



## **CONSOB**

Divisione Strategie Regolamentari Via G. B. Martini, 3  
00198  
Rome  
Italy

**Sent by: SIPE external integrated system**

4 June 2019

To whom it may concern

## **RE: LUNO'S RESPONSE TO THE PUBLIC CONSULTATION ON INITIAL COIN OFFERINGS AND CRYPTO-ASSETS EXCHANGES**

### **Introduction**

Luno Pte. Ltd. (**Luno**) is pleased to provide our written comments on the above consultation paper dated 19 March 2019 (the **Consultation Paper**).

Luno wishes to commend CONSOB for formally addressing the issue of Initial Coin Offerings (**ICOs**), which have historically given rise to enormous risk to investors but do nonetheless hold the potential for economic growth and the fostering of innovation. We support CONSOB's intent to put in place a regulatory framework for the purposes of mitigating the risks posed by ICOs to ensure investor protection and the promotion of confidence in the ICO market.

This letter contains our preliminary views on the questions posed in the Consultation Paper. Luno is willing to engage further on any of the matters highlighted herein and, should you need to reach us, please contact Luno's Manager for Italy, Ms Maria Woncisz at [maria@luno.com](mailto:maria@luno.com).

### **General comments and assumptions**

Our understanding of the Consultation Paper is that it applies to activity associated with crypto-assets issued through initial coin offerings (ICOs) and not to other types of activities and/or crypto-assets.

Luno operates a global crypto-exchange where customers are able to buy and sell cryptocurrencies. This activity is distinguishable from the activity of launching a crypto-asset through an ICO and it would not be practical to regulate these activities in the same way. Our concern with the Consultation Paper is that it does not distinguish between these activities and we recommend that the proposed framework place greater emphasis on establishing an activity

based approach. While we support implementing a regulatory regime aimed at crypto-exchanges and other crypto-asset service providers, separate consultation on this process will be necessary.

In light of the above, we have responded to each of the questions below based on the assumption that the Consultation Paper only applies to crypto-assets issued through ICOs.

### **Question 1:**

*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?*

The suggestion in this Consultation Paper to define crypto-assets as “digital recordings representing rights related to investments in entrepreneurial projects” would, in our view, be unduly limiting. We also believe that this approach is inconsistent with the various European Initiatives mentioned, and, if applied, is likely to lead to confusion.

We understand the term “crypto-asset” to be synonymous with “virtual-asset” and, in this regard, we support the FATF proposed definition for “virtual-assets”, being:

a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets [that are already covered elsewhere in the FATF recommendations].<sup>1</sup>

While Luno does not believe that it is necessary to define crypto-assets with reference to categories, there is some support for this approach<sup>2</sup>. In the event that definition is necessary, Luno supports the approach of the UK's Crypto-asset Taskforce, which differentiates between: (i) exchange tokens: (EG Bitcoin, Litecoin and other cryptocurrencies), (ii) Security tokens and (iii) Utility tokens.

As set out in our opening remarks, we understand it to be the intention of this Consultation Paper to focus on crypto-assets issued through ICOs. On this basis, we would like to put forward the following suggestion to CONSOB:

(i) the term “**crypto-asset**” should only be used where it denotes a broad meaning, as explained above; and

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<sup>1</sup> See [\(http://www.fatf-gafi.org/publications/fatfrecommendations/?hf=10&b=0&s=desc\(fatf\\_releasedate\)\)](http://www.fatf-gafi.org/publications/fatfrecommendations/?hf=10&b=0&s=desc(fatf_releasedate)) (p124)

<sup>2</sup> See for example the FCA's Cryptoasset Taskforce final report available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752070/cryptoassets\\_taskforce\\_final\\_report\\_final\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf) and the FCA's Guidance on Cryptoassets released for public consultation available at <https://www.fca.org.uk/publications/consultation-papers/cp19-3-guidance-cryptoassets>

(ii) an alternative term to “**crypto-asset**” is used where it relates to matters falling within the scope of this Consultation Paper. We suggest using “**crypto-asset, which is issued through an ICO**” in each instance or, to the extent that CONSOB thinks it is necessary, creating a suitable alternative term.

**Question 2:**

*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?*

Please refer to our response under Question 1.

Further, in response to the suggestion that the ultimate objective of ICOs is the trade of crypto-assets, we do not believe that trading of crypto-assets in special trading platforms should be put forward as the ultimate objective of ICOs. Although this may be the case for certain crypto-assets issued through ICOs, other crypto-assets are issued through ICOs for utility purposes.

**Question 3:**

*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)?*

No, we don't believe this comes through clearly. Please refer to our suggestion under Question 1 to use different terminology.

**Question 4:**

*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)?*

We have no objection to the introduction of a graded approach to investor protection, however, we don't believe that it is necessary - particularly at this early stage of the industry.

**Question 5:**

*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.*

We note the suggestion that crowdfunding portal managers and other “crypto-asset offering platforms” list / promote ICOs. As we understand, these crypto-asset offering platforms (the **Authorised Platforms**), will provide a service to the ICO issuer that the ICO issuer will probably not be equipped to provide themselves.

