

Private

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EFRAG

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Amsterdam, 20 September 2021

**Response to Accounting for Crypto-assets (liabilities): holder and issuer perspective
(DP/2020/7)**

Dear Madam, Sir,

As Flow Traders we appreciate the opportunity to comment on the Consultative Paper “Accounting for Crypto Assets (Liabilities): Holder and Issuer Perspective” of the European Financial Reporting Advisory Group (EFRAG). Flow Traders is an investment firm, licensed by the Dutch Central Bank and the Netherlands Authority on the Financial Markets, trading on its own account. We are globally active as a liquidity provider in crypto assets and are stock listed on Euronext in Amsterdam. We strongly support EFRAG in its efforts to raise awareness of the accounting considerations and guidelines for crypto and digital asset related transactions in the context of IFRS (and EU-IFRS). We also would like to suggest some possible alternatives regarding the accounting requirements.

Digital Assets Technology Developments

The growth of the digital ecosystem is rapidly increasing. We have reached an important moment for the adoption of innovative technologies that will improve capital markets by verifiable and transparent information, higher efficiency of clearing and settlement and more liquidity. Crypto-assets have a range of characteristics. Some serve as payment tokens or coins, while others are manifestations of currently tradable, regulated, financial instruments. Flow Traders see great potential and societal benefit in security tokens that serve as a tradeable digital asset, comprising an exposure in underlying traditional assets. We also see viable traditional instruments that provide investors with exposure in underlying digital assets. Over the last year, we see a wider adoption of crypto assets in the financial sector with Exchange Traded Products (“ETP”) approved and listed in Canada, Brasil, Germany, France and Switzerland and in the US Crypto Investment funds like Grayscale and the listing of Coinbase stock on the NASDAQ in April 2021. For the US market we expect the approval of ETP products in the foreseeable future.

We echo the opinion of many leading strategy consultants that digital assets and distributed ledger technology (DLT) platforms will substantially improve transparency of information, automation, distribution and liquidity.¹ New digital assets are emerging that promise greater stability, wider

¹ See for: ‘For Digital Assets, Private Markets Offer the Greatest Opportunities’, Bain & Company, Mike Kühnel, Thomas Olsen, John Filder and Karl Gridl, 16 december 2020; ‘How to audit the next generation of digital assets’, EY, Jeanne Boillet, 30 January 2020; ‘Are you reframing the future of asset management or is it reframing you?’, EY, Alex Birkin, Mike Lee, Natalie Deak Jaros, Jun Li and Elliot Shadforth, 15 June 2021.

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acceptance and increase possible uses. Adoption of crypto assets will expand beyond the first niche application of cryptocurrencies, with DLT removing many sources of inefficiency. All market participants as well as regulators and legislators should focus on enabling, participating and fostering these innovative and groundbreaking developments because there is a large societal benefit for many connected to these new technologies, not only in the global financial markets but also in one's everyday life.²

Technologic and Regulatory evolution

Generally, the approach to develop the framework in an iterative process is important to account for the pace at which the cryptoasset markets and the technologies evolve. We noticed the fast developments in the crypto market and its underlying technology. Although relative to the size of the global financial system but its absolute size is meaningful and the increased attention from a broad range of stakeholders shows its potential. EFRAG should monitor and take into consideration these developments to ensure a level playing field across jurisdictions on a global level and to avoid financial reporting, regulatory and taxonomy mismatches with possible infringements with current legislation as a consequence.

Our view on financial reporting & accounting of crypto assets (liabilities)

We think improving the accounting framework around crypto assets (liabilities) in relations to the recognition, measurement, presentation and disclosure of transactions would support the users of financial statements. We strongly believe that EFRAG option 2 - Amend and/or clarify existing IFRS Standards - is the most relevant way going forward. In our opinion, the current gaps in the accounting requirements for stablecoins, crypto liabilities and derivatives relation to crypto assets will lead to different interpretations and practices. Consequently, this will increase the risk of inadequate or misleading information being provided to users of financial statements. That has to be prevented in Europe, hence the importance of EFRAGs further guidance on this issue.

