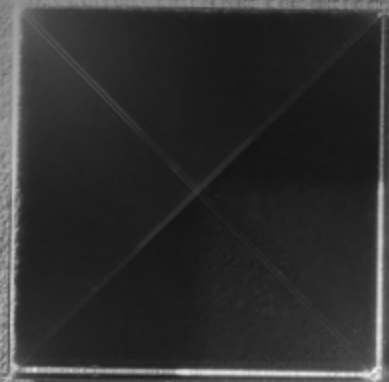


THE CAPCO INSTITUTE
JOURNAL
OF FINANCIAL TRANSFORMATION

ALTERNATIVE RISKS

Will cryptocurrencies regulatory
arbitrage save Europe? A critical
comparative assessment between
Italy and Malta

DAMIANO DI MAIO | ANDREA VIANELLI



ALTERNATIVE CAPITAL MARKETS

#49 APRIL 2019

THE CAPCO INSTITUTE

JOURNAL OF FINANCIAL TRANSFORMATION

RECIPIENT OF THE APEX AWARD FOR PUBLICATION EXCELLENCE

Editor

SHAHIN SHOJAI, Global Head, Capco Institute

Advisory Board

MICHAEL ETHELSTON, Partner, Capco

MICHAEL PUGLIESE, Partner, Capco

BODO SCHAEFER, Partner, Capco

Editorial Board

FRANKLIN ALLEN, Professor of Finance and Economics and Executive Director of the Brevar Howard Centre, Imperial College London and Nippon Life Professor Emeritus of Finance, University of Pennsylvania

PHILIPPE D'ARVISENET, Adviser and former Group Chief Economist, BNP Paribas

RUDI BOGNI, former Chief Executive Officer, UBS Private Banking

BRUNO BONATI, Chairman of the Non-Executive Board, Zuger Kantonalbank

DAN BREZNITZ, Munk Chair of Innovation Studies, University of Toronto

URS BIRCHLER, Professor Emeritus of Banking, University of Zurich

GÉRY DAENINCK, former CEO, Robeco

JEAN DERMINE, Professor of Banking and Finance, INSEAD

DOUGLAS W. DIAMOND, Merton H. Miller Distinguished Service Professor of Finance, University of Chicago

ELROY DIMSON, Emeritus Professor of Finance, London Business School

NICHOLAS ECONOMIDES, Professor of Economics, New York University

MICHAEL ENTHOVEN, Chairman, NL Financial Investments

JOSÉ LUIS ESCRIVÁ, President of the Independent Authority for Fiscal Responsibility (AIReF), Spain

GEORGE FEIGER, Pro-Vice-Chancellor and Executive Dean, Aston Business School

GREGORIO DE FELICE, Head of Research and Chief Economist, Intesa Sanpaolo

ALLEN FERRELL, Greenfield Professor of Securities Law, Harvard Law School

PETER GOMBER, Full Professor, Chair of e-Finance, Goethe University Frankfurt

WILFRIED HAUCK, Managing Director, Statera Financial Management GmbH

PIERRE HILLION, The de Picciotto Professor of Alternative Investments, INSEAD

ANDREI A. KIRILENKO, Director of the Centre for Global Finance and Technology, Imperial College Business School

MITCHEL LENSON, Non-Executive Director, Nationwide Building Society

DAVID T. LLEWELLYN, Emeritus Professor of Money and Banking, Loughborough University

DONALD A. MARCHAND, Professor Emeritus of Strategy and Information Management, IMD

COLIN MAYER, Peter Moores Professor of Management Studies, Oxford University

PIERPAOLO MONTANA, Chief Risk Officer, Mediobanca

ROY C. SMITH, Emeritus Professor of Management Practice, New York University

JOHN TAYSOM, Visiting Professor of Computer Science, UCL

D. SYKES WILFORD, W. Frank Hipp Distinguished Chair in Business, The Citadel

CONTENTS

ALTERNATIVE MODELS

- 08** **Bitcoins, cryptocurrencies, and blockchains**
Jack Clark Francis, Professor of Economics & Finance, Bernard Baruch College, CUNY

- 22** **Designing digital experiences in wealth**
Raza Shah, Principal Consultant, Capco
Manish Khatri, Senior Consultant, Capco
Niral Parekh, Managing Principal, Capco
Matthew Goldie, Associate Consultant, Capco

