

# The classification of tokens and its regulatory implications

Riccardo de Caria\*

## ABSTRACT

The most common classification of tokens divides them into security and utility tokens. However, other categories have been brought forward, most of the times differing just in terminology, but sometimes identifying a self-standing type of token: it is the case of expressions such as payment tokens, currency tokens, investment tokens, equity tokens, asset tokens, commodity tokens, and even more.

Moving from the categories identified and definitions given by the SEC and FINMA, and also considering the legal scholarship in the field, the article tries to offer a comprehensive view of the existing different types of tokens, clarifying when the various labels used are equivalent to each other, and when instead they refer to actually different types of tokens and also proposing a summary of the different definitions proposed.

After that, the article considers the main legal implications of falling into a particular category. It is argued that the definitions should be carefully crafted to avoid the problem of circularity: a token should be classified according to its most essential features, not to its regulatory treatment, which is just a consequence of its falling under a particular category.

The conclusion offers some final remarks, reiterating the need for a sufficiently broad consensus on the taxonomy and definition of tokens, in order to have an informed and fruitful debate on their regulation.

## 1. Introduction and definition of token

The current growth of the so-called tokenized economy has now attracted the attention of many jurists. However, the terminology used is not always uniform, and this may lead to a lower degree of clarity in the discussions on the subject. In this work, I intend to survey the different types of existing tokens, in order to help make order in this area. In fact, I think that it is necessary, for any reasoning on the tokenized economy, that both scholars, regulators, and practitioners reach a substantial agreement on the employed categories and working definitions in the field.

In this work, I will therefore examine the different classifications and definitions elaborated so far by the legal literature and regulatory authorities of the sector and then propose a summary vision (§ 2.). After that, I will focus on the consequences arising, at the regulatory level, from the

---

\* The present article represents a shorter version of a broader chapter that is bound to be included in a work currently under preparation by the author, a monograph on *The Tokenised Economy and the Law* to be published by Edward Elgar Publishing.

classification of a token in one category or another (§ 3), and finally, I will formulate some concluding considerations, summarizing the key findings of the inquiry (§ 4).

Before starting the analysis, however, I think it is appropriate to preface a definition of ‘token’, in order to facilitate understanding even by the reader who is not familiar with the subject. The term token, in the meaning of “symbol”, “representative sign”, has emerged in computer science to designate a process aimed at protecting some important data that is not intended to be disclosed, and achieved through the conversion of such data into a non-significant equivalent that can be transmitted without revealing the original content: it is not substantially possible, or would be deeply uneconomic due to the enormous amount of computing resources needed, to go back to the original without knowing the conversion mechanism, typically based on cryptography.

From the field of data security and data protection, this expression has recently extended to the field of blockchain and applications that rely on it. In this context, “tokenization” refers to the process, connected but different, of converting wealth into digital tokens, which are then issued on platforms based on a blockchain via smart contract. It is on these tokens and this tokenizing process based on the blockchain that this work is focused.

## **2. The categories of tokens in the classification of the SEC and FINMA**

As now well known among scholars of blockchain and its legal implications, the most common classification of tokens divides them into security and utility tokens. However, other categories have been brought forward, most of the times differing just in terminology, but sometimes identifying a self-standing type of token: it is the case of expressions such as payment tokens, currency tokens, investment tokens, equity tokens, asset tokens, commodity tokens, exchange tokens and even more. In this paragraph, I will try to put order in that scenario.

To be sure, if one looks at the existing literature on the subject, the typology of tokens seems to be very large. By way of example, Shermin Voshmgir, in her *Token Economy: How the Web3 reinvents the Internet*<sup>1</sup>, proposes an extremely diversified taxonomy, focusing on “stable tokens”, “asset tokens”, “social media tokens”, “attention tokens”, “purpose-driven tokens”, “Fractional Ownership Tokens”, “Privacy Tokens”, “Lending Tokens”, on top of Central Bank Digital Currencies (CBDCs) and Facebook’s Libra and Calibra.

The first question to be clarified is whether each of them is a category of its own. The alternative view is that instead, these denominations only reflect the commercial characteristics of the tokens in question (for example, the fact of being attributed in exchange for attention, or a contribution to a particular cause), but the latter can be traced back to the more general categories mentioned above.

