

Crypto Council for Innovation's (CCI) Response to ESMA's Consultation Paper on the Draft Guidelines on the Conditions and Criteria for the Qualification of crypto-assets as Financial Instruments

Q1. 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?

CCI fully supports the overarching objectives of MiCA which are to create a single market for the offering of crypto-assets and for the provision of related services across the Union. A core success factor for MiCA will be the ease for offerors and crypto-asset service providers (CASPs) to operate across the Union. We therefore welcome ESMA's efforts to support the development of a common rulebook and to foster convergence in National Competent Authorities' (NCAs) approaches to supervision. ESMA's guidelines, once finalised, adopted and applicable, have the potential to reduce misunderstanding and misinterpretations of policy intent. However, the 'comply or explain' nature of guidelines published by the European Supervisory Authorities (ESAs) may not address divergence in Member State approaches and may act counter to MiCA's overarching objectives.

MiCA envisages that NCAs should be able to request opinions from the ESAs on the classification of crypto-assets, including the classification proposed by offerors or persons seeking admission to trading. Furthermore, MiCA envisages that the classification of a crypto-asset might be challenged at any time thereafter, including for existing crypto-asset that are already being bought, sold and held by investors (Recital 14, MiCA).

Different or conflicting classifications of the same crypto-asset by two or more NCAs will likely create significant challenges for offerors and CASPs - counter to the objectives of MiCA and contrary to internal market outcomes. The publication of an opinion from an ESA, including ESMA, on the classification of crypto-assets has the potential to provide greater legal certainty and enhance the ease for offerors and CASPs to operate across the EU (e.g., if the opinion harmonised NCAs' approaches.) However, the issuance of an opinion may also result in material and likely unintended consequences for the market - including EU consumers who are buying, selling or holding the crypto-asset - and for offerors and CASPs providing related services or undertaking related activities. For instance, the publication of an opinion that classifies a crypto-asset as a financial instrument (therefore subject to MiFID) or deems a non-fungible token (NFT) to be not unique and fungible (therefore subject to MiCA) if viewed negatively by the market, would likely result in price volatility and potentially market disorder.

The ESAs, including ESMA, should put in place a structured framework for the proposed publication of an ESA or NCA opinion on the classification of a crypto-asset to limit likely unintended consequences for the market, including for EU consumers and firms and particularly for existing crypto-assets. If the ESAs (individually or jointly) plan to publish an opinion on the classification of an existing crypto-asset, they should initially issue the opinion in draft form for public comment over a 4-6 week period. During this consultation period, the ESAs

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should consider feedback and, as relevant, any appeals from offerors, CASPs and consumers either for or against the opinion. The ESAs should pay particular regard to the implications for EU consumers who are buying, selling or holding the crypto-asset in question before issuing their final opinion.

While a structured framework is unlikely to mitigate all market effects arising from the publication of an opinion on the classification of an existing crypto-asset, it will have the potential to reduce likely unintended consequences, such as individual or collective volatility in instrument valuations and market volatility.

Q2: 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.

We agree with ESMA's overarching approach to assessing the legal qualification of crypto-assets based on a substantive case-by-case assessment of the features, design and rights attached to a crypto-asset rather than the crypto-asset's form or 'technological envelope' (Paragraph 20, ESMA CP). ESMA should adopt a nuanced, principles-based approach to the assessment of crypto-assets which takes account of the materiality of any financial instrument related features a crypto-asset may exhibit and reflects any identified underlying risks to which users are exposed. We do not support an approach which automatically presumes a crypto-asset is covered by MiFID if it displays any financial instrument related features.

We have set out below proposed revisions to ESMA's approach to assessing negotiability and transferability, defining classes of securities, and to disregard investment purpose as a self-sufficient criterion for a crypto-asset to be classified as a transferable security.

