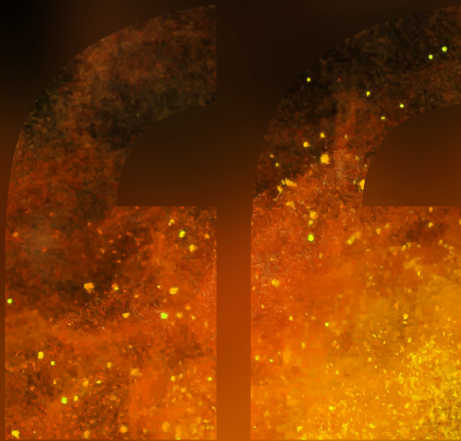


**C L I F F O R D**  
**C H A N C E**



**SECURITY TOKEN  
OFFERINGS –  
A EUROPEAN  
PERSPECTIVE ON  
REGULATION**



**– THOUGHT LEADERSHIP**

OCTOBER 2020

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## SECURITY TOKEN OFFERINGS – A EUROPEAN PERSPECTIVE ON REGULATION

Security token offerings, the issuance of digital tokens using blockchain or distributed ledger technology, are increasingly being seen as an alternative to mainstream debt and equity fundraisings. An evolution of the (supposedly) unregulated initial coin offerings or ICOs, security token offerings or STOs are typically structured to sit within securities law frameworks. This means much greater certainty for both fundraisers and investors, resulting in enhanced liquidity. In this report we consider how STOs are structured and some of the benefits and challenges, and explore the evolving regulatory landscape for STOs across Europe.

### OVERVIEW AND CLASSIFICATION OF SECURITY TOKENS

#### What are security token offerings (or STOs)?

STOs are a form of fundraising involving the offering or issuance of digital tokens to investors, which either are themselves or represent a security under the laws where they are issued. Typically, distributed ledger technology (DLT), such as blockchain, or other digital infrastructure which permits tokenisation, is used to constitute or record the interests in the securities. Such use of DLT can provide greater flexibility, speed and functionality, reduce costs and, in some cases, enhance compliance with legal and regulatory obligations in the issuance of securities. This can open up markets for fundraisers and options for investors, providing enhanced liquidity, particularly for asset classes traditionally viewed as illiquid.

Market participants may be familiar with the “initial coin offerings” (or ICOs) seen in 2017-18, typically conducted through an online platform maintained by the issuer that any investor can access directly through a computer or smart phone. ICOs were sometimes seen as a quick and easy way to fundraise outside the scope of traditional regulatory frameworks for debt and equity issuances. However, structuring of many ICOs fell short, and they often unintentionally triggered legal and regulatory obligations that were not complied with. Combined with a

number of fraudulent issuances, ICOs ultimately drew the scrutiny of regulators globally, gaining a bad reputation and losing appeal.

STOs are the market response to this; a product offering many of the advantages of the ICO without the risks entailed by seeking to remain outside the regulatory perimeter. In some jurisdictions, the form and process adopted for an STO may be similar to an ICO. However, in most jurisdictions, subject to exemptions under applicable securities laws, the process for issuing security tokens should be no different to an initial public offering or IPO for equity or other traditional security offering, i.e. a regulated process with significant documentation requirements and in practice often still effected through a chain of intermediary banks and other financial services providers. The ecosystem of regulated service providers capable of performing the traditional functions required to effect an STO in compliance with local securities laws is emerging, although at varying speeds in different jurisdictions.

#### What is a token?

A token is the common term applied to a digital entry whereby a person owns, or is recorded as owning, a unit or other entitlement through a DLT-based register or other digital infrastructure. The token may, in its simplest form, amount to a permission to control a resource native to DLT (for example, Bitcoin or Ether), it may grant certain rights to the holder (for example, use of office space or rights to share in profits of a company) or it may

### Summary

- STOs involve the issuance of digital tokens which are classed as or represent securities to investors.
- Tokens issued under an STO will typically entitle holders to rights similar to those of a conventional security, e.g. an equity token may grant voting or dividend rights, while a debt token may grant rights to coupon and principal payments.
- There is currently no uniform global or European taxonomy for categorising or defining cryptoassets, and STOs are not currently regulated at an EU level. However, a number of EU-level regulations applicable to the issue of securities bring a degree of harmonisation.
- Despite this overlying framework, the approach to regulation of STOs varies considerably between member states; some have enacted legislation that supplements the EU position, while others are unlikely to classify security tokens as securities meaning that the harmonised framework does not apply.
- In September 2020, a draft proposal for an EU regulation on markets in cryptoassets was published to improve harmonisation in this area, although it may not apply directly to many STOs.

represent an offline “real world” asset, such as a stock, bond, commodity or interest in real estate. The latter is commonly referred to as the “tokenisation” of such underlying assets.

DLT tokens can be differentiated from other forms of electronic register as a DLT platform typically permits holders to verify their holdings on the public chain, to send direct instructions to the relevant network to transfer their tokens, and to use their tokens in other ways, e.g., to interact with a smart contract or to implement sophisticated computing logic. As the real name of the owner is not recorded in the blockchain registry, “holding a token” often means controlling the key or other access credential needed to send the instructions to the network authorising the transfer of the token, in effect making them bearer assets. In the case of tokenised securities, many investors will need or prefer to use a custodian or other service provider to hold the keys for them. In some cases this may be done by the issuer of the securities.

DLT provides enhanced functionality compared with traditional systems of recording ownership of assets by being globally acknowledged as the true source of information on the holdings of the tokens by all members of the network, allowing them to individually verify the validity of token transfers on their own, without needing to trust a central authority or each other. However, the flip side is that instructions can be irreversible once sent to the network in respect of the tokens – creating risks by reducing the rights over tokens to whoever holds that key.

DLT tokens may also be referred to as “cryptoassets” as they are seen as rights in respect of what a person holding a token can do (claim underlying assets, update a network etc), and crypto as a reference to the cryptographic technology used to structure and operate a DLT platform. An STO generally refers to that subset of cryptoassets or other digital assets which constitute, represent, or confer the rights associated with, traditional financial securities.

### What is a security token?

In an STO, the form of the token will be similar to those issued to participants in an ICO in that DLT or other digital infrastructure which permits tokenisation will be used to issue coins or tokens, but, in contrast to an ICO, the tokens distributed are, represent or provide a right to a specific class of financial assets that are legally “securities”, such as shares, bonds, warrants or options, or otherwise provide the same rights as “securities”. The definition of what constitutes a security will vary from jurisdiction to jurisdiction. Therefore a particular token may be a security token under the laws of one jurisdiction but not in another.

In many jurisdictions, a token will amount to a security when it represents a right to any financial return and claim on the issuer – even where such financial return is entirely dependent on the success of a particular project. This is different from ICOs or other cryptoasset offerings with the purpose of fundraising, but which take the form of a sale or pre-sale of specific goods and services (for example, a real-world asset, a licence or a use right), rather than any interest in the issuer itself, such as a claim on its revenues or the right to participate in its governance.

The tokens issued under an STO will typically entitle holders to rights similar to those of a conventional security, depending on the nature of the security represented by the token or the specific rights granted by the token. For example, an equity security token may represent ownership over an underlying share or otherwise grant a claim to the equity in a company, voting rights or the right to dividends, while a debt security token may represent ownership over an underlying bond or grant a right to predefined coupon or principal payments.

In this report, we generally use the term “STO” to refer to security tokens that have been intentionally structured to confer the types of rights granted in conventional securities, i.e. tokenised debt and equity. In some cases, the tokens issued in ICOs or other cryptoasset offerings might unintentionally constitute securities. In the US, for

example, the Securities and Exchange Commission has taken the position that certain issuers of “utility tokens” in ICOs inadvertently offered securities for the purposes of US law, and accordingly violated the registration and disclosure provisions of the federal securities laws.

### **Regulation of STOs**

Due to the legal status of security tokens as securities, the generally more onerous regulatory regimes applicable to securities will typically apply to STOs in addition to any more recent regulations specific to issuing tokens or other cryptoassets.

In contrast, ICOs would typically be structured to avoid the need to register or comply with securities regulations and regulatory bodies. However, as noted above, this is not always clear-cut and, in several jurisdictions, ICO issuers have inadvertently triggered and been in breach of securities laws.

A variety of approaches have been taken globally as to the regulation of STOs. There is now considerable opportunity for regulators to adapt existing securities regulation to the unique features of STOs while also maintaining similar protections for investors and the financial system that underpin securities regulation.

### **Regulatory themes across the European Union (EU) and the UK**

There is currently no uniform global or European taxonomy for categorising or defining cryptoassets, and STOs are not currently regulated at an EU level. However, in September 2020 a draft proposal for a regulation on markets in cryptoassets was published to improve harmonisation in this area.

