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Mr John Berrigan
Director General
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
Brussels
Belgium

30 April 2020

Dear Mr Berrigan,

In light of your recent *Public consultation an EU framework for markets in crypto-assets*, I would like to take this opportunity to advise that the Central Bank of Ireland ("the Central Bank") is supportive of this initiative and welcomes the development of a more harmonised approach to crypto-assets.

Reflecting on the consultation, I provide in what follows some focussed comments relating to areas of relevance to the Central Bank's mandate. This letter sets out the Central Bank's views on crypto-assets that are currently covered by EU legislation and those that are not currently covered by EU legislation. In summary, the Central Bank's perspectives on crypto-assets are as follows (further details are provided in the Appendix):

- It would be beneficial to have a harmonised taxonomy at EU level in relation to crypto-assets, including a harmonised definition of a security token as a transferable security.
- This harmonised taxonomy would facilitate a feature driven, case-by-case assessment by market participants and, as appropriate, National Competent Authorities (NCAs) given the evolving nature of crypto-assets.
- Definitions in the EU AML/CFT legal framework should be brought in line with definitions already adopted in the Financial Action Task Force (FATF) Glossary in so far as possible. The

Central Bank agrees with the view that the five crypto-asset services[1] specified by FATF should be covered by the EU AML/CFT legal framework obligations.

- The risks of 'so called stablecoins'[2] for financial stability, monetary policy, consumer and investor protection, legal certainty and compliance with AML/CFT requirements are a key concern. Among the Central Bank of Ireland's key concerns is that the issuing of currency should firmly remain under the remit of the relevant public authorities (i.e. central bank). Where the reach or other features of 'so called stablecoin' risk it being perceived as a currency, or operating as a quasi-currency, then it should be prohibited.

- It is not readily apparent to us that most utility tokens are, or should be, treated as financial products or that they should be regulated as such. However, we recognise that a utility token may, in substance be, or may become, a financial instrument (transferable security or e-money) and, in that case, it should be clear that it should fall within the regulatory perimeter. Cases where crypto assets start as, or claim to be, one thing but morph into the provision of financial services directly or indirectly should be closely monitored.

As an integrated Central Bank and Financial Regulator, the Central Bank is cognisant of both the important opportunities and material risks associated with crypto-assets. We serve the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy. Our mandate extends to prudential and financial conduct regulation. Therefore, we have multiple perspectives with regard to the potential impact of crypto-assets. The Central Bank supports innovations that increase the efficiency of financial services to consumers. However, the Central Bank does not support innovations that fail to reach the high standards and controls that protect consumers and underpin the integrity of the financial system or those which put financial stability at risk. Risks in relation to the integrity of the crypto-asset market have been well documented. The Central Bank has published warnings in relation to virtual currencies[3] and a consumer explainer in relation to the broader crypto-asset market.[4]

The crypto-asset space is evolving at pace. We urge caution in imposing regulatory changes which may have any unintended consequences such as diminishing security or consumer protections, e.g. expanding the definition of 'e-money' to include payment tokens, where there is no central issuing body or intrinsic value, could lessen consumer protections. The Central Bank notes the lack of verifiable regulatory data with respect to the activities outside of our regulatory remit. Regulatory changes should be supported by data and meet an effectiveness and proportionality test. We

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1 *The five services are: (i) exchange between virtual assets and fiat currencies; (ii) exchange between one or more forms of virtual assets; (iii) transfer of virtual assets; (iv) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and, (v) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.*

2 *The Central Bank supports the term "so called stablecoins" as recommended by the EBA in September 2019. This reflects the fact that as a relatively new development, these forms of crypto-assets have not been irrefutably proven to be stable.*

3 *https://www.centralbank.ie/consumer-hub/consumer-notices/consumer-warning-on-virtual-currencies*

4 *https://centralbank.ie/consumer-hub/explainers/what-are-cryptocurrencies-like-bitcoin https://centralbank.ie/consumer-hub/explainers/what-are-cryptocurrencies-like-bitcoin*

recommend the carrying out of a cost/benefit analysis in respect of regulatory reforms in this context.

We would of course be very pleased to engage further with you or your officials on any of the issues raised here.