In June 2019 for Holding of Cryptocurrencies the IFRS IC concluded that for crypto currencies no new IFRS standards will be issued but that interpretation for existing IFRS standards will be provided. The IC concluded that IAS 2 Inventories applies to crypto currencies when they are held for sale in the ordinary course of business (IAS 2 para 5 broker-trader are those who buy or sell commodities for other or own their own account). Inventories are principle acquired with the purpose of selling in the near future and generating profit from fluctuations in prices or broker-trader margin. If IAS 2 is not applicable, an entity applies IAS 38 Intangible Assets to its holding of cryptocurrencies. We are concerned with applying IAS 2 - Inventory broker-trader exemption - because this would not provide a full representation of the hedging strategies applied in market making for crypto assets (liabilities). Flow Traders as a market maker and liquidity provider in Digital Assets Markets as from 2017. In line with our trading and market liquidity providing strategy we do not take directional positions but hedge our positions. The trading approach has many similarities to trading in other, more traditional assets classes like ETF Equities, ETF Credits & Debts, ETF FX, ETF Options and commodities. In our opinion accounting for both long and short positions while these will be accounted for as fair value through

² 'How governments can harness the potential of blockchain', McKinsey, Ameet Pandey, 6 November 2020.

P&L in Financial Assets and Liabilities-held-for-Trading, will provide the users of the financial statements the best insights. The accounting for Financial Assets & Liabilities held for trading book including Digital Assets & Liabilities is based upon IFRS 9 – Financial Instruments³.

Furthermore, growth in the market capitalization of stable coins, mostly pegged to the USD, and trading pairs and liquidity depth between cryptocurrency pairs have been increasing significantly. We believe the adoption and growth of stable coins is an indication of the importance of the stable coins market and the urgent need to address concerns with the accounting thereof. As an example, we should reconsider IAS 32 / IAS 7 for classification of stable coins as cash & cash equivalents. The current gaps in the accounting requirements for stable coins, crypto liabilities and derivatives relation to crypto assets could lead to diversity in practice and an increased risk of inadequate or misleading information being provided to users of financial statements. We also noticed that the Basel Committee with its Consultative Document “Prudential treatment of cryptoasset exposures – June 2021” starts to recognize stable coins as a potential separate category for its new framework. From a perspective of consistency of the accounting standards related to market practices and the regulatory framework, we suggest EFRAG to further explore option 2 by collecting practitioners and market intelligence and suggestions how to amend and clarify the existing IFRS Standards.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact Niels Lemmers, Head of Public Affairs (31 20 799 6498 or email nlemmers@flowtraders.com) or, alternatively, Jerry van Weldam, Global Head Finance Flow Traders (31 20 799 6458 or email jvanweldam@flowtraders.com).

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³ IFRS 9 effective as per 1 Jan 2018 EU endorsed as per 29/11/2016. The Group applies for its trading position key IFRS standards like IFRS 13 Fair Value Measurement, IAS 32 Financial Instrument Presentation

Comments by the specific questions EFRAG Discussion Paper Accounting for Crypto-assets (liabilities) : Holder and Issuer Perspective

