DIGITAL EURO ASSOCIATION

MICAR'S INFLUENCE ON STABLECOINS

INDUSTRY INSIGHTS AND IMPLICATIONS

DEA Private Digital Euro Working Group

JUNE 2024

MiCAR's Influence on Stablecoins: Industry Insights and Implications

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The views expressed in this paper are the authors' own and do not necessarily reflect the views of their employers or the Digital Euro Association (DEA). The DEA would like to thank its supporting members, whose support was instrumental in making this work possible.

DEA Private Digital Euro Working Group

List of Abbreviations

AML	Anti-Money Laundering
AMLD5	Anti-Money Laundering Directive (EU) 2015/849
ART	Asset-Referenced Token
BSCB	Basel Committee on Banking Supervision
CASP	Crypto-Asset Service Provider
CBDC	Central Bank Digital Currency
CRPTO	Crypto Regulation, Protection, Transparency, and Oversight Act
CTF	Counter-Terrorism Financing
DeFi	Decentralized Finance
DLT	Distributed Ledger Technology
DvP	Delivery vs Payment
EBA	European Banking Authority
EMI	Electronic Money Institution
EMT	Electronic Money Token
ESMA	European Securities and Markets Authority
EU	European Union
EUR	Euro
FSB	Financial Stability Board
G-SIB	Global Systemically Important Bank
IOSCO	International Organization of Securities Commissions
KYC	Know Your Client
MiCAR	Markets in Crypto-Assets Regulation
MiFID-II	Markets in Financial Instruments Directive II
NCA	National Competent Authority
NFT	Non-Fungible Token
P2P	Peer-to-Peer
PSD	Payment Services Directive
SEPA	Single Euro Payments Area
SPP	Supreme People’s Procuratorate
USD	United States Dollar
USDC	USD Coin
USDT	Tether

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1. Introduction

The Markets in Crypto-Assets Regulation (MiCAR) represents a pioneering approach to governing the burgeoning cryptocurrency market, valued at approximately EUR 2.4 trillion as of June 2024 (CoinMarketCap, 2024). As the first legislative framework of its kind in the European Union (EU), MiCAR, effective June 30, 2024, seeks to regulate a broad spectrum of crypto-assets, including asset-referenced tokens (ARTs) and e-money tokens (EMTs), with an eye towards promoting innovation, ensuring market stability, and safeguarding investors.

Central to MiCAR's proposition is its comprehensive treatment of crypto-assets or services thereto: from cryptocurrencies like Ethereum and Bitcoin to stablecoins whose value is pegged to assets or currencies. The regulation specifically targets the operations of ARTs, EMTs, and, from December 30, 2024, utility tokens and other crypto-assets, under a unified, transparent framework. Additionally, it outlines stringent operational standards for crypto-asset service providers (CASPs), aiming to fortify the industry's credibility and investor confidence.

Under MiCAR, stablecoins are classified as either ARTs or EMTs based on their underlying value stabilization mechanism. ARTs are backed by a diversified basket of assets, while EMTs are backed by a single fiat currency. In this paper, we will use the term 'stablecoin' to refer broadly to both ARTs and EMTs, except where a specific distinction is required for clarity.

Importantly, the regulation's broad definition of crypto-assets and its detailed approach towards stablecoins reflect a nuanced anticipation of the market's evolution, aiming to prevent regulatory circumvention. Through this, MiCAR does not only introduce a regulatory framework but also paves the way for an organized market expansion and the strategic entrance of stablecoin issuers into the EU market.

In light of these developments, this publication, developed by the Digital Euro Association's working group, casts a discerning eye on the ramifications of MiCAR for the burgeoning stablecoin market. Beyond examining the regulatory intricacies, it assesses MiCAR's potential to either magnetize stablecoin issuers to the EU or act as a deterrent, signaling that the region's market conditions are set to transform substantially. In weaving together opinions from digital money experts, stablecoin industry veterans, stakeholders, and prospective issuers, the paper distills a multifaceted perspective on navigating the EU's regulatory expanse. Our exploration culminates in a series of recommendations for regulators and financial institutions, pinpointing how MiCAR may influence decisions about market entry or exit. By underlining these strategic considerations, this analysis aims to spotlight the regulation's crucial role as a determinant in the future distribution and operation of stablecoins across the EU.