Best regards,

Gerry Cross,
Director
Financial Regulation - Policy & Risk;
Asset Management and Investment Banking (Interim)

Appendix – Recommendations for consideration

The following section expands on the summary points in the body of the letter, giving some high-level principles and recommendations for consideration when moving forward with a regulatory framework for crypto-assets.

A. Crypto-assets currently covered by EU legislation[5]

Interrogating the substance of crypto-assets

The Central Bank recognises that ***interrogating the substance of a crypto-asset is key to determining whether the particular crypto-asset falls within the current perimeter of EU financial services legislation.*** It would be particularly useful for market participants and NCAs if there were ***clear parameters on when crypto-assets fall within scope of the regulatory perimeter*** (e.g. as security tokens or as e-money tokens) by way of harmonised definitions. This basic framework could be elaborated upon in an Opinion or Regulatory Technical Standard (RTS), along the lines of the basic taxonomy included in the EBA's *Report with advice for the European Commission on crypto-assets* (Jan 2019)[6] and ESMA's *Advice Initial Coin Offerings and Crypto-Assets* (Jan 2019).[7]

In order to establish whether a particular crypto assets falls within scope of EU financial services legislation, i.e. as a security token or e-money token, a case-by-case assessment of the substance of the crypto-asset is necessitated, using the harmonised definitions as referred to above, in determining what legislation is applicable (both at a national and EU level). ***The Central Bank is of the view that a feature driven assessment on a 'case-by-case' basis would be required given the evolving nature of crypto-assets.*** In order to inform the case-by-case assessment, clear parameters on when crypto-assets fall within scope of the regulatory perimeter would be beneficial, in the first instance.

There are several advantages in moving towards this harmonised approach:

i. ***A harmonised definition of security token at an EU level would assist market participants and NCAs by identifying the main criteria that should be considered when assessing crypto-assets to determine if they are within scope of regulation*** *as a MiFID financial instrument* e.g. a transferable security.
ii. A harmonised definition across the EU would better ensure that investors are equally protected when investing in securities markets, regardless of the underlying technology.

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5 *Security tokens and e-money tokens are considered in the EC consultation to be those crypto assets currently covered by EU legislation. In this context, we use the following terms:*
"security tokens" refers to crypto-assets issued on distributed ledger technology (DLT), that qualify as transferable securities or other types of MiFID financial instruments; and,
"e-money tokens" that meet the definition of e-money under the EMD (2009/110/EC).

6 *https://eba.europa.eu/sites/default/documents/files/documents/10180/2545547/67493daa-85a8-4429-aa91-e9a5ed880684/EBA%20Report%20on%20crypto%20assets.pdf*

7 *https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf*

iii. The absence of a common approach on when a crypto-asset constitutes a financial instrument for example is likely to result in barriers to cross-border distribution and an impediment to the effective development of security tokens.

Defining security tokens at an EU level

Determining whether or not a particular security token falls within scope of regulation necessitates an analysis of its characteristics against those financial instruments listed in MiFID II (Annex 2). Having considered this list of financial instruments, ***our view is that security tokens are most likely to be transferable securities, or at least exhibit similar characteristics to transferable securities.*** Therefore, in seeking to provide a clear definition of "security token", it may be useful to begin by considering the application of the existing definition of "transferable security" under MiFID II.

MiFID II defines transferable securities as "*those class of securities which are negotiable on the capital markets*". The definition gives examples of transferable securities, such as shares in companies, bonds, other securities giving the right to acquire or sell such transferable securities. Certain security tokens may fall within the scope of this definition whilst others may be outside of its scope, as they are not considered "*transferable securities*" or are not considered "*negotiable on the capital markets*". On that basis, they fall outside the scope of MiFID II and the regulatory framework notwithstanding that they exhibit characteristics akin to transferable securities or other MiFID II financial instruments. The characteristics that security tokens have in common with "transferable securities" may be useful as a starting point for seeking to define "security token".

