MiCA & Stablecoins

Money on blockchain: promoting Europe's competitiveness through the development of a euro-stablecoins market

February 25, 2021

EU Crypto Initiative

The market in digital representations of euros on blockchains is growing fast, raising both economic, political and societal strategic questions.

In recent years, we have observed tremendous growth in the area of digital money. The numerous projects in this space vary in scope and implementation, which creates a cloud of confusion surrounding their objectives and potential macro-economic impact.

Most of the international political attention is currently on Facebook's Diem project (formerly Libra) and publicly issued central bank digital currency ("CBDC") projects (notably in Europe and China). These initiatives have yet to launch, let alone have any real-world applications today. Meanwhile, privately-issued stablecoins are generating an enormous amount of activity and innovation. In this domain, with the US taking the lead in response to increasing strong demand for digital representations of fiat currencies.

With most global crypto-asset activity already taking place in the US and Asia, EU companies using crypto-assets must rely on USD to manage treasury, as there are no meaningful euro-referenced assets on public blockchains – increasing Europe's economic dependency on the US. Consequently, all new innovative crypto-asset businesses & Decentralised Finance is happening is USD now – threatening the enormous innovation potential in this space in Europe as well as increasing dependency on the USD.

To avoid another missed European opportunity in digital transition, Europe needs a clear and unified vision for digital money innovation that notably takes the form of privately-issued digital representations of euros ("euro stablecoins"). They will enhance and protect Europe's economic competitiveness and sovereignty and strengthen the euro's international role.

The purpose of this paper is, therefore:

- To help inform and clarify the diverse universe of stablecoins;
- To contrast the US and EU approaches and potential implications for Europe's competitiveness;
- To put forward three core pillars for an EU vision for controlled innovation in stablecoins; and
- To propose technical changes to the Market in Crypto Assets (MiCA) regulation in support of such vision[1].

The stablecoin universe

Stablecoins are the most innovative form of digital money. Digital money can take many forms, and most representations of euros are already digital. "Electronic money" is the current digitised form of scriptural euros in the EU zone for payments systems. Following the rise of distributed ledger technology (DLT), new forms of digitised money representation have been created.

Tokens representing a single fiat currency issued on a public blockchain network dominate the stablecoin landscape. Two types of assets make up this category: tokenised fiat money and decentralised fiat money representations. Together, they account for approximately 45 billion USD in market capitalisation. On the other hand, stablecoins issued on private networks and any other representation of value, such as the so-called "global stablecoins" representing more than one fiat currency, have no real use today.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593

The table below provides a high-level description of the current universe of stablecoins.

	Global currency (i.e. initial "Libra" project)	**Wholesale CBDC**	**Retail CBDC**	**Tokenised fiat money (hereinafter defined as "stablecoin")**	**Decentralised fiat money representations ("decentralised stablecoins" - see our "DeFi" paper)**
Representation of legal money	No New money, based on multiple existing fiat currencies	Yes	Yes	Yes	Yes
Issuance	Issued by a legal person	Issued directly by the Central Bank	Issued directly by the Central Bank	Issued by a legal person	Issued by smart contract
Collateral	Digital representation of existing value (no fractional reserve)	Direct emission	Direct emission	Digital representation of existing value (no fractional reserve)	Digital representation of existing value Backed by crypto-assets
Target user	Retail, private companies	Financial institutions	Retail, private companies	Retail, private companies, crypto industry, financial institutions	Retail, private companies, crypto industry, financial institutions
Use case	Payment, investment, settlement	Settlement	Payment, investment, settlement	Payment, investment, settlement	Payment, investment, settlement
Actual use	Not significant	None (ongoing experiments in the EU)	None (ongoing experiments in China)	44b USD equivalent[2] issued on public blockchains	2b DAI[3] (USD stablecoin) issued using the Maker protocol

Numerous pieces of research have studied and analysed those emergent representations of euros such as CBDCs and stablecoins throughout 2020, including from the FSB[4], the IMF[5], the ECB[6], Banque de France[7] and Bundesbank[8]. Whilst important, these analyses have common flaws: they take a "one-size fits all bank-type risk-based approach, they overstate the significance of (currently non-existing) stablecoins issued by Big Tech companies (whose success is far from certain), they ignore the significance and economic potential of crypto-asset markets, and confuse various forms of digital money (CBDC, tokenisation of commodities, tokenisation of crypto-assets, tokenisation of fiat currencies, tokenisation of baskets of assets / currencies etc.).