2. Overview of Global Approaches to Stablecoin Regulation

This section provides an overview of the evolving world of stablecoin regulation, highlighting the varied approaches of key jurisdictions. The analysis serves as a beacon for regulators and industry players, underscoring the potential of harmonized regulatory standards to foster the growth of the global stablecoin market.

A recent paper by the Bank of International Settlements (BIS, 2024) reviews stablecoin regulations across several jurisdictions, including the United States, European Union, United Kingdom, Japan, Singapore, United Arab Emirates, and Hong Kong. The study found that these regulatory frameworks share common requirements: stablecoin issuers must acquire a bank or specific license, meet minimum standards for reserve assets, ensure segregation and custody of assets, and establish clear redemption procedures. Additionally, issuers are required to maintain minimum capital and liquidity standards, implement strong governance arrangements, disclose and manage conflicts of interest, adhere to IT risk governance, comply with anti-money laundering (AML) and counter-terrorism financing (CTF) standards, and provide transparent information and ongoing disclosures.

The BIS paper highlights several conclusions about the current regulatory landscape. Despite shared regulatory efforts, the landscape remains diverse and fragmented, necessitating alignment with international standard-setting bodies like the Financial Stability Board (FSB). The paper emphasizes the need to explore the interplay between Central Bank Digital Currencies (CBDCs), tokenized deposits, and other digital assets to shape the future of digital payments. Ensuring interoperability between stablecoins, CBDCs, and other digital assets is crucial for promoting an integrated financial system. The challenge for regulators is to balance fostering innovation with mitigating risks, requiring ongoing monitoring, research, and international cooperation to create an effective regulatory environment that supports responsible innovation.

The BIS report underscores the importance of harmonizing national regulatory frameworks with international standards to ensure a well-functioning and integrated financial system. As stablecoin markets evolve, authorities must continue to monitor developments, conduct research, and collaborate internationally to establish regulations that balance innovation and risk management.

2.1 State of Stablecoins in Selected Countries

United States: The United States currently lacks a comprehensive federal framework for stablecoin regulation, relying instead on existing state and federal laws (Montague Law, n.d.). Several bills are under discussion in Congress, with notable ones including the Stablecoin TRUST Act of 2022 and the Clarity for Payment Stablecoins Act of 2023, which propose federal licensing for stablecoin issuers and mandate reserve requirements (U.S. Senate Committee on Banking, Housing, and Urban Affairs, 2022; U.S. Congress, 2019.). Regulatory perspectives vary, with the United States Securities and Exchange Commission viewing stablecoins as securities and the Commodity Futures Trading Commission considering them commodities (SEC, 2021). State-level enforcement is significant, with the New York State Department of Financial Services requiring stablecoins to be fully backed and redeemable, and the New York Attorney General's Crypto Regulation, Protection, Transparency, and Oversight Act (CRPTO Act) aiming to enhance transparency and protect investors (New York State Department of Financial Services, 2022a,b).

Singapore: The Monetary Authority of Singapore mandates that reserves backing stablecoins must be held in low-risk and highly liquid assets, with their value always meeting or exceeding the stablecoins in circulation. Stablecoin issuers are required to redeem the par value of the digital currency to holders within five business days upon request. Additionally, issuers must provide appropriate disclosures to users, detailing the value stabilizing mechanisms, holders' rights, and audit results of reserves. Stablecoins must maintain a minimum base capital of 1 million Singapore dollars (approximately USD 740,000 as of 1 June 2024) and ensure redemption within the stipulated five business days.

China: On September 24, 2021, the Central Bank of China declared all cryptocurrency-related transactions illegal. This move aims to curb the use of cryptocurrencies like Tether (USDT) in foreign exchange trading. Chinese authorities, including the Supreme People's Procuratorate (SPP), have issued warnings against using USDT as an intermediary for trading the Chinese yuan with other fiat currencies, emphasizing the illegality of such activities (Supreme People's Procuratorate, 2023).

El Salvador: El Salvador became the first country to adopt Bitcoin as legal tender in 2021. By 2024, the country had introduced significant regulations aligned with international standards. The Salvadoran government now enforces stringent AML and CTF protocols for all cryptocurrency transactions. These regulations include comprehensive identity verification processes, known as Know Your Customer (KYC), and transaction monitoring to prevent illegal activities (Cryptocurrency Law, 2024).