As currently drafted, the regulation would only apply to an STO to the extent that the tokens are not covered by EU financial services legislation (unless the tokens also qualify as e-money tokens). As outlined below, many STOs would currently be covered by EU financial services legislation applicable to MiFID financial instruments and so appear to fall outside scope of the new proposed regulation. It seems likely that as part of harmonisation measures, member states will be required to take action to ensure

that there is consistency across EU jurisdictions between what would be a token offering regulated under this regulation vs. an offering of security tokens regulated under MiFID II, the Prospectus Regulation and other existing regulations. However, it is likely to take many months for the draft regulation to be agreed and come into effect.

In the meantime, a number of EU-level regulations applicable to the issue of securities, including in relation to prospectuses and transparency, trading and market abuse, bring a degree of harmonisation to the European regulatory framework for STOs as outlined further below. However, notwithstanding such overlying framework, the approach to regulation of STOs still varies considerably between jurisdictions.

In certain jurisdictions STOs do not satisfy the requirements to be legally characterised as securities, rendering the EU framework largely irrelevant. In other cases, while the EU framework generally applies, jurisdictions have begun to implement specific legislation which governs the use of DLT that may impact STOs. The current approaches to the regulation of STOs across Europe can be broadly split into two categories:

- jurisdictions that primarily regulate STOs under the traditional rules applicable to securities, including in some cases where specific legislation has been proposed or enacted that facilitates the use of DLT and may impact STOs (including France, Germany, Italy, Luxembourg, the Netherlands, Romania, Spain and the UK); and
- jurisdictions where traditional securities laws are unlikely to apply to STOs without further legislative change, and no specific regulatory regime has been implemented (including the Czech Republic, Poland and the Slovak Republic). In this case, the regulatory treatment of STOs depends instead on other rules, e.g., those governing intangible assets in the Czech Republic, or property law in the Slovak Republic.



No European jurisdiction has implemented its own dedicated regulatory regime for STOs, and that seems less likely now that attention is focussed on harmonisation under MiCA and related amendments.

### Our approach

In this report we have focused on securities and related regulations, however, there are a wide range of legal and regulatory provisions that may also be relevant to participants in an STO over and above the frameworks that we describe, for example, in relation to data privacy, tax and other levies, cyber-resilience, corporate governance and systems and controls. How these apply will depend significantly on the specific STO and, in some cases, the corporate form and status of the service provider (i.e. regulated or not and, if so, how) and so are beyond the scope of this report.

The focus of this paper is on STOs, i.e. primary market offers to the public of tokens that have been intentionally structured to confer the types of rights granted in conventional securities. As

such, this paper does not consider in detail the regulatory treatment of other types of cryptoassets (such as stablecoins, which may in some cases qualify as electronic or e-money under the E-money Directive, or cryptocurrencies). A detailed consideration of the regulatory requirements that may apply when carrying on other activities relating to security tokens (such as secondary market trading or providing investment advice or custody services in relation to security tokens) is outside the scope of this paper.

It is also worth noting that the analysis has broadly been undertaken on a domestic basis, i.e. in relation to an STO that is conducted and also marketed to investors solely in that jurisdiction and/or in relation to an STO by an issuer based in that jurisdiction. However, where there are regulatory requirements in a jurisdiction, these may also apply to an STO conducted elsewhere and/or by a foreign issuer where there is active marketing of security tokens to investors in that regulated jurisdiction.

## OVERVIEW OF LOCAL REGULATION

To aid your review we have drawn together some of the high-level conclusions from this report by ranking each relevant jurisdiction on its approach to the regulation of STOs, as well as considering whether a regulatory sandbox might be available for STO participants and the general level of crypto market activity.

### Level of crypto market activity

- Least active
- Active
- Most active

| Jurisdiction             | Does the usual regulatory framework for securities apply to STOs?  | Do licence requirements apply to investors in an STO? | Is there specific local regulation or guidance relevant to STOs?   | Does a regulatory sandbox exist?   |
|--------------------------|--|---|--|--|
| ● <b>Czech Republic</b>  | There is disagreement among experts. However, the stronger argument, which is also indicated by the Czech Ministry of Finance, is that security tokens do not constitute securities. | Generally, no.  | No   | No regulatory sandbox but a specialised communication channel for fintech consultations has been established by the Czech National Bank.                                   |
| ● <b>France</b>          | Yes, if certain conditions are met.  | Generally, no.  | No, but a specific regulatory framework governing the representation and transmission of unlisted financial securities via DLT is available.   | No.  |
| ● <b>Germany</b>         | Yes, if certain conditions are met.  | Generally, no.  | Draft legislation to introduce the concept of digital bonds has recently been published. BaFin has also provided a guidance note on prospectus and authorisation requirements.                                 | No.  |
| ● <b>Italy</b>           | Yes, if certain conditions are met.  | Generally, no.  | No. Italian civil law may impose restrictions around the form of securities which impacts DLT use.   | A legal framework for a new sandbox is currently under consultation.   |
| ● <b>Luxembourg</b>      | Yes, if certain conditions are met.  | Generally, no.  | Specific legislation exists to allow fungible securities to be held and transferred via DLT. Draft legislation has recently been published to permit DLT to be used for issuance of dematerialised securities. | There is no formal sandbox. However, in addition to various fintech incubators, such as the LHoFT, a specific innovation department within the regulator has been created. |
| ● <b>The Netherlands</b> | Yes, if certain conditions are met.  | Generally, no.  | No   | Yes.   |

|                          |   |                |  |  |
|--------------------------|---|----------------|--|--|
| ● <b>Poland</b>          | There is disagreement among experts. However, the stronger argument is that security tokens do not constitute securities. | Generally, no. | No   | The KNF plans to create a regulatory sandbox as a part of its Innovation Hub Programme.          |
| ● <b>Romania</b>         | Yes, if certain conditions are met.   | Generally, no. | No   | No regulatory sandbox, but regulatory fintech hubs have been established.                        |
| ● <b>Slovak Republic</b> | No - security tokens do not constitute securities.  | Generally, no. | No.<br>The legal classification of security tokens is unclear, perhaps the category of rights or other proprietary values apply. | No regulatory sandbox, but a regulatory fintech hub has been established.                        |
| ● <b>Spain</b>           | Yes, if certain conditions are met.   | Generally, no. | The CNMV has issued certain guidance on regulations applicable to tokens should they be considered transferable securities.      | Legal framework for a sandbox is currently in the process of approval by the Spanish Parliament. |
| ● <b>UK</b>              | Yes, if certain conditions are met.   | Generally, no. | The FCA has published guidance on cryptoassets. Security tokens constitute property.   | Yes.   |

**Note:** Consideration of whether a licence will be required for investors in an STO has been based on a simple STO issuance made directly to investors, but does not constitute legal advice. Other licence requirements are likely to apply to other participants, for example, an underwriter of an STO or a custodian where tokens are issued into a custody arrangement. There may also be a statutory requirement for the involvement of an authorised central securities depository or CSD for the settlement and/or transfer of security tokens as outlined in more detail below.



## OVERVIEW OF EU-WIDE SECURITIES LAWS APPLICABLE TO STOs

STOs are not currently specifically regulated at an EU level. However, following a European Commission consultation on cryptoassets which closed in March 2020, a draft proposal for a regulation on markets in cryptoassets to facilitate the use of DLT in financial services was published in September 2020. We outline how and when this might apply to an STO below.

A number of existing EU securities laws and regulations are potentially applicable to STOs. We have also summarised these at a high level below.

For any individual STO, the regulatory analysis will need to be considered on a case-by-case basis and will be affected by various factors, including the specific laws and regulations of the relevant jurisdiction(s) in relation to STOs or cryptoassets and DLT more generally, and its application by local regulators and the fact that the technical infrastructure and nature of STOs may change or evolve very quickly.

### Proposed EU-wide regulation of cryptoassets

There is currently no uniform global or European taxonomy for categorising or defining cryptoassets. In an effort to establish a cohesive European legal framework with a view to harmonising discrepancies between EU civil law jurisdictions in particular, the European Commission published a draft proposal for a regulation on markets in cryptoassets (MiCA) on 24 September 2020. The regulation is one part of the Commission's broader Digital Finance package, which also includes a proposed regulation on digital operational resilience for the financial sector.

As currently drafted, MiCA would only apply to an STO to the extent that the tokens are not covered by existing EU financial services legislation (unless the tokens also qualify as e-money tokens). As outlined below, many STOs would currently be covered by EU financial services legislation applicable to MiFID financial instruments and so appear to

fall outside scope of the new proposed regulation. It seems likely that as part of harmonisation measures, member states will be required to take action to ensure that there is consistency across EU jurisdictions between what would be a token offering regulated under MiCA vs. an offering of security tokens regulated under MiFID II, the Prospectus Regulation and other existing regulations. Multiple steps will be required before the legislative framework becomes law, and so MiCA is unlikely to come into effect for many months yet.

The draft proposal makes clear that the European Commission's intention is to create an EU framework that both enables markets in cryptoassets as well as the tokenisation of traditional financial assets and the wider use of DLT in financial services.