I believe there can be no doubt that the correct alternative is the second one; therefore, the first conclusion to keep in mind is that the very diversified typology of tokens, of which the above list represents only a partial example, has a value eminently marketing-wise, but not from an IT or

---

<sup>1</sup> Shermin Voshmgir, *Token Economy: How the Web3 reinvents the Internet*, BlockchainHub Berlin, Berlin, 2<sup>nd</sup> edn 2020.

legal point of view. For our purposes, then, the only distinction that matters is the purpose with which a token is issued and offered to subscribers. In this perspective, we can distinguish three essential purposes: tokens issued with the function of a currency, tokens issued to collect an investment by the subscribers, and tokens issued to give the right to request benefits from the issuer.

Among the categories identified by the leading regulators that have dealt with the matter, those developed by the U.S. Securities and Exchange Commission (SEC) and the Swiss Financial Market Supervisory Authority (FINMA) in Switzerland<sup>2</sup> deserve special attention.

As far as the SEC is concerned, it is common consideration that it has adopted the following tripartition<sup>3</sup>: cryptocurrencies, utility tokens, security tokens. In truth, however, the most relevant document on the subject so far by the SEC, or the *Framework for “Investment Contract” Analysis of Digital Assets* published in April 2019<sup>4</sup>, uses different terminology, from which only indirectly the classification just mentioned is derived.

In fact, firstly the SEC refers more generally to “digital asset” and clarifies that “The term “digital asset,” as used in this framework, refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called “virtual currencies,” “coins,” and “tokens””<sup>5</sup>.

The Framework, which has no binding value<sup>6</sup> (a limit criticized by some commentators<sup>7</sup>), therefore never uses the terms “security token” or “utility token”, and indeed the word “utility” does not appear even once in the text<sup>8</sup>. What the Framework does is an analysis of when the “digital assets” must be considered “securities”; from this, we can derive *a contrario* when a token falls into another category, typically called “utility token”, or in the different group of cryptocurrencies or currency tokens.

---

<sup>2</sup> An updated overview of the current definitions can be derived from Security Token Advisors, *Defining Security Tokens — List of All Countries with Legal Definitions of Digital Securities & Security Tokens*, Medium.com, 3 September 2020, <https://medium.com/security-token-group/defining-security-tokens-list-of-all-countries-with-legal-definitions-of-digital-securities-6b19eab6c330>, last accessed 29 September 2020.

<sup>3</sup> Gotaki Maps, *Token Options*, Medium.com, 21 July 2018, [https://medium.com/@marketing\\_41605/token-options-4f66af313c18](https://medium.com/@marketing_41605/token-options-4f66af313c18), last accessed 29 September 2020.

<sup>4</sup> SEC, *Framework for “Investment Contract” Analysis of Digital Assets*, available at <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

<sup>5</sup> *Ibidem*, note 2.

<sup>6</sup> *Ibidem*, note 1: “This framework represents the views of the Strategic Hub for Innovation and Financial Technology (“FinHub,” the “Staff,” or “we”) of the Securities and Exchange Commission (the “Commission”). It is not a rule, regulation, or statement of the Commission, and the Commission has neither approved nor disapproved its content. Further, this framework does not replace or supersede existing case law, legal requirements, or statements or guidance from the Commission or Staff. Rather, the framework provides additional guidance in the areas that the Commission or Staff has previously addressed”.

<sup>7</sup> Sam Miller, *Is There any Utility Left in Utility Tokens? The SEC Speaks*, Medium.com, 7 April 2019, <https://medium.com/@TheFineArtLedger/is-there-any-utility-left-in-utility-tokens-the-sec-speaks-2cfd41782099>, last accessed 29 September 2020: “Congress needs to act. There are bills in progress. Clarification is sorely needed before innovation is stifled for US token-driven blockchain startups”.

<sup>8</sup> An express reference to the token utilities is contained in some SEC enforcement orders; one of them is recalled in the following paragraph.

Then, to determine whether the token in question falls within the notion of security (more precisely, in its subcategory of “investment contract”), the SEC refers to the well-known “*Howey* test”, or the criterion set out in the Supreme Court ruling *Howey*<sup>9</sup> and its progeny<sup>10</sup>. The *Howey* test is structured based on three prongs: according to it, the existence of an “investment contract” should be recognized when there is 1) an investment of money, 2) in a common enterprise, 3) with the reasonable expectation of profits derived from the efforts of others.