2.2 The Gold Standard - MiCAR as a Global Model for Stablecoins?

MiCAR notes “[m]arkets in crypto-assets are global and thus inherently cross-border. Therefore, the Union should continue to support international efforts to promote convergence in the treatment of crypto-assets and crypto-asset services through international organisations” (Regulation (EU) 2023/1114, 2023). Since the late 80s, in particular, and the rise of the internet, citizens have lived in an increasingly global world and some would suggest that we have entered into the ‘second half of the internet revolution’ (The Economist, 2019). As the crypto assets market has continued to grow, globally, regulators have sought to understand the industry and how best to regulate it. There are compelling arguments to suggest that appropriate regulation benefits all actors, including industry players. Notably, issuers can operate with legal and regulatory certainty, users can use the products within a safe framework and other actors can take comfort that the impact of crypto assets on the wider financial system has sufficient oversight (World Economic Forum, 2024).

By implementing MiCAR, the EU has positioned itself as a pioneering force in cryptocurrency regulation, potentially setting a global benchmark for understanding and regulating the crypto-assets industry. The insights gathered by the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) from MiCAR's application could help shape international standards for stablecoins, outlining the criteria for what is considered a secure, institutional-quality stablecoin. However, the transformative potential of Distributed Ledger Technology (DLT) to facilitate global expansion hinges on the development of appropriate and universally aligned standards. Achieving these standards necessitates cooperation across major global governing entities, including the Basel Committee, Financial Stability Board (FSB), and International Organization of Securities Commissions (IOSCO), to prevent fragmented adoption and ensure comprehensive protection (World Economic Forum, 2023).

Drawing parallels with the international regulatory framework for banks set by the Basel Committee on Banking Supervision (BCBS), a similar internationally coordinated committee could strengthen the regulation, supervision, and risk management of stablecoin issuances. Such a preventative and evolving framework would mitigate potential risks and foster a global network of stablecoin ecosystem stakeholders under adequate oversight, quality, and transparency. Conversely, excessive regulation by the EU or insufficient engagement in global dialogues could undermine MiCAR’s potential advantages. Aligning MiCAR more closely with the FSB's "High-level Recommendations for the Regulation, Supervision, and Oversight of Global Stablecoin Arrangements" (Financial Stability Board, 2023) represents a constructive step forward. This alignment underscores the necessity for international regulatory cooperation and proportionate regulation, especially as the early-stage financial stability risks of these arrangements could escalate (Financial Stability Board, 2023).

One particular area of improvement would be to apply MiCAR equally to stablecoins pegged to a currency of an official EU Member State and those which are pegged to major global currencies. For example, if MiCAR imposes restrictions on EMTs pegged to the US Dollar, it is likely to serve to isolate the European market from cross-border trade. By weakening the most liquid trading pair (EUR/USD) that exists, the European economy will be cut off from global trade including investments, exchange of goods and services and financial transactions severely limiting global economic activity. This means, among other outcomes, the European stablecoin market would not readily be able to use forex transactions to offset risks or diversify investments. Not allowing for safe technological innovation between two of the world's most stable currencies, therefore, undermines the ability to build economic stability and effectively manage financial risks within that innovation. An approach which could lead to long-term detriment.

3. Opportunities and Challenges: An Issuer's Perspective

This section offers an overview of the opportunities and challenges that MiCAR presents, specifically from the viewpoint of stablecoin issuers. An array of advantages that stem from MiCAR's implementation are outlined, setting the stage for issuers to understand how regulatory compliance can be a catalyst for enhanced market access and credibility. Simultaneously, this analysis sheds light on the hurdles issuers may encounter in achieving compliance with MiCAR's standards.

3.1 Opportunities for Stablecoin Issuers under MiCAR

Regulatory Clarity and Compliance Assurance: MiCAR offers a clearly defined regulatory framework unique to stablecoins, which eradicates uncertainties previously faced by issuers. This compliance assurance fosters a secure environment for both issuers and investors, potentially attracting more capital to the European stablecoin ecosystem.

Enhanced Market Access and Consumer Trust: By harmonizing regulatory standards across the EU, MiCAR enables stablecoin issuers to tap into a broad, unified market. The regulation's stringent standards for operational resilience, transparency, and consumer protection are likely to elevate consumer trust, thereby strengthening the market position of compliant issuers.