Negotiability and Transferability

We do not agree with ESMA's broader interpretation of 'negotiability' as a criterion for assessing whether a crypto-asset qualifies as a transferable security. ESMA's proposal to base negotiability on whether an asset is 'capable of being transferred or traded' - even if inherent restrictions exist - coupled with the definition of capital markets to encapsulate 'all contexts where buying and selling interests ... meet' goes beyond the approach of most Member States and risks misclassifying crypto-assets based on form rather than substance.

As set out in more detail below, ESMA should adopt a principles-based approach to assessing negotiability which:

- does not automatically presume that the capability for a crypto-asset to be sold for fiat money or traded with other crypto-assets is sufficient to demonstrate negotiability; and
- takes account of whether legal, market, technical or other restrictions make the transfer or trading of a crypto-asset practically impossible or unlikely (even if theoretically capable) such as due to a lack of standardisation.

NCA's unanimously agreed that pure utility-type crypto-assets may fall outside Member State regulation as the rights they convey seem to be too far removed from the financial and monetary structure of a transferable security and/or a financial instrument (see Case 5, ESMA's 2019 NCA survey referenced in its advice on ICOs).

On this basis, ESMA concluded that although the crypto-asset in question can be sold for crypto-assets or fiat money, this was not sufficient to automatically deem the crypto-asset a transferable security (or financial instrument). ESMA should therefore clarify its interpretation of ‘negotiability’ to reflect that while a crypto-asset may be capable of being transferred or traded, the assessment of the qualification of the crypto-asset must take account of other factors.

ESMA should also clarify that the assessment of negotiability should take account of whether the materiality of legal, market, technical or other restrictions make the transfer or trading of a crypto-asset practically impossible or unlikely, even if theoretically capable. Furthermore, ESMA should consider carrying out further consultation to determine the principles that can be used to assess the interaction between negotiability and transferability, including the extent to which a crypto-asset can be transferred to other users without changes in its legal or technical substance (e.g., if it meets a token standard). The development of principles should seek to account for the unique characteristics of blockchain-based assets, including the ability to transfer the ownership of assets through decentralised networks rather than through intermediaries that are traditional to the capital markets.

Classes of Securities

ESMA asserts that for crypto-assets to form a class of securities, they should confer similar rights to investors. ESMA also asserts that this ensures their tradability on markets (Paragraph 32, ESMA CP). ESMA further provides that in order to form a class, crypto-assets will generally have ‘similarities’ and provide ‘access to equal rights’. Furthermore, ESMA noted in its results of its survey of NCAs on the legal qualification of crypto-assets, that certain NCAs include the right to participate in community management as one of the criteria used to define what constitutes a ‘class’ of crypto-assets.

We recommend that ESMA clarifies that the ability for users to participate in blockchain protocol governance processes, such as protocol improvement proposals, is distinct from ‘voting rights’ typically associated with transferable securities. Unlike shares and other transferable securities, participation in protocol governance processes does not allow the token holder to vote on matters of ‘corporate decision-making’ and also does not allow holders to control the issuer’s decisions.

Investment Purpose

ESMA recalls that some NCAs have domestic categories of financial instruments and other investment products that go beyond the MiFID II definition of financial instruments, on the basis that they are deemed to have an ‘investment purpose’, an ‘expectation of profit’ or a ‘promise of returns’. ESMA notes that the existence of a non-enforceable expectation of profit, without having necessarily ownership or governance rights attached, is considered sufficient for some NCAs to qualify crypto-assets as transferable securities. However, ESMA also cautions that the ‘expectation of profit’ is not a concept that is defined or even used to qualify a financial instrument under MiFID II and therefore such criteria has no clear legal basis in EU law.

We agree with ESMA’s determination that having an investment purpose is not a self-sufficient criterion to qualify a crypto-asset as a transferable security. ESMA notes that an investor may intend for investment purpose to be a qualifying criterion for a crypto-asset to be a transferable security (Paragraph 26, ESMA CP)

but we would urge ESMA not to introduce, in any way, the subjective concept of an investor's intention as a qualifying criterion for assessing a crypto-asset's legal status. As ESMA correctly recalls elsewhere in the consultation paper, the application of financial markets legislation does not depend on the actual use of any technology (Recital 9).

