coinbase

To:

Verena Ross
Chair, ESMA
201-203 Rue de Bercy
75012 Paris

Date:

29 April 2024

Qualification of Crypto-assets as Financial Instruments – Coinbase's response to the European Securities and Markets Authority

Coinbase Global, Inc. and its EU subsidiary Coinbase Europe Limited (together, "Coinbase") welcome the opportunity to respond to ESMA's consultation on *"Draft Guidelines on the conditions and criteria for the qualification of crypto-assets as financial instruments"*.

Coinbase started in 2012 with the idea anyone, anywhere, should be able to send and receive Bitcoin easily and securely. Today, we are publicly listed in the US and provide a trusted and easy-to-use platform relied on by millions of verified users in over 100 countries to access the broader crypto economy.

We are committed to the EU, where we have a significant presence reflecting its importance as one of our largest international markets outside of the US. Coinbase has a crypto licence in Germany, EMI licence in Ireland and a number of registrations in national markets across the EU. We believe we are well placed to transition to a MiCA licence, and we are excited by the opportunities presented across the region. The EU has taken a leadership role globally with MiCA, introducing the most comprehensive regulatory framework in the world, and is now well positioned to capitalise on this new wave of technological innovation towards Web3, and to achieve its strategic autonomy ambitions by onshoring tech investment.

However, MiCA is not "done" and ESMA's work is critical to maintaining EU competitiveness. Countries around the world continue to watch to see if the EU achieves the right balance: of fulfilling important regulatory objectives of financial stability, market integrity and consumer protection, and creating the right conditions to spur innovation and growth. We appreciate the thoughtful approach ESMA is taking to regulating the sector, and we stand ready to support it in this important work.

Yours sincerely,

Tom Duff Gordon, Vice President, International Policy, Coinbase

Introduction

Coinbase recognises and appreciates the work done by ESMA in seeking to provide clarity on the classification of different crypto assets, particularly given the complexity of this issue and the importance of it to the proper functioning of MiCA alongside securities regulations.

Overall Coinbase supports the general concept followed in the draft guidance to approach each crypto asset on a case-by-case basis for classification, and the recognition that there are many different nuances to the question of classification which must be considered before the question can be answered.

We would also support, based on our extensive experience in reviewing and classifying a huge number of crypto assets across a wide variety of jurisdictions, some adjustments to the draft guidance we believe are needed. We are pleased to share some of our thoughts in this letter, and at a high level recommend the following:

- **Ensure a harmonised approach across NCAs by providing practical examples of assets on either side of the perimeter**. One core aspect of a pan-European approach to crypto asset regulation is ensuring that the classification of crypto assets into "MiCA vs MiFID" is harmonised across the NCAs. It is imperative to avoid one NCA classifying an asset under MiCA that another NCA classifies as a security. Such situations, if not avoided, will create unhealthy tensions across the industry with respect to offering services in relation to that asset, and materially impact the ability for firms to passport their services in relation to that asset. Therefore we would request that ESMA provide more practical examples on how to apply the guidance in practice, in order to illustrate clearly to the NCAs how ESMA expects classification to take place.
- **Be clear that asset-referenced tokens are carved out of MiFID**. As currently written, the definition of an asset-referenced token under MiCA could in some circumstances be read to capture certain types of derivatives products or collective investment undertakings. ESMA should provide greater clarity in the guidance on what an asset-referenced token is, and how they are differentiated from derivatives and collective investment undertakings.
- **Further clarify that staking-as-a-service should not be considered by NCAs as the provision of a collective investment undertaking**. MiCA does not specifically reference staking services, however it is clear from Commission positioning to date that it is permissible activity under MiCA and does not fall within the scope of MiFID as a collective investment undertaking (as certain NCAs have been querying). It is important to clarify that firms can provide these services as part of their MiCA-regulated operations, as staking is a critical part of blockchain infrastructure and an environmentally friendly way to secure proof of stake

blockchain networks. Specifically, ESMA should clarify that staking services that simply enable clients holding assets in a custodial wallet to be able to stake those assets, should not be treated as involving any element of "investment". It is critical to ensure that NCAs take a harmonised approach to staking services and do not miscategorise staking as an investment product to be regulated as a collective investment undertaking.