MiCA introduces specific disclosure and transparency requirements, such as a requirement for a prospectus or white paper to be issued with a number of crypto-specific disclosures, and a requirement that issuers are established as legal entities and supervised effectively. Additional obligations will apply to issuers of asset-referenced tokens (or so called stablecoins). MiCA will purportedly be accompanied by amendments to existing financial services legislation that presents obstacles to the use of DLT in the financial sector, such as those outlined below. To the extent there is any conflict, an EU regulation would override any existing dedicated national cryptoasset frameworks that have been implemented within member states.

The Commission is also building on existing national initiatives by proposing a pilot or sandbox regime for DLT market infrastructures, to allow experimentation within a safe environment at an EU level and which may provide evidence for possible further amendments to existing regulation.

The publication of the draft proposal follows a public consultation on an EU framework for cryptoassets which closed in March 2020, having received nearly 200 responses. The consultation was broad-ranging and, amongst others topics, included questions on the

assessment of applicable existing legislation to STOs. In particular, as local civil or property laws represent the primary obstacle to (validly) creating and transferring tokenised assets in a given jurisdiction, the consultation tried to characterise a token under the laws of the relevant jurisdiction by also taking into account the following questions:

1. Is the token an asset over which ownership rights can be claimed?
2. Does the token embed rights enforceable against a specific person and/or any third parties?
3. Can the token be transferred from a person to another? If so, which rules of law govern its transfer? Can the token be transferred according to the same rules governing the transfer of securities?

### Security tokens in the primary markets

The Prospectus Regulation regulates “offers of securities to the public”, and there is a reasonable argument that this would include the offering of security tokens under an STO.

“Securities” are defined in the Prospectus Regulation by reference to the definition of “transferable securities” under MiFID II. These are defined as *“those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:*

- a. *shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;*
- b. *bonds or other forms of securitised debt, including depositary receipts in respect of such securities;*
- c. *any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures”.*

A key question to consider is therefore whether the tokens being offered in an STO fall within one of the types of

securities described in points (a) to (c) of the definition above or are equivalent. For example, STOs with equity-like characteristics could be argued to confer rights similar to those of shares, thus potentially falling within “other securities” in paragraph (a) of the definition. One of the STOs first approved in the EU was a token with equity characteristics; NEX, a profit-sharing token issued by Neon Exchange AG after its approval by the Liechtenstein Financial Market Authority in late 2018.

A similar argument could be made that STOs with debt-like characteristics potentially fall within “other forms of securitised debt” of paragraph (b) of the definition. A relevant example here was the first debt security token or token-based bonds issued in Germany in July 2019 by Fundament RE Germany GmbH after approval from BaFin.

However, in general, there is a lack of harmonisation in the way that different member states interpret the definition of “transferable securities” under MiFID II, particularly in the absence of EU-level guidance on what is meant by securities being “negotiable on the capital market”. According to advice issued by ESMA in early 2019 on initial coin offerings and cryptoassets, most member states interpret negotiability as potential transferability or tradability. However, some member states also emphasise the importance of other characteristics, such as standardisation or fungibility, when assessing negotiability. Other countries (such as the Czech Republic) do not recognise security tokens as “securities” at all. Nevertheless, if STO tokens are characterised as “transferable securities” under MiFID II, the requirements of the Prospectus Regulation will apply, unless certain exemptions are applicable (e.g., offers below €1 million are exempt from the obligation to publish a prospectus) or the STO falls outside of the scope of the Prospectus Regulation for another reason (e.g., there is no offer to the public).

Although the Prospectus Regulation framework is generally compatible with STOs, some of the information that is required to be contained in a prospectus pursuant to it will likely need to be adapted. Risk factors relating to the

securities will need to reflect the specificities of owning and holding securities on a distributed ledger, and the issuer will likely need to provide information on the security token's listing, as well as the applicable legal characterisation.

For example, in compliance with the information requirements under the relevant annexes to the Prospectus

Regulation, there is a requirement to detail the involvement of relevant financial intermediaries. STOs may be traded on centralised platforms, or fully decentralised, with peer-to-peer trading and no financial intermediaries involved. As a result, certain risks involving the trading of such tokens may also need to be addressed for the prospectus to be approved.

#### Licensing considerations for STO participants

Licensing requirements for participants in an STO, such as the issuer, underwriters or other investment firms involved in structuring and investors, are likely to vary from jurisdiction to jurisdiction and are very fact-dependent. For this reason, specific legal advice should be sought by each participant in an STO. A detailed analysis of such requirements is therefore outside the scope of this report, however, we list here some relevant considerations.

#### MiFID II requirements

Where the security tokens being issued in an STO are considered to be transferable securities for the purposes of MiFID II, firms involved in the STO will need to consider whether they are carrying on any investment services or activities with respect to the security tokens, which would require them to be licensed. Most obviously, MiFID II introduces licensing requirements for placement agents or underwriters of tokens which constitute transferable securities or other categories of financial instruments.

Depending on the role of the issuer in a particular STO, and how active it is in structuring and/or marketing the tokens, the issuer may also require a licence. Our experience is that issuers in STOs tend to be more involved in structuring and marketing of tokens than a standard corporate issuer of securities and so may be more likely to be considered to be carrying on investment activities by way of business that require a licence from a MiFID II-perspective.

Firms carrying on other MiFID activities with respect to security tokens (such as secondary market trading or investment advice) should also consider whether they may need to be licensed under MiFID II to carry on these activities.

#### AMLD5 requirements

AMLD5 came into force in July 2018, giving member states until 10 January 2020 to give effect to its provisions in local law. AMLD5 encompasses a range of potentially onerous new requirements, including the introduction of several new requirements in relation to virtual or cryptocurrencies.

AMLD5 brings two types of crypto-related business within the scope of the money laundering perimeter: "providers of exchange services between virtual currencies and fiat currencies" (i.e. platforms used to exchange money for cryptocurrency) and "custodian wallet providers", defined as those providing "services to safeguard private cryptographic keys on behalf of [their] customers, to hold, store and transfer virtual currencies". Providers of those services will be required to register and meet the wider requirements of the EU's money laundering regime, such as fulfilling customer due diligence obligations, assessing the money laundering and terrorist financing risks they face and reporting any suspicious activity they detect.

AMLD5 defines a virtual currency as "a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically".

While AMLD5 was required to be transposed into national law by member states by 10 January 2020, a number of member states did not meet this deadline and have faced infringement proceedings from the European Commission. For example, Spain is still in the final stages of transposing AMLD5's requirements into national law. Conversely, a number of member states that have already transposed AMLD5 have elected to "gold-plate" the legislation, i.e. introduce additional or extended obligations to those strictly mandated under the directive. This includes Germany, as described in further detail in the country-specific analysis below.

Security tokens may in many cases not constitute "virtual currencies" as defined under AMLD5, in particular because they may not be accepted as a "means of exchange". However, as implementations of AMLD5 and local guidance vary significantly, it will be important for participants in an STO to consider the implementation in all relevant jurisdictions to check applicable licensing requirements.

For example, as part of its gold-plating, the UK has expanded the scope of its implementation to cover the Financial Action Task Force (FATF) standards on Virtual Asset Service Providers (VASPs). Rather than referring to virtual currencies, the UK legislation instead refers to the much broader definition of a cryptoasset which: *"(i) is a cryptographically secured digital representation of value or contractual rights; (ii) that uses a form of DLT and (iii) can be transferred, stored or traded electronically"*. It is difficult to envisage a security token using DLT that does not meet these criteria. The FCA has also published guidance that indicates that firms involved in issuing or arranging the issue of cryptoassets may be considered "cryptoasset exchange providers", meaning that they would need to register as such with the FCA. The French implementation of AMLD5 is also wider and likely to apply to security tokens.

The FATF VASPs guidance was also followed by the Luxembourg legislator when transposing AMLD5 into the Luxembourg legal framework. Similarly to the UK, Luxembourg law refers to a wider definition of virtual assets which are: *"a digital representation of value (including a virtual currency), that can be digitally exchanged, or transferred, and can be used for payment or investment purposes"* but specifically excluding virtual assets which constitute electronic money or financial instruments. Security tokens would normally fall within the legal definition of virtual asset. Firms providing a number of services in relation to virtual assets, including exchange, transfer, safekeeping and administration and the participation in and provision of financial services related to an offer of virtual assets is subject to a registration requirement as a VASP with the CSSF.

### Other requirements

As outlined above, security tokens as we have defined them in this report are unlikely to meet the definition of e-money under the E-money Directive. However, for completeness we flag that for other types of cryptoassets, there are likely to be other relevant regulatory regimes and licensing requirements to be considered. For example, as well as new rules to potentially be introduced pursuant to MiCA, stablecoins may fall within the existing e-money regime, meaning that issuers would be subject to licensing and other regulatory requirements applicable to e-money issuers.

