of the NFT should qualify as a supply of the said good, according to the working paper. 2. The working paper provides an overview of the nature of NFTs as well as the way NFTs are created, traded and sold, doing so by comparing NFTs with property titles, vouchers, composite supplies and electronically supplied services. It also addresses whether certain payments (e.g. gas fees) could qualify as consideration for a supply from a VAT perspective, and how to determine the taxable amount. 3. The paper also includes an overview of available guidance in relation to the VAT treatment of supplies linked to NFTs in the Member States and European Economic Area. [↑](#footnote-ref-1)
2. This is illustrated by the identifiers for major tokens: Bitcoin (DTI:4H95J0R2X), Ethereum (DTI:X9J9K872S), TetherUSD (FFG DTI: L09Q657BK), BNB (FFG DTI:8N2VXJKB1), Solana (DTI:20J63Z4N3). This adoption not only underscores our commitment to precision but also aligns with broader industry trends towards standardisation and unambiguous categorization. [↑](#footnote-ref-2)
3. See e.g. <https://www.reuters.com/technology/roblox-forecasts-strong-2024-bookings-in-game-spending-gets-holiday-boost-2024-02-07/#:~:text=T>)%20%2C%20opens%20new%20tab%20PlayStation,billion%2C%20according%20to%20LSEG%20data [↑](#footnote-ref-3)
4. https://blog.nftvaluations.com/cyberpunks-universe/ [↑](#footnote-ref-4)
5. Source: NFTValuations [↑](#footnote-ref-5)
6. Source - data analysis provided by NFTValuations.com [↑](#footnote-ref-6)