

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Directive/regulation establishing a European framework for markets in crypto assets
LEAD DG (RESPONSIBLE UNIT)	FISMA - Unit B2
LIKELY TYPE OF INITIATIVE	Legislative proposal
INDICATIVE PLANNING	2020
ADDITIONAL INFORMATION	–

The Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

Crypto-assets are a type of digital assets that depend primarily on cryptography and distributed ledger technology (DLT)¹. A wide range of crypto-assets exist, encompassing different features and functions, hence presenting different challenges and risks. Even though there is no EU classification for crypto-assets, regulators generally agree to distinguish three main types of crypto-assets. These are: (i) payment/exchange-type tokens (for example, the so-called virtual currencies such as 'Bitcoin'), (ii) investment-type tokens (which give right to ownership rights and/or entitlements similar to dividends, such as 'security' tokens which may or may not qualify as 'financial instruments' under the [Market in Financial Instruments Directive](#) – MiFID II), and (iii) the 'utility-type' tokens that enable access to a specific product or service.

In the [Fintech Action Plan](#), adopted in March 2018, the Commission mandated the European Securities and Market Authorities (ESMA) and the European Banking Authority (EBA) to assess the suitability and the applicability of existing EU legislation to crypto-assets and initial coin offerings² (ICOs). Based on their advice, the Commission initiated two work streams in April 2019. For crypto-assets covered by the existing EU financial services regulatory framework (e.g. those which qualify as 'financial instruments' and those which qualify as 'e-money' under the [Electronic Money Directive](#) – EMD2), the Commission services have been assessing the framework to make sure that the rules are fit for purpose and can be applied effectively. For crypto-assets that fall outside the scope of EU rules, the objective was to determine whether an EU regulatory approach is needed. In September 2019, the [mission letter](#) sent by President-elect Ursula von der Leyen to Vice-President Dombrovskis highlighted the need to '*ensure a common approach with Member States on cryptocurrencies to ensure we understand how to make the most of the opportunities they create and address the new risks they pose*'. During his opening speech at his confirmation hearing before the European Parliament, Vice-President Dombrovskis indicated his intention to propose new legislation for a common EU approach on crypto-assets, including the so-called 'stablecoins'³.

Problem the initiative aims to tackle

The overarching problem is the lack of legal certainty that currently exists around treatment of crypto-assets in EU financial regulation. There is currently no EU definition of what constitutes a crypto-asset (or potential sub-categories) nor is it clear if and how the existing EU financial services regulatory framework applies to them. As

¹ DLT is a means of saving information through distributed ledger, i.e. a repeated digital copy of data available at multiple locations. DLT is built upon a cryptographic system: public keys, which are publicly known and essential for identification and private keys, which are kept secret and are used for authentication and encryption.

² ICOs allow businesses to raise capital for their projects, by issuing digital tokens in exchange for fiat currencies or other crypto-assets. Those tokens generally give access to a product or a service.

³ 'Stablecoins' are a relative new form of payment/exchange crypto-asset with a goal to achieve price stability.

such, it presents a major hurdle to the development of a sustainable crypto-asset ecosystem. This is true for both crypto-assets that present key characteristics of financial instruments or e-money (thereby falling into scope of existing regulation) as well as crypto-assets that due to their features are not currently covered by existing EU legislation.

For **crypto-assets that are currently covered by the EU financial services legislation**, there is a lack of clarity on how the existing regulatory framework for financial services applies to such assets and whether that framework is fit for purpose. While ‘tokenised’ financial instruments offer equivalent rights to traditional financial instruments, there are certain technical deviations, especially in post-trading processes⁴. This raises questions concerning the interpretation and application of existing requirements and can lead to diverging approach by national competent authorities (NCAs). Moreover, there are provisions in existing legislation that may preclude the application of certain technologies, including DLT. In addition, it is uncertain whether the current framework can effectively address the operational risks inherent to such technologies (for instance, cyber resilience and operational risks change in a distributed system with more access points).