### Licensing requirements for investors

Generally, the onus is on issuers and underwriters to market securities in accordance with applicable laws and regulation and investors are not generally required to have a licence to purchase security tokens. However, depending on the structure of an STO and the type of security tokens offered, it may be that only a limited class of investors are eligible to purchase the tokens and so proof of eligibility is likely to be required.

## Security tokens in the secondary markets – trading

### Trading venues

Once security tokens have been issued on a DLT platform, the question of trading them will arise.

MiFID II sets out rules relating to trading for any security tokens that qualify as transferable securities or other categories of financial instruments. The applicable rules will depend on the way in which the security tokens are intended to be traded; in particular, these rules distinguish between trading on multilateral trading venues and bilateral trading.

MiFID II identifies three types of multilateral trading venues. These comprise two types of non-discretionary platforms, namely regulated markets (RMs) and multilateral trading facilities (MTFs), and one type of venue where execution of orders is carried out on a discretionary basis, namely organised trading facilities (OTFs). Bilateral trading may be carried out via a systematic internaliser, i.e. an investment firm which, on an organised, frequent, systematic and substantial basis, deals on its own account by executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system, or alternatively may be considered fully “over the counter” (OTC), i.e. not on-exchange.

Multilateral platforms allowing the trading of security tokens should generally fall under the MiFID II definition of a trading venue, meaning that they would be subject to MiFID II requirements relating to RMs, MTFs or OTFs, as relevant. It is worth noting that issuance of tokens using a fully decentralised DLT platform does not appear on its face compatible with many of the MiFID II trading venue requirements (such as the requirement to have a platform manager or operator that is a legal entity), as they imply a form of centralisation of the venue or its management.

Firms trading in security tokens by way of business (whether bilaterally or via trading venues) will need to be authorised under one of MiFID II, CRD IV or another national regime that permits them to

carry on this business. Such firms will be subject to ongoing conduct of business requirements with respect to their trading activities, including transaction reporting, transparency rules (if certain liquidity thresholds are reached) and requirements to execute orders in clients’ best interests.

MAR prohibits certain actions (including insider trading, disclosure of privileged information and market manipulation) relating to financial instruments traded on regulated platforms. Therefore, if security tokens are traded on EEA trading venues (including MTFs and OTFs), MAR will be applicable.

The Short Selling Regulation applies to certain financial instruments, in particular the short selling of shares and of sovereign debt instruments and the taking of sovereign credit default swaps positions. Security tokens could fall within the scope of the Short Selling Regulation, either directly when they fall under one of those categories of financial instruments and are trading or admitted to trading on a trading venue, or indirectly if they confer a financial advantage in the event of a decrease in the value of one of the aforementioned financial instruments. The Short Selling Regulation imposes mainly transparency and disclosure requirements, as well as restrictions on the short selling of certain financial instruments.

Issuers of security tokens that are admitted to trading on a regulated market within a member state will also be subject to the requirements of the Transparency Directive. The Transparency Directive imposes periodic and ongoing disclosure requirements such as annual financial reports, which can be onerous.

### Settlement and delivery

CSDR sets out requirements relating to the settlement of transactions in transferable securities.

Pursuant to CSDR, security tokens that are transferable securities and are traded or admitted to trading on a MiFID trading venue will be, or become, subject to requirements for the securities to be recorded in book-entry form in a central securities depository (CSD), meaning that



the settlement of transactions in those security tokens would need to be performed by the CSD.

A key challenge for STOs is whether the DLT or other digital platform on which security tokens are held and owned could be recognised as a CSD. A CSD is defined in the CSDR as “a legal person” that operates a security settlement system (which in turn is defined in the Settlement Finality Directive) that is not operated by a CCP and whose activity includes a notary service or central maintenance service. A DLT platform is unlikely to constitute a legal person in its own right and therefore qualify as a CSD, unless it has been structured around a central operator (losing some of the benefits of decentralisation). This may be an issue which is addressed by the European Commission’s Digital Finance proposals.

In addition, there are several potential difficulties for the application of the Settlement Finality Directive to DLT platforms that will need to be considered for any STO:

1. the need to identify a securities settlement system operated by a ‘system operator’ on which transactions in security tokens can be settled, which would exclude decentralised security token platforms and, more generally, the use of public blockchains which are based on a decentralised consensus;
2. the requirement for access to, or membership of, the securities settlement system to be intermediated by a credit institution or an investment firm, meaning that natural persons are not generally permitted to have direct access to the settlement and delivery system, which again is problematic in the context of some of the advantages of decentralised DLT platforms;
3. if security tokens are recorded in an existing CSD, whether the recognition of ownership rights at the level of CSD participants’ accounts may conflict with the basis of the recording of the security tokens in the distributed ledger; and

4. requirements for the settlement of the payment leg of securities transactions to be made in cash, in central bank or commercial currency, which makes end-to-end transactions conducted within a DLT platform problematic (until such time as we see a widely accepted central bank digital currency, at least).

## Country-specific analysis of STO regulation across Continental Europe and the UK

As outlined above, pending implementation of a dedicated EU regulation on markets in cryptoassets under MiCA, a number of EU-level regulations applicable to the issue of securities, including in relation to prospectuses and transparency, trading and market abuse, bring a degree of harmonisation to the European regulatory framework for STOs.

However, notwithstanding such overlying framework, the approach to regulation of STOs varies considerably between jurisdictions as outlined in more detail below. The different approaches to the regulation of STOs across Europe can be broadly categorised as follows:

- jurisdictions that primarily regulate STOs under the traditional rules applicable to securities, including in some cases where specific legislation has been proposed or enacted that facilitates the use of DLT and may impact STOs; and
- jurisdictions where traditional securities laws are unlikely to apply to STOs without further legislative change, and no specific regulatory regime has been implemented.

We anticipate these distinctions reducing in relevance in time, particularly when MiCA becomes law. It seems likely that as part of harmonisation measures related to MiCA, member states will be required to take action to ensure that there is consistency across EU jurisdictions between what would be an offering of security tokens regulated under MiFID II, the Prospectus Regulation and other existing regulations vs. a token offering regulated under the MiCA. No



European jurisdiction has implemented its own dedicated regulatory regime for STOs, and that seems less likely now that the focus is moving towards harmonisation.

In each case this country-specific analysis should be read alongside the broader EU analysis set out above and, in particular, the separate pull out box on general licensing considerations for STO participants including under AMLD5 on pages 11-12.

## Jurisdictions where STOs are primarily regulated under traditional securities law

### France

Legal and regulatory framework

Following the publication of the PACTE Law on 23 May 2019, there are two separate sets of rules for tokens under French law:

- that of digital assets, which cover “utility tokens” and virtual currencies as defined in the French *code monétaire et financier*. These new definitions are provided by exclusion from the field of financial instruments; and
- that of financial instruments, which cover “security tokens” and which are by nature subject to the various European and French financial regulations according to the conditions of their issuance and trading.

Further, Order 2017-1674 of 8 December 2017 (the Blockchain Order) created in French law a regulatory framework governing the representation and transmission of unlisted financial securities via a blockchain or DLT. The Blockchain Order makes it possible to issue and transfer security tokens in the form of units or shares in collective investment undertakings not admitted to the operations of a central depository, negotiable debt securities, and equities and bonds not traded on a trading venue within the meaning of MiFID (in practice, OTC and brokerage platforms). For unlisted securities within the scope of the

Blockchain Order, settlement and delivery can already be performed on a DLT platform, and the securities do not have to be recorded on an account with the central depository.

### AMF's view on the EU framework

The French *Autorité des marchés financiers* (the AMF) is of the view that for security tokens listed on a trading venue within the meaning of MiFID, the current regulations (including the CSDR, Settlement Finality Directive and obligations relating to custody account-keeping) cannot ensure delivery versus payment entirely using DLT. An overview of some of the key legal challenges here is presented in the European section above.

In February 2020, the AMF published its legal analysis of the application of financial regulations to security tokens. According to the document:

- the Prospectus Regulation appears compatible with STOs, but the information contained in the prospectus will have to be adapted to the specific features of security tokens; and
- the exchange of security tokens faces major legal obstacles because of the decentralised nature of DLT.

The AMF therefore suggests:

- the creation of a European “digital lab” or sandbox to secure the settlement of financial instruments using DLT notably by suspending regulatory obstacles to token security market infrastructure projects (in line with the pilot or sandbox regime for DLT market infrastructures that has subsequently been proposed in September 2020 as part of the European Commission’s Digital Finance plan); and
- clarification of the fact that, as a matter of established law, the financial securities registered using DLT take nominative form under French law, and that the liability of collective investment undertaking depositaries is limited to record-keeping.

Following its legal analysis, the AMF published a position paper which discusses the scope of the trading venue, and is applicable in particular to financial instruments registered on DLT.

