

Cryptocurrencies as an investment object*

Fernando Zunzunegui

Carlos III University of Madrid

fernando.zunzunegui@uc3m.es

Abstract

Investment in cryptocurrencies has acquired a financial and social importance that obliges the authorities to take action. New products and services are emerging as a result of this new technology, and infrastructures managed by digital platforms that process financial ecosystems are being created. Applying standards designed for traditional finance to crypto-finance is a framework with shortcomings in which regulatory loopholes arise. The cryptocurrency industry is calling for consistency.

Keywords: Cryptocurrencies, Monetary phenomenon, Financial instrument, DLT

Investment in cryptocurrencies, which had a capitalization of three trillion dollars in 2021, has gained financial and social significance, prompting action by the authorities. In Spain, one in six investors has acquired cryptoassets,¹ with a total volume of 60,000 million euros.² These products emerged in 2009 following the publication of a nine-page article under the pseudonym of Satoshi Nakamoto, with the protocol for developing Bitcoin as a currency based on blockchain technology. There are currently thousands of cryptocurrencies, including Bitcoin and Ethereum, constituting 80% of the market value.³ Distributed Ledger Technology ("DLT") is a generic term that contrasts with the traditional centralised ledgers used by payment and securities settlement systems. New products and services emerge with this new technology. Infrastructures are created that are managed by digital platforms that operate financial ecosystems.

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¹European Commission, *Disclosure, inducements, and suitability rules for retail investors study*, May 2022, p. 11. According to CNMV, *Estudio sobre las criptomonedas y la efectividad de las medidas impulsadas por la CNMV*, 4 August 2022, 6.8% of citizens have invested in cryptocurrencies.

²HERNÁNDEZ DE COS, Pablo: "Crypto-assets: a financial authority's view", 31 May 2022, p. 4.

³Banco de España, "Cryptoassets Special", *Financial Stability Report*, Spring 2022, p. 159.

Monetary Phenomenon: Cryptocurrencies are a monetary phenomenon.

Cryptocurrencies are a monetary phenomenon. Their value arises from trust in the technology, in the distributed records that are identified with Blockchain. They lack the backing of a central bank. They aim to create an alternative monetary system. With these aspirations, cryptocurrencies have caught the attention of investors attracted by their continuous appreciation. Their high volatility does not make them unattractive. They are born as currencies but develop as investments. The cryptocurrency crisis of spring 2022 generated losses amounting to 600 billion dollars due to fraud or insolvency.

Central banks and supervisors merely issue warnings, highlighting their risks. They are volatile investments, lacking saver protection. They have no guarantee funds. They are not suitable for retail investors. But their marketing is not prohibited. There is a siloed approach to regulation and supervision that is inadequate to manage this digital ecosystem. There are only rules to prevent money laundering or terrorism, prudential rules to defend banking stability and, in Spain, control of their advertising by the CNMV.

Regulatory silos lead to sectoral measures that lack coherence. They apply to crypto-finance rules designed for traditional finance. It is a flawed framework in which regulatory gaps emerge. The cryptocurrency industry calls for consistency. Legal uncertainty hinders the development of the business, which needs a legal framework that favours innovation while preserving the integrity of the market and the protection of investors. Progress needs to be made in the dialogue between the authorities and programmers for the adoption of best practice standards that are incorporated into the design of protocols. This is the path taken by the Eurosystem with the Pisa Framework concerning digital payment services.⁴ And it is the one that is intended to be achieved by considering cryptoassets as financial instruments.

Crypto-assets as financial instruments

The draft of the new Securities Markets Act currently before Congress extends its scope to financial instruments "when they are issued using distributed registry technology

⁴ *Eurosystem oversight framework for electronic payment instruments, schemes and arrangements*, November 2021, which extends its oversight to all electronic payment instruments that enable transfers of value between end-users, including digital assets.

or other similar technologies" (art. 2.2). This requirement is included in a proposal for a directive that forms part of the European Union's Digital Finance Package; a provision that has already been incorporated into the legislation of several Member States such as France,⁵ Ireland,⁶ and Luxembourg.⁷ However, the Spanish project goes beyond this extension of its scope by providing the instruments represented by DLT with their own legal regime. In line with French law, it starts from the principle of functional equivalence to extend the regime of book entries to entries in distributed registers.

The Draft considers the regime for negotiable securities represented by book-entry securities to be applicable to instruments represented by DLTs provided that the terms and conditions of their issue provide for the application of the LMV or, in the absence of such a provision, the issuer has its registered office in Spain or appoints an administrator of the DLT system with its registered office in Spain. It uses the issuer or its agent as the centre of imputation of liability. This requirement excludes from the legal system systems based on decentralised finance where an entity in charge cannot be identified.