For **crypto-assets that are not covered** by EU financial services legislation, the absence of applicable rules leaves consumers and investors exposed to substantial risks, while, if they were properly regulated, crypto-assets could become a new asset class for investment by EU citizens. Consumers’ lack of understanding of the intricacies of the underlying technology may exacerbate the operational risks and the risk of fraud. There are also considerable risks as regards market integrity in the secondary market of crypto-assets. Given the novelty and complexity of the technologies used as well as the low liquidity and price volatility, the price discovery mechanism is very susceptible to market manipulation. Furthermore, some Member States have or are considering bespoke rules at national level for all or a subset of crypto-assets that do not qualify as ‘financial instruments’. This is likely to lead to a substantial regulatory fragmentation, which may distort competition in the single market and give rise to regulatory arbitrage. Furthermore, a new subset of crypto-assets (that are usually not covered by EU legislation) that seek a wide adoption by consumers by stabilising their price has recently developed. While the crypto-asset market remains modest in size and does not currently pose a threat to financial stability, this type of ‘stabilised’ crypto-assets would likely raise additional challenges in terms of financial stability, monetary policy transmission and monetary sovereignty if they reach a global scale, due to their capacity to be an alternative to fiat currency and based on their take up in the market (as underlined in a recent [G7 report on ‘stablecoins’](#)).

Basis for EU intervention (legal basis and subsidiarity check)

The Treaty on the Functioning of the European Union (TFEU) confers upon the European institutions the competence to lay down appropriate provisions that have as their object the establishment and functioning of the internal market (Article 114 TFEU). Depending on the policy option chosen and the specific design of the rules, the appropriate legal base could also be Article 53(1) TFEU on the taking-up and pursuing of activities by self-employed persons, which is used to regulate financial intermediaries, their investment services and activities.

For crypto-assets that are already covered by EU legislation (mostly those which qualify as financial instruments under [MIFID II](#)), the impact assessment will examine whether targeted changes are necessary to the existing EU financial services regulatory framework to allow for the use of DLT. As financial markets are cross-border by nature, legislation applying to the issuance, trading, clearing and settlement of financial instruments is largely harmonised at EU level (notably through the [Prospectus Regulation](#), [MIFID II](#), the [Central Security Depositary Regulation](#)), leaving limited flexibility for Member States to adapt their legal framework to technological developments. Therefore, any modifications of these rules to ensure that the existing EU regulatory framework for financial services can be effectively applied to ‘tokenised’ financial instruments would require legislative action at EU level. Furthermore, different interpretations on how the current financial services legislation applies to service providers using DLT could lead to disparities in terms of investor protection, market integrity and competition across the Single Market and they can lead to regulatory arbitrage, thus justifying a common EU approach.

For crypto-assets that fall outside the scope of existing EU financial services legislation, some Member States have put in place (or are considering) bespoke national regimes to regulate crypto-assets. These national regimes can follow different approaches and can make the cross-border provision of services in relation to crypto-assets (such as wallet providers, trading platforms and exchanges...) difficult. This proliferation in national approaches also pose risks to the level playing field in the Single Market in terms of investor/consumer protection, market integrity and competition. Furthermore, while some risks could be mitigated in the Members States that introduced a bespoke regime on crypto-assets, consumers, investors and market participants in other Member States would remain unprotected against some of the most significant risks posed by crypto-assets (e.g. fraud, cyber-attacks, market manipulation...). The aim of EU regulatory action would be to improve the functioning of the internal market by laying down a regulatory framework that set the ground rules on which a larger cross-border market for crypto-assets could develop, thereby reaping the full benefits of the Single Market.

⁴ Post-trade processes comprises the services that are performed subsequent to the execution of a trade, and include the clearing, the settlement, the custody and asset services, as well as related activities such as collateralisation.

B. Objectives and Policy options

The overall objective of the initiative is to provide clarity as concerns the applicability of the EU financial services legislation to crypto-assets (and related activities) and to ensure that the regulatory framework adequately addresses the risks inherent to these assets and related services. The aim is to find a proportionate approach that would fulfil these objectives without creating undue administrative burden. This would facilitate competition and support further innovation.