- 32** **Token offerings: A revolution in corporate finance**
Paul P. Momtaz, Ph.D. Candidate, Anderson School of Management, UCLA
Kathrin Rennetseder, Consultant, Financial Advisory, Deloitte
Henning Schröder, Assistant Professor of Corporate Finance, University of Hamburg, and Hamburg Financial Research Center

- 42** **Future-proofing insurance: Asia insurers gearing up for digitization**
Isabel Feliciano-Wendleken, Managing Principal, Capco
Edith Chow, Principal Consultant, Capco
Matthew Soohoo, Consultant, Capco
Ronald Cheung, Consultant, Capco

ALTERNATIVE RISKS

- 58 **Seeing around the cyber-corner: What's next for cyberliability policies?**
Karin S. Aldama, Partner, Perkins Coie LLP
Tred R. Eyerly, Director, Damon Key Leong Kupchak Hastert
Rina Carmel, Senior Counsel, Anderson, McPharlin & Conners LLP
- 66 **Life after LIBOR: What next for capital markets?**
Murray Longton, Principal Consultant, Capco
- 70 **An implementation framework to guide system design in response to FRTB requirements**
Olivier Collard, Principal Consultant, Capco
Charly Bechara, Director of Research & Innovation, Tredzone
Gilbert Swinkels, Partner, Capco
- 78 **Cyber risk for the financial services sector**
Antoine Bouveret, Senior Economist, European Securities and Markets Authority
- 86 **Will cryptocurrencies regulatory arbitrage save Europe? A critical comparative assessment between Italy and Malta**
Damiano Di Maio, Financial Regulation Lawyer, Nunziante Magrone
Andrea Vianelli, Legal and Compliance Manager, Amagis Capital
- 94 **AI augmentation for large-scale global systemic and cyber risk management projects: Model risk management for minimizing the downside risks of AI and machine learning**
Yogesh Malhotra, Chief Scientist and Executive Director, Global Risk Management Network, LLC

ALTERNATIVE MARKETS

- 102 **U.S. law: Crypto is money, property, a commodity, and a security, all at the same time**
Carol R. Goforth, Clayton N. Little Professor of Law, University of Arkansas
- 110 **Behavioral basis of cryptocurrencies markets: Examining effects of public sentiment, fear, and uncertainty on price formation**
Constantin Gurdgiev, Trinity Business School, Trinity College Dublin (Ireland) and Middlebury Institute of International Studies at Monterey (CA, USA)
Daniel O'Loughlin, Trinity Business School, Trinity College Dublin (Ireland)
Bartosz Chlebowski, Trinity Business School, Trinity College Dublin (Ireland)
- 122 **Interbank payment system architecture from a cybersecurity perspective**
Antonino Fazio, Directorate General for Markets and Payment Systems, Bank of Italy
Fabio Zuffranieri, Directorate General for Markets and Payment Systems, Bank of Italy
- 134 **Has "Economics Gone Astray?" A review of the book by Bluford H. Putnam, Erik Norland, and K. T. Arasu**
D. Sykes Wilford, Hipp Chair Professor of Business and Finance, The Citadel



DEAR READER,

Welcome to edition 49 of the Capco Institute Journal of Financial Transformation.

Disruptive business models are re-writing the rules of our industry, placing continuous pressure on financial institutions to innovate. Fresh thinking is needed to break away from business as usual, to embrace the more rewarding, although more complex alternatives.

This edition of the Journal looks at new digital models across our industry. Industry leaders are reaching beyond digital enablement to focus on new emerging technologies to better serve their clients. Capital markets, for example, are witnessing the introduction of alternative reference rates and sources of funding for companies, including digital exchanges that deal with crypto-assets.

This edition also examines how these alternatives are creating new risks for firms, investors, and regulators, who are looking to improve investor protection, without changing functioning market structures.

I am confident that you will find the latest edition of the Capco Journal to be stimulating and an invaluable source of information and strategic insight. Our contributors are distinguished, world-class thinkers. Every Journal article has been prepared by acknowledged experts in their fields, and focuses on the practical application of these new models in the financial services industry.

As ever, we hope you enjoy the quality of the expertise and opinion on offer, and that it will help you leverage your innovation agenda to differentiate and accelerate growth.

A handwritten signature in black ink, appearing to read 'Lance Levy', with a stylized, flowing script.