- **Guidance on hybrid tokens should make clear that they should only be considered securities when they meet all aspects of the relevant securities definition**. There is some ambiguity in the draft guidance around hybrid tokens and how they should be classified, in that it can be inferred from the draft guidance that meeting part (but not all) of one of the definitions of a security could cause a hybrid token to be considered a security. We would request that the draft guidance is revised to make clear that a hybrid token must meet all aspects of the relevant securities definition in order to be considered a security.

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 condition and criteria?

A core promise of the single market is the harmonisation of laws, so that businesses such as Coinbase, and more importantly, consumers, know where they stand, and that NCAs will take aligned and predictable approaches. Coinbase supports this goal and process.

The risks of fragmentation across the single market are most tangible with disruptive new technologies and business methods. The nature of such a disruptive force often means a misalignment between the old and the new, with new processes having to be interpreted against laws and rules created in a different time and context. Resolving this tension can involve new interpretations of old texts, or attempting to understand the mindset of long-gone legislators – but without precedent there can be uncertainty. In addition, the pace of change can mean many novel fact patterns are simultaneously being put to regulators and courts to interpret, and so a variety of incompatible results can arise.

The ESMA Advice on Initial coin offerings and crypto-assets[1], that the Consultation cites, illustrates this very difficulty. Attempts to map the novel crypto-asset concept against the historic definition of transferable security gave a range of outcomes. Even in cases 1 and 2 within the ESMA Advice which are the most clear-cut in terms of interpretation, almost a third of NCAs disagreed with the majority.

The guidance on the token perimeter in MiCA is therefore critical in aligning NCAs, and in helping MiCA achieve its core objective, as per Recital 1 "*that Union legislative acts on financial services are fit for the digital age, and contribute to a future-proof economy that*

[1] ESMA50-157-1391

works for people, including by enabling the use of innovative technologies" - particularly given the international nature of the crypto assets market and the passporting regime in MiCA, we feel it is fundamental to strive for harmonisation to avoid some types of crypto assets being considered MiFID instruments in one member state, and MiCA instruments in another.

MiCA calls for a technology neutral approach[2], which ESMA appropriately heeds in the Consultation. The rapid pace of development of the crypto-asset sector requires that equivalent activities and assets be subject to the same or very similar regulatory outcomes regardless of form.

The key to achieving this entails putting forward sufficient detail to realise harmonisation, but without resorting to technological specificity. To this end, ESMA is correct in its approach of providing general conditions and criteria; however, this should be complemented with guidance to NCAs on how to manage some of the more difficult interpretative examples that may arise. In particular, providing specific and detailed examples would increase alignment, and make the guidance more implementable, without the constraints that come with more precise and inflexible criteria which inevitably become quickly dated.

Q2: Do you agree with the conditions and criteria to help the identification of cryptoassets qualifying as transferable securities? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples.

Coinbase supports the technology neutral approach, as set out in MiCA[3], and adopted by ESMA in Guideline 1. This is the correct and proper way to approach regulation of fast moving technological methods, into non-technology sectors (such as finance).

Specifically, we consider that paragraph 106 captures the key element here. In our experience of having analysed hundreds of crypto assets to determine if they are MiFID instruments, it is the characteristics of the crypto asset that are crucial here, and, on the face of it, if the crypto asset is akin to an already regulated financial instrument. We believe it may be necessary for ESMA to provide further guidance on how NCAs should be making determinations, in particular by looking at the economic realities and relative outcomes that crypto assets provide relative to securities. This will require extending the well-made points put forward at paragraphs 102 and 103 around determining the importance of financial arrangements attaching to crypto assets, and voting rights – both of which are questions which regularly arise in undertaking a MiFID review of a crypto asset.

---

[2] Recital 9
[3] Ibid

For debt, we would recommend considering further the situation described in paragraph 104 where an instrument is used in a way that "*represent[s] a debt akin a monetary debt like [a portion of] a loan ... should be considered as securities*" - given the versatile nature of crypto assets and their ability to be used in different ways by different people and projects, it should be clarified if the intention here is to suggest that the instrument in question becomes a security only when used in this way, or whether the classification of that crypto asset becomes fixed generally, based on this use case.