Q4: 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 should clarify that crypto-assets which have utility (i.e., a commercial or industrial purpose) are not units in collective investment undertakings (and their issuers, if one, are not collective investment undertakings). crypto-assets with utility often may be exchanged for goods or commodities and/or the supply of non-financial services - even in the case of hybrid crypto-assets - and therefore have a general commercial or industrial purpose. ESMA should further clarify that staking where rewards are generated solely from validation activity and does not involve discretion, trust and other characteristics of financial transactions should not be within the scope of MiFID. Such forms of staking are processes that are integral to the technology infrastructure and security of the blockchain network.

Q5: 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 should revise its proposed approach to utility token classification by adopting a more nuanced, principles-based approach which better takes account of the materiality of any financial instrument related features which a utility token may exhibit and better reflects the underlying risks to which users are exposed .

We do not agree with ESMA's broad interpretation of the scope of the MiFID II financial instruments definition with respect to crypto-assets. For instance, we note that ESMA proposes that where utility tokens confer financial rights, unless these rights are narrowly construed, then the utility token is likely to be considered a MiFID financial instrument (e.g., Paragraph 63, ESMA CP).

We support an overarching mantra of *same risk, same regulatory outcomes* and encourage ESMA to adopt a principles-based approach which reflects the risks that users are exposed to on a net basis, including where such risks are mitigated through mechanisms such as decentralisation. Unlike traditional securities, decentralised crypto-assets can be viewed as inherently 'trustless'. The transparent nature of blockchains means that all relevant information about digital assets can typically be found 'on-chain'. This means that all potential holders of crypto-assets have access to the information necessary to value and trade assets on a level playing field. This is distinct from the 'classical' information asymmetry in traditional markets where non-public information on the financial well-being of an issuer enables an assessment of the likelihood of claims against the issuer's business enterprise being met and therefore the 'fairness' of the current market price. In crypto markets, the financial well-being of the issuer or other person seeking to admit the crypto-assets to trading is likely less relevant (or irrelevant) and, coupled with decentralisation, this mitigates many of the classic risks

associated with intermediaries in traditional markets such as reliance on managerial efforts and information asymmetry.

ESMA acknowledges that utility tokens may be accompanied by governance rights (Paragraph 62, ESMA CP) and contrasts some of these rights to those for shares (Paragraph 63, ESMA CP). ESMA should clarify that the ability for a token holder to participate in the governance of a protocol, such as in respect of protocol improvement proposals, are not the equivalent of a shareholder's voting rights in a company's decision-making process. In many blockchain projects, governance is decentralised, and the original issuer's role has come to a conclusion. Decentralised governance processes allow for improvements to the protocol, but are not mandates for the issuer's decision making process.

Q6: 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.

We respectfully disagree with ESMA's proposed conditions and criteria for assessing and classifying NFTs. We are concerned that ESMA's approach could have a detrimental impact on the industry and users of NFTs in the EU. The EU co-legislators properly excluded unique and non-fungible crypto-assets from the scope of MiCA because many NFTs, such as those representing ownership of digital art or music, do not have a direct and proximate financial use case (i.e., they are not issued with the primary objective of creating a financial instrument). Furthermore, while MiCA alludes to potential suggestive indicators of fungibility, ESMA's proposal to introduce new criteria and expansive indicators of fungibility such as value interdependency as an indicator of the absence of non-fungibility risks the inclusion of NFTs within the scope of MiCA counter to the spirit and letter of the primary legislation (footnote 49, ESMA CP).

