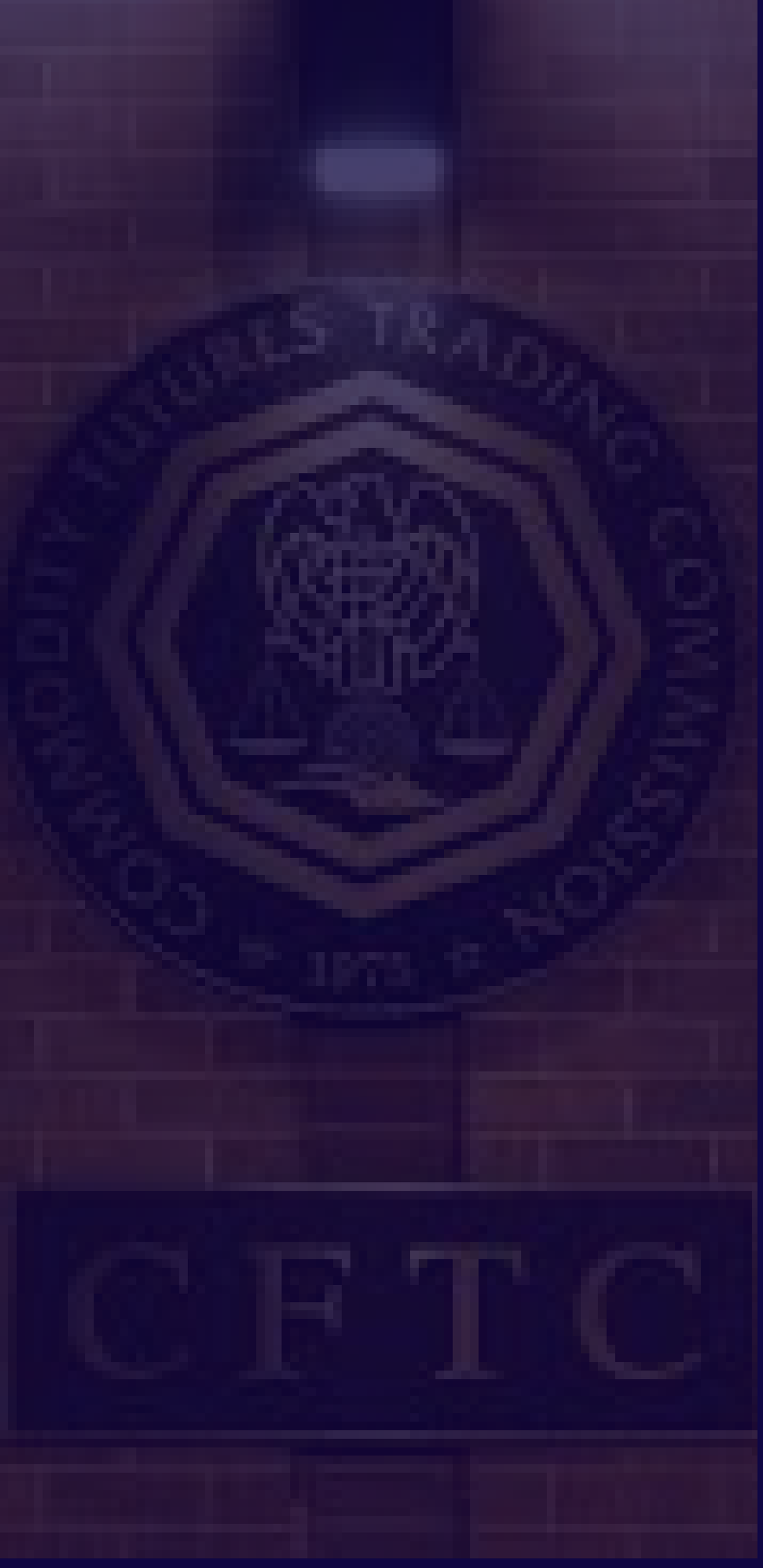


GBBC
Global Blockchain
Business Council

VALUE
VERSE

CFTC Digital Assets Taxonomy

Comparing the EU and US Approaches: Convergence or Divergence?

gbbc.io

valueverse.eu

Contents

1 Introduction

As the Web3 Economy transitions from the proof of concept to the proof of value, indicating strong growth potential, the need for a clear taxonomy to underpin token classification is essential for delineating the framework of opportunities in different business models. While many private stakeholders and Blockchain Associations have introduced their taxonomies, the multiplicity of these approaches has not been able to inform policy decisions and regulatory approaches.