The application of this test to digital assets, and therefore also to tokens, means for the SEC that a token must be qualified as security (hence, as a “security token”) if it meets all the three criteria just outlined. Please refer to the following paragraph for an illustration of the consequences that this qualification determines in terms of regulatory compliance.

As anticipated, in the Framework under examination, the SEC does not analyze utility tokens. However, their qualification can be obtained in a residual manner: tokens that do not meet at least one of the three criteria identified above, which lead to the qualification as security tokens, should be considered as utility tokens.

According to this approach, cryptocurrencies seem to fall into the residual category of utility tokens. In fact, the SEC considers the “virtual currencies” within the third prong, after having observed that one of the elements to understand if it is met is “whether the instrument is offered and sold for use or consumption by purchasers”: where this is the case, it goes beyond the notion of security<sup>11</sup>.

The application of this component of the test to “virtual currencies” leads to the assertion that to the extent that a virtual currency “can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency”, it will tend to fall in the cases of use or consumption purposes, with the consequent exclusion of the application of the rules relating to securities.

Ultimately, what matters to the SEC, in the absence of specific new regulations of the matter, is to clarify under what conditions a token falls under the existing regulations on securities: the issuance and trading of instruments that should be considered outside this notion are currently unregulated and therefore tend to be lawful.

---

<sup>9</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (“*Howey*”).

<sup>10</sup> The Framework refers to *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) (“*Forman*”); *Tcherepnin v. Knight*, 389 U.S. 332 (1967) (“*Tcherepnin*”) (on top of the previous *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (“*Joiner*”).

<sup>11</sup> The Framework references *Forman*, 421 U.S. at 852-53 “(where a purchaser is not “attracted solely by the prospects of a return’ on his investment . . . [but] is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.”). More generally, one can recognise that, in the Us, “there is no uniform definition of “cryptocurrency,” which is often referred to as “virtual currency,” “digital assets,” “digital tokens,” “cryptoassets” or simply “crypto””: cf. Joe Dewey, *Blockchain & Cryptocurrency Regulation 2020 / Usa*, Global Legal Insights, available at <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/usa>, last accessed 29 September 2020.

Moving on to consider the Swiss FINMA, on 16 February 2018, this authority published its *Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs)*<sup>12</sup>. The statement that opens the examination of the token categories is quite remarkable, i.e., “There is no generally recognized classification of ICOs and the tokens that result from them, either in Switzerland or internationally. FINMA bases its own approach to categorization on the underlying economic function of the token”<sup>13</sup>. Therefore, FINMA immediately recognized how this was an open problem (and since then no solution has been found), and declared that it wanted to base its analysis on the economic purpose pursued by the token issuer.

It is an approach that appears to largely overlap the American one, particularly as far as the third prong of the *Howey* test is concerned, which is also focused to a certain extent on the purpose pursued by the issuer. It is arguably to be welcomed because it avoids the risks of circularity, i.e., the tendency to define a token based on its regulatory treatment, which instead is only the consequence of its attribution – based precisely on its intrinsic characteristics and purpose – to a particular category.

In any case, unlike the SEC, the Swiss authority expressly uses the commonly used terminology, or rather the most frequently accredited tripartition: it refers to “payment tokens”, “utility tokens”, and “asset tokens”.

According to FINMA, payment tokens correspond to cryptocurrencies, which in this case, are then identified as a self-standing category. They are “tokens which are intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer”<sup>14</sup>.

The utility tokens, on the other hand, “are intended to provide access digitally to an application or service by means of a blockchain-based infrastructure”: the reference to the blockchain is therefore explained here, but it seems curious since it is common to all three types of tokens; in fact, it is arguably preferable that the explanation of the link with the blockchain is made at the level of the general definition of the term token, as proposed above. In any case, this is not a residual category here, unlike for the SEC, but an explicit definition can be found that refers to the possibility offered by these tokens to use a digital application or service.

Finally, asset tokens are thus defined: they “represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives”. To this, FINMA adds the following clarification: “tokens which enable physical assets to be traded on the blockchain also fall into this category”.

