Crypto-assets and Financial Products: the Italian Regulatory Landscape after the Recent Ruling of the Supreme Court

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The Italian Supreme Court recently issued a new decision on the controversial subject regarding the qualification of cryptocurrencies, stating that the offer of cryptocurrencies (ICO) must be subject to the Italian rules regulating the provision of financial services.

The decision comes at a time of great turbulence for the crypto market and is expected to create regulatory uncertainty for companies offering crypto services in Italy – at least until the new MiCA Regulation will come into force.

The Court argued that cryptocurrencies in general are equivalent to financial products. The risk is that Italian Courts will apply this principle to all crypto-assets without analysing their respective features on a case-by-case basis.

Cryptocurrencies and Financial Products

Virtual currencies are defined under the Italian AML framework. However, the Italian AML rules do not clarify whether cyptocurrencies must be considered as financial products

Under Italian law there is currently no comprehensive regulatory framework applying to cryptocurrencies.

A definition of "*virtual currencies*" was introduced in order to implement the 5th AML Directive. The definition is aimed at identifying those entities that must be enrolled in the register kept by the competent authority (*Organismo Agenti e Mediatori*) ("**OAM**") which became operational a few months ago.

The Italian AML regulations do not clarify though whether cryptocurrencies qualify as financial products.

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The qualification of cryptocurrencies as financial products is essential to determine whether the offer, exchange or negotiation of cryptocurrencies or crypto-assets in Italy is permitted

The notion of financial products – which is something peculiar of the Italian regulatory framework, as there is no similar notion under EU law – applies in all cases where there is (i) an investment of capital, that is made on the basis of (ii) a promise / expectation of financial return and (iii) the assumption of a risk that is directly connected with and related to the invested capital.

Any offer of financial product to retail customers must be made in compliance with the Italian prospectus obligations, subject to the relevant exemptions. In addition, certain limitations and restrictions apply in case of door-to-door sale or distance marketing of financial products. Any breach of these provisions may constitute the criminal offence of illegally performing financial services (*abusivismo finanziario*) in accordance with relevant provisions of the Italian Financial Act.

The qualification of cryptocurrencies as financial products is accordingly of the utmost importance in order to understand whether it is possible to offer, exchange or negotiate cryptocurrencies or crypto-assets in Italy.

The Case Addressed by the Supreme Court

With its recent decision (No. 44378 of 22 November 2022) the Italian Supreme Court examined the question relating to the qualification of cryptocurrencies on the basis of some other case law precedents (which are commented below).

The decision was taken by the Criminal section of the Supreme Court in the context of a proceeding concerning the validity of a criminal seizure measure requested for the crime of "self-laundering".

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The case addressed by the Supreme Court was related to an ICO of coins made to fund the development of a blockchain platform, where the tokenholders received passive income in the form of a reward

The application of the seizure measure was requested in relation to a wallet containing cryptocurrencies collected through an Initial Coin Offering ("**ICO**") launched in 2017 in order to fund the realization of a decentralized platform based on the blockchain for the management of certain logistic processes. The Public Prosecutor argued that the offeror collected money by breaching the rules of the Italian Financial Act on the provision of financial services.

Features of the Coins

The offer of the coins in the context of the ICO was aimed at establishing a multi-service logistic platform supported by a blockchain working on the basis of a DPoS mechanism (Delegated Proof of Stake Technology),

with a view to decentralizing the information contained in traditional logistic systems.

The project required the participation of so-called delegates appointed on the basis of a democratic system by the entire network. The delegates were entitled to receive a reward for each new block on the blockchain.

The rewards were paid through the coin issued in connection with the platform. There were also bonus mechanisms paid depending on the timing of the investment made by the purchasers of the coins.

The governance and economic rights of the tokenholders were described in the white paper published in connection with the launch of the ICO – which is mentioned in the Supreme Court decision.

Cryptocurrencies and AML Rules

In the first part of the decision the Supreme Court makes some introductory remarks on the qualification of virtual currencies in accordance with the Italian AML rules.

