EC Consultation Paper: An EU Framework for Markets in Crypto-assets

Barclays is a universal consumer and wholesale bank with global reach, offering products and services across personal, corporate and investment banking, credit cards and wealth management, with a strong presence in our two home markets of the UK and the US. With over 325 years of history and expertise in banking, Barclays operates in over 40 countries and employs approximately 85,000 people. Barclays moves, lends, invests and protects money for customers and clients worldwide.

Barclays welcomes the chance to input into the European Commission's (EC) recent consultation paper on an EU Framework for Markets in Crypto-assets (the CP) which seeks views on the suitability of the existing regulatory framework for crypto-assets including "stablecoins" and looks to bring forward a comprehensive EU framework for the regulation of crypto assets that promotes innovation whilst mitigating risks to financial stability, consumers and investors.

Barclays further welcomes the questions and highlights that the CP and its responses should form part of a drive for common global standards for regulation in this fast developing sector, and with this in mind, should perhaps call out differences and similarities with regulatory frameworks introduced in other jurisdictions.

We are supportive of the AFME and EBF responses, however, we want to highlight the following high-level considerations in response to the CP. In addition we are supportive of the recommendations provided in the EC's ROFIEG 'Thirty Recommendations on Regulation, Innovation and Finance' and urge the EC to move forward with these. We hope these insights are valuable and we would of course be happy to discuss them further if helpful.

1. Key Points

- We believe that a common taxonomy and clear and expanded regulatory perimeter is needed to provide regulatory certainty for market participants engaging in crypto-asset activity.
- The most important factor of the EU's approach to crypto-assets is a uniform one that applies the principle of 'same activity, same risk, same regulation' that avoids fragmentation and allows market participants to benefit from scaling effects.
- We recommend that a more in depth analysis of how current financial service regulations impact crypto-assets is undertaken and additional guidance is provided to clarify how these regulations will apply to crypto-assets
- Given the cross-border nature of many types of crypto-assets we urge regulators and policymakers across jurisdictions to work together to have agreed definitions and regulations.
- We believe that the current definitions commonly used by EU policymakers ie exchange, security and utility tokens, are too broad and require further clarification based on a token's characteristics. We have included a proposed taxonomy that will by definition, need to be agile and will require updating as market structures develop, uses evolve, and technology changes.
- Where a product changes characteristics during its lifecycle we recommend that additional analysis is undertaken in relation to a framework, which will account for these changes.

- There are both purported advantages as well as known disadvantages to using the set of emerging technologies known as DLT, but we believe that the purported benefits should be called out as being worthy of further analysis. DLT has the potential to bring significant benefits to both market participants and consumers, including increased efficiencies at various stages of the capital markets transaction lifecycle (from trading to settlement). In addition, it has the potential to be used to increase access to certain financial products, drive financial inclusion, improve the resiliency of market infrastructure and change the way market participants interact.

2. Classification of Crypto-assets and Common Taxonomy

Barclays believes that there is a need for a common taxonomy and updated framework for analysis for crypto-assets at the global level to reduce regulatory fragmentation. Clear definitions and consistent regulation will be crucial for providing regulatory certainty for market participants whilst fostering and promoting innovation. Whilst this CP provides a wide reaching set of questions to help understand the suitability of the existing regulatory framework for crypto-assets, we believe that a taxonomy is required.

Barclays has been working on a recommended approach to the classification and understanding of "crypto assets" and this is set out below. These categories have been included for discussion purposes to help provide a more comprehensive view of crypto-assets. This taxonomy will, by definition, need to be agile and will require updating as market structures develop, uses evolve, and technology changes. It is important to flag that it is not intended as a recommendation on the legal or regulatory treatment of categories of crypto-assets, but rather it may be helpful as an input to assess the current universe of crypto-assets, coupled with a understanding of the various regulatory frameworks that apply to different types of financial instruments, in order to discuss appropriate existing or new regulatory frameworks for crypto assets.

In order to provide legal certainty to market participants on where a firm's activity falls in respect to the regulatory perimeter we request that categories are made mutually exclusive at the point of issuance to provide legal certainty. A challenge that exists is that the classification of a crypto-asset may change during the lifecycle of a product ("Hybrid Crypto-assets"), however we ask that there is exclusivity in the initial regulatory classification of the crypto-asset whilst highlighting that in assessing the appropriate regulatory treatment, further consideration should be given to the appropriate treatment of crypto assets that may be classes as Hybrid Crypto-assets.

In addition, we note that stablecoins have characteristics that distinguish them from the categories previously provided by policymakers in the EU ie exchange, utility and security token categories most notably due to their stabilisation functionality with underlying or reference asset.