The administrator of the DLT issue is the equivalent of the book-entry book-entry entity. It should be noted that the key figure in the legal framework for securities represented by DLTs is the entity in charge of the book-entry system. This may be the issuer itself or a third party. In the case of DLT securities admitted to trading, the administration function will be performed by the infrastructure authorised by the CNMV.⁸ This creates a secure framework for access to trading venues to enable the development of DLT-based infrastructures. In particular, it creates the framework for BME to develop its new DLT-based business model with legal certainty.⁹

⁵ France anticipated with l'ordonnance n° 2017-1674 of 8 December 2017 reforming the Code monétaire et financier, according to which: "Les titres financiers qui ne sont pas admis aux opérations d'un dépositaire central doivent être inscrits, au nom du propriétaire des titres, dans un compte-titres tenu par l'émetteur ou, sur décision de l'émetteur, dans un dispositif d'enregistrement électronique partagé" (Article L211-7); "L'inscription dans un dispositif d'enregistrement électronique partagé tient lieu d'inscription en compte" (Article L211-3).

⁶ Statutory Instrument No. 443/2022 - European Union (Markets in Financial Instruments) (Amendment) (No. 4) Regulations 2022 of 6 September 2022.

⁷ By Law of 22 January 2021 amending the Law of 6 April 2013 on dematerialised securities.

⁸ In accordance with Regulation (EU) 2022/858 on a pilot scheme for market infrastructures based on decentralised registry technology.

⁹ See Tim GRANT, "Building next-generation institutional Digital Market Infrastructures", *Alastria Legal*, No. 3, 2021 pp. 22-29.

It is therefore a registry system that provides for the participation of a trusted third party. It is the administrator who must ensure the effectiveness of the principle of equivalence between book entries and DLT registers. The administrator is subject to the control of the CNMV. It must ensure the proper functioning of the system, enable holders to be identified and guarantee them the exercise of their rights. Defective or irregular management of issues of securities represented by DLTs constitutes a serious infringement of securities market regulations or a very serious infringement when it is continuous or affects many investors.

The proposed regime sets out the requirements that a DLT system must meet in order for its securities to be recognised by Spanish law to be marketed and traded in Spanish territory. The principle of uniqueness is maintained, which requires the same representation regime to be applied to all instruments of the same issue. Beyond what happens with book entries, the issuer of DLTs must make available to holders a document identifying the instruments issued, the registration and governance system, and the contingency and continuity plans for the system. Given the aspiration for immutability and infallibility of DLT systems, the envisaged framework requires that system failures be addressed and managed.

The issuance document must detail the mechanism for proving ownership of the securities. Thus, the system must have a functionality that allows the holder to prove the entitlement to transfer and exercise the rights deriving from the securities represented by DLTs. In addition, the creation of securities represented by DLTs takes place through the registration of the issue and the putting into circulation takes place with the registration of the subscribers. It is the registration of the subscription in the decentralised register that confers ownership. The transfer, in turn, takes place through the registration of the transfer of the securities, once the transaction has been validated on the blockchain, which is equivalent to the securities being removed from the transferor's account and added to the acquirer's account in the book-entry system. The registration in favour of the acquirer has the same effect as the delivery of the securities. These transfers, as in the book-entry system, do not require notarial intervention. Functional equivalence also applies to rights in rem. Rights in rem in securities represented by DLTs must be registered. The registration of the pledge in the DLT system is equivalent to the possessory displacement

of the title. The person who is legitimated in the DLT system is presumed to be the legitimate holder and can demand that the issuer performs in his favour the services to which the security entitles him.

This legal regime for financial instruments represented by DLTs is designed to allow them to be incorporated into stock exchanges and other trading venues. This is done by adding to the traditional book-entry system the representation through DLTs with an equivalent legal regime. The creation and issuance of cryptocurrencies and other cryptoassets will continue to be a free activity under the protection of free will. But where the issuer intends for securities represented by DLTs to be considered as financial instruments for the purposes of the MiFID system, it will have to comply with the regulated requirements and be subject to the legal regime for creation, transfer, and legitimisation. This measure is intended to attract the cryptocurrency industry to traditional markets. The regulated markets are not forced to use this gateway. But the truth is that without regulation and good governance, it is not possible to develop a financial system. This principle is universal. It applies to traditional finance and cryptocurrency ecosystems.