



EXECUTIVE SUMMARY

R3 welcomes CONSOB's "Initial Coin Offerings and Crypto-Assets Exchanges" call for evidence issued on 19 March 2019 and appreciates the opportunity to feed in our views. This is an important topic, and we support the overall approach that CONSOB is taking, which we believe to be balanced and proportionate. Regulators around the world are grappling with the appropriate classification and treatment of digital assets or crypto-assets. It is critical that as part of that exploration, all regulators examine the underlying technology and the relationship between the technology and the asset. We applaud CONSOB for its contribution to this global effort, and for issuing this call for evidence. We broadly agree with the classifications of different types of digital assets and the regulatory perimeter set out in the paper.

Introducing R3

R3 is an enterprise blockchain software firm working with a broad ecosystem of more than 300 members and partners across multiple industries from both the private and public sectors to develop on Corda, its open-source blockchain platform, and Corda Enterprise, a commercial version of Corda for enterprise usage. R3's global team of over 200 professionals in 14 countries is supported by over 2,000 technology, financial, and legal experts drawn from its global member base.

The Corda platform is already being used in industries from financial services to healthcare, shipping, insurance and more. It records, manages and executes institutions' financial agreements in perfect synchrony with their peers, creating a world of frictionless commerce.

We believe the creation of new global capital markets powered by enterprise digital assets will usher in the next phase of blockchain innovation. We are very excited about this opportunity and invested in the continuing evolution of crypto-assets. We are keen to work with CONSOB and your peer regulators to ensure that regulation in this area develops with the technology in a way that protects consumers and enables innovation and growth.

R3's Corda platform

The fundamental design decision of Corda, which was made at the very beginning, is that Corda allows for limited data sharing and facilitates compliant transactions between regulated institutions subject to reporting and data privacy regulations. We have been developing this platform significantly over the past few years and went to market with our open source version in November 2016 and our first enterprise version in July 2018. As an enterprise-grade blockchain platform, Corda removes costly friction in business transactions by enabling institutions to transact directly using smart contracts, while ensuring the highest levels of privacy and security. This provides value to the economy and consumers.

Corda was originally built by the financial services industry, for the financial services industry. It was developed to leverage the power of blockchain to address their specific business

challenges in highly regulated markets. Corda can now be applied seamlessly to other areas of the business and sectors including healthcare, energy, and supply chains.

Further information on R3's work, portfolio and its partners can be found on our website: <https://www.r3.com/>.

RESPONSES TO QUESTIONS

Q1: Do you agree with the definition of 'crypto-assets' in Box 1? Does this definition capture the relevant specificity of crypto-assets with respect to the approach outlined in this document?

Yes, R3 generally agrees with the definition given to crypto-assets and that it captures the specificity of crypto-assets outlined in the consultation document.

Q2: In particular, do you agree about the centrality of the finalisation of the funding of entrepreneurial projects, the use of Distributed Ledger Technology and the ultimate objective of trading of crypto-assets in special trading platforms?

Yes, R3 agrees with the centrality of the finalisation of the funding of entrepreneurial projects, the use of Distributed Ledger Technology and the ultimate objective of trading of crypto-assets in special trading platforms.

Q3: Does this definition clearly exclude those crypto-assets that do not fall within the scope of the approach outlined herein (i.e., pure-commodity tokens not intended for trading on secondary trading facilities, securities/financial instruments as codified by EU regulations)?

Yes, R3 broadly agrees that the definition provided for those crypto-assets excludes those that do not fall within the scope of the approach outlined. However, the definition may be so narrow in scope that it excludes other types of crypto-assets that could be involved with an ICO – e.g. security token, exchange or utility token.

More broadly, R3 would welcome the opportunity to engage with CONSOB on the broader definition of different types of crypto-assets and how they relate to the wider regulatory perimeter beyond ICOs, exchanges and trading platforms.

Q4: The regulations applicable to financial instruments and products provide for entry rules aimed at grading the various investor protection arrangements. Do you agree with the opportunity of establishing, for regulated crypto-assets, that specific regulations shall not provide for, e.g., threshold values for exemptions (for issues below the thresholds), or additional arrangements (for issues above the thresholds)?