This raises a wider question (beyond just debt instruments) on how crypto assets should be classified when the way they are used, in only one particular circumstance, causes them to have relative outcomes akin to a MiFID instrument - but when used outside of that context, they do not. The versatile nature of some crypto asset types means that they can be used in many different contexts and with different relative outcomes, some of which may look akin to MiFID instruments, and some of which will not. Our view is that the crypto asset should only be considered a MiFID instrument in the contexts where it is used as such, and that a crypto asset should not be considered a MiFID instrument in contexts where it does not seek to offer relative outcomes akin to MiFID instruments. Accordingly, our view is that further guidance should be provided to clarify that classification of a crypto asset as a security in one context, does not mean that same crypto asset being considered a security in all other contexts.

We would note at paragraph 103 that, where it is noted that "*National competent authorities and market participants should also consider whether the cryptoasset gives rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities, or other indices or measures.*" – this describes what should be considered, but does not suggest why it should be considered. If this is considered a strong indication of a crypto asset being a security, then we would suggest further clarification of that point in paragraph 103.

In relation to paragraphs 120 - 124 around derivatives classification, one overarching point we would recommend is considered further is the interaction between this guidance and the concept of an asset referenced token under MiCA. At points the guidance describes the concept of a derivative deriving its value from an underlying asset, for example at paragraph 122:

"*The underlying is the basis for determining the value or payoff of the derivative. The value of the crypto-asset should also depend on changes in the value of the underlying reference asset.*"

Given the broad definition of an asset referenced token under MiCA, we would suggest that further guidance is given on how to differentiate between an asset referenced token

and a token that is a derivative, by confirming in this guidance that an asset-referenced token is an asset which maintains a stable fiat value (i.e. one asset-referenced token will always equal EUR 1, for example) and therefore they cannot be considered a future or a Contract for Difference (CFD). Without this clarity it will be difficult to reconcile the two concepts, leading to confusion in the market - as if the definition of an asset-referenced token can be read as having a floating fiat value that is fixed against the value of the underlying assets, it could be considered a future or a CFD and therefore be a MiFID instrument, meaning it cannot fall within MiCA.

Finally, we would also note that, as referenced in Question 3 of the Consultation, derivatives that reference crypto assets are often settled in stablecoins, and we would therefore advocate for the guidance to make clear that derivatives can be settled in electronic money tokens, for clarity.

Q4: Do you agree with the conditions and criteria to help the identification of cryptoassets 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 condition, criteria and/or concrete examples to suggest?

Money Market Instruments

We generally agree with the guidance provided in relation to money market instruments.

In practice we anticipate that these types of instruments will arise primarily in relation to projects that are specifically seeking to tokenise money market funds, and therefore their classification as a MiFID instrument will likely not be in doubt.

In relation to the final two sentences of paragraph 114 we would raise a question around the relevance of this specific point within this guidance. This guidance is intended to provide clarity in relation to consideration of specific instruments as either securities or crypto assets - in relation to this wording, it describes the concept of a type of savings account potentially being considered a money market instrument, presumably on the basis that the savings account itself could be considered a money market fund. We believe this confuses the intent of the guidance by offering a view on the regulated status of a particular structure or service, rather than focusing on a particular instrument and whether or not that instrument itself is, or is not, a security, and therefore suggest that this section be removed or amended instead to focus on specific instruments and their classification.

Collective Investment Undertakings

In relation to paragraphs 115 to 119, we generally agree with the guidance as stated, but would request further clarity is given in this section to the industry on staking, and that it

does not fall within the definition of a collective investment undertaking. This is particularly important given a number of NCAs are querying whether or not staking activities should be considered collective investment undertakings. The majority of NCAs do not consider staking services to be collective investment undertakings, a determination that we deem appropriate (see below). Further, from discussions we have had, the Commission's position appears clear in that staking services are permitted under MiCA (and do not fall within MiFID scope).

To that end, regarding the concept of "investment" and the requirement for a defined investment policy, we would recommend that further guidance is provided around ESMA's view on "proof of stake" validation activities, and services that allow users to access the offerings of proof of stake validators. Specifically, where a service is provided for users to hold their assets in custody with a crypto asset services provider, with the crypto asset services provider then providing a service to stake those assets with a validator and direct rewards from that validation activity back to the user, clarification that no part of that service and activity is considered an "investment" is crucial – this will enable the market to be clear that simply having a strategy around validation and which validators to use to carry out validation activity is not considered as having a defined investment policy, and therefore there is not a collective investment undertaking.