This is very important because it eliminates any possible doubt that this category includes not only securities that entail the participation in a company’s capital and the resulting involvement in its

---

<sup>12</sup> The press release with links to the document in the four available language versions (FINMA, *FINMA publishes ICO guidelines*, 16 February 2018) is available here, <https://www.finma.ch/en/news/2018/02/20180216-mm-ico-wegleitung/>, last accessed 29 September 2020.

<sup>13</sup> P. 3.

<sup>14</sup> *Ibidem*.

decision-making process, or that are built in the form of debt and therefore attribute the right to repayment with interest, but also securities resulting for example from the tokenization of real estate, or a work of art, or intellectual property rights, or even a commodity<sup>15</sup>. From this point of view, tokenization leads to the securitization of property rights, thus expanding the sphere of contractual relationships and reducing that of property in the traditional sense.

It is interesting how the two terms, the American security token and the Swiss asset token, are mainly used to refer to two different aspects: on the one hand, the reference to securities recalls the securitization that also affects the rights of tokenized property; on the other hand, the reference to assets seems very effective in including any asset of economic value that is tokenized for investment purposes<sup>16</sup>.

From the terminological point of view, distinguishing between assets and security contributes to the clarity also because it makes the risk of circularity, as stated above, more unlikely: the asset tokens are identified by their purpose and are then subject to the rules relating to securities because they qualify as such under the respective regulations. In my opinion, to use only the term ‘security’ risks to make this double step less evident, while instead, it is good to maintain it, in order to avoid incurring in the logical error to claim that security tokens are the ones that must be subjected to the regulation on securities, and at the same time that the regulation on securities is applied to the tokens qualified as securities (the circularity is to be found precisely in such line of reasoning).

In any case, if this classification appears convincing from a theoretical perspective, the concrete reality of the entrepreneurial operations founded on the issuing of tokens, typically started with an Initial Coin Offering (ICO)<sup>17</sup>, makes the boundaries between a category and the other not always net and well defined. The existence of possible grey areas and overlaps is recognized by FINMA itself, which appropriately clarifies that “The individual token classifications are not mutually exclusive”.

However, the guidelines of the Swiss regulatory authority continue to consider only one case, namely the possibility that utility tokens on the one hand, and asset tokens on the other, are simultaneously classified as payment tokens, and seem to use the term “hybrid tokens” only with

---

<sup>15</sup> It therefore seems appropriate to bring tokens back into this category, and not to make them a separate category as some observers have argued: see for instance Petros Ring, *The 3 Types of Tokens and Why They're Worth So Much*, Medium.com, 4 May 2018, <https://medium.com/block-16/the-3-types-of-tokens-and-why-theyre-worth-so-much-86e65703e320>, last accessed 29 September 2020.

<sup>16</sup> From this point of view, even the definition of investment token appears convincing, but it has an eminently descriptive value, since it is not used by regulatory authorities.

<sup>17</sup> Even with regard to ICOs there is a considerable confusion of terminology: the business practice has seen the emergence of qualified transactions as Security Token Offering (STO), Tokenized Security Offering (TSO), Tokenized Asset Offering (TAO), Equity Token Offering (ETO), Initial Exchange Offering (IEO). Here, we can take the ICO as a genus, meaning “coin” as a synonym for token (and therefore not limited to cryptocurrencies or payment tokens, as was probably intended at the beginning), and the STO as a species, which qualifies the ICO as a security token (unless we want to introduce the expression, which would seem to be the most appropriate, but is strangely less used, ‘Initial Token Offering’). Thomas Lambert, Daniel Liebau, and Peter Roosenboom disagree, offering a different perspective, in *Security Token Offerings*, 24 June 2020, available at SSRN, <https://ssrn.com/abstract=3634626>, last accessed 29 September 2020.



regard to this case (specifying that, in terms of regulatory treatment, such tokens should be subject to both securities and means of payment regulations).

However, this limited meaning of the term “hybrid tokens” appears misleading, since it does not seem to embrace the widespread and problematic case of the overlap between utility and asset (or security) tokens. The guidelines consider this type of token a little further on and clarify the consequences on the regulatory level, but the term “hybrid” would seem to have to be more appropriately reconsidered in order to include tokens that have this dual nature, without necessarily acting (also) as a means of payment.