The diversity of the stablecoins universe is a very important consideration for EU policy-makers to take into account when looking at MiCA, as current trends in usage, funding and investor interest are indicative of future long-term developments. Yet, MiCA would currently operate to effectively ban those most active stablecoins as it focuses on others, such as Diem, which do not yet exist.

[2] https://www.coingecko.com/fr/stablecoins
[3] https://daistats.com/#/
[4] Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements, FSB, 13 October 2020
[5] Digital Money Across Borders: Macro-Financial Implications, IMF, October 19, 2020
[6] Report on a digital euro, ECB, October 2020
[7] Stablecoins: A Brave New World?, March 2020, WP 757, Banque de France
[8] Bundesbank, Geld in programmierbaren Anwendungen Branchenübergreifende Perspektiven aus der deutschen Wirtschaft, Frankfurt am Main, 21. December 2020

US dominance of the stablecoin market

The US is moving ahead and encouraging the development of USD stablecoins by the private sector: relying on public blockchains to deliver real-time investments, settlements and payment technologies

Significant growth in volume and use of USD stablecoins. Crypto-asset markets and use cases are rapidly growing, recently reaching 1 trillion USD in value. DeFi, in particular, is heavily reliant on USD stablecoins, collateralised one-to-one by fiat US dollars. Some of the most well-known stablecoins in this category include Tether (USDT), USD Coin (USDC), Binance USD (BUSD), True USD (TUSD), and Paxos Standard (PAX). As of February 2021, 90% of current exchange volumes on crypto-asset markets were settled in tokenised USD[9.] The total value in circulation exceeded 44 billion, with a significant growing trend observed in 2019 and 2020. 99 % of innovative use cases (decentralised finance, DAOs, etc.) use USD stablecoins.

This growth is very likely to become a permanent feature of the US market. Existing USD stabecoins are issued by US-regulated entities under FinCEN supervision (the US Financial Intelligence Unit). Recently, US banks were authorised to issue, safeguard and realise transactions in stablecoins by the Office of the Comptroller of the Currency (OCC)[10]. Earlier in 2020, the OCC had authorised banks to safeguard their clients' crypto-assets[11]. This regulatory clarity is already bearing fruit for the US financial sector: Paypal is providing access to Bitcoin, Ethereum and other crypto-assets; VISAsigned a partnership with Circle (an issuer of USD Coin) for USD 5 billion supply to enable direct payments in stablecoin using credit cards[12]., Anchorage, a digital asset platform for institutional actors, has been registered as a fully-fledged bank (OCC Conditional Approval, January 13[13]).

These initiatives from US regulators have sent a strong signal to the US market about the long-term value of open crypto-asset networks and provided the necessary regulatory clarity and incentives for US companies to enter and grow in the space. It further signals the US's political intention to develop the US dollar's reach in international finance and modernise its financial industry by supporting the development of private stablecoins. It is no exaggeration to qualify these recent moves as taking the offensive on the next generation of financial markets.

Initiatives lead by other jurisdictions

In the UK: the FCA launched a public consultation on stablecoins & crypto-assets on January 7 ("UK regulatory approach to crypto-assets and stablecoins: Consultation and call for evidence", January 2021). The consultation's objective is clear: the UK identifies ways to be more competitive than Europe for crypto-assets companies in a post-Brexit environment. GBP stablecoins will likely be favoured, with the same private-focused strategy as the US.

In Switzerland: a few stablecoin projects are gaining ground. The most well-known is XCHF, issued in 2018 by Swiss Crypto Tokens, a subsidiary of Bitcoin Suisse. in the form of a first token called CryptoFranc – as an ERC-20 token on the Ethereum blockchain. The CryptoFranc (XCHF) is a stablecoin, representing a Swiss Franc-denominated bond. The value of 1 XCHF = 1 CHF. The total value of all XCHFs in circulation is fully backed by physical CHF bank notes, which are audited by Grant Thornton Bank Audit Ltd on a monthly basis.