Innovation and Sectoral Growth: The establishment of a clear regulatory landscape creates a fertile ground for innovation. Issuers can now channel their resources into developing novel stablecoin projects, confident in their alignment with regulatory expectations. This is anticipated to drive growth and diversification within the sector, although there is concern that heavy compliance burdens might limit some innovation initiatives.

Cross-Border Efficiency and Expansion Potential: MiCAR could serve as a benchmark for global regulatory approaches to stablecoins, potentially streamlining cross-border operations and collaborations. This international resonance might empower EU stablecoin issuers to explore markets beyond the EU, fostering global expansion.

Catalyst for Infrastructure Development: The regulatory demands of MiCAR compel issuers to invest in robust technological infrastructure, which, although challenging, might spur advancements in security, efficiency, and scalability within the stablecoin domain.

3.2 Challenges for Stablecoin Issuers under MiCAR

Regulatory Overhead and Small Issuer Marginalization: The intricate regulatory demands and the collateral prerequisites stipulated by MiCAR might disproportionately affect smaller issuers. The resource intensity required for compliance could stifle innovation and concentrate market power among larger, more established entities.

Technological and Financial Strain: The need to align with MiCAR's stringent security, data protection, and operational resilience requirements imposes a significant financial and technological burden on issuers. These demands could detract from innovation and strain the resources of existing issuers, especially those with limited capital or technological capacity.

Challenges in Global Scalability: While MiCAR positions EU stablecoins for international competitiveness, the specificities of the regulatory framework might inadvertently limit the global scalability of EU-issued stablecoins. The potential for regulatory divergence between the EU and other major markets may hinder the international adoption of EU-compliant stablecoins.

Capital Allocation Constraints: The regulatory mandate for stablecoins to be fully collateralized by low-risk assets introduces a dimension of capital inefficiency. This restriction curtails the flexibility of issuers in managing reserves, possibly impacting the profitability and growth potential of stablecoin ventures.

Financial Stability Concerns: MiCAR's provisions for stablecoin reserves are designed to enhance stability, yet the necessity for a 30 -60% of reserves to be held at commercial banks expose issuers to risks like bank runs and can precipitate instability.

Uncertainty around Supervision: The exact scope and nature of supervisory responsibilities under MiCAR may take time to clarify, resulting in uncertainty for stablecoin issuers.

Jurisdictional Ambiguity: The presence of vaguely defined legal terminology (see 4.4) within the MiCAR framework poses a risk of jurisdictional competition. This ambiguity can lead to inconsistencies in how MiCAR is applied across different EU Member States, creating a landscape where companies might seek out jurisdictions that interpret MiCAR's rules more favorably to their operations. This scenario, often referred to as forum shopping, arises from the challenge of navigating the regulatory environment without full legal clarity. It underscores the potential for a fragmented approach to rule interpretation among the various National Competent Authorities (NCAs). As entities look to align themselves with MiCAR, the allure of jurisdictions offering favorable interpretations could significantly impact where they choose to establish their operations.

Adaptation to Evolving Standards: As digital finance continues to evolve, stablecoin issuers must remain agile, ready to adapt to potential amendments in MiCAR or the introduction of new regulations. This continuous adaptability challenge necessitates ongoing investment in regulatory compliance and legal expertise.

4. Industry Insights and Issuer Perceptions

This section delves into the specific perspectives of stablecoin issuers and prospective issuers within the DEA's community, highlighting their insights on the challenges presented by MiCAR's compliance requirements and regulatory framework.

From an industry perspective, MiCAR presents a compelling and promising framework. It has the potential to position the European Union at the forefront of digital and financial innovation. If implemented effectively and appropriately, the industry stands to benefit from operating within clearly defined legal and regulatory boundaries. However, if these rules are disproportionate or ill-suited to the industry's needs, the regulation may prove counterproductive.

Regulation needs to be effective to be useful. If it is unduly burdensome on the regulators and those who are regulated, it undermines its own efforts towards sector growth and, in turn, for society to benefit from the innovation it aims to foster. MiCAR's effectiveness could be significantly enhanced through considered revisions in key areas including:

1. the significant stablecoins regime,
2. enhanced reserve requirements,
3. AML and KYC obligations under MiCAR,
4. definition uncertainties and custodian limitations in currencies.