The picture is then further complicated by the fact that, as acknowledged by FINMA, according to some legal experts, “all types of tokens should be considered as securities; others disagree”. However, FINMA appropriately states that “payment tokens are designed to act as a means of payment and are not analogous in their function to traditional securities” and therefore, it “will not treat payment tokens as securities”.

### **3. The regulatory treatment of the different categories of tokens**

We now come to consider the consequences of tracing a token back to one or the other category, or its qualification as a hybrid token.

As partly already mentioned in the previous paragraph, what makes it particularly relevant to determine the nature of a token are the consequences on the plan of regulatory treatment that this entails.

Starting with payment tokens or cryptocurrencies, the first to emerge on the market, the picture, at least in the United States, is still somewhat confusing and contradictory, also due to an overlapping of regulations and practices between the state and federal levels. Limiting our analysis to the latter, we can identify several observers who have highlighted the discrepancy between the position of the SEC, which tends to trace cryptocurrencies back to the securities category (thus blurring the line of the distinction mentioned above), and that of other authorities, such as the Commodities Futures Trading Commission, which instead qualifies them as commodities<sup>18</sup>. On its turn, since 2014, the Internal Revenue Service established that it would tax cryptocurrencies as property and not as commodities<sup>19</sup>.

If the resulting risk of confusion for the operators is evident, the picture is even more complicated if we consider that the well-known judgment of the EU Court of Justice in the so-called Bitcoin VAT case<sup>20</sup> established that the exchange of Bitcoin (and other cryptocurrencies, for that matter) for fiat coins should be considered exempt from VAT, as these transactions should be included in the exemption provided for the exchange of “currency, bank notes and coins used as legal tender”. Such a conclusion, although favorable for the operators, appears to be in open contrast with the

---

<sup>18</sup> See for instance Elena Perez, *How the US and Europe Are Regulating Crypto in 2020*, Cointelegraph, 12 July 2020, <https://cointelegraph.com/news/how-the-us-and-europe-are-regulating-crypto-in-2020>.

<sup>19</sup> IRS Notice 2014-21, *Guidance on Virtual Currency*, 25 March 2014.

<sup>20</sup> CJEU, *Skatteverket v David Hedqvist*, C-264/14, 22 October 2015.

cryptocurrencies' nature of an alternative instrument to coins used as legal tender, in competition with them.

As for Switzerland, FINMA's approach seems to be the most precise and consistent: excluding, as was said, the nature of securities (except for hybrid tokens)<sup>21</sup>, the so-called payment tokens are considered a means of payment, and as such, they are essentially subject to the anti-money laundering legislation contained in the Anti-Money Laundering Act, which "gives rise to a range of due diligence requirements including the requirement to establish the identity of the beneficial owner and the obligation either to affiliate to a self-regulatory organization (SRO) or to be subject directly to FINMA supervision".

Turning now to consider utility tokens, this is the least regulated category. The issuance of utility tokens, in fact, in most jurisdictions (with the notorious exception of countries such as China, which banned all ICOs in 2017<sup>22</sup>) is a lawful activity, which falls under more general civil and possibly corporate law rules, but not under the special financial regulations related to the issuance of securities.

Since, as will be said in a moment, the issuance of security or asset tokens is instead subject to such rules, there is an incentive for issuers to qualify their tokens as utility tokens in order to avoid compliance with the obligations in question. For this reason, all jurisdictions that have dealt with the matter specify that utility tokens should be exempt from the need to comply with the rules for securities only "if their *sole* purpose is to confer digital access rights to an application or service"<sup>23</sup>. What must be entirely missing is the "investment purpose", the willingness to "grant the access rights and the connection with capital markets": if this element is even partially present, the token under consideration will have a dual nature of security and utility token, and therefore will still be subject to securities legislation.

Similarly, the SEC tends to adopt a restrictive view of utility tokens, considering that an ICO qualifies for an exemption from securities rules only in limited cases<sup>24</sup>, equivalent to those outlined by FINMA. This conclusion emerges from its enforcement orders against issuers who evaded the regulations in question, but allegedly unlawfully: see, for example, the case of the company Munchee, which intended to issue tokens called MUN. The SEC observed that "even if MUN tokens had a practical use at the time of the offering, it would not preclude the token from being a security. Determining whether a transaction involves a security does not turn on labelling such as characterizing an ICO as involving a 'utility token' - but instead required an assessment of the

---

<sup>21</sup> Except possibly in the phase of "pre-financing" and "pre-sale" when the token does not exist yet but "the claims are tradeable".