[9] https://stablecoinindex.com/volume
[10] https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2.html
[11] https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html
[12] https://www.ledgerinsights.com/analysis-circles-stablecoin-deal-with-visa-is-more-than-just-another-crypto-card/
[13] https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-6.html

A very timid EU response

The EU is lagging in developing crypto-asset markets and stablecoin issuance, notably due to the lack of regulatory clarity. The EU has a very nascent crypto-asset industry, far behind American and Asian markets. This has a significant impact on stablecoins-related activities. Few EU industry players can bear the costs associated with stablecoin issuance (which MiCA, as proposed by the Commission, will exacerbate). Almost no actor[14] has taken the step of issuing such an asset, mainly due to the cost of maintaining the collateral (ECB interest rates being low or negative), regulatory uncertainties introduced by the e-Money directive and strong negative political signals coming from Finance Ministries all around Europe. **The absence of euro stablecoins means that the strong demand for a EUR-based stablecoin by the crypto-assets industry, especially from EU-based companies and individuals, cannot currently be met.**

The EU risks repeating the mistakes made at the beginning of the Internet age, as France did in the 90s, believing that its centralised, more easily controllable telecom networks (the “Minitel”) would compete with the open internet. **The parallel is not trivial: the value proposition of crypto-assets is heavily dependent on the openness of public blockchain infrastructures and the highest degree of innovation they allow, akin to the innovation that the Internet’s openness made possible.** Should Europe miss this opportunity, it will face challenges on financial sovereignty and foreign market dominance in 10 to 20 years – one cannot help but look at Europe’s defensive position regarding FAANGS as an indication of what could come.

It is increasingly clear European Central Bank’s vision for stablecoins, supported by prominent Member states, is to favour the development of a CBDC and to hinder the growth of private stablecoin initiatives, irrespective of the issuing entity. This 5-year vision (as stated recently by ECB President Mrs Lagarde) is a laudable objective which we support longer-term. However, this timeframe is an eternity in the fast-developing crypto-finance space. Furthermore, there is no guarantee that a euro CBDC will compete with privately-issued stablecoins on crypto-asset markets.

The current EU approach will likely lead to durable domination from the US and Asia-based actors in the new digital economy opportunities that crypto-assets bring. The all-encompassing nature of the MiCA proposal, which imposes a unique way of doing business to most crypto projects, effectively banning or hindering the development of some of the most innovative use cases, is a worrying signal.

[14] in **Germany,** EURB issued on a public blockchain by a German bank as a test; In **Malta**: the only effectively used stablecoin is STASIS EURO

The EU's necessary innovative and competitive shift

A vibrant private ecosystem based on crypto-assets and public blockchain has emerged in Europe over the last few years. Europe needs a more ambitious vision to unleash its potential, relying on strong public and private sector initiatives and structured around three key pillars.

1) Creating favourable conditions for the issuance of EUR private stablecoins by commercial banks or e-money institutions, allowing for direct competition with USD stablecoins. Those stablecoins could be 1-to-1 collateralised to avoid any financial stability risk and have consumer protection supervision, investor protections and KYC/AML. Such a shift would require the following conditions to exist:

- **Regulatory clarity.** MiCA is a fantastic opportunity for Europe. But it also carries a high risk of dampening the massive innovation potential that Europe could deploy through the appropriate, proportionate regulation of EUR-stablecoins that could also support a more significant international role for the euro:
    - Over-burdening on e-money tokens that present a minimal risk in terms of financial stability[15].
    - Misguided in its scope, thus preventing innovation (see below);

- **Political support**: the political messaging around tokenisation initiatives must shift from a blunt rejection of privately issued representation of money towards a more positive and nuanced stance on those tokens issued according to the regulation. Entrepreneurs will not dare invest in risky, growth generating ventures if politicians keep signalling that they will not welcome their business, based on a misguided "1 size DIEM fits all" view of the stablecoins market.

- **The traditional financial services sector and the EU crypto-asset industry** are best positioned to issue EUR-based stablecoins. Issuing commercial money is the business of banks. Stablecoins are merely a new representation of this activity. European banks and e-Money institutions should embrace this innovation and issue stablecoins, leveraging the EU crypto-asset industry's technical and functional expertise.

- **Active investment from the EU**: issuing stablecoins is a costly activity that requires a significant amount of capital. The EU could financially support certain ventures and even actively participate in the issuance of such tokens. The European Blockchain Service Infrastructure initiative from DG CONNECT could be leveraged to this end.

2) Supporting the development of "decentralised" stablecoins in Europe.

In another paper focusing on DeFi[16], we present the business cases surrounding crypto-blockchain technology in decentralised finance (DeFi). We conclude that the EU should favour developing those use cases in the EU by providing the private sector with regulatory certainty. In this context, it is equally essential that DeFi use-cases involving the issuance of tokenised fiat money stablecoins are allowed to exist in the EU.

The four conditions outlined in the previous section are desirable for the development of DeFi. It should be noted that DeFi use cases already benefit from enormous traction and attract phenomenal talents. While a large part of DeFi research and development is led by Europeans, we estimate that a significant portion of them work for companies incorporated outside the European Union.