Lance Levy, Capco CEO

WILL CRYPTOCURRENCIES REGULATORY ARBITRAGE SAVE EUROPE? A CRITICAL COMPARATIVE ASSESSMENT BETWEEN ITALY AND MALTA

DAMIANO DI MAIO | Financial Regulation Lawyer, Nunziante Magrone

ANDREA VIANELLI | Executive Director, Amagis LX and Legal & Compliance Manager, Amagis Capital

ABSTRACT

Since the start of the new millennium, financial markets have been through two major financial crises that have partly been blamed on regulatory shortcomings. In response, European regulatory authorities seem to have overreacted, and ended up limiting the freedom of the financial services industry. An industry-driven reaction to the overregulation has been the evolution of cryptocurrencies, which represent a new and disruptive form of business within the financial markets. Regulators the world over are struggling to determine what legal description crypto assets fall under, and hence how to regulate them. In Europe, where one would expect there to be greater uniformity in terms of how these assets are regulated, we find that there is a patchwork of national regulations that are anything but aligned. In this article, we will focus on the current regulatory framework applicable to crypto assets across the E.U., and in particular on two jurisdictions that have adopted radically different approaches to dealing with crypto assets, namely Italy and Malta.

1. INTRODUCTION

Crypto assets and the provision of certain investment services concerning those assets have been a hot-button topic among supervisors, practitioners, and academics, specifically on whether those assets and the respective services fall within the existing regulatory frameworks. In this article, we will focus on the current regulatory framework applicable to crypto assets across the E.U., and in particular on two jurisdictions that have adopted radically different approaches to dealing with crypto assets, namely Italy and Malta.

Before looking into the particular national regimes of Italy and Malta, however, we will initially assess the approach

that ESMA is currently taking vis-à-vis crypto assets and its implications for the potential developments at the E.U. level.

At the national level, Italy's approach to cryptocurrencies regulation is a clear example of fragmentation and incompleteness compared to other European state members. Even though an initial attempt has been made to regulate these assets through level 1 measures (i.e., legislative acts) by the Italian legislators, we must emphasize that there a number of entities and ideas being considered that aim to provide a clear framework for cryptocurrencies in Italy. Indeed, the Italian supervisory authorities¹ and, in specific CONSOB,² have undertaken a guiding role in the context of the classification of

cryptocurrencies and their regulatory treatment. In this article, we will provide a brief critical illustration of the Italian approach towards crypto assets and their regime. Starting from a scrutiny of the relevant legal and regulatory frameworks, we will then examine their interpretation and implementation by the Italian supervisory authorities.

“...the Italian definition of cryptocurrencies is based on the regulations associated with a specific category of providers engaged in exchange services between virtual currencies and fiat currencies.”

To place the current Italian regulatory environment vis-à-vis crypto assets in perspective, we felt that it was useful to compare it with another E.U. jurisdiction that has adopted a proactive attitude toward crypto assets, namely Malta. Notably, the Maltese legislator and local regulator introduced a bespoke regime compatible with the E.U. regulatory framework and, in particular, MiFID II. Among the many important steps taken by the Malta Financial Services Authority (MFSA) to regulate this market, the “financial instrument test” represents one of the most innovative.

2. THE E.U. APPROACH

Following the request from the E.U. Commission in its 2018 FinTech Action Plan [EC (2018)], on the 9th of January 2019 the European Securities Market Authority³ (ESMA) issued an advice, in coordination with a similar initiative from the EBA, to E.U. institutions on initial coin offerings (ICOs) and crypto assets.

Following a prolonged consultation and survey with several National Competent Authorities (NCAs) across 2018 and, in particular, analysis of certain existing cryptocurrencies, ESMA has identified a number of concerns in the current financial regulatory framework regarding crypto assets.

As a preliminary comment, four main macro categories have been identified by ESMA in conjunction with the relevant NCAs, namely (i) investment-type, (ii) utility-type, (iii) payment type, and (iv) hybrid-type crypto assets. The conclusions reached by ESMA with respect to crypto assets differ based on their classification as either (i) financial instruments, as defined under MiFID, or (ii) as those falling outside the perimeters of MiFID II.

Whilst ESMA acknowledges that with respect to the assets that fall within the parameters of MiFID there are areas that require potential interpretation or reconsideration of specific requirements to allow for an effective application of existing regulations, they reckoned that a lack of a clear regulatory framework in respect of “other crypto assets” may expose investors, particularly retail investors, to substantial risks. Among the key risks identified – though financial stability seems not to be a key concern – ESMA lists the risks of fraud, cybersecurity breaches, money laundering, and market manipulation.

Despite ESMA's recommendation that the Anti Money Laundering (AML) framework is applied to all crypto assets and activities involving crypto assets, additional interventions are also required to protect consumers, in particular, the insertion of appropriate risk disclosures in place.