Yes, R3 broadly agrees with this. As the consultation paper sets out on page 5 in reference to French authorities, the Autorité des marchés financiers (AMF) developed an optional authorisation scheme for ICO promoters. Such an approach is welcome as it introduces protections for investors without stifling innovation.

Q5: Do you agree with the proposal to extend the range of activities that can be carried out by crowdfunding portal managers to also include promotion of newly-issued crypto-asset offerings? Please provide motivations and/or supporting data for identifying possible synergies/opportunities that may arise from the conduct of both activities, or with respect to any reasons for opposition.

The expansion of crowdfunding regulatory frameworks, practices, and products to include crypto-asset offerings is logical. Crowdfunding portal managers already address the problems posed by two market realities, which are widespread in crypto-asset offerings: high volume low value retail participation, and relatively low value offerings which are not covered by institutional research or highly liquid market trading.

Q6: Do you agree with the proposal to extend the possibility to manage crypto-asset offering platforms even to entities that have been exclusively operating in the field the crypto-assets from the outset (i.e., entities that have not already begun operating as managers of crowdfunding portal with CONSOB authorisation)?

Yes, we agree with a proposal to register crypto-asset trading systems in a special CONSOB register. The requirements outlined in the proposal are fundamentals that should be met by all types of exchanges. Initially we think a self-attestation process with supporting documentation would be the right approach since a CONSOB review would be a resource strain and place significant liability on CONSOB. As the industry starts maturing and exchange volume hits a certain threshold, the use of third-party independent auditors to evaluate risk and IT systems should be a requirement.

Q7: Can the approach outlined for the conduct of offerings upon new issues of crypto-assets effectively reconcile the characteristics of the phenomenon in question with investor protection needs and requirements? In particular, do you agree with the hypothesis of an opt-in regime, structured as described in the foregoing?

Yes, R3 broadly agrees with this. The balance between developing a regulatory framework to ensure the safe and secure use of crypto-assets while ensuring investors and entrepreneurs can innovate is rightly at the forefront of efforts to review regulation concerning crypto-assets and innovative sectors more broadly.

Q8: Do you consider it appropriate, in view of greater investor protection, to establish a close link between the offering of newly-issued crypto-assets - conducted through supervised platforms - and their subsequent access to a dedicated trading system that is subject to regulation and supervision?

We do think a close link between the offering of newly-issued crypto-assets through supervised platforms and then subsequently trading on a system that is subject to regulation and supervision would closely align to financial markets today and minimize risk to the industry. While this seems to be the right approach, implementation will be challenging given the global nature of the crypto-asset industry. No standard global regulations exist to properly assure investors that a platform is truly “compliant”. We

recommend CONSOB collaborate with existing global working groups on this effort (e.g. Global Digital Finance) and adopt similar attestation methods to avoid additional hurdles for crypto-asset companies.

Q9: In your opinion, what are the minimum requirements that issuers of crypto-assets should meet for their crypto-assets to be admitted to trading?

As reflected in the French regulatory framework for crypto-asset trading, important minimum requirements to consider should include: the requirement that the issuer of the tokens or digital assets be incorporated as a legal entity established or registered in the regulating country; the provision of an informational document containing all relevant information on the token offering, the project to be financed and the company; the creation of a system for monitoring and safeguarding the assets raised during the offering and compliance with the Anti Money Laundering and terrorist financing rules.

As a general matter, it is critical that token issuance and the lifecycle of the token be conducted and managed in a secure and regulated manner. That means trading platforms with well-defined governance, settlement finality, and strong identity. Each is detailed below:

- Well-defined governance enables participants to ensure liabilities are assigned, that they are dealing with appropriate actors, and that they can identify, manage and mitigate risks. Firms issuing, exchanging, and transacting in digital assets without proper governance and regulatory compliance threaten the firm's viability, cause uncertainty for market participants and generate operational risk.
- Settlement finality enables the real-world issuer to demonstrate compliance with associated finality regulations as well as reduce their own risk stemming from blockchain 'reorganizations' that can occur on other platforms (i.e. on platforms that use probabilistic settlement such as proof of work or proof of stake platforms that use the "longest chain" rule).
- A strong identity layer enables firms to know who is holding or has held tokens they have issued. This is particularly important from a compliance perspective. As an additional note, cybersecurity is of utmost importance in any blockchain solution that is meant to be safe and reliable and, therefore, a prerequisite for use particularly in the enterprise context. Unfortunately, we have seen many platforms fall short on cybersecurity to date. Strong cybersecurity and strong security measures are a core focus of Corda and have been since the beginning. Corda transactions are secured using public key cryptography: the public key is used to confirm the identity of the entity participating in the Corda Network and the private key allows transactions to be signed between parties on a need to know basis.