We note the suggestion in Box 3 that the Platform should have in place “suitable arrangements for the selection of entrepreneurial projects deserving access to the platform”. As we understand, this suggests some form of vetting that the Platform must conduct into the merits of an ICO. We believe that this is a suitable requirement because, having conducted the initial assessment, the Platform will be familiar with both the Issuer and the crypto-assets to be issued. The Authorised Platform will therefore be in the best position to ensure the crypto-assets is listed, marketed and issued in a manner that is beneficial to all relevant parties, including investors. If we have understood the intention correctly, CONSOB should, however, consider whether crowdfunding portal managers have the required market knowledge and expertise to conduct the assessment outlined above. The structure and subject matter of an ICO will in most cases be complex and unique, rendering the assessment difficult for those not familiar with crypto-assets and the industry more broadly.

We note the suggestion that the Authorised Platforms will be subject to supervision by CONSOB and will be required to implement information, procedural and control arrangements which are proportionate to the entities risk. The eligibility requirements and regulatory obligations are, however, unclear and we suggest that these are properly defined by CONSOB and subject to further public consultation. In particular, clarity should also be provided on the following:

- Scope for assessment. For example, will the Authorised Platform be responsible for conducting an assessment of the fitness and propriety of an ICO issuer? These matters may be difficult for the Authorised Platform to perform since these may not fall within their expertise.
- Issues of liability. For example, if an Authorised Platform deems an ICO suitable, and investors ultimately lose money, what are the regulatory consequences?
- Extending supervision to the ICO issuer and/or the offering itself and what, if anything, would this entail. For example, would CONSOB vet the offering before it is made available on the Authorised Platform?

Finally, we support the suggestion to properly standardise the information provided by the issuer about an ICO (usually set out in a white paper). If each Authorised Platform were responsible for establishing its own rules, there is a risk that ICO issuers would shop around for the easiest authorised platform on which to list. We suggest that CONSOB establish the criteria, taking into

account responses to question 9 (where applicable), and that the criteria are made available for further public consolidation.

**Question 6:**

*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)?*

We note the suggestion to broaden the scope by allowing existing crypto-asset platforms to seek to become Authorised Platforms, should they wish to participate in the issuing of ICOs. We understand this to be a voluntary decision and will not oblige all existing crypto-asset platforms to seek authorisation under this regime.

Assuming that our understanding set out in question 5 is correct (i.e. that these Authorised Platforms will undertake some form of vetting into the merits of an ICO), we support the extension.

The comments under question 5 relating to supervision and standardised information also apply here.

**Question 7:**

*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?*

We understand the reasoning behind creating an opt-in regime and that, as a consequence, an ICO promoted outside of an Authorised Platform would still be lawful but would not be afforded protection of an authorised platform. CONSOB should, however, consider the potential for abuse here and any further proposals should address the following concerns:

- How will investors be made aware of the option to invest through one of the Authorised Platforms?
- How will CONSOB ensure that ICOs are making potential investors aware that an ICO is either sanctioned or not sanctioned by an Authorised Platform? If the aim is to achieve this by requiring ICO Issuer / Platform to make a mandatory disclosure, clarity should be given on how this should be done and what it should contain.
- If a platform, who is not supervised by CONSOB, claims that either (i) it has obtained authorisation by CONSOB or (ii) that a particular ICO falls within the protection of the regulation, what course of action would be available by CONSOB?

### **Question 8:**

*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 (cf following section)?*

**Luno:** As we understand, CONSOB's suggestion is to create a separation between (i) the platforms on which investors may utilise to subscribe for crypto-assets issued through an ICO (which we've referred to as Authorised Platforms) and (ii) the platforms investors may then utilise for purposes of trading those crypto-assets (referred to as Crypto-Asset Trading Systems in section 4 below). CONSOB's stated aim is to ensure that a close link between these platforms is maintained. In this regard, we note the suggestion in section 4 of a double-opt in mechanism, whereby both the Authorised Platform and the Crypto-Asset Trading System can opt-in to supervision. Doing so is intended to lay the foundation for investors to make conscious choices, on the basis that using Authorised Platforms followed by registered Crypto-Asset Trading Systems will be more reliable than participating in ICOs, and/or the trading of the tokens issued through them, in a non-regulated environment.

Luno suggests that further clarity on the "double opt-in" mechanism is provided, such that it is clear whether the intention is to -

- Prevent the trading of crypto-assets issued through ICOs on a supervised Crypto-Asset Trading System unless that crypto-asset had been issued through an Authorised Platform; or
- Allow the trading of crypto-assets issued through ICOs on a supervised Crypto-Asset Trading System irrespective of whether that crypto-asset had been issued through an Authorised Platform.

If it is the former, a close link would indeed be achieved. We consider this to be the most practical approach and support the suggestion. Under this approach, consumers would have some level of assurance that both the issuance and the subsequent trading of the token meet certain minimum standards. Further assurance would be provided if, as indicated above, either or both of the platforms are required to perform some degree of prior "vetting" of the ICO and/or token. This kind of assurance would not be achieved if the latter approach were to be applied and, if introduced, further consideration will be needed on the extent of the Crypto-Asset Trading System's obligations.