We would recommend ESMA to adopt a principles-based approach to the classification of NFTs that takes account of the predominant purpose and use of the NFT and whether the NFT represents ownership of an underlying asset. ESMA's approach should acknowledge that NFT use can be manifold and change over time, so the classification of an NFT may need to be revised. ESMA should also adopt an approach to the classification of fractionalised NFTs (F-NFTs) which avoids arbitrarily classifying the fractional parts of an F-NFTs as within the scope of MiCA based on their form rather than their substance.

ESMA should make the following changes to its proposed approach for determining whether an NFT is within MiCA's scope (summarised in the bullets below and detailed in subsequent sections of this response):

1. Add a principles-based, purposeful look-through test to assess the following for an NFT:
 - a. its predominant purpose and use;
 - b. whether it represents ownership of an underlying asset; and
 - c. whether it has a financial or non-financial use case.

ESMA should exclude by default, those tokens with non-financial use cases from MiCA's scope to reflect their limited risks to holders and the financial system, treating tokens that represents ownership of an underlying asset as that asset for regulatory purposes and applying a substance over form approach to how the NFT is being used in practice rather than the technical standard upon which it is based.

2. Revise the methodology for assessing tokens' interchangeability to take account of whether a token is 'readily interchangeable' to better align ESMA's approach with the criteria in MiCA.
3. Calibrate the proposed 'value interdependence' test with that in MiCA by incorporating the concept of 'relative value' interdependence and clarifying that value interdependence does not indicate fungibility.

Each of the proposed changes above is described in more detail below.

1. *Add a principles-based purposeful Look-Through Test*

ESMA should introduce a preliminary principles-based assessment of the predominant purpose and use of an NFT and whether the NFT represents ownership of an underlying asset. Where an NFT represents ownership of an underlying asset, then it should be treated in the same way as that asset for regulatory purposes. Consistent with a substance over form approach (Recital 11, MiCA), ESMA should analyse how an NFT is being used in practice and rather than the technical standard upon which it is based.

ESMA should supplement its preliminary look-through assessment with a secondary assessment of whether an NFT has a financial or non-financial use case. MiCA acknowledges that the unique and non-fungible nature of NFTs limits the extent to which they have a financial use and thus limits risks to token holders and the financial system, thereby justifying their exclusion from MiCA (Recital 10, MiCA). NFTs that are assessed as having a non-financial use case should therefore be determined by default to be out of MiCA's scope. Illicit finance concerns from NFTs are already being addressed through other dossiers, including the AMLR.

2. *Revise the 'Ready Interchangeability' Methodology*

ESMA should revise its proposed methodology for assessing an NFT's interchangeability to explicitly consider whether an NFT is 'readily interchangeable' with other tokens, as is set out in the MiCA criteria (Recital 10). ESMA proposes to define 'uniqueness' based on the absence of 'comparable and interchangeable attributes' and the presence of characteristics and rights that distinguish a token from the others. This proposed approach does not appropriately capture whether a token is readily interchangeable with others. For instance, an NFT representing a piece of art may have comparable characteristics to a piece of art represented by another NFT (e.g., shape, size, colour etc.) The two pieces of art may also have similar characteristics such as when they were created and their current value. They may however have been created by different artists and have values that have moved in opposite directions over the same period (e.g., one could have decreased in value rapidly and the other could have increased in value rapidly). The essential characteristics of the two NFTs would therefore appear to suggest that they are not readily interchangeable and therefore should be out of MiCA's scope.

ESMA asserts that NFTs issued "in a large series or collection" may be considered fungible and thereby covered by MiCA (Paragraph 139, ESMA CP). ESMA should clarify that being part of a series or collection does not automatically indicate fungibility and a principles-based approach should be adopted to analysing whether an NFT is unique and therefore how it should be classified. In general, NFTs in a series retain their non-fungibility: trading card NFTs (representing, for instance, a sports team) may be issued in a large series or collection, but

each individual NFT can retain its non-fungibility by, for example, representing different members of the sports team. The misclassification of NFTs in such a series as being fungible could be avoided with the principles-based approach, outlined above, which would assess each NFT in a series on its own merits.