The most obvious steps to take regarding decentralised stablecoins are to 1) ensure that MiCA allows for the creation and use of decentralised stablecoins, and 2) send strong positive signals to the industry indicating that the EU will welcome innovation in this field.

3) Development and issuance of a CBDC by the ECB will complement the private sector's initiative in the longer term.

[15] See IMF conclusions on "global stablecoins" that replicate the price of one fiat currency.
[16] DeFi: Why Europe needs to get on the front foot on financial innovation, February 2021, EUCI

Conclusion

Addressing the "elephant in the room" without "throwing the baby with the bathwater"

It is no secret that the MiCA regulation is primarily a response to Facebook's led Diem (formerly Libra) project. **The perspective of a tech giant issuing quasi-currencies accessible to an enormous client base with no proper supervision is indeed concerning. We support initiatives that aim to regulate stablecoins, and even more strongly, those that would pose any kind of systemic risk even more strongly.**

However, the regulator should not throw the baby out with the bathwater. Properly regulated stablecoins:

- represent a key component in the development of innovative and fast-growing digital markets based on crypto-assets;
- could be leveraged as tools to develop the euro's reach outside of Europe, as those markets are inherently international (as adequately understood by the USA);
- do not pose a significant threat to either financial stability or indeed to monetary policy, as they are fully backed by fiat or fiat equivalents;
- can ensure the required levels of investor and consumer protection through appropriate regulation and oversight.

By creating high barriers to entry to any actor that would envision the issuance of EUR-based stablecoins, MiCA will have the adverse consequence of discouraging new and smaller European actors from issuing those, effectively leaving the stablecoin market to USD-denominated tokens.

If the crypto-assets market becomes, as we envision, a significant part of the financial infrastructure in the future, this de-facto domination by US-based actors would have very adverse consequences for European actors.

Straightforward technical adjustments to MiCA which protect EU innovation and enhance the international role of the euro

MiCA should allow for: 1) the deployment of suitable private Euro stablecoins; 2) the use and deployment of decentralised stablecoin projects from Europe; and 3) the issuance of a CBDC on public blockchains.

We see no significant obstacle to the latter point in current MiCA drafting. However, we observe proportionality issues regarding the private Euro stablecoins as well as blocking dispositions concerning decentralised stablecoin projects.

1. **On private Euro stablecoins**

The regulatory clarity required for the deployment of such stablecoins is not entirely granted by MiCA. The regulatory burden placed on projects that are a simple tokenisation of existing reserves and therefore do not pose significant risk to financial stability is not justified.

Proposal 1: Increase thresholds for exemptions and significance

Proposal (non-exhaustive):

- MiCA, article 43§2: Raise the issuance thresholds to be exempted from rules related to the issuance of crypto-assets;
- MiCA, article 50: Raise significantly the criteria to be considered "significant"; in this regard, (i) increase minimum daily transactions size, issuance size / market capitalisation and size of the reserve assets and (ii) do not consider the "significance of the cross-border activities". Reduce the EBA arbitrary power in determining the significance of e-money tokens.

Proposal 2: Adapt the requirements progressively based on the size and maturity of actors

Proposal (non-exhaustive):

- MiCA, articles 31: Ease own funds requirements and the possible adjustment by competent authorities
- MiCA, article 119: The delegated act on supervision fees to be adopted by the Commission should take into account the impact of such fees on issuers of stablecoins regarding their size and stage of development. This should be reflected in a progressive fee scale. The level of fees should not be such as to deter actors willing to participate in EU crypto-markets.

2. On decentralised stablecoins.

At this stage in the process, the reasonable way forward is to adapt MiCA to ensure that the text does not hinder the development of decentralised stablecoins in Europe. As discussed in our "DeFi" paper, this can be achieved by introducing the concept of "effective control", which is exerted by a centralised entity.

With regards to asset-referenced tokens and e-money tokens, a newly defined category of "*algorithmic tokens*"[17] should be exempted from the application of current MiCA's requirements. Those stablecoins are defined as those for which the issuer has no control over the reserve assets and would consequently be incapable for complying with MiCA's obligations.

We look forward to discussing and explaining any of the proposals put forth in this document.
Get in touch with us: contact@euci.io

[17] Algorithmic stablecoins are use cases where the issuance rules and reserve assets of the stablecoins are not under the effective control of their issuer but rather under the control of rules defined by the protocol deployed on a blockchain network (so-called "smart-contract").