<sup>22</sup> Cf. Rain Xie, *Why China had to "Ban" Cryptocurrency but the U.S. did not: A Comparative Analysis of Regulations on Crypto-Markets Between the U.S. and China*, 18(2) *Washington University Global Studies Law Review* 457 (2019); Wulf Kaal, *Initial Coin Offerings: The Top 25 Jurisdictions and their Comparative Regulatory Responses (as of May 2018)*, *Stanford Journal of Blockchain Law and Policy*, 23 June 2018.

<sup>23</sup> Italics added.

<sup>24</sup> Smith, Gambrell & Russel Blog, *Initial Coin Offerings (ICOs): SEC Regulation and Available Exemptions From Registration*, available at <https://www.sgrlaw.com/initial-coin-offerings-icos-sec-regulation-and-available-exemptions-from-registration/#:~:text=Therefore%2C%20under%20current%20SEC%20guidelines,the%20Securities%20Act%20of%201933>, last accessed 29 September 2020.



economic realities underlying transaction”. What matters for the SEC is, therefore, the investigation of the substantial economic reasons of the ICO transaction, an assessment that appears to be comparable to the one on the existence or non-existence of the investment purpose adopted by FINMA.

Finally, it remains to be considered the regulatory framework applied to security tokens. An analytical treatment goes beyond the purposes of this work, but in general, the obligations in question can be summarized in the following terms. First, there is typically a need for registration with supervisory authorities, and in some cases licensing requirements, as well as the need to provide several essential pieces of information, typically contained in the prospectus. However, several exemptions are possible that make compliance less burdensome<sup>25</sup>. At the European Union level, the obligations appear to be even more penetrating<sup>26</sup>.

One of the tools that have developed in an attempt to avoid having to comply with this regulation is the so-called “Simple Agreement for Future Tokens” (SAFT)<sup>27</sup>. However, in this regard, the enforcement practice of the SEC has shown a considerable severity against what it perceived as attempts by issuers to escape from the securities discipline (think of the story, which raised a lot of press coverage, of the successful action against the ICO promoted the messaging company Telegram<sup>28</sup>).

The compliance costs arising from securities regulation are undoubtedly an obstacle for issuers. However, currently, the supervisory authorities seem careful to avoid any possible circumvention of the regulation, which ultimately can be summarized as attempts to qualify as utility tokens some tokens that are in fact (and remain) security tokens, which brings us back to the importance of appropriate classifications and definitions.

#### **4. Conclusion: a clear taxonomy as a basis for studying the legal issues of tokenization**

The synthetic analysis carried out in this article has allowed us to reach some firm points. Firstly, despite the considerable growth of the ICOs market and, consequently, of the interest of operators and scholars, the picture is still somewhat hazy in terms of terminology. This is due to the fact that many different token qualifications have spread commercially, but they do not correspond to a difference in terms of either substance or law.

---

<sup>25</sup> This is the most complete list with regard to the United States: Regulations CF, D, A+, S: see Torsten Sandor, *Security Token Regulations Demystified*, Otonomos, 15 January 2020, <https://otonomos.com/2020/01/security-token-regulations-demystified/>, last accessed 29 September 2020. As far as Switzerland is concerned, FINMA itself indicates in its Guidelines the existence of such exceptions and exemptions.

<sup>26</sup> See the summary table on p. 14 of this analysis: Deloitte, *Are token assets the securities of tomorrow?*, available at <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/technology/lu-are-token-assets-the-securities-tomorrow.pdf>, last accessed 29 September 2020.

<sup>27</sup> Cf. Juan Batiz-Benet, Jesse Clayburgh, Marco Santori, *The SAFT Project: Toward a Compliant Token Sale Framework*, 2 October 2017, available at <https://saftproject.com/static/SAFT-Project-Whitepaper.pdf>, last accessed 29 September 2020.

<sup>28</sup> Robert Stevens, *The SEC killed Telegram’s \$1.7B crypto project. Who’s next?*, *Decrypt*, 13 May 2020, available at <https://decrypt.co/28749/sec-killed-telegram-saft-token-sale-ton>, last accessed 29 September 2020.