### Germany

Germany has not implemented a specific cryptoasset regime, but instead takes a technology-neutral approach by regulating security tokens generally in the same way as other types of securities with similar characteristics.

#### Characterisation as a security

In its guidance note on prospectus and authorisation requirements in connection with the issuance of cryptotokens from August 2019 (BaFin Guidance), the German Federal Financial Supervisory Authority (BaFin) describes security tokens as granting the relevant holder membership rights or contractual claims on assets that are comparable to those of a shareholder or bondholder (for example, claims to dividend-style payments, voting rights, repayment claims and interest payments). In this respect, security tokens generally constitute securities under the German Securities Trading Act (WpHG) and under the German Prospectus Act (WpPG). They also qualify as financial instruments under the German Banking Act (KWG). Entities issuing security tokens in Germany will therefore need to consider and ensure they comply with the prospectus requirements imposed by the Prospectus Regulation, just as they would when offering other types of securities.

BaFin generally decides on a case-by-case basis whether a token constitutes a security instrument or whether the token instead qualifies as a utility token, payment token or e-money. Therefore, as a first step, entities offering tokens would need to consider carefully the structure and material characteristics of the token being offered in order to determine whether or not they would be categorised as security tokens or some other type of (regulated) token for the purposes of the German regulatory regime.

In the BaFin Guidance, the following criteria in particular are considered relevant for assessing whether a token

would qualify as a security for the purpose of the WpHG/WpPG:

- transferability, i.e. the tokens can be assigned to another person, irrespective of whether certificates exist that register or document the existence of the tokens;
- negotiability on the financial market or capital market (trading platforms for tokens can generally be deemed financial or capital markets according to BaFin);
- the embodiment of relevant rights in the token, i.e. either shareholder rights or creditor claims or claims comparable to shareholder rights or creditor claims; and
- the token must not meet the criteria for a payment instrument under MiFID II.

Tokens that do not meet the above requirements (for example, because there are contractual restrictions on transfer) and hence do not qualify as securities may nevertheless qualify as capital investments under the German Capital Investment Act (VermAnlG) which also imposes a prospectus requirement for public offerings.

#### Additional licence requirements

Notwithstanding the prospectus requirement, the creation and initial offering of security tokens by the issuer does not generally trigger a licensing requirement under the KWG. Directly issuing tokens to investors without involving third parties as intermediaries does not require authorisation by BaFin, even if the tokens are financial instruments under the KWG. However, a licence requirement under the KWG for deposit-taking business may be triggered if the issuer also offers tokens against legal tender and gives the buyers an unconditional repayment right. This would be the case, for example, if the issuer promises to buy back the tokens later at a price equal to or higher than the issue price.

Under Germany's gold-plated implementation of AMLD5, the offering of custody, management and backup services for cryptoassets or for private cryptographic keys which are used to

keep, store or transfer cryptoassets for others is subject to a licence requirement (Crypto Custody Business). Cryptoassets here means a digital representation of value that is not issued or guaranteed by a central bank or a public authority and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange or payment or which can be used for investment purposes and which can be transferred, stored and traded electronically. However, where cryptoassets also qualify as securities under the WpHG/WpPG and are exclusively managed or held in custody for alternative investment funds within the meaning given in the German Capital Investment Code, such activity falls under the scope of the more specific provision of restricted custody business (*eingeschränktes Verwahrgeschäft*). If cryptoassets qualify as securities, safekeeping activities may qualify as safe custody business (*Depotgeschäft*). If an entity is already authorised as a central securities depository under CSDR, according to BaFin guidance from March 2020, no separate authorisation under the KWG to conduct Crypto Custody Business is required since the authorisation requirement stipulated in the CSDR is the more specific provision in this respect and has priority over the general provision of the KWG.

#### Draft law on digital bonds

In August 2020, the German Federal Ministry of Finance and the Federal Ministry of Justice and Consumer Protection published a draft law which aims to digitise corporate financing in the capital markets by introducing the concept of an electronic bearer bond which no longer requires the embodiment of the respective claim in a physical certificate. The draft law applies existing German property law requirements to a digital value by defining electronic bonds as goods (*Sachen*) under the German Civil Code (*Bürgerliches Gesetzbuch*, or *BGB*).

Differing from the current German law regime for the issuance of bearer bonds – which requires an issuance agreement between the issuer and the initial holder of such bearer bond, as well as the issuance of a certificate by the issuer –

the draft law replaces the requirement for the issuance of the certificate by a two-part process consisting of (i) the filing (*Niederlegung*) of the terms and conditions and (ii) the registration of the bond in the relevant electronic securities register (*Elektronisches Wertpapierregister*). An electronic bond is deemed to be a “good” within the meaning of the BGB. Accordingly, even though no longer evidenced by a certificate but rather by a register entry, the provisions under German law governing securities in general (including their in rem transfer) would be applicable to electronic bonds as well.

Electronic securities registers can be (i) a central register operated by a CSD, or (ii) a decentralised DLT or crypto register (*Kryptowertpapierregister*) which may be operated by any adequately licensed person named by the issuer. If the issuer does not name any such person, the issuer itself will be regarded as administrator of the crypto securities register for the relevant security. The operation of a crypto register is defined as a licensable financial service under the KWG. Hence, operators require a banking licence under the KWG and will be supervised by BaFin as financial service institutions (*Finanzdienstleistungsinstitut*).

The draft law is currently a ministerial proposal (*Referentenentwurf*). In this respect, the legislative process will bring further changes and clarifications.

#### Italy

In Italy, there are currently no specific laws and regulations that would apply to STOs or concerning digital tokens or DLT more generally. The *Comissione nazionale per le società e la Borsa* (CONSOB), the Italian securities commission, has taken a technology-neutral approach in its considerations regarding securities tokens, and is largely following a similar approach to the US Securities and Exchange Commission in distinguishing security tokens from utility tokens.

#### Characterisation as a security

In general, CONSOB considers a transaction a financial investment if:

- there is a use of capital;

- there is an expectation of a financial return; and
- the investment risk is directly connected and related to the use of capital.

From an Italian civil law perspective, it is less clear whether security tokens can be classified as securities (*titoli di credito*). If a token were to be characterised as a security, then it could be transferred in accordance with the transfer regime applicable to securities. This would imply that, by transferring the token, one would simultaneously transfer to the transferee the rights embedded in the token. Conversely, should a token not be deemed a security, the transfer of the rights attaching to it would need to follow the ordinary regime for transfers of rights (which may require notifications and/or other formalities).

As currently drafted, it would seem that under the applicable provisions of Italian law a security could exist only in the form of either a hard copy certificate or a dematerialised instrument held through a CSD. Issuing a security token through a CSD would negate some of the benefits of tokenisation (as it would require the involvement of a large number of intermediaries). That said, it might be possible to interpret the law such that the applicable framework permits the creation of securities that are neither hard copy certificates, nor dematerialised instruments held through a CSD.

Regulatory matters generally follow the European regulation and there are currently no additional local law requirements.

#### Other relevant legislative initiatives

In terms of legislative and regulatory initiatives, in 2019 the Italian legislator tasked the Italian Ministry of Economy and Finance with establishing a regulatory sandbox to facilitate the adoption of new technologies in the financial sector, by simplifying the process for granting regulatory licences in relation to fintech initiatives and/or waiving certain regulatory requirements. The legal framework governing the sandbox is currently under consultation.

#### Luxembourg

In Luxembourg, there is no specific legal or regulatory framework for STOs. The general Luxembourg financial sector and capital markets legislation containing, among others, the implementation of relevant EU texts (and applicable authorisation and licence requirements thereunder), such as the Prospectus Regulation and MiFID II, would broadly be applicable to STOs falling within their scope of application.

#### Characterisation as a security

As there is no statutorily defined category of “securities” (*titres*) under Luxembourg law, tokens issued in an STO could be characterised as transferable securities or other categories of MiFID II financial instruments (such as derivatives or units in collective investment undertakings) or broadly as a security (*titre*) on the basis of their specific features, such as transferability, tradability, fungibility or revenue or ownership rights. Such assessment must be carried on a case-by-case basis and should also take into consideration the overall purpose of the tokens. The Luxembourg financial sector authority *Commission de Surveillance du Secteur Financier* (CSSF) has not published any specific guidance on how they would assess security tokens, except for indicating, in relation to ICOs, that they would assess whether the financial sector laws and regulations, including in relation to prospectuses for securities and anti-money laundering legislation, would be applicable to such tokens.

#### Relevant legislative initiatives

In February 2019, Luxembourg implemented specific legislation to permit securities accounts for the holding and circulation of fungible, book-entry securities through DLT (or other similar technological solutions). This still requires accounts to be held with licensed Luxembourg depositaries but now allows such accounts to be operated within or by virtue of a secured electronic recording system (using DLT or otherwise).