The Supreme Court correctly notes that, unlike the definition of virtual currencies provided for under EU law (5th AML Directive), under Italian law a virtual currency can be considered as such also if it can be used for investment purposes (rather than as a means of exchange).

Then the Supreme Court outlines the regime applying to entities providing services related to cryptocurrencies (VASP) and in particular the obligation to enrol in the OAM register and comply with the Italian AML obligations.

Rules on Financial Services

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The Supreme Court argues that the offeror was responsible for the crime of illegally performing financial services, as it collected capital to create its platform against the sale of the platform coins

The Supreme Court subsequently examines the question relating to the application of the Italian rules on financial services on the basis of the decision previously taken in 2020 (No. 26807 of 17 September 2020). In this precedent the Supreme Court already stated that "*if the sale of bitcoin is marketed as a true investment proposal*" then this activity is subject, among others, to the Italian prospectus obligations.

The Court argued that in the case at hand the offeror committed the crime of illegally performing financial services in Italy. This crime is committed whenever a person "*offers outside of its premises, or promotes or places through distance marketing means, financial products or financial instruments or investment services or activities*" (Article 116(1)(c) of the Italian Financial Act).

The Court's argument was based on the observation that "*the funds were collected with a view to creating a centralized platform of logistic services, and those who contributed to this project received as a consideration*" the platform coins, "*which entitled the holders of the coins to use the services*" offered by the platform.

Qualification of Virtual Currencies

The core part of the Court's decision is focused on the qualification of virtual currencies and follows a precedent decided by the Court of Verona (24 January 2017) where the Court stated that virtual currencies qualify as "*financial instruments*".

The Supreme Court confirms that also in the case in question all distinctive elements of a financial investments were met, due to the fact that the investors that purchased the coins (i) invested their own capital (in the form of bitcoin), (ii) with the expectation to get a financial return (*i.e.* the distribution of additional virtual currencies), and (iii) by undertaking a risk connected with the capital invested by them.

It follows from the foregoing, according to the Supreme Court, that "*a virtual currency must be considered as a form of investment because it qualifies as a financial product, meaning that it must be subject to the rules on financial services*".

How Does the Supreme Court Decision Differ from the Previous Cases?

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The Italian Supreme Court seems to state that cryptocurrencies in general qualify as financial products regardless of the way in which they are marketed. In addition, it gives specific relevance to the subjective expectation of return by the investor, as opposed to the objective purpose of the transaction

The Supreme Court already issued two separate decisions (No. 26807 of 17 September 2020 and No. 44337 of 10-30 November 2021) where it confirmed that cryptocurrencies qualify as financial products.

However, in the previous decisions this statement was essentially based on the way in which the offer was marketed to the public. The rules on financial products were deemed to be applicable because the crypto-assets were offered as an investment proposal or in a way which created an expectation of financial return in the potential purchasers.

In its last decision the Supreme Court – whilst making confusion between the notion of "financial instrument" and "financial product", attributing to the former the typical features of the latter – seems to establish a more general principle whereby cryptocurrencies are financial products by definition, *i.e.* regardless of the way in which they were marketed.

The Supreme Court also seems to give a specific relevance to the *subjective* element consisting in the *expectation* of a financial return by

the investor, as opposed to the *objective* element represented by the (financial or non-financial) *purpose* of the transaction.

Finally, the decision appears to extend the scope of the notion of financial products also to those crypto-assets (such as utility tokens) which did not qualify as financial products at least in accordance with the prevailing interpretation.

Critical Aspects of the Supreme Court Decision

Besides the fact that the Supreme Court makes a clear mistake in overlapping the concepts of financial products and financial instruments, the decision is not in line with the interpretation followed thus far by the case law of the Private Law Section of the same Supreme Court as well as by the Italian regulator (CONSOB) with respect to the notion of financial product.

The subjective expectation of financial return that the investor may have (*i.e.* the reason for which it purchases a certain asset) is not the leading element to determine whether such asset qualifies as a financial product. It is essential to determine whether the transaction itself was entered into for a financial purpose (*causa*), as noted by the Private Law Section of the Supreme Court in a landmark case (No. 2736/2013) which is mentioned several times also by CONSOB.