I. Crypto-Asset Definition

A **crypto-asset** is a digital representation:

- of value or rights,
- which may be transferred and stored,

- using cryptography and DLT or similar technology[1]

II. Uses and Key Attributes of Crypto-Assets [2]

A. **Payment:** Is the crypto-asset being held and transferred primarily for the purposes of buying or selling other assets?[3]

B. **Security/ Investment/Financial instrument:** Does the crypto-asset provide interests to underlying assets or a pool of assets? Does the crypto asset have expected fluctuation in pricing? Does the crypto asset provide entitlement to proceeds or a right to vote?

C. **Access to Platform/Services (Utility):** Crypto-asset's use as a means of accessing a DLT platform and/or a medium of exchange for the provision of goods and services provided on the DLT platform, and does not have value or application, outside of the DLT platform on which it was issued?[4]

D. **Other**: As the crypto-asset market evolves and the understanding of uses matures, additional uses beyond those identified in A, B, and C above may need to be addressed or identified.

III. Classification of Crypto Assets[5]

A. Cryptocurrencies

- No central issuer
- Does not represent a financial interest in a company, partnership, or fund, including an ownership or debt interest, revenue share, entitlement to any interest or dividend payment or otherwise

B. Price-Stable Crypto-Assets

1. Central Bank Digital Currencies
   - Liability of a central bank representing fiat sovereign currency
   - Withdrawable for cash at par
2. Depository Coins
   - Represents a claim on a bank or other highly regulated depository institution
   - Representation of customer deposits in a single fiat currency held at a bank or other highly regulated depository financial institution which may or may not pay interest
     - "Redemption at par" (e.g., it is a withdrawable for fiat credit to account at a stated fixed fiat value)

[1] crypto-assets are typically implemented on distributed ledger technologies and it remains to be seen whether other technologies will also be used to implement crypto-assets.
[2] Question for Consideration: Should this be from the perspective of the issuer? In the case of no central issuer, should it be from the prospective of the developer of the software protocol? How would intended use be evidenced?
[3] May bear interest while remaining a payment token.
4 Note that the crypto asset may used as a means for data and database management, data recordation, or other bookkeeping or recordkeeping activity. As these do not constitute financial instruments, they are intentionally excluded here.
[5] Some assets may have characteristics of different instruments and become 'hybrids' either at a point in time or through time

3. FMI Tokens

- Participants hold settlement balances in a payment system which are "tokenised"Settlement balances reflect deposits in a single fiat currency held at a central bank
- "Redemption at par" (e.g., it is a withdrawable for fiat credit to account at a stated fixed fiat value)

4. Stablecoins: designed to minimize/eliminate volatility inherent in cryptocurrencies

   a. Variable Redemption Asset Backed Coin

   - One for one backed with underlying assets
   - Variable redemption value from the issuer based on price of real (including financial) assets

   b. Fixed Redemption Asset Backed Coin

   - One for one backed with underlying assets
   - Fixed redemption price based on price of real (including financial) assets supplemented by claim on issuer

   c. Algorithmic Coin

   - Typically not backed by any underlying assets
   - Each token can be pegged to a price level or a unit
   - Token price peg is maintained through buying, selling or exchange[6] among assets[7] or some other pre-determined mechanism[8]

C. Native Security/Financial Instrument Token

- Originated/issued solely on DLT with its own unique characteristics
- Satisfies the applicable regulatory definition of a security or analogous term/categories, such as certain types of 'financial instruments', under local law

D. Token Representing Securities Ownership

- Representation on DLT of underlying securities issued on a different platform (i.e. a traditional CSD, registrar, etc.)There is a process to link those tokens with the underlying securities

E. Representation on DLT of Ownership or Rights in Other Assets

- Representation on DLT of underlying assets (not securities) controlled/owned by the issuer, or of certain rights in underlying assets (e.g., warrants that are not considered financial instruments).
- Includes ownership in real estate, art, intellectual property rights, etc.

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[6] "Buying, selling, or other exchange" may be facilitated algorithmically (pre-programmed) or through market practices (participant arbitrage)
[7] Asset may involve the native stablecoin itself or other crypto asset used for exchange or collateralisation
[8] Pre-determined mechanisms may involve pre-programmed economic policies, including, but not limited to, asset staking or exchange, dynamic transaction fees, seigniorage, asset supply control, recapitalizations and/or use of financial instruments

- Includes also non fungible assets that only exist in digital form on a DLT network such as digital art, digital collectibles or domain names on smart contract platforms

F. Utility token

- A means of accessing a DLT platform and/or a medium of exchange for which participants on a DLT platform may use for the provision of goods and services provided on a DLT platform[9] or
- Tokens that are not native to the underlying network but are used for accessing applications that are built on top of a DLT platform (dApp).