Where security tokens do not meet the definition of transferable security above but exhibit the following characteristics, in substance, they would appear to us to be similar to transferable securities. To this extent they should be included within scope of regulation.

i. There is an initial delivery of consideration, either in cash or in kind, to the issuer of the instrument for use in an enterprise organised by the issuer, or by a third party under whose control the issuer operates; and,
ii. There is created, as a result of the initial delivery, on the part of the investor of a reasonable expectation of financial gain as a result of (a) having rights to share, in some way, in the issuer's revenues or retained earnings or other measure of the value of the enterprise, or (b) some other right to receive a payment from the issuer, or related entity, for the use of the consideration provided. The gain does not have to be promised or guaranteed, nor does the consideration necessarily need to be returned; and,
iii. There is a reasonable expectation of transferability of the security on the part of the investor.

AML/CFT considerations

The characteristics of crypto-assets present a number of additional risks beyond those associated with more traditional financial products from a ML/TF perspective, and accordingly entities

providing services in relation to such crypto-assets should be subject to AML/CFT obligations in line with other obliged entities. For example, crypto-assets can allow for greater anonymity when compared to more traditional financial products. This may act to prevent crypto-asset transactions from being adequately monitored and further might impede investigations into potential AML/CFT issues. The fact that crypto-assets can be sent across borders, often in seconds, presents additional concerns to regulators and law enforcement alike in trying to prevent their abuse from an AML/CFT standpoint. In order to ensure that transactions in crypto-assets can be monitored by service providers to allow for suspicious transactions to be reported to Law Enforcement agencies, it would seem sensible that the EU Funds Transfer Regulation (2015/847) on information accompanying transfers of funds (the FTR) be amended to apply to entities that provide services related to crypto-assets (this would also ensure that EU member states were in compliance with FATF's Recommendation 16, as expected by FATF).

In order to ensure that criminals/bad actors are not able to exert influence over entities providing services in relation to crypto assets, senior management and the beneficial owners of such entities should be subject to an assessment of their fitness and probity.

To ensure that there is no scope for confusion or incompatibility in this regards, ***the Central Bank is of the view that definitions in the EU AML/CFT legal framework should be brought as closely as possible into line with definitions already adopted in the FATF Glossary.*** The Central Bank is of the view that the description used in the FATF definition of "virtual asset" is useful as it is sufficiently broad to cover both "centralised" and "decentralised" virtual currencies. Furthermore, adoption of the FATF definitions would mean that the EU's approach does not diverge from the approach already followed by FATF members and members of the FATF-style regional bodies (FSRBs), ensuring a consistent taxonomy at a global level for the purposes of AML/CFT supervision.

The Central Bank agrees with the view that the five crypto-asset services[8] specified by FATF should be covered by the EU AML/CFT legal framework obligations. It is essential that these service providers should be subject to the same AML/CFT obligations as is expected from other obligated entities e.g. credit and financial institutions. Furthermore, adherence to the FATF categorisation of virtual asset service providers (VASPs) will ensure that the EU's approach does not diverge from that of FATF and the FSRBs.

The Central Bank is of the view that the parties can be identified to a large extent by requiring crypto-asset service providers to put in place an effective, risk-based AML/CFT framework, which includes the application of a risk based approach, customer due diligence (CDD) measures, reporting of suspicious transactions, governance, policies and procedures, record keeping and training. This is provided for in the Anti-Money Laundering Directives in respect of certain crypto-asset service providers. In addition, FATF expects VASPs to comply with FATF Recommendation

[8] *The five services are: (i) exchange between virtual assets and fiat currencies; (ii) exchange between one or more forms of virtual assets; (iii) transfer of virtual assets; (iv) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and, (v) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.*

16 concerning wire transfers, (having reference to the interpretive note thereto). As stated above, ***the Central Bank recommends amending the FTR in order to encompass virtual assets and VASPs. This would serve to increase transparency and assist law enforcement agencies in the fight against ML/TF.***

Peer-to-peer transactions have no central administrating authority or oversight and may present heightened risks in respect of AML/CFT considerations. Such transactions could be attractive to criminals in the layering stage of the money laundering process for the purposes of disrupting the audit trail. Ultimately, criminals can convert the proceeds of peer-to-peer transactions into fiat currency by going off-shore to an exchange located in a jurisdiction which does not adhere to the FATF Recommendations. The Central Bank notes that if there is a large volume of peer-to-peer transactions (e.g. if there is mass adoption of a stablecoin), then there would be no "AML/CFT gatekeeper" to these transactions. Should this occur, FATF may move to amend its Standards to apply to peer-to-peer transactions. The Central Bank suggests that the European Commission monitor and reflect on any such amendments to consider if corresponding amendments to EU legislation is required.