In July 2020, the Luxembourg government submitted a further bill to the Luxembourg Parliament allowing the use of secured electronic recording systems

(including DLT) to operate issuance accounts for dematerialised securities, which is one of the specific forms of securities recognised under Luxembourg law (in addition to registered and bearer securities). The issuance or conversion (from another form) of dematerialised securities is carried out exclusively by registering the securities in an issuance account, which may be held and the securities records therein may be effected within or by virtue of secured electronic recording systems, including ledgers or databases relying on DLT. In combination with the 2019 law, once adopted, this law would allow an end-to-end issuance and circulation of securities in dematerialised/book-entry form in a DLT-based solution (relying on licensed intermediaries to hold the issuance or securities accounts).

#### Other relevant regulatory guidance

In 2018, the CSSF issued several press releases in the context of ICOs which notified entities under its supervision that investing in tokens (including security tokens) through ICOs is not suitable for all kinds of investors and investment objectives. In particular, according to the CSSF, UCITS and other undertakings for collective investment open for non-professional investors and pension funds are not allowed to invest directly or indirectly in these products.

As practical guidance to ICO service providers and initiators, the CSSF indicates that ICO projects (including STOs) will be assessed on a case-by-case basis.

#### Additional licence requirements

There are certain local law licence requirements applicable to professionals carrying out a financial sector activity under the Financial Sector Law, some of which depend on the qualification as “securities”, such as the licence requirement for professionals borrowing or lending securities (*titres*) on own account, professionals acting as depository of financial instruments or professionals acting as agents holding registers of financial instruments. Such requirements may not be relevant to the issuer of security tokens, they would normally apply to professional intermediaries, service providers or

own account dealers in or in relation to security tokens.

The issuance of security tokens which qualify as units of a collective investment undertaking would trigger a licence requirement as an undertaking for collective investment for the issuer under the relevant Luxembourg investment funds laws and regulations, except where such issuer would be structured as a reserved alternative investment fund (RAIF) and made subject to the RAIF law of 23 July 2016 (as amended).

Security tokens qualifying as repayable funds could trigger a credit institution licence requirement under the Financial Sector Law if the issuance of such tokens is considered as taking deposits or other repayable funds from the public.

#### The Netherlands

In the Netherlands there is no specific regulatory regime for STOs or cryptoassets in the Dutch Financial Supervision Act (*Wet op het financieel toezicht*, or FSA). The FSA contains the financial regulatory framework in the Netherlands and includes both typical Dutch regulatory regimes as well as European regulatory regimes including CRD IV, MiFID and AIFMD, for example.

#### Characterisation as a security

The FSA regulates activities and services in relation to financial products (*financiële producten*). The most relevant financial products and regulatory definitions in the context of assessing whether security tokens fall in scope of the FSA are financial instruments (i.e. securities, derivatives), units in collective investment schemes and investment objects.

The Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten*, or AFM) takes a technology-neutral approach to regulating security tokens. Cryptoassets or tokens do not, as a separate category, fall within the definition of financial instruments. Therefore it needs to be assessed on a case-by-case basis if a cryptoasset qualifies as a financial instrument.

Depending on their characteristics, security tokens may qualify as financial instruments, and more specifically, as



securities under the FSA. A security is defined under the FSA as:

- a. a negotiable share or an equivalent right;
- b. a negotiable bond or other negotiable debt instrument (i.e. instruments creating or acknowledging indebtedness); or
- c. any other negotiable instrument issued by a legal person, company or institution by which securities referred to under a) or b) may be acquired through exercising the rights attached to this instrument or through conversion, or that can be settled in cash.

The AFM has provided some practical guidance on when tokens may qualify as securities within the meaning of the FSA. The following criteria are relevant:

- **Negotiability:** The concept of securities relates to the term “negotiable” (*verhandelbaar*). For instruments to be negotiable, they must first be transferable. It is not decisive whether there is a specific market for particular instruments, but rather whether the instruments are negotiable based on their characteristics. A clear indication that the instrument is negotiable is the extent of standardisation. The more standardised an instrument is, the more likely it is to be negotiable. The AFM has provided guidance on the concept of negotiability and uses a wide and economic approach. All constructions where the economic interest of a standardised instrument is or may be transferred, directly or indirectly, to a third party qualify as a negotiable instrument. Generally, tokens that are traded on an exchange or platform will be considered negotiable.
- The embodiment of rights in the specific token, i.e. either shareholder rights (i.e. shares) or creditor claims (i.e. bonds or other forms of indebtedness) or claims comparable to shareholder rights or creditor claims. Rather than the labelling of the token, the specific structure of the rights embodied in the token is the decisive factor.

The AFM generally decides on a case-by-case basis whether a security token constitutes a security. Entities issuing security tokens in the Netherlands will need to consider and ensure they comply with any prospectus requirements imposed by the Prospectus Regulation, as they would when offering other types of securities.

### **Characterisation as units in a collective investment scheme**

From a regulatory perspective it is also relevant to assess whether security tokens may qualify as units in a collective investment scheme, within the meaning of the FSA. Security tokens may qualify as units or shares in a collective investment scheme if they meet certain elements: i.e. raising capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. For instance, the AFM indicated that an ICO is subject to financial supervision if it concerns the offering of units in a collective investment scheme. This is the case if an issuer of an ICO raises capital from investors in order to invest this capital in accordance with a certain investment policy in the interests of those investors. The funds raised have to be used for the purpose of collective investment so that the participants will share in the proceeds of the investment.

### **Additional licence requirements**

Cryptoassets may, under specific circumstances (e.g. certain utility tokens), qualify as investment objects (*beleggingsobject*) within the meaning of the FSA. Under the FSA, it is prohibited to offer an investment object without a licence obtained from the AFM. The Dutch regulatory regime for investment objects does not derive from European regulation. An investment object is defined in the FSA as “*an object, a right to an object or a right to the full or complete return in cash or part of the proceeds of an object, (...) which is acquired for payment at which acquisition the acquirer is promised a return in cash and where the management of the object is mainly carried out by someone other than the acquirer*”. An object (*stoffelijk object*) within the meaning of the Dutch Civil Code is a tangible or physical asset,



for instance gold or art. In other words, if a cryptoasset is backed by a physical object, it may qualify as an investment object pursuant to the FSA. This is not likely to be relevant for most security tokens.

### Romania

There is no specific legal framework for STOs in Romania, nor have Romanian regulators issued any guidance in this respect. Nevertheless, the Romanian regulators should in principle follow the guidance issued at EU level outlined above.

### Characterisation as a security

As such, the Romanian regulators should evaluate each STO independently to consider whether the offered tokens are classified as “transferable securities” based on the Romanian legislation transposing MiFID and, consequently, the national and EU legal rules must be followed (including the Prospectus Regulation, the Transparency Directive, MiFID II, MAR, the Short Selling Regulation, CSDR and the Settlement Finality Directive).

### Relevant regulatory initiatives

In order to encourage and support innovation in payment and financial services, both the National Bank of Romania and the Financial Supervisory Authority launched fintech hubs in summer 2019. In this way, the Romanian regulators have established an institutional framework for dialogue with companies developing fintech solutions, which may also include issuers of security tokens in relation to the assessment of the classification of such tokens as financial instruments.

### Spain

### Characterisation as a security

The Spanish Securities Market Commission (CNMV) has highlighted the following factors to determine the qualification of a token as a transferable security (as defined in MiFID II and in the Spanish securities market regulations):

- whether the token grants rights or confers an expectation to participate in a potential value appreciation of businesses or projects;

- whether the token grants rights similar to those of shares, bonds or other financial instruments;
- whether the token entitles access to services or to receiving goods or products; or
- whether the token is offered (a) referring explicitly or implicitly to the expectation that the purchaser or investor will obtain a profit as a result of its rise in value or of some remuneration associated with the instrument or (b) mentioning its liquidity or tradability on a securities market or equivalent.

The CNMV has stated that those tokens in which it is not reasonable to establish a correlation between the revaluation or profitability expectations and the evolution of the underlying business or project should not be considered transferable securities. Despite that exclusion, the CNMV also stated that it expects most security tokens to be considered transferable securities.

If a security token is considered a transferable security, the regulations applicable in Spain to securities (most of which are EU regulations either directly applicable in Spain or implemented under Spanish law) would be applicable to them (e.g., regulations in connection with the requirement of a prospectus to conduct certain public offerings in Spain or regulations governing the publicity and marketing or placing of transferable securities in Spain). Other Spanish regulations may be applicable even in those cases where tokens are not considered transferable securities (e.g., rules regarding publicity or, depending on the type of offering, consumer protection rules).

With regards to representation and transferability, the CNMV has confirmed that its understanding of Spanish law allows transferable securities to be represented by means other than those specifically provided under Spanish law (i.e., certificates (*títulos físicos*) and book-entries (*anotaciones en cuenta*)), which have their own rules with regards to ownership evidence and transferability. In accordance with that understanding of the CNMV, tokens could be represented

via DLT but, for the time being, no specific rules have been enacted in Spain in connection with these alternative means for representing transferable securities.