Q	EFRAG DP ACCOUNTING FOR CRYPTO A (L)	FLOW TRADERS RESPONSES
1	<p>QUESTION 1 – USE OF CRYPTO-ASSETS (LIABILITIES) Chapter 7 discusses some of the factors that may influence the uptake of crypto-assets (liabilities) by mainstream institutions. Furthermore, as noted in Chapter 3 (Paragraph 3.98), the business purpose for holding a crypto-asset should be a key consideration in the accounting classification. Please describe the areas in which your company (or institutional clients) use or expect to use crypto-assets (liabilities). What are the main factors influencing the usage of crypto-assets (liabilities)? For what purposes are crypto-assets usually held or issued by your company or institutional clients?</p>	<p>Flow Traders as a market maker and liquidity provider in Digital Assets Markets as from 2017. In line with our trading and market liquidity providing strategy we do not take directional positions but hedge our positions. The trading approach has many similarities to trading in other more traditional assets classes like ETF Equities, ETF Credits & Debts, ETF FX, ETF Options and commodities. The position both long and short are accounted for a fair value through P&L in Financial Assets and Liabilities-held-for-Trading. The accounting for Financial Assets & Liabilities held for trading book including Digital Assets & Liabilities is based upon IFRS 9 – Financial Instruments</p>
2	<p>WAY FORWARD</p>	
2.1	<p>As detailed in Chapters 3 and 4, this DP proposes that there is need to address accounting topics, not in scope of the IFRS IC agenda decision on cryptocurrencies and to include unaddressed holders' and issuers' accounting topics.</p> <p>Do you agree that there is need to address accounting topics not in scope of the IFRS IC agenda decision on cryptocurrencies? Please explain.</p>	<p>We are concerned with applying IAS 2 – Inventory broker-trader exemption – would not provide a full picture of the hedging strategies applied in market making for crypto assets (liabilities) i.e. only showing Long Position Cryptocurrencies with further disclosing of commercial hedging strategy in the notes to the financial statements.</p> <p>In the absence of a comprehensive financial reporting framework for digital assets accounting the Group in line with IAS 8 applied an internally consistent accounting and reporting framework for digital assets in our Trading Books as part of Trading Assets and Trading Payables held for sale with Fair Value Changes through P&L measurement and hence adjust current IFRIC interpretations around IAS 32 Cash & Cash Equivalents as well as IFRS 9 Financial Instruments (See responses at 2.2.).</p>
2.2	<p>Chapter 6 and Paragraphs ES35 to ES46 of the executive summary section analyses three possible approaches on the way forward for addressing IFRS requirements. Chapter 6: Paragraph 6.26, Table 6.1 outlines the pros and cons of each option. The three options are as follows: • Option 1: No amendment to existing IFRS requirements; • Option 2: Amend and/or clarify existing IFRS requirements; and • Option 3: A new Standard on crypto-assets (liabilities) or digital assets (liabilities). Which of the three options do you consider to be the most appropriate solution to address IFRS requirements?</p> <p>Alternatively, please elaborate if you consider there to be other possible approaches towards clarifying and developing IFRS requirements for crypto-assets. If a new standard is to be developed, what should be in its scope?</p>	<p>We think improving the accounting framework around crypto assets (liabilities) in relations to the recognition, measurement, presentation and disclosure of transactions would support the users of the financial statements. We strongly believe that EFRAG option 2 – Amend and/or clarify existing IFRS Standards – is the most relevant way going forward.</p>
3	<p>ACCOUNTING FOR HOLDERS</p>	

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Q	EFRAG DP ACCOUNTING FOR CRYPTO A (L)	FLOW TRADERS RESPONSES
3.1	<p>Question 3.1. This DP (Chapter 3: Paragraphs 3.37 to 3.41) has identified that applicable IFRS Standards for crypto-assets holders (IAS 2 and IAS 38) do not explicitly address situations where crypto-assets are considered to be held as nonfinancial asset investments.</p> <p>Furthermore, as outlined in Chapter 3: Paragraphs 3.42 to 3.48, there are situations where the measurement requirements under IAS 2 or IAS 38 may not allow FVPL or FVOCI to reflect the economic characteristics of crypto-assets with trading or investment asset attributes.</p> <p>For example, under IAS 38, FVOCI is only allowed if there is an active market. Do you agree that standard-setting activity is needed to address the limitations of IAS 2 and IAS 38 requirements towards addressing non-financial asset investments; namely that: IAS 38 does not allow FVPL when cryptocurrencies are held as trading or investment assets; and IAS 38 does not allow fair value measurement when markets are inactive? Please explain.</p>	<p>We are concerned with applying IAS 2 – Inventory broker-trader exemption – would not provide a full picture of the hedging strategies applied in market making for crypto assets (liabilities) i.e. only showing Long Position Cryptocurrencies with further disclosing of commercial hedging strategy in the notes to the financial statements.</p> <p>In the absence of a comprehensive financial reporting framework for digital assets accounting the Group in line with IAS 8 applied an internally consistent accounting and reporting framework for digital assets in our Trading Books as part of Trading Assets and Trading Payables held for sale with Fair Value Changes through P&L measurement and hence adjust current IFRIC interpretations around IAS 32 Cash & Cash Equivalents as well as IFRS 9 Financial Instruments (See responses at 2.2.).</p>
3.2.	<p>Question 3.2. This DP (Chapter 3: Paragraphs 3.49 to 3.56) has identified the need to clarify the eligibility of some cryptoassets for classification as financial assets. There may be a need to update IAS 32 such that crypto-assets that have similar characteristics or functional equivalence to equity or debt securities (e.g. rights to profit, stakes in partnership arrangements, voting rights, right to cash flows from entities) but do not meet the current definition of financial assets under IAS 32.</p> <p>Alternatively, there may be a need to classify crypto-assets as a unique asset and to allow accounting treatment that is similar to that of financial assets where appropriate.</p> <p>a) Do you agree that there is need to clarify crypto-asset holders' eligibility to apply IFRS 9? Please explain.</p> <p>b) Do you have views on whether or not IAS 32 needs to be updated to include crypto-assets (tokens) with functional equivalence to equity or debt securities, within the IAS 32 definition of financial instruments (financial assets for holders and financial liabilities for issuers) or alternatively whether crypto-assets should be classified as a unique asset and allowing accounting treatment similar to financial</p>	<p>Ad a) Yes, clarify IFRS 9 for crypto asset holders and crypto asset liabilities.</p> <p>In the absence of a comprehensive financial reporting framework for digital assets accounting the Group in line with IAS 8 applied an internally consistent accounting and reporting framework for digital assets in our Trading Books as part of Trading Assets and Trading Payables held for sale with Fair Value Changes through P&L measurement and hence adjust current IFRIC interpretations around IAS 32 Cash & Cash Equivalents as well as IFRS 9 Financial Instruments (See responses at 2.2.). We are concerned with applying IAS 2 – Inventory broker-trader exemption – focus upon the long side only – would not provide a full picture of the hedging strategies applied in market making for crypto assets (liabilities) i.e. only showing Long Position Cryptocurrencies with further disclosing of commercial hedging strategy in the notes to the financial statements.</p> <p>Ad b) Yes, we think that IAS 32 should be updated. We think that the adoption and growth of stablecoins is an indication of the importance of the stablecoins market and the urgent need to address concerns with the accounting for stablecoins, for example to reconsider IAS 32 / IAS 7 for classification of stable coins as cash & cash equivalents. The current gaps in the accounting requirements for stablecoins, crypto liabilities and derivatives relation to crypto assets could lead to diversity in practice and an increased risk of inadequate or misleading information being provided to users of financial statements.</p>