Effective regulation of e-money tokens

An e-money token is any crypto asset that meets the definition of e-money under the EMD (2009/110/EC). The Central Bank has not identified any immediate need for legal amendments to EMD2, PSD2 or supervisory guidance to be issued, to ensure the effective functioning and use of e-money tokens. The Central Bank will continue to closely monitor developments.

B. Crypto-assets that are not currently covered by EU legislation

The crypto-asset market is evolving rapidly. While the Central Bank notes that some crypto-assets may not fall within the regulatory perimeter at present, it is evident this should continue to be the case.

Stablecoins

The Central Bank notes the increased global focus on stablecoins and welcomes the work of international regulatory bodies and institutions including the EU Commission, G7, the FSB, FATF and the BIS in bringing regulatory clarity and defining the path forward.

The potential risks associated with global stablecoins have been well documented by the EBA, ECB, FSB, IOSCO and others. The Central Bank concurs with concerns expressed by many in this context. The Central Bank echoes the view of Benoît Cœuré, then Member of the Executive Board of the ECB, (26 Nov 2019) '*Global stablecoin arrangements, for example, raise potential risks across a broad range of policy domains, such as legal certainty, investor protection, financial stability and compliance with anti-money laundering requirements. Public authorities have made clear that the bar will be set very high for these stablecoin initiatives to be allowed to operate*'.[9] These forms of crypto-assets

[9] https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp191126~5230672c11.en.html#footnote.2

are continuously evolving with the aim of addressing regulatory concerns. At this juncture, it is hard to see how any proposal could be put in place to mitigate against the substantive risks posed by so-called global stablecoins, in particular when looking at their global nature and potential scale.

Central banks are structured in such a way, i.e. independent from government, to ensure trust and a common understanding globally of how they operate in terms of issuing legal tender (currency) and their regulation of financial services. Among the Central Bank's key concerns is that the issuing of currency should firmly remain under the remit of the relevant public authorities (i.e. central bank). Where the reach or other features of 'so called stablecoin' risk it being perceived as a currency, or operating as a quasi-currency, then it should be prohibited. The Central Bank agrees with comments of Yves Mersch, Member of the Executive Board of the ECB (2 Sept 2019) highlighting the public good aspect of money and how money represents an expression of state sovereignty.[10] This is an important consideration in the context of global stablecoin proposals with the capacity and reach to establish themselves as a privately operated but quasi-sovereign issuer of currency. A 'so called stablecoin' could become a global, regional or jurisdiction specific stablecoin relatively quickly, any regime adopted would need flexibility to cater for such. Among the Central Bank's key concerns is that such a stablecoin could become 'too big to fail' in a very short period. ***Defining criteria which constitute a crypto-asset being classified as a quasi-currency will be required. The Central Bank is of the view that in circumstances where the reach of 'so called stablecoin' risks it being perceived as a currency, or operating as a quasi-currency, then it should be prohibited.***

<u>Utility tokens</u>

Broadly, utility tokens can take a number of forms, including tokens that can be redeemed for a specific service. The Central Bank does not currently have a role in regulating these products, with the exception of our AML/CFT role in relation to Virtual Asset Service Providers (VASPs). While there may be arguments in favour of regulation, particularly increased protections, ***it is not readily apparent to us that most utility tokens are, or should, be treated as financial products, and consequently that they should fall within scope of the mandate of financial services regulators***. However, we recognise that a utility token may exhibit or develop characteristics that would make them comparable to financial instruments (transferable security or e-money) and, in that case, it should be clear that such cryptoassets should fall within the regulatory perimeter. ***We recommend that as the market develops such cases should be closely monitored to ensure the test (case-by-case analysis referred to earlier) is adequate i.e. where crypto-assets claim to be one thing, but transition into the provision of financial services directly or indirectly should be closely monitored.***

[10] *https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190902~aedded9219.en.html*