Also, the expectation that the value of an asset can increase over time is not sufficient to determine that such asset qualifies as a financial product. It is necessary to this end that the expected increase in the value of the asset (and the related risk) is an intrinsic element of the transaction.

The notion of financial product can be excluded if the non-financial purpose of the transaction (*i.e.* the possibility for the investor to own and dispose of the asset) has a prevailing importance, or when the investor must perform certain actions that are additional to the contribution of money.

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While the decision of the Italian Supreme Court probably marks the end of the ICOs launched to finance a specific platform through the issue of crypto-assets, the key question is whether there are any broader implications for market operators

The End of the ICOs in Italy?

The Supreme Court decision probably marks the end of the ICOs launched to finance the development of blockchain platforms through the offer in Italy of crypto-assets connected with the platform itself.

In the case examined by the Court the offeror collected capital for the purpose of creating its own platform through the placement of its own coin without issuing any (debt or equity) instruments (*i.e.* through a sort of crowdfunding scheme). This circumstance probably led the Supreme Court to argue – albeit quite confusedly – that the coins should have

been offered in compliance with the Italian rules regulating the provision of financial services.

The ICO saga is largely at its sunset (at least for this type of initiatives) and the crypto market has already developed more advanced products. Crypto exchange platforms in Italy are now subject to a specific registration regime and operate under the supervision of the OAM, while the MiCA Regulation – which will introduce detailed regulatory obligations for crypto companies – is going to be approved at EU level.

The key question is accordingly whether the Supreme Court decision can have broader implications for the crypto market beyond the specific case that was examined by the Court.

What are the Implications for Crypto Operators?

The general principle stated by the Supreme Court does not take into account the various types of crypto-assets offered on the market and the need to verify on a case-by-case basis if all elements to classify a crypto-asset as a financial product (or to exclude this qualification) are met. This assessment must be made on the basis of the indications given in this respect by the Private Law Section of the Supreme Court and the guidelines issued by CONSOB on this matter.

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The decision does not supersede the guidelines issued thus far by the Private Law Section of the Supreme Court and CONSOB, which are still valid and relevant

These indications and guidelines are still valid and relevant, as they have not been superseded by the last decision of the Supreme Court, which was not extensively motivated and was probably issued on the basis of the specific features of the case examined by the Court.

Crypto operators should pay specific attention to the way in which crypto-assets are marketed and offered, as per the precedents already issued by the Supreme Court. Any mechanism providing for the payment of passive income (*i.e.* any income that does not result from an action taken by the investor) must also be carefully assessed.

The risk is that, based on the general principle established by the Supreme Court, Italian Courts and Public Prosecutors will not take into

account the distinctive elements of each crypto-asset and will start qualifying all crypto-assets as financial products.

The Paradox of the Italian Debate in the Light of the MiCA Regulation

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The Italian debate on the qualification of crypto-assets as financial products is a paradox considering that the Italian rules on financial products will have to be significantly reviewed as a result of the MiCA

Putting the case into perspective, the Italian debate on the qualification of cryptocurrencies as financial products is a bizarre paradox. It is already clear indeed that the Italian rules on financial products will have to be amended with respect to the offer of crypto-assets on the basis of the MiCA Regulation.

The MiCa Regulation does not provide for any prospectus obligation for the offer of crypto-assets, and does not require the offeror to comply with the rules applying under Italian law to the door-to-door sale or the distance marketing of financial products.

The topic addressed by the Supreme Court will become out-of-date soon, and the decisions of the case law will be overcome by the evolution of the regulatory framework.

In 2019 CONSOB also anticipated the intention to apply specific rules to the offer of crypto-assets derogating from the general regime concerning financial products.

It would accordingly be more logical to avoid this regulatory uncertainty through interpretative guidelines issued by competent authorities which could steer the case law of Italian Courts pending the entry into force of the MiCA Regulation.

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