IV. Other Key Attributes

A. **Underlying:** Is the crypto asset a representation of another asset and, if so, is the other asset held in custody? If the other asset is held in custody, by whom (e.g. the issuer)?

B. **Issuer:** Is there an identifiable central issuer of the crypto-asset and, if so, what, if any, regulatory regime applies to the issuer and is the crypto asset issued as part of a regulated function of the issuer?

C. **Network:** Is the crypto-asset issued on a public network? Is the crypto-asset part of the incentive/consensus mechanism of the network?

D. **Fungibility:** Is the crypto-asset created with the purpose or nature that one part or quantity may be replaced by another equal part or quantity or otherwise being mutually interchangeable?

E. **Users:** Are the end users of the crypto-asset retail or wholesale in nature?

F. **Transferability: Is the security tradable/transferable or not?**

G. **Systemic importance:** Does the crypto-asset have the propensity to impact global financial markets or global financial stability, or incur mass scale adoption?

3. Further analysis of existing regulations

Whilst the CP highlights a number regulations and we welcome the questions posed by the EC, we believe it is worth noting that these regulations were not written with crypto-assets in mind. This is highlighted by the advice provided to the EC by the European Securities and Markets Authority (ESMA)[10] and the EBA on Initial Coin Offerings (ICOs) and crypto-assets, which notes that there are instances where the regulation does not apply perfectly. This is also true of other industry guidance including FATF. For instance, the application of MiFID II and RAO for crypto-assets classified as securities. Therefore, we believe that a more in depth analysis of the applicability of existing regulation is required. In addition, we note that further clarity and analysis is required with relation to stage activity such as buying or selling stable coins involving fiat and whether these would fall within scope of the regulatory perimeter and existing regulation. This would assist in making it clearer to consumers as to regulatory protections applicable to crypto-assets.

[9] Examples include loyalty rewards programs/systems, gift card rewards, credit points that is only usable within the DLT platform, memory and network server space, and other utilities-based value.
[10] https://www.esma.europa.eu/press-news/esma-news/crypto-assets-need-common-eu-wide-approachensure-investor-protection

We have a particular concern relating to the regulatory expectation for products whose characteristics may change during their lifecycle and suggest that analysis is undertaken in relation to a framework which will account for these changes. Crypto-assets are evolving rapidly, and a product can move across the regulatory perimeter more than once within its lifecycle. As a result, it will be necessary to continuously monitor the evolution of crypto-assets, keeping in mind that existing regulation may not apply perfectly to these products and the underlying DLT technology, which could hinder innovation in this area. We are supportive of the conclusion provided by in ESMA's paper that a bespoke regime at the EU level will likely be necessary to account for the nuances will arise, as for example, hybrid tokens will not map directly into traditional securities.

4. Fragmentation

Due to the cross-border nature of crypto-assets there is an increased risk of fragmentation across jurisdictions. In the EU there are diverging views amongst Member States relating to the application of a number of regulations including (but not limited to) EMD2, PSD2, AMLD5 and MiFID II and this could limit the development of crypto-assets.

For instance, we note the potential conflicts of law regarding the classification of crypto-assets in different national jurisdictions across Europe, and we request the Commission to consider how possible fragmentation in the application of a high-level classification (such as the one proposed in this CP) could create additional barriers for market participants.

We understand and appreciate the ongoing dialogues with the ESAs, EC, Member State regulators, G7/G20 and FSB and we urge the EC to globally harmonise, where feasible, guidance on regulatory obligations for regulated crypto-assset activities. Further we ask that the EC continues works with global standard setting bodies such as the FSB and IOSCO.

We are supportive of the Global Financial Innovation Network (GFIN), the European Forum for Innovation Faciliatators (EFIF) and the International Association for Trusted Blockchain Applications (INATBA) and believe that these could be good forums to share best practices and challenges and potentially test use cases.

5. Market Participants

We request that central banks, trade finance platforms and miners/mining pools be captured in any definition/list of key market participants that are a part of the crypto-asset market value chain. For example, central banks manage the liquidity of the fiat currencies that back stablecoins. It is also important to consider a regulatory framework that will be able to account for a larger role they may play in the medium and long term.

In addition we also ask that the EC differentiates between eMoney platforms, open domain stablecoins and enterprise projects that are truly backed in a fiscally appropriate way such as Utility Settlement Coin (which is central bank money) and JPM Coin (which is commercial money). Further, we ask that the EC provides a clear definition of a 'trading platform' and highlights whether this includes social media platforms that can facilitate the exchange of crypto-assets (including chat rooms).