Without delving deep into the definitions and comments by ESMA on blockchain-related concepts and the technicalities applicable to crypto assets, it is useful to highlight the fact that while ESMA has acknowledged that member states aim “to bring to the topic both a protective and supportive approach,” it has also raised concerns regarding the risks of regulatory arbitrage, which may harm the EU internal market, as a result of the impossibility of providing a level playing field across the E.U. As a result, ESMA has suggested that an EU-wide approach would be more preferable in order to provide homogenous protection for investors across the E.U., given also the peculiar cross-border nature of crypto assets.

¹ Bank of Italy and CONSOB are the Italian authorities that supervise and regulate the Italian banking and financial markets. The Bank of Italy “[a] the national supervisory authority seeks to ensure the sound and prudent management of intermediaries, the overall stability and efficiency of the financial system and compliance with the rules and regulations of those subject to supervision. Also, the Bank of Italy is the designated National Competent Authority (NCA) under the Single Supervisory Mechanism (SSM)” [Bank of Italy (2017)]. “CONSOB is the supervisory authority for the Italian financial products market; its aims are to protect investors and the efficiency, transparency and development of the market.”

² CONSOB decision n. 20751, December 19, 2018; CONSOB decision 20740, December 12, 2018; CONSOB decision n. 20694, CONSOB decision n. 20695; CONSOB decision n. 20720; CONSOB decision n. 20656; CONSOB decision n. 20660; CONSOB decision n. 20573; CONSOB decision n. 20617; CONSOB decision n. 20593; CONSOB decision n. 2045; CONSOB decision n. 20555; CONSOB decision n. 20509; CONSOB decision n. 20491; CONSOB decision 20461; CONSOB decision n. 20480; CONSOB decision n. 20481; CONSOB decision n. 20461; CONSOB decision n. 20454; CONSOB decision n. 20381; CONSOB decision n. 20336; CONSOB decision n. 19866 February 1, 2017; CONSOB decision n. 20110, September 13, 2017; CONSOB decision n. 20207, December 6, 2017.

³ According to the ESA's warning, “The VCs currently available are a digital representation of value that is neither issued nor guaranteed by a central bank or public authority and does not have the legal status of currency or money. They are highly risky, generally not backed by any tangible assets and unregulated under EU law, and do not, therefore, offer any legal protection to consumers” [ESA (2018)].

A look at the approaches adopted by two member states that are geographically close but quite different in terms of their attitudes toward crypto assets could offer an interesting overview of how valid ESMA's concerns are.

3. THE RELEVANT ITALIAN LEGAL FRAMEWORK ON CRYPTOCURRENCIES

The Italian legislative decree no. 231/2007, as amended by legislative decree n. 90/2017 of May 25, 2017 (the "Decree 231/2007"), represents a first attempt to provide a primary source of regulation for cryptocurrencies. More precisely, article 1, paragraph 2, letter qq) of the Decree 231/2007 has introduced the definition of virtual currencies as "the digital representation of value, not issued by a central bank or a public authority, not necessarily related to a currency that has legal tender value, used as a medium of exchange for the purchase of goods and services transferred, stored and negotiated electronically."

The definition appears to be consistent with the approach of the European Central Bank (ECB), which attempted to categorize cryptocurrencies in 2012 [ECB (2012)] and 2015 [ECB (2015)], the European Banking Authority⁴ (EBA), ESMA, and the European Insurance and Occupational Pensions Authority's⁵ definitions. According to the first qualification given by ECB, bitcoins are regarded as a "virtual currency scheme based on a peer-to-peer network. It does not have a central authority in charge of money supply, nor a central clearing house, nor are financial institutions involved in the transactions, since users perform all these tasks themselves. Bitcoins can be spent on both virtual and real goods and services" [ECB (2012)].

In its second report, the ECB stated that virtual currency is "not money or currency from a legal perspective" and has defined it "as a digital representation of value, not issued by a central bank, credit institution or e-money institution, which in some circumstances can be used as an alternative to money" [ECB (2015)].

Digitization, decentralization, and utilization as a means of exchange: these are the relevant features of the Italian version of cryptocurrencies. However, the qualification of cryptocurrencies is limited to the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

Indeed, the Italian definition of cryptocurrencies is based on the regulations associated with a specific category of providers engaged in exchange services between virtual currencies and fiat currencies.