On the 6th of March, under the CFTC, the Global Markets Advisory Committee (GMAC)'s Digital Asset Markets Subcommittee (DAMS) working group on taxonomy published the Digital Asset Classification Approach and Taxonomy, which was presented during the GMAC meeting at the CFTC. Much of the value of the taxonomy is that it reflects consensus, for the time being, among key stakeholders that include major global financial institutions, banks, international organisations, crypto native entities, and regulatory entities aiming to bring clarity, a common vocabulary, and a basis for competent authorities in the US to introduce a prudential framework. This framework will enable innovative business models to flourish in an environment of regulatory certainty and legal clarity.

This paper briefly describes the main points of the recommendation in the light of the EU's Taxonomy. We believe that as the Web3 Economy is by nature borderless, enhanced regulatory coordination and a common vocabulary between jurisdictions is essential. Moreover a convergence of the taxonomies in the two sides of the Atlantic would be absolutely beneficial for the ecosystem.

Despite the fact that the taxonomy recommendation of the CFTC is not a Law, if it becomes the consensus approach of the US stakeholders it is highly possible to form the backbone of a future prudential regime. For this reason, it is important for the entrepreneurs to know how much this taxonomy recommendation converges with the taxonomy of the EU's regulatory framework.

Key Points

Adoption of a **consensus approach** between the stakeholders who have attempted to introduce their own taxonomy.

Provides a definition for digital assets and basis the taxonomy on the **economic function** of the token. The taxonomy is open to a use-case driven approach.

Aknowledges the need for **re gulatory intervention in the US** and spires to provide the background for regulatory initiatives.

Recognises the need for global coordination and collaboration with international prudential standards setters.

2 Definitions and Key Topics

The Report provides a definition of a Digital Asset

Digital Asset is a controllable electronic record where one ore more parties exercise control through transfer of this record and when the controllable electronic record is uniquely identifiable.

Identifies Seven Key Features of a Digital Asset

The digital asset:
(1) is issued;
(2) holds value;
(3) confers rights;
(4) is fungible;
(5) is redeemable;
(6) is recorded in books and records.

Proposes Seven Types of Digital Assets

(1) Money or Money-like Digital Assets;
(2) Financial Digital Assets;
(3) Alternative Digital assets;
(4) Cryptoassets;
(5) Functional Digital Assets;
(6) Settlement Controllable Electronic Records;
(7) Other Digital Assets.

3 Comparing the CFTC / EU Taxonomies

US Digital Asset vs. EU Crypto Asset Definition

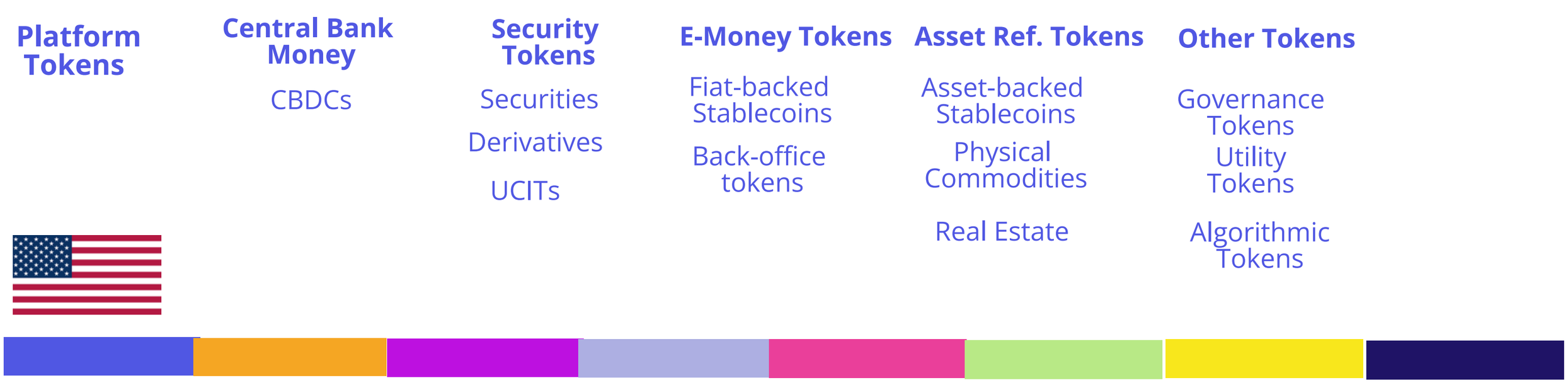
Definitions matter. Other than the obvious difference between "digital asset" and "crypto asset", we see that the CFTC places emphasis on the control and transferability of the tokens and then goes on with a list of features that a digital asset may (or may not) have.

The EU's approach focuses not on "control" but rather on "what" this asset "represents".