Q	EFRAG DP ACCOUNTING FOR CRYPTO A (L)	FLOW TRADERS RESPONSES
	instruments where appropriate? Please explain.	
3.3	<p>Question 3.3. This DP (Chapter 3: Paragraphs 3.57 to 3.63) has identified that the definition of cash or cash equivalents may need to be updated to include some of the stablecoins that are pegged to fiat currency on a 1:1 basis, cryptocurrencies that qualify as e-money and CBDCs. And that crypto-assets received in exchange for goods and services could also be treated as being equivalent to foreign currency.</p> <p>Do you have views on whether or not the definition of cash or cash equivalents needs to be updated? Please explain</p>	<p>Yes, we think that definition of cash equivalents needs to be updated given the adoption and growth of stablecoins is an indication of the importance of the stablecoins market and the urgent need to address concerns with the accounting for stablecoins, for example to reconsider IAS 32 / IAS 7 for classification of stable coins as cash & cash equivalents. The current gaps in the accounting requirements for stablecoins, crypto liabilities and derivatives relation to crypto assets could lead to diversity in practice and an increased risk of inadequate or misleading information being provided to users of financial statements⁴.</p>
3.4	<p>Question 3.4. This DP (Chapter 3: Paragraphs 3.79 to 3.93) proposes that the clarification of IFRS requirements is needed for holders on behalf of others (e.g. custodial services) including on interpretation of the indicators of economic control.</p> <p>Clarification is also needed for accounting by holders of utility tokens and hybrid tokens, and for holdings arising from barter transactions and proof-of-work mining activities (Chapter 3: Paragraphs 3.64 to 3.76).</p> <p>For hybrid tokens, there is a question of whether the predominant component should be considered or if/how bifurcation principles should be applied to determine their classification and measurement. For utility tokens, there is also a question of the appropriate recognition and measurement of atypical tradeable rights (e.g. rights to update network functionality; and rights to contribute resources and effort to the system) and the lack of IFRS guidance for prepayment assets.</p> <p>Do you agree that the aforementioned areas need clarification in IFRS requirements as has been identified in this DP? Please explain</p>	<p>In general we think that on top of a reporting framework for cryptocurrency assets and liabilities more tailored application guidance would be useful but such guidance should be build up, like the guidance for other more traditional assets was build up over years of interpretation and real life examples of preparers, regulators and auditing firms.</p>
4	ACCOUNTING FOR ISSUERS	
4.1	<p>Question 4.1. This DP (Chapter 4: Paragraphs 4.23 to 4.29) concludes that in the absence of clarification by the IASB, the preliminary conclusion of this research is that ICO issuers (and issuers in similar offerings) can apply one or a combination of the following IFRS Standards: IFRS 9 Financial Instruments, IAS 32 Financial Instruments: Presentation, IFRS 15 Revenue from Contracts with Customers, IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IFRS 13 Fair Value Measurement.</p>	<p>As a trading firm trading for own account we do not issue ICO, however as matter of principle we think that the IFRS Framework should provide guidance relevant for ICO.</p>