Pursuant to article 2 paragraph 2, letter ff) of the Decree 231/2007, these providers are defined as any natural or legal person providing on a professional basis, services related to the use, exchange, and storage of virtual currencies, and exchange services between virtual currencies and fiat currencies (VC Exchange Providers, VCEPs). The Decree 231/2007 applies VCEPs. This means that they must comply with the obligations as set forth in the Decree, namely (i) apply customer due diligence measures; (ii) perform record-keeping measures; and (iii) report suspicious transactions.

In order to perform their activities, VCEPs must notify the Ministry of Finance of their operations in Italy.

Once the Ministry of Finance has received such notification, VCEPs must register⁶ in a special section of the register of agents and ombudsmen held by the ombudsmen body (the "Registro tenuto dall'Organismo degli Agenti e dei Mediatori") and supervised by the Ministry of Finance.

According to article 8-ter of the Legislative Decree n. 141/2010, as amended by Legislative Decree n. 90/2017 on May 25, 2017 (the "Decree 141/2010"), the Minister of Finance establishes the methods and timing with which VCEPs are required to communicate to it their activity in Italy.

In this regard, the Minister of Finance issued a public consultation that ended on February 16, 2018. Once the communication sent by the VCEPs is received, the Minister of Finance is obliged to check the correct completion of the form, the validity of the attached documents, and the qualified digital or electronic signature, as well as compliance with the submission deadlines.

⁴ According to EBA (2013), "A virtual currency is a form of unregulated digital money that is not issued or guaranteed by a central bank and that can act as means of payment." See also EBA (2014): "VCs are a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a FC, but is accepted by natural or legal persons as a means of exchange and can be transferred, stored or traded electronically."

⁵ Idem.

⁶ Article 17-bis of the Legislative Decree n. 141/2010 as amended by Legislative Decree n. 90/2017 of May 25, 2017

Article 5 of the public consultation provides a strict cooperation between the Minister of Finance, the Italian financial enforcement authority (Guardia di Finanza), and the Italian postal police. Such bodies shall exchange information on VCEP applicants in order to carry out investigations to prevent and monitor money laundering and terrorist financing.

VCEPs that are non-compliant are sanctioned with an administrative fine between €2,065 and €10,329 by the Ministry of Economy and Finance. This fine is applicable to any person providing VCEP services without being compliant with article 8-ter of the Decree 141/2010 (i.e., (i) they have not notified the Minister of Finance; or (ii) they are not registered in a special section of the register of agents and ombudsmen held by the ombudsmen body, the “Registro tenuto dall’Organismo degli Agenti e dei Mediatori”) [D’Agostino (2018)].

Consequently, the Italian legislator has classified such activity within the regulatory perimeter.

However, so far the Ministry of Finance has not published the final regulation to duly enact the secondary legislation drafted in the public consultation.

In conclusion, we may suggest that Italy is a pioneer in the regulation of virtual currencies in Europe. Indeed, the Decree 231/2007 implemented in advance the provisions as set forth in the Directive 2018/843 of the European Parliament and of the Council of May 30, 2018⁷ (the “Fifth Anti Money Laundering Directive”). This notwithstanding, the absence of an effective secondary legislation creates

uncertainty within the market of VCEPs that aim to offer their services in Italy. In addition, we may find a hole in the regulation of crypto-to-crypto exchanges that do not fall under the obligations the Decree 231/2007 and Decree 141/2010.

Having provided a strict regulation for crypto-to-fiat exchanges and no regulation for crypto-to-crypto exchanges without a clear rationale for this choice, it appears that inconsistencies are present in the design of the regulations of cryptocurrencies by Italian legislators.

4. CONSOB APPROACH

Moving from the legislative to the regulatory approach (more precisely, the supervisory approach), CONSOB has increasingly focused its attention on cryptocurrencies issued between 2017 and 2019. Indeed, its intervention follows a series of warnings [Bank of Italy (2015, 2018)] issued by the Bank of Italy whereby the Italian central bank illustrates the features and risks of cryptocurrencies.

It is important to point out that the Bank of Italy has stressed that issuing virtual currency and conversion of virtual currencies and fiat currencies may entail a breach of the relevant rules of the Italian Consolidated Banking Act and the Italian Consolidated Financial Act for the provision of reserved activities.⁸ Similarly, CONSOB has highlighted the legal risks of cryptocurrencies for consumers.