3. *Calibrate the Proposed 'Relative Value Interdependence' Test*

ESMA should revise its proposed approach to assessing value interdependency as an indicator of fungibility. ESMA should: (i) incorporate the concept of 'relative value' rather than absolute value; and (ii) only deem material relative value interdependency to be a proximate factor in fungibility.

ESMA proposes to define 'uniqueness' based on: (i) the intrinsic connection of the individual attributes and specific utility of an NFT conferred to its holder; and (ii) the extent to which the value of one NFT influences the value of another. Furthermore, ESMA suggests that the notions of uniqueness and fungibility within the meaning of MiCA seemed to be detached from that of negotiability on a secondary market.

We agree that uniqueness and fungibility should not be linked to negotiability on a secondary market. These are fundamentally different concepts and have fundamentally different underlying drivers e.g., the presence of buyers and sellers and operations of the marketplace, none of which relate in any way to the features such as uniqueness and fungibility of the traded tokens or other assets.

We believe that ESMA's proposed approach overweights intrinsic factors driving value interdependence and underweights extrinsic factors such as overall market or user sentiment towards crypto-assets, including NFTs. ESMA notes that the market may view certain NFTs as having similar value (e.g., expressed as price) despite their unique attributes. We believe this can be extrapolated to the entire crypto market. Investors and users of crypto-assets may rationally change the value they attribute to crypto-assets in general to take account of market events, easier access to/accessibility of crypto-assets, regulatory changes or a multitude of other factors. This investor/user behaviour may drive most, if not all, prices of crypto-assets up or down and within this overall market movement, certain assets will increase or decrease more in value/price than others. These fundamental characteristics are similar to those in other financial and non-markets.

MiCA acknowledges that a core criteria for determining the uniqueness and non-fungibility of crypto-assets traded in the marketplace is the relative value of one crypto-asset to another (Recital 10, MiCA). ESMA should therefore revise its methodology to assess the relative value interdependency (rather than the absolute value interdependency) between NFTs as one measure of uniqueness. ESMA should only deem relative value interdependency that is material be a proximate factor in any assessment of uniqueness or fungibility.

ESMA acknowledges in passing in its proposed approach that there are instances where genuine NFTs will exhibit value correlation precisely because of their common features – such as the same author, as is the case with art in the real world (footnote 49, ESMA CP). This is a critical and core aspect of the assessment of the materiality of relative value interdependency as the value of NFTs, including the correlation in their pricing may change over time due to factors that are entirely unrelated to uniqueness or fungibility. For instance, the NFTs of digital collectibles related to a sports team may increase in value in an independent manner, but each NFT may represent a different sports player or sports moment (e.g., a match) and therefore retain their fungibility.

ESMA should revise its proposed approach to clarify that value interdependence is not a proximate factor in fungibility.

Fractionalised NFTs

ESMA should adopt a principles-based approach to the classification of F-NFTs to avoid arbitrarily classifying the fractional parts of an F-NFTs as within the scope of MiCA based on their form rather than their substance. As set out in more detail below, ESMA's proposed approach to classifying F-NFTs should be revised to:

- take account of how likely or possible it is that the complete ownership of an F-NFT can be reconstituted; and
- clarify that F-NFTs made up of fractionalised parts which have limited financial use - even if the fractionalised parts are deemed to possess identical attributes - are deemed to be outside the scope of MiCA.

MiCA attributes a crypto-asset's unique characteristics to the utility it gives to the holder (Recital 10, MiCA). Furthermore, MiCA acknowledges that while unique and non-fungible crypto-assets can be accumulated speculatively, when their relative value cannot be ascertained by means of comparison to an existing market or asset this limits their financial use and justifies their exclusion from the scope of MiCA. NCAs are therefore required to assess the substance rather than form of a crypto-asset's features to determine its classification.