4.1 Significant Stablecoin Regime

Significant stablecoins, under MiCAR, refer to stablecoins that pose a significant risk to financial stability, monetary policy transmission, or monetary sovereignty. These stablecoins are subject to stricter requirements, including higher capital requirements, interoperability requirements, and liquidity management policies. Some of the criteria for determining whether a stablecoin is significant include, amongst others:

- Large customer base: The stablecoin is used by a large number of holders.
- High market capitalization: The stablecoin has a high market capitalization.
- Large volumes of transactions: The stablecoin is involved in a large number of transactions.

While the regulation of significant stablecoins is essential to maintain system integrity, it is important to balance these controls to avoid impeding the early growth stages of the stablecoin sector. Setting the “significance” threshold too low may inadvertently constrain the industry's development, as the additional regulatory requirements could overwhelm smaller, growing entities. This could lead to regulatory arbitrage, with stablecoin issuers migrating to jurisdictions with lighter regulations or being pushed out of the market altogether. Historical examples, notably the 2008 financial crisis, illustrate how excessive regulation may drive financial activities into the unregulated "shadow" realm, eluding oversight. Effective regulation should enhance transparency and thereby provide real protections for both the financial system and its users.

Reflecting on banking regulation lessons, the EU would benefit from fostering an environment where the stablecoin industry can grow within a supportive regulatory framework—what can be described as regulatory 'scaffolding'. This approach would enable the EU to benefit from the economic growth and digital innovation without compromising financial stability or consumer protection. Unfortunately, the current MiCAR thresholds for determining significant stablecoins appear too restrictive and could undermine the initial goals of understanding, passing, and implementing MiCAR. The regime for significant issuers fails to offer the stability, clarity, or assurance needed for businesses to expand and does not proportionally safeguard the financial system or its users against the risks posed.

For context, consider one criterion for identifying a significant stablecoin issuer: possessing a market capitalization exceeding EUR 5 billion. As of March 2024, the entire market cap of the stablecoin sector was approximately EUR 148 billion (CoinMarketCap, 2024). Breaking this down, USDT and USDC, which are the market's most prominent fiat-backed stablecoins, had market caps of approximately EUR 102 billion and EUR 30 billion respectively (Blockworks, 2024a,b). In contrast, the cumulative market capitalization of the world's 100 largest banks stood at EUR 6.4 trillion, with top-tier banks individually boasting market caps reaching into the hundreds of billions of euros (Statista, 2024). The current framework under discussion proposes that crossing the EUR 5 billion market cap threshold should trigger a significant leap in capital requirements for stablecoin issuers, increasing them to 3%. This contrasts markedly with the graduated scales used for Global Systemically Important Banks (G-SIBs), which start at 1% and can go up to 3.5%, depending on a scoring system that assesses each bank's systemic relevance to the global financial network. Intriguingly, some of the most monumental financial entities, with market caps in the hundreds of billions, face an additional capital buffer that starts at just 1%—the same rate being considered for stablecoin issuers that barely pass the EUR 5 billion mark (European Parliament, 2017).

This juxtaposition raises critical questions about the proportional nature of the MiCAR guidelines. Are the designated thresholds for stablecoins in MiCAR truly in line with the levels of systemic risk they present, especially when compared with the much larger and more systemically integral global banking institutions?

Given its relative scale within the broader financial markets, the stablecoin industry is quite small, making the thresholds set by MiCAR for defining a significant stablecoin issuer—and the ensuing obligations like increased reserve assets and own funds requirements—disproportionately burdensome in comparison to the actual systemic risk posed. Without adjustments, these measures risk inhibiting the growth potential of the stablecoin market and compromising MiCAR's objectives, which, as noted in Recital 6, aim to smooth the scale-up process for crypto-asset service providers across borders and facilitate banking services access (Regulation (EU) 2023/1114, 2023).

The current significance criteria fail to meet MiCAR's aim for enabling industry growth. Instead, they risk imposing heavy regulatory demands not only on market participants but also on the European Banking Authority (EBA), which would divert its resources to overseeing comparatively minor players with limited impact on both the industry and the broader financial system. A more nuanced approach could involve a progressive regulatory framework where requirements escalate in line with issuers' growth, allowing for more efficient use of EBA's resources through selective engagement with national regulators. This would provide the EBA with valuable industry insights, laying the groundwork for proportionate regulation as issuers expand. A more reasonable threshold for the EBA's direct supervision might be closer to EUR 100 billion, not EUR 5 billion.