With specific reference to the latter, several supervisory authorities have embarked on a path towards the regulation of ICOs, which, however, is not always preceded by an adequate preliminary classification of “coins”, or tokens. However, this operation is indispensable, and mainly the SEC and even more so by FINMA have distinguished themselves for carrying it out.

The study of the respective rulings and documents of various kind, binding and non-binding, has shown numerous similarities between the two authorities, which leads to the conclusion that the most accurate classification is the one that provides for a tripartition between tokens respectively intended as a means of payment, as an instrument to obtain goods or services, or as an investment. The labels adopted for each of these categories may vary, but, as highlighted by the same authorities, what is most relevant is the economic substance of the economic operation pursued.

In particular, the SEC has shown that it is ready to react against attempts to circumvent the securities legislation: the improper qualification as utility token of securities that imply an investment leads to the levying of sanctions in case of non-compliance with the legislation to protect investors, and almost inevitably to the subsequent sinking of the project<sup>29</sup>. Therefore, the call for caution made by several parties to issuers<sup>30</sup>, who will easily see their entrepreneurial initiative blocked if they underestimate the need for regulatory compliance, is to be welcomed.

While, to a large extent, the SEC’s and FINMA’s approaches coincide, some significant differences have emerged. Beyond the aforementioned terminological question (in particular, asset tokens versus security tokens), that is eminently formal, there are two in particular: the fact that the SEC seems to configure utility tokens as a residual category, while FINMA gives them a self-standing qualification and the fact that cryptocurrencies are alternatively qualified as securities or commodities in the United States, and as means of payment in Switzerland. Especially the second aspect can lead to some significant differences in the treatment of cryptocurrencies.

Ultimately, what is evident at the end of this study is that although the blockchain is an invention dating back more than a decade, and although the reflections of lawyers on the subject are now abundant, still much remains to be done to achieve a sufficiently clear picture, to the benefit of operators. In fact, the latter inevitably risk seeing their innovative drive slowed down by a still partially uncertain and contradictory regulatory framework. I hope this paper has indeed shown that on the classifications and definitions (of tokens, as well as of ICOs) it is still necessary to

---

<sup>29</sup> For some critical observations in this regard, cf. James J. Park, *When Are Tokens Securities? Some Questions from the Perplexed*, December 2018, UCLA School of Law, Law-Econ Research Paper No. 18-13, 10 December 2018, available at SSRN: <https://ssrn.com/abstract=3298965>. Among other aspects, the authors dwells on what he defines the “Hinman paradox”, named after then head of the Corporate Finance division of the SEC, who (in Park’s reconstruction) had declared that Ether, “a cryptocurrency that was initially sold through an ICO, was once a security but is no longer a security”. About this, the same Park further explains that “Selling tokens through an ICO without SEC registration requires escaping what we call the “Hinman paradox”. A token can only be widely distributed to the public if the project it is associated with is functional. But a blockchain project can only be functional if its tokens are widely distributed”.

<sup>30</sup> For instance John Alun, *Token sellers beware: it’s a legal minefield out there*, South China Morning Post, 11 December 2017, available at <https://www.scmp.com/business/banking-finance/article/2123700/token-sellers-beware-its-legal-minefield-out-there>, last accessed 29 September 2020.

make appropriate clarifications, taking a step back in order to be able to make others ahead firmly; hopefully, this article can contribute to this effort.

### **Appendix. The Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937**

After this article was originally drafted, the European Commission published its proposed regulation on crypto-assets<sup>31</sup>. It was not possible to give a full account of it within the text of the article, and to be sure it is probably wise to wait and see what changes will be implemented during the legislative procedure.

However, it is certainly possible and in fact advisable to give an account of the approach followed by this draft regulation, as far as the definitory issue is concerned.

I would respectfully submit that the European Commission is at least partly falling in the circularity trap that I mentioned above. In fact, no definition of security tokens is provided<sup>32</sup>: they would simply appear to be included in the general definition of ‘crypto-assets’, and then identified as the ones qualifying as ‘financial instruments’ under MiFID II.