Under a baseline scenario, the Commission would continue to monitor and maintain regular dialogue with the ESAs, the NCAs and Member States as well as with crypto-assets service providers, in order to promote the sharing of best practice and keep developments of national legislation under review. An increasing number of Member States could implement bespoke regimes for crypto-assets that do not qualify as financial instruments under [MIFID II](#) or as e-money under EMD2.

On that basis the impact assessment will analyse several policy options, ranging from soft-law measures (e.g. a Commission's interpretative Communication and/or Guidelines, Questions and Answers from the ESAs) to further detail the applicability of existing EU legislation to crypto-assets to targeted amendments to sectoral legislation (such as the [Prospectus Regulation](#), [MIFID II](#), the [Central Security Depository Regulation](#)...) in order to make sure that tokenised 'financial instruments' or 'e-money' can be issued and that specific risks stemming from the use of DLT technology are effectively addressed. This will be considered in combination with a mandatory EU framework for crypto-assets that are not currently covered by the EU legislation. This legislation could cover aspects such as the issuance of crypto-assets and set requirements for the provision of certain crypto-asset services (such as trading platforms, exchanges, wallet providers...). This would support the tokenisation processes⁵.

C. Preliminary Assessment of Expected Impacts [max 20 lines]

Likely economic impacts

DLT and specifically blockchain⁶ technologies are set to lead a major breakthrough which hold the potential to transform the way that financial assets (either tokenised 'financial instruments' or crypto-assets falling outside EU regulation) are issued, exchanged, shared or accessed through digital networks.

ICOs are examples of recent applications of blockchain for finance, allowing for a cheaper, less burdensome and more inclusive way of financing for small and medium-sized companies (SMEs). A proportionate regulatory approach could address key concerns in terms of investor protection without stripping away ICOs' advantages in terms of speed and costs. By mitigating risks associated with some market players in the crypto-asset ecosystem that are largely unregulated (such as wallet providers, crypto-exchanges or trading platforms), the initiative aims at fostering investor and consumer protection, which could broaden the investment opportunities for EU citizens while bringing regulatory clarity for the service providers. Security Tokens Offerings (STOs, i.e. offers of crypto-assets that qualify as financial instruments under [MIFID II](#)) have developed in a second step and seem to respond to the need for more legal clarity from institutional investors who prefer operating in a regulated environment. The initiative which aims to clarify the legal framework could foster this kind of operations.

Tokenisation processes have the ability to make liquid tangible assets (such as cars or real estate) that otherwise would be illiquid or to facilitate the protection and monetisation of immaterial rights (such as intellectual property rights and software).

By facilitating the 'tokenisation' of financial instruments, the initiative is expected to open up opportunities for efficiency improvements across the entire trade and post-trade value chain, contributing to more efficient risk management and pricing. A number of promising pilots or use cases are being developed and tested by new and incumbent market participants across the EU. Provided that DLTs prove that they have the ability to handle large volumes of transactions, it could lead to a reduction in costs in the trading area and for post-trade processes. This will promote competition and lower costs for market participants.

Payment tokens with price stabilisation mechanisms can present opportunities in terms of cheap, fast and efficient payments (especially on a cross-border basis).

This initiative will also contribute to the overarching objective of financial stability. In line with the Financial Stability Board's (FSB) recent report on "[decentralized financial technologies](#)", risks to financial stability remain remote today, as the use of DLT applications in securities trading and post-trading is still limited. However, the use of this technology could entail new forms of risks, such as concentration and cyber risk. The level of those risks will vary, depending on the type of asset classes and the volumes involved and the features of the DLTs that are deployed in the trading and post-trading areas. While the volume of issuance of crypto-assets is relatively low and do not raise financial stability issues, the recent [G7 report on 'stablecoins'](#) indicates that these 'stablecoins' (if they reach

⁵ Tokenisation refers to the process whereby traditional financial instruments or other assets are issued and/or represented on DLT.