Under the EU's approach, the characteristics of a crypto asset are part of its definition. Similar to the CFTC, "transferability" is a key feature, followed by the requirement that a crypto asset digitally represents a value or rights and the possibility that it can be stored electronically on a distributed ledger or a similar technology.

Focusing on the substance of the two definitions we believe that the stated differences do not necessarily affect the business models of an actor operating both in the US and the EU.

Comparing the EU and the US Taxonomies in one picture



4 What Does it Mean for Diferent Business Models

Taxonomy from a Business-Model Perspective

Taxonomies of crypto assets frame business opportunities and risks, and affect the way organisations create value (business model), deliver value (operational model) and capture value (profitability model). A taxonomy is much desired because, if it is linked with a relevant prudential regime, it directly defines and structures the market in which a token operates.

EU introduced early a functional taxonomy and allows the most of the business models that use tokens to operate within specific and clearly defined prudential frameworks, ensuring consumer and investor protection, prevention of market abuse and financial stability. US, on the other hand, has been slow to create this framework, and has excluded a variety of business models from the scope of a regulatory regime or arbitrarily extended financial securities regulation to tokens that do not necessarily fall under this remit, causing significant market turmoil.

The CFTC's taxonomy recommendation calls on the relevant US authorities to create appropriate regulatory regimes where they do not already exist, taking into account the different functionalities of tokens.

As the market space between the EU and the US is closely interlinked, it is of vital importance for both sides of the Atlantic to ensure a very similar treatment of tokens that perform similarly in the EU and the US. This will ensure that firms operating in both jurisdictions are not forced to adopt vastly different business, operational and profitability models.

This part of the paper stresses the similarities and differences between the EU's crypto assets taxonomy and the CFTC's recommendation trying to "predict" divergences in the prudential regimes of the EU and the US for firms employing different types of tokens.

Business Models using Security Tokens

The US and the EU share a consistent stance—when a token, in essence, functions as a security, it is required to adhere to the pertinent financial regulations. Business models employing security tokens have a clearly defined path to follow on both sides of the Atlantic. It's worth noting that many existing Securities Laws reflect technological realities predating the advent of tokenization and DLTs.

Business Models using Platform Native Tokens

Both the EU and the CFTC recommendation recognize that tokens native to a platform (e.g. Bitcoin, Ether, etc.) constitute a distinct category of tokens and may not necessarily be deemed securities. If this recommendation is adopted, it settles the debate within the SEC regarding whether ETH is considered a security or not. The next step is to determine if these tokens will be subject to any prudential regime. If the US adopts an approach similar to that of the EU, these tokens could be excluded from any future Digital Assets regime, mirroring the approach taken by the EU in MiCA.

Business Models using Payment Tokens (1)

It appears that both sides of the Atlantic hold the belief that stablecoins, when utilized as a medium of exchange, should be regulated within the banking system framework. However, the US primarily operates with Credit Institutions, whereas the EU boasts a dynamic parallel ecosystem of Electronic Money Institutions functioning within the framework of a constantly updated E-money Directive. The absence of E-money Institutions in the US has been a significant obstacle in the adoption process of payment tokens thus far. Nevertheless, despite this fundamental institutional difference between the EU and the US, both taxonomies share the perspective that Central Bank money should be distinct and that Digital Money instruments should be subject to current banking regulations. Additionally, they concur that stablecoins pegged to a fiat currency should be regarded as payment instruments rather than securities, aligning with the EU's perspective on Electronic Money Tokens (EMTs).

Business Models using Payment Tokens (2)

Despite the EU and CFTC recommendation's similar classification of fiat-pegged stable coins, there exists a subtle difference in their treatment of stablecoins whose value is pegged to another asset or a basket of assets (such as Libra-like tokens). Once again, the CFTC advises classification based on the substance of the token (which is payments), while the EU does not. ARTs encompass a broad category that may include real assets, commodities, financial assets, baskets of currencies, etc., and the use of an ART is not necessarily limited to act as medium of exchange. The precise classification of stable coins of this type as Money-like Digital Assets may impact their prudential treatment differently than how the EU treats ARTs, revealing a discrepancy that could affect the business, operational, and profitability models of these stable coins.

Moreover, the CFTC recommendation introduces a novel category of Digital Assets known as settlement tokens. The utility of these settlement tokens is tied to the streamlining of back-office settlement functions within regulated credit and financial institutions. We believe that this distinct category may not significantly impact the operational model of the organizations that will use them. However, we acknowledge the rationale behind this approach when compared to the EU's regime. The EU does not necessarily require a separate category for "settlement" tokens, as this function can be executed by Electronic Money Tokens (EMTs). EMTs are qualified as funds under both the Electronic Money Directive and the Payment Services Regulation, allowing them to perform settlement functions.