CONSOB points out⁹ that without a legal framework in place it is impossible to implement an effective legal and/or contractual protection of consumers, who can be exposed to economic losses as a result of (i) fraudulent conduct and/or (ii) bankruptcy or disruption of online trading platforms where personal digital portfolios (e-wallets) are stored.

With the absence of a clear legal framework,¹⁰ CONSOB is required to intervene on a case-by-case basis in order to clarify which rules should apply for certain market conducts.

Despite these efforts, leaving the regulation of cryptocurrencies in the hands of national regulators will not help budding entrepreneurs and creates regulatory arbitrage between E.U. members states.¹¹ In addition, it may impede the creation of a business-friendly environment for financial advisors and consumers willing to invest in cryptocurrencies.

⁷ Article 4 of the Fifth Anti Money Laundering Directive provides that “Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with [such] Directive by 10 January 2020.”

⁸ With regards to the Italian Consolidated Act the relevant provisions are: Article 130 on deposit-taking, Article 131 on banking activity; Article 131-ter TUB on the provision of payment services. With regards to the Italian Consolidated Financial Act, see Article 166 on the provision of investment services. Please note that the breach of these rules is punished with a criminal sanction. For instance, article 166 paragraph 1 of the Italian Consolidated Financial Act provides the “imprisonment from one to eight years and a fine from Euro four thousand and Euro ten thousand shall be imposed on any person who, without being authorized pursuant to this decree: a) provides investment services or activities or collective asset management services; b) markets units or shares of collective investment undertakings in Italy; c) sells financial product or financial instruments or investment services door-to-door or uses distance marketing techniques to promote or place such instruments and services or activities; and c-bis) carries out data communication services.

⁹ CONSOB, “Risks for consumers: virtual currencies and cryptocurrencies,” <https://bit.ly/2BJNeQ4> (only in Italian).

¹⁰ Or at least a creation of a limited legal framework aiming to regulate cryptocurrencies in connection with anti-money laundering.

¹¹ ESMA has recently highlighted that a “key consideration of the legal qualification of crypto assets is whether they may qualify as MiFID II financial instruments. (...) There is currently no legal definition of ‘crypto assets’ in the EU financial securities laws” [ESMA (2019)].



CONSOB has classified cryptocurrencies and their offerings as (i) financial products and (ii) financial products offerings.

While the MiFID II Directive provides a list of financial instruments,¹² the Italian implementation of that Directive has introduced the notion of financial products. According to article 1, paragraph 1 letter u) of the Italian Consolidated Financial Act, financial products shall mean financial instruments and every other form of investment of a financial nature. Consequently, the Italian national implementation of MiFID II has provided a broader qualification of the notion of financial instrument. This approach is the basis of CONSOB's decisions on cryptocurrencies.

CONSOB decision n. 28014/2019 analyzed an offering of a cryptocurrency where the structure of the operation was presented as an investment opportunity. The initiative was promoted in Italian by a company based in Bermuda for the launch of a new digital currency offering users the possibility of purchasing the aforementioned cryptocurrency to receive periodic returns, related

to the amount of cryptocurrency, generated through an algorithm, in proportion to the amount of the purchased cryptocurrency.

Pursuant to article 1, paragraph 1, letter t) of the Consolidated Financial Act, the "public offering of financial products" shall mean "any communication addressed to the public, in whatsoever form and by any means, that presents sufficient information on the conditions of the offering and of the financial products so as to enable an investor to decide to purchase or subscribe such financial products, including the placement through authorised entities."

In this regard, CONSOB is considering that:

- The elements of the public offering that are relevant for the purposes of the aforementioned provisions can be summarized as follows: (i) in circumstances where the activity concerns a specific "financial product," a category which includes – within the meaning of Article 1(1)(u) of the TUF – both the "typical figures" of "financial instruments" and "any other form of investment of a financial nature"; (ii) the existence of communications aimed to purchase or underwrite a specific financial product or products and containing, consequently, at least a representation of the essential characteristics

¹² "Financial instruments" are defined in Article 4(1)(15) of MiFID II as those "instruments specified in Section C of Annex I." These are inter alia "transferable securities," "money market instruments," "units in collective investment undertakings" and various derivative instruments.

and conditions of the same; (iii) the representation of the offering in uniform and standardized terms and the consequent inability of the individual investor to intervene in the formation of the contractual agreement and the subsequent use of the sum transferred; and (iv) circumstances where the aforementioned offer is addressed to the public resident in Italy.