⁶ The blockchain is a form of distributed ledger in which details of transactions are held in the ledger in the form of blocks of information. A block of new information is attached into the chain of pre-existing blocks via a computerised process by which transactions are validated.

<p>global scale) can raise concerns in terms of financial stability, monetary policies and the functioning of the international monetary system. The initiative will aim to address those risks.</p> <p>This analysis could also inform possible initiatives aimed at the establishment of appropriate administrative instruments enabling the tax authorities of each EU Member State to be duly informed about the related cross-border accounts and relevant transactions with a view to prevent any negative impact of the development of new technologies on the tax revenues.</p> <p>The likely economic impacts of the various options will be analysed in more detail in the Impact Assessment.</p>
<p>Likely social impacts</p>
<p>Reducing legal barriers to the cross-border development of ICOs and STOs is expected to broaden access to finance for innovative companies, start-ups and other unlisted firms, including SMEs and may have a beneficial impact on employment.</p> <p>As regards the financing of criminal activities and the financing of terrorism, it should be noted that the providers engaged in exchange services between virtual currencies and fiat currencies as well as custodial wallet providers are now listed among the ‘obliged entities’ within the scope of the Anti-money Laundering Directive 5 (AMLD5). The characteristics and use of, and services offered in relation to, crypto-assets have evolved rapidly in recent years. The impact assessment will also be an opportunity to identify crypto-assets (other than virtual currencies) and services (such as crypto-to-crypto exchanges) that have become more prevalent and that are not covered by AMLD5. The impact assessment could therefore inform any modifications of AMLD5 that would take into account the last modifications to the Financial Action Task Force’s Recommendations on ‘virtual assets’ published in October 2018.</p> <p>Some payment tokens with a price stabilisation mechanism (the so-called ‘stablecoins’) can also present opportunities in terms of financial inclusion.</p>
<p>Likely environmental impacts</p>
<p>In its advice issued in 2019, the EBA draws the Commission’s attention to the energy consumption entailed in some crypto-asset activity and the need for a cost-benefit analysis to take account considerations relating to the sustainable development of the financial sector and other climate-related EU initiatives.</p>
<p>Likely impacts on fundamental rights</p>
<p>Some NCAs have adopted, or plan to consult on, a ban on the sale of certain crypto-asset products⁷. If the initiative results in a new EU framework that regulates crypto-assets, then the initiative could have an impact on the right to conduct a business (e.g. freedom of establishment), by allowing those activities. Strengthening the operational resilience of some unregulated entities (such as wallet providers, trading platforms and crypto-asset exchanges...), including in the area of cyber security, would likely lead to an increased protection of personal data of customers that those entities can hold.</p>
<p>Likely impacts on simplification and/or administrative burden</p>
<p>On the one hand, the initiative aims at providing legal clarity about the applicability of the current EU financial services regulatory framework. This could lead to simplifications for firms and may result in a reduction of the administrative burden and compliance costs for regulated entities. On the other hand, this initiative could aim at providing the rules for entities providing crypto-asset services (such as wallet providers, trading platforms) and that may not constitute regulated financial activities. While potentially increasing their compliance costs at the initial stage, it will avoid fragmented regulatory approaches across Member States in the future. As such, compliance costs are ultimately expected to be lower.</p>
<p>D. Evidence Base, Data collection and Better Regulation Instruments</p>
<p>Impact assessment</p>
<p>An impact assessment is being prepared to support the preparation of this initiative and to inform the Commission’s decision.</p>
<p>Evidence base and data collection</p>
<p>In January 2019, the Commission received advice from ESMA and EBA that assesses the applicability and the suitability of the existing current EU financial services regulatory framework to crypto-assets. That advice provides qualitative evidence to support a common approach at EU level on crypto-assets. The Commission will also build its analysis on the 2016 ESMA report on ‘the Distributed Ledger Technology Applied to Securities Markets’ that analysed in-depth the key benefits and risks of DLT and the 2014 EBA Opinion on ‘virtual currencies’.</p>