Business Models using Alternative (pegged) Tokens

The CFTC recommends that tokens whose value is pegged to real-world assets, commodities, real estate, emission certificates, etc., should be categorised as "alternative tokens". The similarity with the EU approach lies in the fact that many of these tokens may fall under Title 3 of MiCA, specifically the Asset-Referenced Tokens discussed earlier. However, depending on how the white paper is structured and the actual utility of the token, the classification under the EU could differ. Scenarios range from Title 2 Tokens under MiCA (Other Tokens) to financial instruments under MiFID. We believe that this could be an area where views between the two jurisdictions may or may not diverge, potentially impacting the business models of entities operating on both sides of the Atlantic.

Business Models using NFTs

It is evident that an increasing number of Web3 business models incorporate the use of NFTs. The EU has opted to exclude NFTs from MiCA; however, it remains uncertain whether this stance will persist in a potential MiCA-2 update in the future. Anticipated in 2025, the European Commission is expected to release a study recommending either "no further action," or the "inclusion of NFTs under Title 2 of MiCA," or "the introduction of a bespoke regime." The specifics are unclear at this stage. Similarly, the proposed classification by the CFTC doesn't provide extensive information about NFTs. The recommendation differentiates between fungible and non-fungible tokens but does not explicitly classify them under any of the proposed seven categories of Digital Assets. This ambiguity could be interpreted in two ways: either an NFT may fall into multiple categories based on its functionality, or it is entirely excluded as it does not fulfill the requirement of "fungibility" emphasized in the list of Digital Assets features.

Business Models using "Utility ++" Tokens

It appears that the CFTC recommendations align with the EU taxonomy in defining tokens not pegged to the value of other assets, not used as means of exchange, or securities as "utility plus" tokens, termed "Functional Tokens" by the CFTC. The approach taken by Title 2 tokens of MiCA closely resembles this perspective. However, a potential issue arises in the CFTC recommendation, where it states that the ownership of these digital assets can provide the holder with claims to future revenue. This could pose a problem, as the commitment to future cash flows may lead regulators to categorize these instruments as "securities."

The EU's approach is notably clear in this regard, attempting to avoid, at least in theory, the risk of classifying an "other token" as a security. While there is no hierarchy between MiCA and MiFID, there remains a possibility that a token classified as "other" in one Member State might qualify as a "security" in another, introducing complications. We believe that business models employing "functional tokens" may not be as straightforward as their features suggest, posing significant risks to firms using them in both the EU and the US.

Key take aways

A very good starting point: The CFTC's taxonomy, though not without controversies, serves as a robust starting point. It has the potential to establish a common vocabulary within the ecosystem and regulatory authorities in the US, laying the foundation for a much-needed prudential regime.

Convergence and Divergence: Comparing the CFTC classification to the EU's reveals insights when viewed through a business model lens. Recognizing that a taxonomy doesn't constitute a prudential regime in itself, we observe that for a substantial number of tokenization models, the treatment in both the EU and the US can be quite similar.

This alignment enables firms operating in both regions to maintain similar business, operational, and profitability models without encountering substantial regulatory distinctions. However, as there is no regulatory equivalence between the EU and the US, we expect different compliance and procedural costs as well as significant divergence in the licensing and authorisation processes.

Nevertheless,notable differences persist, posing risks of regulatory arbitrage or disproportionate compliance costs.

Classifying points of convergence/divergence: Applying the business model approach, we can discern differences between the EU and CFTC taxonomies, highlighting three potential effects: (1) Convergence, (2) Divergence that does not significantly impact business models, and (3) Divergence that poses a risk to the business models of firms operating in both the EU and the US. Stressing, once again, that we compare taxonomies and not prudential regimes, we see that the approach of CFTC:

Converges with the approach of the EU on:
(1) Security tokens;
(2) Platform-native tokens;
(3) Fiat-pegged stable coins;
(4) Alternative tokens;
(5) Central-Bank issued tokens.

Diverges with the approach of the EU on:
(1) non fiat-pegged stable coins;
(2) algorithmic tokens;
(3) functional digital assets and tokens.

Diverges with the EU but it is not critical:
(1) Settlement tokens;

Not clear:
(1) Functional Tokens - "utility++" tokens;
(2) NFTs.

GBBC HQ

Rue de Lyon 42B
1203 Genève
Switzerland

www.gbbc.io

Global Blockchain Business Council

ValueVerse HQ

Rue au Bois 370
1150 Brussels
Belgium

www.valueverse.eu

ValueVerse Digital Finance Strategy Group