- The notion of “investment of financial nature” implies that these three elements are present at the same time: (i) an investment of capital; (ii) an expectation of return of a financial nature; and (iii) the assumption of a risk associated with the investment of capital.
- The structure of the operation in question provides that (i) the user uses their own capital for the purchase of the digital currency; (ii) by virtue of the aforementioned purchase, they are promised a predetermined return; and (iii) with the consequent assumption of a risk related to the use of the capital entrusted.

CONSOB noted that: (i) the initiative carried out by the crypto company was promoted in standardized and uniform terms, by means of a proposal containing a representation of the characteristics of the investment plans designed to enable investors to assess whether or not to join the offering; and (ii) there was unequivocal evidence that the offering in question was aimed at the public resident in Italy as the contents published on the website of the crypto company were also available in Italian.

Consequently, forbade the crypto company from making an offering of these types of financial investments to the Italian public.

5. REGULATING CRYPTO ASSETS AND INVESTMENT SERVICES RELATED TO CRYPTO ASSETS: A LEGISLATIVE APPROACH

Following several consultations and feedback from the industry, Malta became the first European jurisdiction to introduce a comprehensive regulatory framework applicable to the provision of blockchain-based financial services in or from within Malta. In this respect, the Maltese parliament published and approved three bills (the “Acts”), which came into force on November 1, 2018. The Acts set out, respectively, (i) the legal framework applicable to “initial virtual financial asset offering” (equivalent to

ICOs) and the provision of certain investment services related to virtual financial assets (the “VFA Act”); (ii) the establishment of a Maltese Digital Innovation Authority; and (iii) the recognition and certification of “Innovative Technology Arrangement Services.”

A high-level overview of the contents of the aforementioned Acts, with a particular focus on the VFA Act, is provided below.

5.1 The legal regulatory framework applicable to ICOs

The VFA Act regulates the statute of Initial Virtual Financial Asset Offering and the provision of certain investment services with respect to Virtual Financial Assets (“VFA Services”), setting out the framework applicable to service providers, issuers, and, in particular, the entities involved in the provision of the aforementioned VFA Services.

The offer of virtual financial asset (VFAs) to the public in or from within Malta and/or the admission to trading of a virtual financial asset on DLT exchanges fall within the scope of the VFAA. In terms of the VFAA, an ICO process may be broadly summarized as follows.

STEP 1: APPOINTMENT OF VFA AGENT

In terms of the VFAA, the issuer shall appoint an independent regulated entity (VFA Agent) to advise and guide the issuer as to its responsibilities and obligations to ensure compliance with the provisions of the VFAA. The VFA Agent shall act as point of liaison with the MFSA during the pre-ICO stage and shall be subject to several duties and on-going responsibilities, including the submission, on behalf of the issuer, to the MFSA on an annual basis of a certificate of compliance.

STEP 2: FINANCIAL INSTRUMENT TEST (FIT)

The first step consists of an assessment on the nature of the token under issue (using the terminology of the VFAA, a “DLT asset”). The issuer shall, through the appointed VFA Agent, categorize the DLT asset as (i) a financial instrument, (ii) electronic money (subject to the applicable legislation), or (iii) a virtual token (and then unregulated) through the so-called FIT.¹³ If the token does not fall within any such categories, it shall classify automatically as VFA and shall fall within the scope of the VFAA. In particular, if the token qualifies as security token (i.e., financial instrument) it shall be subject to the harmonized E.U. securities law, including MiFID and the Prospectus

¹³ The Test and its guidance may be accessed at <https://bit.ly/2S0dfUb>.

Directive and its cross-border marketing will be subject to the aforementioned rules.

STEP 3: WHITE PAPER REGISTRATION

In order to conduct an ICO, the issuer shall publicly issue a “white paper” (WP). The WP shall be submitted by the VFA Agent (which is usually in charge of its drafting) to the MFSA ten working days before its circulation to the public and, upon MFSA acceptance, registered on a public register.

5.2 VFA services (including the operation of a VFA exchange, custody of VFA, and reception and transmission of VFA orders)

The scope of the VFA Act is extending to all those services, other than the launch of an ICO, listed under schedule 2 of the VFA Act, and carried out with respect to a VFA (hereinafter “VFA Services”). Indeed, the performance of any of the aforementioned VFA Services shall be subject to a licensing requirement with regards to the terms of

Article 13 of the VFAA. In this sense, the entity interested in engaging in any of the aforementioned activities shall submit an application to the MFSA through a duly appointed VFA agent. As part of the application, several documents need to be prepared and submitted to the regulator. Among them, a program of operations setting out the systems, security access protocols, and any other matters as may be required to be set out by the MFSA. Notably, the VFA Agent shall be required to be satisfied that the applicant (including its ultimate beneficial owners and directors) is a fit and proper person to provide the VFA services concerned and will comply with and observe the requirements of the VFA Act.