⁷ EBA, Report with advice for the European Commission on crypto-assets, 2019

In line with the general principles in the Better Regulation guidelines on the need for evidence-based impact assessments, the Commission will collect evidence through several sources. The Commission will notably rely on:

- The Report from the [Regulatory Obstacles to Financial Innovation Expert Group](#) (ROFIEG) that was set up by the Commission in Spring 2018, to review the application and suitability of the European regulatory framework to FinTech from the perspective of identifying issues that may impede the scaling-up of FinTech in the EU;
- The work carried out in the context of the [EU Blockchain Observatory and Forum](#), and in particular the outcomes of the two workshops organised respectively in May and September 2019 on digital assets and blockchain use cases in the financial sector;
- “The Commission’s study on “Blockchains: legal, governance and interoperability aspects” to be finalised in January 2020;
- The various studies on crypto-assets produced by the European Parliament (e.g. ‘[Cryptocurrencies and blockchain](#)’ - July 2018 - ‘[Virtual Currencies and Central Banks Monetary Policies: Challenges ahead](#)’, July 2018) and the occasional papers published by the European Central Bank (e.g. ‘[Virtual Currencies Schemes – A Further Analysis](#)’, February 2015; ‘[Distributed Ledger Technologies in securities post-trading](#)’, April 2016; ‘[In search for stability in crypto-assets: are stablecoins the solution?](#)’, August 2019);
- The international works on ‘stablecoins’, in particular the [G7 report on ‘investigating the impact of global stablecoins’](#) published in October 2019 and the ongoing work of the G20/Financial Stability Board ‘Regulatory Issues of Stablecoins’ Working group;
- Warnings and Guidelines on crypto-assets issued by EU and third-country National Competent Authorities;
- Reports on DLT and crypto-assets from international organisations and standard-setting bodies, such as the Financial Stability Board (e.g. “[Decentralised financial technologies: Report in financial stability, regulatory and governance implications](#)”; ‘[Crypto-assets: Work underway, regulatory approaches and potential gaps](#)”; ‘[Crypto-asset markets: Potential channels for future financial stability implications](#)’...), the International Organisation of Securities Commissions (IOSCO) (‘[Issues, Risks, Regulatory Considerations Relating to Crypto-Asset Trading Platforms](#)’, May 2019; ‘[study of emerging global stablecoins proposals](#)’, November 2019) the Organisation for Economic Co-operation and Development (OECD) (“[Initial Coin Offerings for SME Financing](#)”, 2019);
- Publicly available reports, studies, surveys, position papers and other relevant documents drawn up by private and public stakeholders;
- Input from workshops, bilateral meetings and consultation with Member States and industry stakeholders active in the field of crypto-assets;
- The results of the public consultation targeting all interested parties, which will be launched in December 2019.

Consultation of citizens and stakeholders

The European Commission will launch an open public consultation related to this initiative. The Internet-based consultation is an opportunity for all stakeholders (EU citizens, Member States, ESAs, NCAs, financial institutions, crypto-asset service provider, investors etc.) to provide their views on the risks and opportunities related to crypto-assets and the use of DLT in financial services, the need for action and the possible solutions necessary in order to address the current issues. The public consultation will be published on the [Have your Say](#) portal (open for 13 weeks). This consultation will represent one of the main sources of evidence for the impact assessment.

The Commission will also consult the Expert Group on Banking, Payments and Insurance (EGBPI), the Expert Group of the European Securities Committee (EGESC) and the Financial Services Users Group (FSUG), and will continue to liaise with stakeholders through bilateral *ad hoc* contacts to help further substantiate the analysis of the available policy options in line with the Better Regulation guidelines. The Commission will also liaise with the NCAs through the relevant task forces, working groups and Standing Committees at the EBA, ESMA and the European Insurance and Occupational Pensions Authority (EIOPA).

Will an Implementation plan be established?

If a legislative approach is taken to enact this initiative and if the new rules take the form of a directive, an implementation plan will be established.