#### **Additional licence requirements**

In order to conduct a public offering of transferable securities in Spain addressed to retail investors but exempted from the obligation to publish a prospectus, in which any type of publicity is used, the Spanish securities market rules require the participation of an entity authorised to render investment services in Spain.

Another issue that may be important to consider under Spanish law is whether an STO could be considered as taking repayable funds from the public, which is an activity reserved to credit institutions (especially in those cases where the token is not considered a transferable security).

### **United Kingdom**

#### **Characterisation as a security**

In the UK, security tokens are generally regulated in the same way as other types of securities with similar substantive characteristics. In this respect, the UK regulatory regime is technology-neutral and so firms offering security tokens in the UK will be subject to the same regulatory requirements as if they were offering traditional securities with the same substantive characteristics.

In its Guidance on Cryptoassets, the UK Financial Conduct Authority (FCA) defines security tokens as cryptoassets which provide holders with rights and obligations akin to traditional financial instruments such as shares, debentures or units in a collective investment scheme. They are therefore considered to be specified investments for the purpose of the Financial Services and Markets Act 2000 (FSMA) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, and are regulated as such. Firms offering security tokens in the UK will therefore need to consider and ensure they comply with the authorisation and financial promotions requirements of sections 19 and 21 FSMA, just as they would when offering other types of securities.

The FCA guidance distinguishes security tokens from e-money tokens, which are tokens meeting the definition of e-money under the Electronic Money Regulations 2011, and unregulated tokens such as utility tokens and cryptocurrencies. The FCA indicates that a case-by-case analysis is needed to determine which of these categories a cryptoasset will fall into and that cryptoassets “*may move between categories during their lifecycle*”. The FCA’s categorisation of different types of cryptoassets is based on substance rather than form. Therefore, as a first step, firms involved in an STO would need to consider carefully the structure and substantive characteristics of the tokens being offered in order to determine whether or not they would in fact be categorised as security tokens or some other type of cryptoasset for the purposes of the FCA guidance and UK regulatory regime.

Firms offering security tokens in the UK will also need to consider whether those tokens qualify as “transferable securities” under FSMA, which cross-refers to the definition of transferable securities in MiFID II. If so, they would therefore fall within the prospectus regime and other regulatory requirements that apply to transferable securities.

Security tokens that do not meet the MiFID II definition of transferable securities (for example, because there are contractual restrictions on transfer) may nevertheless fall within the UK crowdfunding regime and related financial promotion rules for non-readily realisable securities.

#### **Additional licence requirements**

Under the UK regulatory regime, security tokens include units in collective investment schemes. Again, a case-by-case substantive analysis would be needed to consider whether or not the security token offering structure meets the definition of a collective investment scheme under FSMA and/or an alternative investment fund (AIF) as defined in the Alternative Investment Fund Managers Regulations 2013. If so, the usual UK regulatory requirements would apply, such as the requirement for an AIF to have an authorised or regulated manager (AIFM) who would be

responsible for compliance with the UK regulatory requirements applicable to AIFs and AIFMs.

### Legal classification

As well as analysing the regulatory position, key questions for firms offering or investing in security tokens relate to the legal nature of the token (i.e. whether security tokens are capable of being owned and transferred as property) and, where relevant, whether or not smart contracts used to transfer security tokens are capable of being legally binding. From an English law perspective, the UK Jurisdiction Taskforce of the LawTech Delivery Panel (UKJT) issued a statement in November 2019 confirming that cryptoassets are capable of being owned and transferred as property under English

law and that smart contracts are capable of constituting binding legal contracts.

Whilst the UKJT's legal statement itself is not binding, these questions have also been considered by the English courts, notably in the case of *AA v Persons Unknown* [2019] EWHC 3556 (Comm), where Mr Justice Bryan expressly considered the legal statement and agreed with its conclusions, stating that "*for the reasons identified in that legal statement, I consider that a crypto asset such as Bitcoin [is] property*". Therefore, both the Legal Statement and recent case law indicate that, from an English law perspective, cryptoassets (including security tokens) are capable of being owned and transferred as property.

### What impact does Brexit have?

The UK left the EU on 31 January 2020 pursuant to a withdrawal agreement between the UK and the EU, which sets out the terms of the UK's departure from the EU. The withdrawal agreement provides for a transition period during which the UK will no longer have any role in the EU's institutions or law-making processes but will remain subject to EU law and participate in the EU's single market and customs union. The transition period ends on 31 December 2020.

At the end of the transition period, the European Union (Withdrawal) Act 2018 (EUWA) (as amended by the European Union (Withdrawal Agreement) Act 2020) provides for the "onshoring" of EU financial services legislation that applies at that date into UK domestic law. The EUWA also grants the UK government powers to make statutory instruments remedying deficiencies in this retained EU legislation arising from the UK's withdrawal from the EU, including in connection with the end of the transition period or other effects of the Withdrawal Agreement. This is to ensure that the UK has a functioning statute book at the end of the transition period.

Therefore, the way in which STOs are regulated in the UK is not expected to change materially as a result of the end of the transition period. However, the UK will no longer participate in the EU's single market, and so the end of the transition period will likely involve a step change in market access between the UK and EU for financial services, which may impact the ability of UK firms to offer security tokens in the EU and vice versa. As MiCA is unlikely to enter into force before the end of the transition period, it is likely that this will mark the first potential deviation in crypto policy between the UK and EU (although MiCA's applicability to STOs may be limited as outlined above).

## Jurisdictions where STOs are unlikely to be regulated by securities law and no specific regime has been enacted

### Czech Republic

STOs are arguably largely unregulated in the Czech Republic. However, there is some uncertainty around this position.

There is no specific piece of legislation for cryptoassets in place in the Czech Republic. From a private law perspective, the general understanding is that tokens fall within the definition of intangible assets and are transferable, but do not fall within the legal definition of securities (*cenné papíry*) or book-entry securities (*zaknihované cenné papíry*) under the Czech Civil Code. This is because DLT lacks the necessary form prescribed by law for securities (*cenné papíry*) or book-entry securities (*zaknihované cenné papíry*), and does not meet the specific requirements for record-keeping.

In November 2018, the Ministry of Finance of the Czech Republic (MF) issued a non-binding public consultation document regarding cryptoassets to evaluate whether the national legal framework should be changed. Based on this document, some security tokens, depending on the rights connected with them, may be seen as investment instruments under the Czech Act on Capital Market Undertakings (ZPKT) and MiFID II regulation and be regulated accordingly.

However, the current and non-binding opinion of MF is that security tokens do not fall within the definition of securities (*cenné papíry*) relevant for the ZPKT regulation as the MiFID II regulation itself does not define securities and refers to national laws. MF proposes changing the legal definition of book-entry securities (*zaknihované cenné papíry*) so that security tokens would fall within the definition contained in the Czech Civil Code.

Some experts disagree with MF's non-binding opinion, arguing that for the purposes of public law regulations (mainly ZPKT), security tokens should be seen as

transferable securities since the definition set by MiFID II is autonomous and independent of national law. Should this interpretation prevail, the regulation set out in ZPKT, including the obligations regarding the publication of a prospectus, would apply to an STO in the Czech Republic.

The Czech National Bank has not issued any statements in relation to security tokens that might give further clarity, having focussed only on exchange tokens to date.

### Poland

Poland has not yet implemented any specific regulatory framework applicable to STOs, and official statements of the regulators are scarce. In July 2020, the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*, or KNF) launched a consultation on its draft position on cryptoassets. This marks the first communication in relation to assets held using DLT by the KNF since a communiqué on offerings of coins and tokens in November 2017.

As security tokens are not specifically regulated, there is no definitive answer as to whether security tokens would be classified as securities (*papier wartościowy*) under Polish law. While the analysis should be performed on a case-by-case basis, we believe that the better view is that they would normally not be classified as such under Polish law. This is because, as a rule, Polish law securities exist either in paper form (currently, a marginal format for securities other than promissory notes) or as book-entries in a manner specified in the relevant legislation (the dominant format). Further, it is still a dominant view that the list of types of securities is closed-ended, and specific types of securities must be specifically regulated in the law. Therefore, it is fair to say that the legal framework in Poland, at least with regard to book-entry securities, is still not technology-neutral and, subject to the exception noted below, DLT is not yet recognised as a medium where securities can "exist".

Some scholars have expressed dissenting views and believe (coupling that belief with a technology-neutral

approach taken at EU level, including in the Prospectus Regulation) that new types of securities can also be created in novel ways, including by using DLT. Some amendments to the Polish Act on trading in financial instruments appear to be needed in order to provide a definitive answer.

