



CSSF Guidance on Virtual Assets

Virtual assets

The Luxembourg Financial Sector Supervisory Commission (Commission de Surveillance du Secteur Financier or CSSF) has recently published a communication on virtual assets (CSSF Guidance on Virtual Assets).

It is not the first time that the CSSF addresses the topic as it previously issued similar guidelines about investments in virtual assets by investment funds, direct investments in virtual assets, and depository duties in the context of virtual assets.

According to the communication, the CSSF is committed to promoting an open, technology-neutral, and prudent risk-based regulatory approach and aims to provide professionals with concise answers to the main practical issues they are facing.

The CSSF also emphasizes that digital assets represent a large diversity range: from digital representations of traditional assets with a simple return/risk rationale to more complex representations of rights that are more difficult to assess.



Corpag Luxembourg

10, rue Mathias Hardt
L-1717 Luxembourg

T: +352 621 282 906
E: Luxembourg@corpag.com
W: www.corpag.com



Although all tokens constitute a digital representation of value, that can be digitally traded or transferred, and are provided by the same technology using DLT and cryptography, they also come with a variety of rights (non-exhaustive list):

- Tokens may have different purposes or even multiple purposes (such as payment, investment, or utility).
- Tokens may come with underlying or sophisticated stabilization mechanisms designed to follow one or more baskets of assets (e.g. “custodial” stable coins collateralized by fiat, gold, equity... or even by a cryptocurrency reserve assets) or simply constitute a new type of asset without underlying asset that does not exist outside of the DLT space (e.g. cryptocurrencies).
- Although the majority of tokens is, as such, unregulated and thus does not fall under any existing legislation (such as cryptocurrencies for example), those that fulfill the conditions of financial instruments or e-money are subject to the relevant regulations.
- The characteristics of tokens may even be so specific and unique that they are not fungible and not interchangeable (such as NFTs).
- Tokens may be created to finance a specific project, such as the creation of a new cryptocurrency, or in the context of an initial coin offering (ICO), or the tokenization of real estate in the context of security token offering (STO).



Due Diligence

The CSSF points out that any activity involving virtual assets entails specific risks pertaining to their volatility, liquidity, technological risk, counterparty, custody, or even reputation.

Any entity under the prudential supervision of the CSSF interested in pursuing an activity involving virtual assets bears the responsibility to carry out thorough due diligence and to carefully weigh up the risks and benefits associated with the proposed virtual assets activity with respect to the entity’s existing business model and risk appetite.



Internal governance arrangements

The CSSF notes that internal governance must ensure a sound and prudent management of all the activities of the entity and the internal governance arrangements shall include a clear risk-taking process, including a risk appetite, that is formally and precisely defined in all the business areas, as well as a rigorous decision-making process. The management body of the entity is thus responsible for developing a business strategy with respect to the activities involving virtual assets. It requires that all specific risks pertaining to virtual assets and the risk strategy concerning virtual assets are properly considered, including notably the definition of the risk appetite and the overall framework for risk-taking and risk management.



Regulatory updates

Entities are further reminded by the CSSF of the need to closely follow any regulatory developments, in particular those concerning the prudential treatment of virtual assets and the related practical implications for their investments and customers.

Professionals will remain obliged to carefully weigh up the risks and benefits associated with the proposed virtual assets activities considering current regulations. Professionals should also consider and adapt their business and operational activities to concrete foreseeable regulatory developments, for example those under the upcoming European Markets in Cryptoasset Regulation (MICA) that will regulate certain virtual assets which until now have fallen outside of the scope of existing legislation.

Finally, professionals should proactively engage with the CSSF when planning any activity involving virtual assets.

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