ESMA asserts that as multiple investors who collectively own all the fractional parts of an F-NFT could theoretically reconstitute it, the fractional parts of an F-NFT may be inherently devoid of uniqueness and have identical attributes (paragraph 73, ESMA CP). Furthermore, ESMA proposes that F-NFTs are classified based on the 'possibility of reconstructing complete ownership' by aggregating the fractional components (paragraph 140, ESMA CP).

ESMA's proposed approach appears to prioritise form over substance and risks arbitrarily misclassifying F-NFTs. On an arbitrary basis, it would seem theoretically possible to reconstruct the complete ownership of any F-NFT. However, the fractionalised parts of many F-NFTs - even those whose parts possess identical attributes - may be held by multiple investors who are independent of each other (e.g., if the fractional parts were brought through different platforms). Investors may not be able to identify other holders of the fractionalised parts and, even if they are able to do so, other holders may not be willing or able to sell their fractionalised holdings. As such, while it is theoretically possible to reconstruct the complete ownership of an F-NFT, this may be practically impossible or unlikely.

ESMA asserts that the outcome of fractionalisation may be the creation of fractional parts of an F-NFT which possess identical attributes and are inherently devoid of uniqueness (paragraph 73, ESMA CP). Furthermore, NCAs should consider 'separately' the fractional parts of a unique and non-fungible crypto-asset to determine whether they are also unique and non-fungible and within the scope of MiCA (paragraph 140, ESMA CP). If applied arbitrarily, ESMA's proposed approach may result in the fractional parts of an F-NFT, which itself is unique and non-fungible, from being in-scope of MiCA if the fractionalised parts are deemed to possess identical attributes. For instance, an F-NFT that is fractionalised into parts that have identical attributes which are held by a single investor would appear, under ESMA's approach, to risk being classified as in-scope of MiCA

as a result of the mere operation of fractionalisation. However, such an F-NFT would appear to have limited financial use without a means through which its relative value can be ascertained by comparison to an existing market or asset, therefore justifying its exclusion from MiCA (Recital 10). ESMA should revise its approach to clarify that F-NFTs made up of fractionalised parts which have limited financial use - even if the fractionalised parts are deemed to possess identical attributes - are deemed to be outside the scope of MiCA.

Q7: 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 should revise its proposed approach to hybrid token classification process to better take account of the materiality of any financial instrument related features which a hybrid token may display and to more rigorously consider the comparability of financial instruments that may exist for a given 'type' of crypto-asset.

We respectfully disagree with an approach which automatically presumes a hybrid token is covered by MiFID if it displays any financial instrument related features. Hybrid tokens are a relatively new type of crypto-asset and therefore a case-by-case in depth analysis is required to ensure the correct classification. As set out in our other responses, ESMA should adopt a principles-based approach to hybrid token classification which considers a token's primary function and is grounded on the risks that it exposes users to, including the extent to which those risks are mitigated through decentralisation. As mentioned in our response to Q5, decentralised crypto-assets can be viewed as inherently 'trustless'. The transparent nature of blockchains means that all relevant information about digital assets can typically be found 'on-chain'. This means that all potential holders of crypto-assets have access to the information necessary to value and trade assets on a level playing field. This is distinct from the 'classical' information asymmetry in traditional markets where non-public information on the financial well-being of an issuer enables an assessment of the likelihood of claims against the issuer's business enterprise being met and therefore the 'fairness' of the current market price. In crypto markets, the financial well-being of the issuer or other person seeking to admit the crypto-assets to trading is likely less relevant (or irrelevant) and coupled with decentralisation this mitigates many of the classic risks associated with intermediaries in traditional markets such as reliance on managerial efforts and information asymmetry.

We agree that crypto-assets which are structured as hybrids - combining, spanning or associating several characteristics, components and purposes - can make classification more difficult. We also acknowledge that the prevalence of characteristics and components of a crypto-asset and therefore its purpose can change during its life cycle.