Considering such modifications is crucial to fostering innovation, preferring a scalpel over a sledgehammer approach to regulation that balances growth with systemic safeguarding more effectively (Hansen & Bauer, 2024).

4.2 Reserve Requirement Impact

MiCAR Articles 36 and 45 mandate stablecoin issuers to segregate 30% of their reserves—and 60% for significant stablecoins—at commercial banks, while also enforcing a limit of 5% for each segregated account, is likely to raise concerns regarding operational complexity and liquidity management (Regulation (EU) 2023/1114, 2023). Requiring such a broad distribution of reserves could hinder the issuer's ability to access funds swiftly in times of need. Managing a dozen segregated bank accounts to meet this requirement imposes a significant administrative burden and numerous transaction costs on issuers.

It is a widely recognized principle in financial markets that government bonds, backed by a sovereign entity, offer superior credit risk compared to commercial banks, engendering a higher level of confidence in repayment. Therefore, instead of dispersing reserves across multiple institutions, policymakers might find promoting investment in government bonds to be a more straightforward and reliable method for safeguarding liquidity and managing risk.

The stringent reserve requirements, set by the new regulations, are poised to impact issuer business models significantly by diminishing interest income, which is the primary revenue source generated through the issuance of e-money tokens. This decrease in revenue could pose several challenges for issuers, potentially leading to a reduction in European issuers and undermining the objective of bolstering the growth of European stablecoins.

4.3 AML and KYC Obligations Under MiCAR

The financial industry faces stricter regulations regarding AML and KYC enforcement, with lower thresholds for cash transactions. This raises questions about how stablecoin issuers issuing stablecoins under MiCAR need to comply with AML and terrorist financing obligations.

Specifically, should stablecoin holders be treated as clients of the stablecoin issuer according to the fifth Anti Money Laundering Directive (AMLD5)? In other words, should KYC requirements apply continuously to stablecoin holders, not just when tokens are issued but also during secondary market trading?

Stablecoins (e-money tokens) are defined as electronic money under MiCAR and can only be issued by electronic money institutions or credit institutions, both of which are obligated entities under AMLD5. Therefore, AML requirements apply to issuers of e-money tokens and issuers of asset-referenced tokens (ART) who are credit institutions, meaning they must conduct client due diligence and transaction monitoring for their respective token holders.

While MiCAR does not explicitly address AML regulations for stablecoin issuers, the need for continuous identification of stablecoin holders can impact token distribution in secondary markets, requiring clarity.

The scope of AMLD5 has expanded with MiCAR, adding CASPs as obligated entities. However, stablecoin distribution can occur without CASP involvement, raising different considerations for CASPs compared to stablecoin or credit institution issuers.

With the new MiCAR regime for issuing stablecoins effective from June 30, 2024, there is an urgent need for clarity on these questions to ensure consistent application and address the significant practical impact on stablecoin product development.

4.4 Regulatory Ambiguities and Global Stablecoin Compliance Challenges

Several provisions have raised concerns and discussions within the industry. One such concern is the dual definition of EMTs. Contrary to the definition of EMTs given in Article 3, Recital 66 and Article 48 of MiCAR state that EMTs are deemed to be e-money. This dual definition creates uncertainty since if considered as e-money, EMTs would be regarded as funds under the Payment Services Directive (PSD). Consequently, issuers of EMTs and entities providing payment services using EMTs would fall within the scope of the PSD. However, this would potentially create a number of challenges, as the PSD's current framework is designed for centralized payment service provision rather than the distributed ecosystems that characterize crypto-assets.

Another provision, Article 75, which poses operational challenges for global issuers of ARTs, is MiCAR’s prohibition against engaging custodians not authorized under its regulations. This restriction compels ART issuers who wish to operate or expand into the European market to use only those custodians that have been authorized under MiCAR. An issuer based outside the EU that already has established relationships with custodians in its home country or other non-EU regions will find itself unable to leverage these existing partnerships for managing ARTs intended for the EU market.

This requirement can act as a barrier to entry, particularly for smaller issuers who may lack the resources to navigate these regulatory demands efficiently. Furthermore, this limitation could hinder the pace at which ARTs are offered and innovated within the EU, affecting the overall dynamism of the crypto-asset market in Europe.