⁴ Refer also to research "Can Fiat-backed Stablecoins be considered cash or cash equivalents under IFRS rules?", Australian Accounting Review, Filip Hampl, Lucie Gyonyorova, 20 May 2021 (AAR 2021, 1-23).

Q	EFRAG DP ACCOUNTING FOR CRYPTO A (L)	FLOW TRADERS RESPONSES
	Do you consider that existing IFRS Standards provide a suitable basis to account for crypto-liabilities by issuers of ICOs, IEOs and STOs? Please explain	
4.2	Question 4.2. The DP (Chapter 4: Paragraph 4.28) highlights a number of areas that could pose concerns with the application of IFRS 15 for an entity issuing crypto-assets through ICOs (or other offerings such as IEOs and STOs). In cases when an issuing entity establishes that the issuance of crypto-assets falls within the scope of IFRS 15, which areas, if any, would you consider need further guidance/clarification for an entity to apply the principles in IFRS 15? Please explain	As a trading firm trading for own account we do not issue ICO, however as matter of principle we think that the IFRS Framework should provide guidance relevant for ICO.
4.3	Question 4.3. The DP (Chapter 4: Paragraphs 4.25 and 4.29) highlights a number of areas that could pose concerns with the application of IAS 37 for an entity issuing crypto-assets through ICO (or other offerings such as IEOs and STOs). In cases when an issuing entity establishes that the issuance of crypto-liabilities qualify as a financial liability under IAS 32/IFRS 9 or as a provision under IAS 37, which areas, if any, would you consider need further guidance/clarification for an entity to apply these Standards? Please explain.	As a trading firm trading for own account we do not issue ICO, however as matter of principle we think that the IFRS Framework should provide guidance relevant for ICO.
5	VALUATION	
5.1	Question 5.1. The DP (Chapter 5: Paragraphs 5.44 and 5.45) observes that when considering fair value measurement under IFRS 13, determining an active market for crypto-assets is not always straightforward. Do you consider that the guidance in IFRS 13 provides an adequate basis to determine an active market for cryptoassets (and, if applicable, related crypto-liabilities) when these are measured at fair value?	Yes, we think that size and depth of crypto currency markets allows for applying the concepts of active markets in line with IFRS 13 albeit with more tailored cryptocurrency markets application guidance, like the guidance for other more traditional assets was build up over years of interpretation and real life examples of preparers, regulators and auditing firms.
5.2	Question 5.2. The DP (Chapter 5: Paragraph 5.42) observes that there is an emergence of valuation methodologies, that might differ from the fair value measurement guidance in IFRS 13, tailored for crypto-assets. In the absence of an active market under IFRS 13, do you consider that IFRS 13 provides an adequate basis to determine an appropriate valuation technique to measure crypto-assets	Yes, we think that size and depth of crypto currency markets allows for applying the concepts of active markets in line with IFRS 13 albeit with more tailored cryptocurrency markets application guidance.
6	OTHER	
6.1	Question 6.1. Do you have other comments on the accounting for crypto-assets (liabilities), or on any other matter in the DP not addressed by the above questions?	As part of the ecosystem and with the increasing number of ETF instruments with Cryptocurrency or digital exposures it is important to have a comprehensive financial reporting framework for liquidity providing and market maker activities, aligning reporting with transparency on the underling risk and having a a consistent reporting framework for more traditional assets classes like ETF Equities, ETF Credits & Debts, ETF FX, ETF Options and commodities. A framework for financial reporting should be address recognition, valuation and presentation for positions of a trading firm contains both long and

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Q	EFRAG DP ACCOUNTING FOR CRYPTO A (L)	FLOW TRADERS RESPONSES
		short in regulated instruments (ETF, Futures) as well as in the underlying crypto coins/digital assets.

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