We do not agree, however, with ESMA's proposed classification process for hybrid tokens which appears to overweight (or give 'precedence' to) the identification of a hybrid token as a financial instrument where either:

- it displays any financial instruments-related features (para 79, ESMA CP); or
- a financial instrument exists for such a 'type' of crypto-asset (para 81, ESMA CP).

ESMA is proposing that only when an NCA's rigorous assessment determines that the crypto-asset does not fit the definition of a financial instrument should the NCA consider other classifications, such as utility tokens (para 80, ESMA CP).

ESMA's proposed approach risks NCAs adopting an approach whereby a hybrid token is, by default, considered to be a financial instrument unless the NCA finds that the token has no possible financial instruments-related features and no financial instrument exists for even a closely related type of token. This proposed approach might result in a large number of new and existing hybrid tokens being (unduly in our view) classified as financial instruments. The resulting classification may subject new hybrid tokens to an unsuitable regulatory regime - MiCA is tailored to tokens and related activities and services and MiFID/R is not - and create market distortion for investors and service providers of existing tokens by subjecting them to new, inappropriately crafted rules.

We instead encourage ESMA to revise its proposed approach to:

- better take account of the materiality of any financial instrument related features or characteristics which a hybrid token may display or exhibit; and
- more rigorously consider the comparability of financial instruments that may exist for a given 'type' of crypto-asset.

We recommend an approach that does not assume a hybrid token is a financial instrument by default. Instead, the characteristics, features, components, rights, functions and purpose of the hybrid token should be examined at face value without preconceived assumptions. The substance and form of any financial instrument related features or characteristics that are identified should be assessed based on their materiality and their ability to change the nature of the crypto-asset over time to determine if they are core or ancillary to the token. For instance, the circumstances and conditions that need to be met for a utility token granting access to content or features on a platform to also provide governance, profit-sharing or ownership rights.

We also recommend an approach which more rigorously considers the comparability of financial instruments that may exist for a given 'type' of crypto-asset. We support the need for regulatory clarity and consistency in the overarching MiCA framework. However, we are concerned ESMA's proposed approach that 'if a financial instrument exists for hybrid types of crypto-assets, it should prevail' will encourage NCAs to seek to identify comparable financial instrument(s) for hybrid tokens types even if this is not a good comparator. Instead, we would encourage NCAs to only 'designate' a financial instrument as being a comparator to a hybrid token where both share common core elements rather than merely just ancillary characteristics.

We agree with ESMA that the labels given to hybrid tokens by issuers or offerors should reflect the token's classification and that the documentation of tokens and marketing materials of tokens that are classified as financial instruments should present core features as predominant elements and not ancillary characteristics (paragraph 81, ESMA CP).

Hybrid Utility Tokens

As set out in CCI's above response to Q4, ESMA should clarify that crypto-assets which have utility (i.e., a commercial or industrial purpose) are not units in collective investment undertakings (and their issuers, if one, are not collective investment undertakings). This clarification should also apply to hybrid utility tokens - as a one category of crypto-assets with utility.

The treatment of hybrid tokens should distinguish different aspects of their substance. Hybrid utility tokens should be treated like utility tokens for those aspects which provide access to a good or service or otherwise have a general commercial or industrial purpose (with the clarification that these are not collective investment undertakings). This reflects the definition of utility token without the restriction that goods and services must be supplied directly by the token's issuer, thus permitting goods or services to be supplied by a decentralised network. Furthermore, it reflects that hybrid utility tokens are exempt from MiCA for those aspects that are related to their utility such as those:

- created as a reward for the maintenance of the distributed ledger or the validation of transactions (Article 4(3)(b), MiCA)
- providing access to a good or service that exists or is in operation (Article 4(3)(c), MiCA).

This is also in keeping with the exemption from MiCA for 'crypto-asset services that are provided in a fully decentralised manner without any intermediary' (Recital 22, MiCA).