6. FINAL REMARKS: IS ITALY READY TO COMPETE AGAINST MALTA ON CRYPTOCURRENCIES REGULATION?

DLT-based technologies are reshaping the traditional way of approaching investment products and investment services by both retail and institutional investors. New technologies have made it possible to create new products



to meet investors' demands and offering exposure to a new asset class, while, at the same time, making it easier for unsophisticated parties to have access to very risky and often unregulated products.

These developments have forced financial regulators across the globe, and, in particular, across the E.U., to reassess the current regulatory landscape and create a bespoke regime for crypto assets by means of creating a regulatory system capable of balancing investor protection and financial innovation.

National regulators in Europe are not unified in their assessments of whether crypto assets fall within the existing investment services frameworks. In addition, the one-size-fits-all approach may not be appropriate given the nature of each crypto asset and their continuing evolution.

Given the above, an interesting conundrum deals with the opportunity to adopt a national or supranational approach of dealing with crypto assets. Whilst the Maltese regulatory landscape offers a new and useful framework for facilitating a better understanding of the relations between crypto assets and the existing investment services regulatory framework, other member states, such as Italy, have adopted a different and more reluctant approaches.

Based on the considerations set out above and backing the approach adopted by the ESMA, we strongly support enhanced coordination across the E.U. to avoid a run to the bottom. Indeed, the bespoke national regime already existing in Malta may offer a very interesting starting point.

REFERENCES

Bank of Italy, 2015, "Warning on cryptocurrencies," June 30, <https://bit.ly/2JXJh0d> (only in Italian)

Bank of Italy, 2017, "Our role," July 30, <https://bit.ly/2TY4mbz>

Bank of Italy, 2018, "Warning to consumers on virtual currencies by the European Authorities," March 19, <https://bit.ly/2SfCONu> (only in Italian)

CONSOB, 2018, "Risks for consumers: virtual currencies and cryptocurrencies," Commissione Nazionale per le Società e la Borsa, <https://bit.ly/2BJNeQ4>

CONSOB decision no. 28014/2019, Commissione Nazionale per le Società e la Borsa

D'Agostino, L. 2018, "Operazioni di emissione, cambio e trasferimento di criptoaluta: considerazioni sui profili di esercizio (abusivo) di attività finanziaria a seguito dell'emanazione del D. Lgs. 90/2017," Riv. dir. banc., *dirittobancario.it*, 5, 2018 (only in Italian)

EBA, 2013, "Warning to consumers on virtual currencies," European Banking Authority, December 12, <https://bit.ly/2Vaeemo>

EBA, 2014, "Opinion on Virtual Currencies," European Banking Authority, July 4, <https://bit.ly/2HPe8v2>

EC, 2018, "FinTech action plan: for a more competitive and innovative European financial sector," European Commission, March, <https://bit.ly/2HwsJqv>

ECB, 2012, "Virtual currencies schemes," European Central Bank, October, <https://bit.ly/23N8vPM>

ECB, 2015, "Virtual currencies schemes – a further analysis," European Central Bank, February, <https://bit.ly/1Ch16LJ>

ESA, 2018 "ESMA, EBA and EIOPA warn consumers on the risks of Virtual Currencies," European Supervisory Authorities, February 12, <https://bit.ly/2Nm15IA>

ESMA, 2019, "Advice on initial coin offerings and crypto assets," January 9, <https://bit.ly/2CXsJFc>

© 2019 The Capital Markets Company (UK) Limited. All rights reserved.

This document was produced for information purposes only and is for the exclusive use of the recipient.

This publication has been prepared for general guidance purposes, and is indicative and subject to change. It does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (whether express or implied) is given as to the accuracy or completeness of the information contained in this publication and The Capital Markets Company BVBA and its affiliated companies globally (collectively "Capco") does not, to the extent permissible by law, assume any liability or duty of care for any consequences of the acts or omissions of those relying on information contained in this publication, or for any decision taken based upon it.

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

WORLDWIDE OFFICES

APAC

Bangalore
Bangkok
Hong Kong
Kuala Lumpur
Pune
Singapore

EUROPE

Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA

Charlotte
Chicago
Dallas
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA

São Paulo

WWW.CAPCO.COM



CAPCO