Q10: Is the proposed definition of 'crypto-asset trading system' suitable to understand the (currently known) business models used by crypto-asset trading facilities?

Yes, R3 agrees with the definition proposed for crypto-asset trading facilities. The trading of crypto-assets is essential to their function and the technology that underpins the asset.

Q11: With regard to the requirements identified above, compliance with which is necessary for a system to be recognised as a crypto-asset trading system by CONSOB, are they sufficient to neutralise the risks inherent to the trading of crypto-assets?

Yes, R3 broadly agrees with the use of the requirements identified. The risks within trading are inherent and regulators must ensure those risks are taken by those able to bear them. This question demonstrates that CONSOB is taking the right approach to understanding and minimising the risk. While these requirements are sensible initially, CONSOB should keep expanding the requirements as more adverse risks are identified through customer complaints and operational inefficiencies. R3 stands ready to support CONSOB in this.

Q12: With regard to the requirements identified above, compliance with which is necessary for a system to be registered in the register kept by CONSOB, are they sufficient to neutralise the risks related to the safekeeping of financial resources, crypto-currencies and crypto-assets on the part of the system, and are they sufficient for the efficient and safe settlement of the trading transactions carried out through the system?

Yes, R3 broadly agrees with the use of the requirements identified. As in answer to Q11, a responsible regulator must manage the inherent risks of trading and these requirements are sensible initially. More in-depth audits performed by independent auditors on business continuity and disaster recovery may be needed to mitigate risk associated with sophisticated hacking techniques and operational risk.

Q13: What characteristics should the blockchain present in order to ensure an adequate security level of the distributed ledger on which the crypto-assets are recorded and transferred?

To serve as a sufficiently reliable, effective, and efficient system of record for crypto-asset offerings and transactions, a distributed ledger should be able to represent digital assets in a consistent fashion, execute transactions with finality, and prevent market participants from receiving data related to transactions to which they were not party. The ability to represent assets that include sufficient data and conditional functionality is vital for crypto-asset offering and management through the asset lifecycle. This requires a consistent asset taxonomy and smart contracting capability that supports key asset updates. The distributed ledger must allow participants to transact without fear of rollback or system “forks.” Transacting parties must have confidence that once committed, a transaction is final and irrevocable. This – generally speaking – precludes consensus mechanisms based on proof of work or proof of stake. Finally, the distributed ledger must allow participants to transact without sharing or spreading data widely among all market participants. Crypto-asset networks work best when data is shared on a transaction by transaction basis, and only between parties who must receive that data.

Q14: Do you agree with the decision to introduce an opt-in mechanism for inclusion in the register of crypto-asset trading systems to be kept by CONSOB?

Yes, R3 broadly agrees with the decision taken by CONSOB to advocate an opt-in mechanism. As before, R3 believes in the need to strike a careful balance between protecting investors

through a carefully designed regulatory framework whilst allowing investors and entrepreneurs to innovate through the trading of crypto-assets.

Q15: In connection with the possible introduction of a special regime for the issue and trading of crypto-assets, aimed at investor protection, do you deem it appropriate that the Authorities should evaluate the possibility for a transitional regime that would make it possible to continue trading already-issued tokens only on condition that the organiser of the trading system registered with CONSOB has verified that adequate information on the traded tokens are made available to investors, and are duly publicised?

R3 broadly agrees with the CONSOB with regards to the introduction of a transitional regime for changes to the issue and trading of crypto-assets. However, in pursuing a transitional regime, this must not come at the detriment of a disruption to trading. CONSOB should therefore seek to minimise disruption to trading, working with industry to deliver this.