### **Question 9:**

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

We support the suggestion to standardise the information provided by an ICO issuer (whether this is to investors directly, to an Authorised Platform or to any subsequent Crypto-Asset Trading Systems) in order to promote greater investor protection. We suggest that clear direction is given by CONSOB on what these requirements are and, in this regard, encourage CONSOB to consider the following:

#### Information about the ICO:

The ICO issuer should provide detail on the structure and subject matter of an ICO, including:

- a description of the ICO tokens, including but not limited to the tapped blockchain technology, token model, the value of each token, lock-up period, if any, and the returns, profits, bonuses, rights and/or other privileges to the buyer of the token, both monetary and non monetary;
- proposed use of the proceeds of the sale of the tokens, including percentage of allocation to each usage category;
- target market, including respective percentages, number and reasonable demographic descriptions
- descriptions of the currency, other currency and/or other assets that will be received as payment for the tokens;
- amount of discount and/or premiums given for early birds etc.
- proposed timeline, including identification of the determined or determinable date for each major phase in the ICO
- any methods which will be used to monitor and manage funds

#### Information about the ICO issuer:

The ICO issuer should also be required to demonstrate business integrity and stability in some form. This is critical to ensuring the protection of both investors and the market more generally. These requirements could include:

- Setting minimum capital requirements
- Setting minimum equity requirements for the Board of Directors and Senior Management Teams with minimum lock in periods
- Requiring the issuer to demonstrate how they will effectively manage conflict of interest and risk management issues
- Requiring the issuer to demonstrate business continuity management and cyber resilience frameworks
- Requiring the issuer to have in place a compliance function
- Requiring the issuer to demonstrate robust security arrangements, including the existence of experienced security personnel capable of implementing and monitoring the relevant systems and processes
- Requiring the issuer to maintain appropriate record keeping procedures.

In determining the specifics of these requirements, CONSOB should be wary of the early stage of many ICO issuers and not impose requirements that could be unduly restrictive and therefore

risk deterring innovation.

**Question 10:**

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

In line with our opening remarks and our comments under Question 1, Luno has proceeded on the basis that this consultation is focused solely upon the issuance and subsequent trading of crypto-assets issued through ICOs. As such, it is suggested that the term "Crypto-Asset Trading Systems" be replaced with a more suitable term to ensure that proper distinction is made between systems used to trade crypto-assets issued through ICOs and those used to trade other crypto-assets (such as cryptocurrencies).

**Question 11:**

*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?*

We don't have any objections to the admission requirements imposed under Box 5 for Crypto-Asset Trading Systems, each of which offer useful controls. CONSOB may also wish to explore the following requirements for potential inclusion:

- has a compliance function in place
- has comprehensive security (including information security) arrangements in place to effectively implement and monitor its systems and processes
- has business continuity arrangements in place to protect against identified risks such as major outages or loss of data
- has anti-money laundering and countering the financing of terrorism controls (AML/CFT) in place including policies and procedures in relation to financial crime, customer due diligence, transaction monitoring, suspicious activity reporting and record keeping

CONSOB should, however, be mindful that there is no one-size-fits-all list available to neutralise the risks associated with the trading crypto-assets issued through ICOs. In developing its guidance, CONSOB is encouraged to frame the requirements in line with a risk based approach.

**Question 12:**

*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?*

The Crypto-Asset Trading Systems, as contemplated by this section, should be required to take all reasonable steps to ensure that the relevant crypto-assets stored by them are kept safe and secure. CONSOB should be mindful that highly prescriptive requirements in terms of security will neither be suitable for all businesses covered by the proposed framework nor appropriate in light of ever-evolving technical capabilities. However, certain basic requirements should be prescribed and may include:

- Different 'levels' of crypto-asset storage, with only a small amount stored in a 'hot' wallet
- Multi-signature procedures, including by using independent third parties
- Physical storage of crypto-assets across geographies
- Use of segregated bank accounts for customer funds and business funds respectively
- Regular reconciliations and other best practice controls

**Question 14:**

*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?*

As we understand, CONSOB are seeking views on whether Existing Trading Facilities (as defined by us in Question 10) should be subject to an opt-in mechanism. We do not believe that the opt-in regime discussed herein has a connection with the regime chosen for participating in crypto-asset via Existing Trading Facilities. We support implementing a regulatory regime for Existing Trading Facilities but believe that separate consultation will be necessary.

**Question 15:**

*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?*

As we understand, CONSOB are seeking views on whether we support the described transitional arrangements for ICOs which exist at the time when regulation becomes effective. In light of number of crypto-asset currently issued through ICOs, we believe that a transitional regime is desirable. We do, however, suggest removing the obligation to verify, with reference to already issued tokens, that adequate information has been made available to investors and duly publicised. We believe that this obligation would not be practical and would be unduly burdensome during the transitional period.

Luno trusts that the comments provided in this letter are of assistance to the CONSOB and reiterates its willingness to assist further in this regulatory process, to the extent required.

Yours faithfully

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**Maria Woncisz**

Luno Country Manager, Italy