To be sure, the proposed regulation on crypto-assets is not comprehensive, but explicitly leaves out (above all) security tokens, which are indeed already covered by existing Eu financial services legislation. On the other hand, tokens qualifying electronic money/e-money under Directive 2009/110/EC are the subject of a specific set of rules, making the picture a bit confused. In fact, Article 2 (Scope) of the proposed Regulation clarifies that «this Regulation *does not apply* to crypto-assets that qualify as: [...] (b) electronic money as defined in Article 2, point (2), of Directive 2009/110/EC, *except* where they qualify as electronic money tokens under this Regulation»<sup>33</sup>. The drafting choice of the double negative does not appear the happiest one.

The particular, and somewhat questionable, focus on stablecoins, announced multiple times in the Explanatory Memorandum, but then not coherently developed in the proposal (where the term is not picked up), arguably further adds to the confusion.

In any case, the proposed Regulation defines ‘crypto-asset’ as «a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology»: therefore at first sight the notion, per se, would seem to encompass both utility tokens and security/asset tokens, as well as payment tokens/cryptocurrencies (even though, as recalled just above, security tokens fall outside the scope of the regulation, and cryptocurrencies are subject to a specific regime). There is also no explicit reference to cryptography, although this feature is included in the reference to DLTs<sup>34</sup>.

---

<sup>31</sup> Brussels, 24.9.2020, COM(2020) 593 final, 2020/0265 (COD).

<sup>32</sup> In spite of the fact that originally the legislative initiative was purportedly aiming at providing a clear framework also for Security Token Offerings (cf. Framework of the Proposal/Initiative, p. 145; see also p. 6).

<sup>33</sup> Italics added.

<sup>34</sup> According the Proposed Regulation, «‘distributed ledger technology’ or ‘DLT’ means a type of technology that support [sic] the distributed recording of encrypted data».

After defining the broad category of crypto-assets, three subcategories are then identified, namely ‘asset-referenced token’, ‘electronic money token’ or ‘e-money token’, and ‘utility token’. However, these three subcategories would not seem to be the only existing ones: suffice it so say that security tokens (or any equivalent expression, for that matter) are not defined, and thus they lie completely outside of the scope of this Regulation. This appears coherent with the initial statement that «‘Crypto-assets’ and ‘distributed ledger technology’ should [...] be defined as widely as possible to capture all types of crypto-assets which currently fall outside the scope of Union legislation on financial services»<sup>35</sup>, but seems to miss an opportunity of providing a comprehensive piece of legislation; instead, the framework for security tokens is left completely unchanged.

After all, ‘asset-referenced tokens’ do not appear to correspond to the ‘asset tokens’, i.e. the Swiss expression to designate security tokens. An ‘asset-referenced token’ is indeed defined as a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets». On its turn, an ‘e-money token’ is «a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender». And finally, a ‘utility token’ is «a type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token».

The first two categories both include a reference to the goal of stability, which does not contribute to clarity, also in light of the above-mentioned frequent references in the Explanatory Memorandum to stablecoins, a category that is not taken up in the actual Proposed Regulation<sup>36</sup>. On the other hand, it would appear that the category of ‘utility token’ covers all the crypto-assets which do not fall under the former two categories, or do not qualify as financial instruments (and can therefore be deemed security tokens). However, the expression ‘utility token’ only appears four other times in the draft, and most importantly Title II is not dedicated to them, but rather to ‘Crypto-Assets, other than asset-referenced tokens or e-money tokens’.

This choice seems to mimic the SEC choice of identifying utility tokens as a residual category, however the fact that this category is not referred to as ‘utility tokens’ seems to imply that it also includes that are not utility tokens, however this is another aspect that does not stand out for clarity.

To conclude, there appears to exist much room for improvement in the Proposed Regulation, as far as the basic issue of taxonomy and definitions is concerned. One can only hope that the Eu institutions will listen carefully to commentators and provide a better reasoned proposal. There is still time.

---

<sup>35</sup> § 8, p. 17 of the Explanatory Memorandum.

<sup>36</sup> Only limited clarification is offered by the following in the Explanatory Memorandum: «So-called algorithmic ‘stablecoins’ that aim at maintaining a stable value, via protocols, that provide for the increase or decrease of the supply of such crypto-assets in response to changes in demand should not be considered as asset-referenced tokens, provided that they do not aim at stabilising their value by referencing one or several other assets» (§ 26, p. 21).