With the exception of dematerialised shares (*akcje zdematerializowane*), including shares in a simple joint-stock company (*prosta spółka akcyjna* or PSA), a new type of company, introduced by the Polish Commercial Companies Code (the PCCC) amendment effective as of 1 March 2021, no other legislation recognises distributed ledgers as a legal medium where book-entries creating or transferring securities could be made. We are also not aware of any legislative proposal in this respect. The provisions of the PCCC, which will come into force starting March next year, introduce a simplified procedure for the dematerialisation of shares, including PSA shares. Records of shares may be kept in a distributed and decentralised database, provided, however, that the security of the data contained therein is ensured (which seems to enable the use of DLT for this purpose).

As Polish contract law is generally based on freedom of contract, there is nothing in Polish law which prohibits participants (be it within a permissioned or permissionless DLT system) from agreeing that records on DLT systems represent a contractual entitlement to physical assets (e.g., shares, bonds or commodities deposited “traditionally” with a custodian) or synthetic assets (e.g., “phantom” shares or rights in a profit-sharing arrangement). In most cases, such assets are likely to be classified as “derivative instruments” within the meaning of MiFID II and, in consequence, should be deemed financial instruments (but not necessarily securities, as discussed above) under the Polish Act on trading in financial instruments.

In this scenario, we believe that Polish law would recognise the relevant entries on the ledger as transferring the entitlement (but not necessarily the transfer of a physical asset) as the rules

applicable to the transfer would be part of the contractual framework applicable to the DLT and entries made in the system. Enforceability would be primarily based on the concept of freedom of contract.

If security tokens were classified as securities under Polish law, the public offer limitations and prospectus requirements would be applicable. Whilst such interpretation is currently not likely to apply in most cases, in some specific cases the position could differ. For example, if an STO involved the offering of tokens representing securities deposited with a custodian and there is a possibility that the tokens could be converted or exchanged into actual securities, then this would likely trigger the relevant restrictions and prospectus requirements would likely be applicable to that STO.

Given the above, it seems that supplementary legislation will be required in order to resolve doubts with regard to: (i) classification of certain cryptoassets as financial instruments (transferable securities or derivative instruments dependent on the price or value of other assets (real or crypto)); and (ii) transfer of rights to digital assets, bearing in mind that rights attached to book-entry securities arise upon their entry in a securities account (and accrue to a person who is a holder of that securities account).

The consultation on the KNF’s new official position on cryptoassets ended on 30 July 2020. While the outcome may shed new light on certain ambiguities or help achieve a market consensus in some areas, it seems that without a new legislative initiative most of the ambiguities discussed above cannot be rectified.

### Slovak Republic

There is no specific legislation for cryptoassets in place in the Slovak Republic. From the private law perspective, cryptoassets do not fall within the definition of assets (*veci*), since they do not meet the criterion of materiality. Theoretically, cryptoassets could fall under the definition of rights or other proprietary values (*iná majetková*

*hodnota*), and thus would, from a civil law perspective, be capable of being the subject of proprietary rights. However, we are not aware of any official guidance or case law that would provide a definitive answer in this respect. Cryptoassets such as tokens do not fall within the definition of securities (*cenné papiere*). The primary reason is that DLT does not meet the specific requirements for record-keeping.

From the regulatory perspective, cryptoassets, including security tokens, are not regulated under Slovak law. Such products do not represent investment products and business activities connected with their distribution do not fall under any specific regulation.

The official regulatory guidance with respect to cryptoassets is minimal and

limited to an article published in the periodical newspaper issued by the National Bank of Slovakia (NBS), where the representatives of the NBS provide their personal opinions on the potential future regulation of cryptoassets.

In terms of future regulation, the Government's action plan for digital transformation over the period 2019 to 2022 provides, amongst others, the task of analysing the possibilities of the tokenisation of assets for the purpose of their usability on the financial markets. However, we are not aware of any particular drafts of legislation that would aim to address the deficiencies of national law when addressing the existence of cryptoasset markets.





## GLOSSARY OF DEFINED TERMS

|                                      |  |
|--------------------------------------|--|
| <b>AFM</b>                           | Dutch Authority for the Financial Markets ( <i>Autoriteit Financiële Markten</i> )   |
| <b>AIF</b>                           | Alternative investment fund  |
| <b>AIFM</b>                          | Authorised or regulated manager of an alternative investment fund  |
| <b>AIFMD</b>                         | Alternative Investment Fund Managers Directive 2011/61/EU  |
| <b>AMF</b>                           | French Financial Markets Authority ( <i>Autorité des marchés financiers</i> )  |
| <b>AMLD5</b>                         | Fifth Money Laundering Directive 2018/843 amending Fourth Money Laundering Directive 2015/849/EU and the Regulation (EU) No. 2015/847 on information accompanying transfers of funds |
| <b>BaFin</b>                         | German Federal Financial Supervisory Authority ( <i>Bundesanstalt für Finanzdienstleistungsaufsicht</i> )  |
| <b>CCP</b>                           | Central clearing counterparty  |
| <b>CNMV</b>                          | The Spanish National Securities Market Commission ( <i>Comisión Nacional del Mercado de Valores</i> )  |
| <b>CONSOB</b>                        | Italian securities commission ( <i>Commissione nazionale per le società e la Borsa</i> )   |
| <b>CRD IV</b>                        | Capital Requirements Regulation (EU) No. 575/2013 and Capital Requirements Directive IV 2013/36/EU   |
| <b>CSD</b>                           | Central Securities Depository  |
| <b>CSDR</b>                          | Central Securities Depositories Regulation (EU) No. 909/2014   |
| <b>CSSF</b>                          | Luxembourg financial sector authority ( <i>Commission de Surveillance du Secteur Financier</i> )   |
| <b>DLT</b>                           | Distributed ledger technology  |
| <b>EBA</b>                           | European Banking Authority   |
| <b>E-money Directive</b>             | E-money Directive 2009/110/EC  |
| <b>EMIR</b>                          | European Market Infrastructure Regulation (EU) No. 648/2012  |
| <b>ESMA</b>                          | European Securities and Markets Authority  |
| <b>EU</b>                            | European Union   |
| <b>FCA</b>                           | UK Financial Conduct Authority   |
| <b>ICO</b>                           | Initial coin offering  |
| <b>KNF</b>                           | Polish Financial Supervision Authority ( <i>Komisja Nadzoru Finansowego</i> ),   |
| <b>MAR</b>                           | Market Abuse Regulation (EU) 596/2014  |
| <b>MF</b>                            | Ministry of Finance of the Czech Republic  |
| <b>MiCA</b>                          | Draft proposal for a regulation on markets in cryptoassets issued by the European Commission on 24 September 2020  |
| <b>MiFID</b>                         | Markets in Financial Instruments Directive 2004/39/EC  |
| <b>MiFIDII</b>                       | Markets in Financial Instruments Directive II 2014/65/EU   |
| <b>MTFs</b>                          | Multilateral trading facilities  |
| <b>NBS</b>                           | National Bank of Slovakia  |
| <b>OTC</b>                           | Over the counter   |
| <b>OTFs</b>                          | Organised trading facilities   |
| <b>Prospectus Regulation</b>         | Prospectus Regulation (EU) 2017/1129   |
| <b>RM</b>                            | Regulated markets  |
| <b>Settlement Finality Directive</b> | Settlement Finality Directive 98/26/EC   |
| <b>Short Selling Regulation</b>      | Regulation (EU) 236/2012   |
| <b>STO</b>                           | Security token offering  |
| <b>Transparency Directive</b>        | Directive (EU) 2013/50 amending Directive (EC) 2004/109  |
| <b>UCITS</b>                         | Undertakings for Collective Investment in Transferable Securities  |

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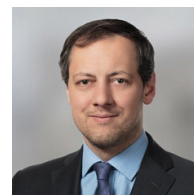
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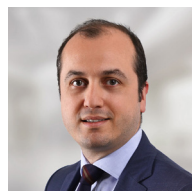
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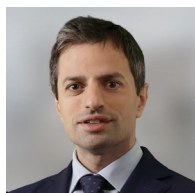
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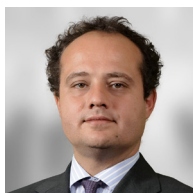
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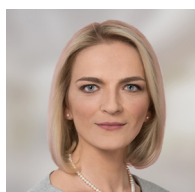


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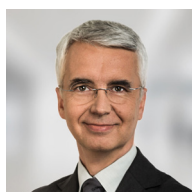
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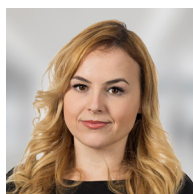


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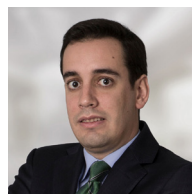


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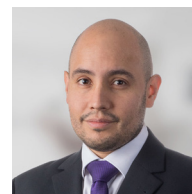
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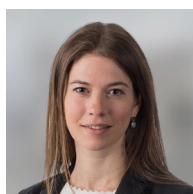


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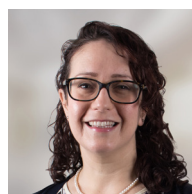


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