This is an appropriate determination given that the assets themselves remain in custody and are not themselves invested to generate returns. Instead, they are staked for the purpose of supporting validation activities. To that end, we believe there is a clear delineation between staking services and the operation of a collective investment undertaking, and would strongly advocate in favour of ESMA providing this clarity via the guidance.

One other point, related to the discussion above on asset referenced tokens and derivatives, is around the potential complexity as to whether an asset referenced token, if structured in a particular way, could be considered a unit in a collective investment undertaking. We would consider that the prohibition on payment of interest or interest-like returns on asset-referenced tokens should reduce the possibility of this, but there is still the possibility of a holder of an asset referenced token potentially receiving a return from the underlying assets, which could in some cases lead to a suggestion of the entire arrangement around the asset referenced token being a collective investment undertaking. We would recommend that ESMA provides further guidance on this point to ensure that the delineation is clear.

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 condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

We generally agree with the guidance provided in paragraphs 130 to 133, but would suggest that ESMA has an opportunity in this section to clarify how private blockchains, and assets traded on them, should be treated.

Assets on private chains are caught in the middle under the draft guidance - they are not as widely transferable as a crypto asset on a public chain such as BTC (since they can only be traded between participants within the private chain environment), but are generally more widely transferable than that described in paragraph 132 (since whilst they have limited potential recipients, they can still be transferred). ESMA clarification here on how these types of "limited transferability" assets should be treated under MiCA would be helpful to ensure there is no ambiguity on this point.

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

We do not agree with certain aspects of the guidance in relation to NFTs. We appreciate the need to take significant care to ensure that the concept of non-fungibility is not used as an avoidance mechanism, but otherwise believe the guidance goes too far in attempting to treat genuinely non-fungible assets as being MiCA-regulated assets.

In particular, we recommend reconsideration of the "interdependent value test" and how it operates. We appreciate and agree that as assets become more similar their values should converge, but the same principle does not hold in reverse. Assets do not become fungible just because their values converge. We disagree that assets should be considered "interchangeable in practice" if they have equivalent characteristics because the market views them as having similar values despite unique characteristics. Fungibility should be determined by an asset's intrinsic characteristics – as the test suggests, at point (iii) – and not the marginal or average effects of market pricing.

To the extent that ESMA believes this element of the test should remain, we strongly recommend for it to be made clearer in the guidance that "interdependent value" in monetary terms should be determined by assets that trade at sufficient scale on registered exchange platforms at broadly identical values in a way that clearly demonstrates economic fungibility. Otherwise, it will be impossible to create a series of NFTs which are not captured by MiCA. For example this could be a series of art works that should not fall within a financial services regime.

Q7: Do you agree with the conditions and criteria proposed for hybrid-type tokens? Do you have any additional condition and/or criteria to suggest that could be used in the Guidelines? Please illustrate, if possible, your response with concrete examples.

Overall we agree that in classifying hybrid-type crypto assets, emphasis should be placed on considering attributes which the crypto asset shares with securities, as simply adding some crypto-like attributes to what would otherwise be a security token should not result in the asset being a MiCA instrument.

However we suggest that the guidance be clearer that, in order for a hybrid token to be a security, it must meet all of the requirements of the relevant securities definition. For example, if a crypto asset has one attribute that makes it similar to a share of equity but no other attributes of an equity security, then it should not be considered a share. This is because of the nature of the difference between securities and crypto asset definitions – securities definitions are specific and therefore all aspects of those definitions must be met for something to be classed as a security, whereas crypto asset definitions under MiCA are much broader and seek to capture all instruments that are enabled by DLT and are not securities. If the guidance blurs this line by suggesting that crypto assets can be securities where they partially meet the definition of a security, this would cut across a large part of the guidance as a whole.

Related to all of the above, it is important in our view that no presumption is established that, for all assets, they are first considered as financial instruments and then it must be proved that they are crypto assets - to suggest that hybrid tokens are effectively financial instruments as a starting point begins to create that presumption, which does not fit with the mechanics of the MiCA definitions (which are broad, catch-all definitions) and MiFID definitions (which are narrow, specific definitions that effectively represent subsets of the MiCA definitions where you have a blockchain-traded asset that meets the financial instrument tests).

Therefore we would request that ESMA make clear that a hybrid token will only become a security where it meets all the relevant requirements of a security - if not, it will be a crypto asset under MiCA. Hybrid tokens should be presumed to be MiCA instruments as a starting point, unless they meet the requirements of the MiFID definitions in full.