Additionally, a critical challenge that has emerged is the ambiguity surrounding the treatment of global stablecoins under the MiCAR. As it stands, MiCAR falls short of providing a straightforward regulatory pathway for stablecoins that have already been issued and are in circulation on a global scale. Unlike other regulatory frameworks worldwide, MiCAR does not distinguish between local and foreign stablecoins, placing them under the same regulatory umbrella. This lack of differentiation poses a significant hurdle for issuers of global stablecoins, as they are now compelled to navigate the complexities of implementing a bespoke double-issuer structure. Such a model requires issuers to tailor unique, dual-compliance strategies to satisfy MiCAR's requirements without infringing on existing global operations. This complexity not only adds layers of operational and legal challenges but also places a considerable strain on issuer resources, potentially stifling innovation and growth within the sector. The need for a more nuanced approach that recognizes the distinct nature and global reach of these digital assets is therefore not just beneficial but essential for fostering a regulatory environment that supports rather than impedes the evolution of the global stablecoin ecosystem.

5. Stablecoin Use Cases and MiCAR's Impact

The implementation of MiCAR not only consolidates the stablecoin position in the market but also opens the door to innovative use cases, further enriching the already well-functioning digital payment ecosystem beside traditional and emerging offerings like the SEPA Instant and the anticipated digital euro. The majority of use cases for stablecoins are likely to stem from their new and innovative features, which are currently not achievable with traditional payments, such as Peer-to-peer (P2P) transferability and programmable attributes. The following is a non-exhaustive list of stablecoin use cases and the hypothesized impact MiCAR may have on them:

Safe Haven for Traders: Stablecoins provide a crucial stability option in the volatile cryptocurrency market, serving as a safe haven for traders. Driven by MiCAR's regulatory framework, which aims to enhance the stability and reliability of EUR stablecoins, there could be a shift in interest from USD to EUR stablecoins, potentially making them more attractive to traders seeking stablecoin alternatives.

Cross-Border Payments: Stablecoins facilitate real-time, cost-effective cross-border transactions, providing a viable alternative to traditional banking systems. Companies like SAP and VISA are actively exploring stablecoin-based payment solutions due to the efficiencies they offer (SAP, 2024; VISA, 2024). MiCAR's regulatory clarity and consumer protection measures could accelerate the adoption of EUR stablecoins in cross-border payments accordingly.

Inflation Hedge: In certain countries, stablecoins pegged to the USD have functioned as a safeguard against inflation, serving effectively as a store of value. The ability of Euro-denominated stablecoins to assume a similar function seems limited owing to the rigorous compliance mandates and the prohibition of interest accrual as stipulated in MiCAR, thereby deviating from the practical applications witnessed in developing economies.

Peer-to-Peer and E-Commerce Payments: In the realms of P2P transactions, e-commerce, and in-game transactions, stablecoins are used for condition-based payments and smart escrow services, reducing reliance on traditional payment processors. MiCAR's robust regulatory framework aims to ensure that these transactions are secure and transparent, legitimizing their use, and potentially promoting wider adoption of stablecoins in these sectors too.

Means of Payment for DeFi, Metaverse, and NFTs: Despite regulatory uncertainties in areas like decentralized finance (DeFi), the metaverse, and non-fungible tokens (NFTs), stablecoins are expected to be pivotal in supporting blockchain-based innovations. MiCAR's regulatory oversight aims to balance innovation with consumer protection, which could foster a safer environment for the growth of these emerging sectors.

Delivery vs Payment (DvP) and the DLT Pilot Regime: Stablecoins are crucial for the development of Delivery vs Payment (DvP) use cases, particularly within the DLT Pilot Regime. The European Securities and Markets Authority (ESMA) published a note on 3 April 2024 regarding the implementation of the Pilot Regime, highlighting a potential timing mismatch with MiCAR authorizations, which will only commence this year. This delay complicates the process for DLT Pilot Regime applicants in finding cash leg providers, such as commercial banks or e-money token issuers. Since stablecoin issuers will not be eligible for MiCAR authorization before the end of June 2024 at the earliest, the swift implementation of stablecoin settlement solutions for DLT market infrastructures depends heavily on the expediency of competent authorities in granting the necessary approvals to service providers.

Towards fostering the growth of new use cases, it is crucial that regulators avoid excessive regulation and the imposition of prohibitive regulatory costs. This includes careful regulation of the entry and exit points of stablecoin ecosystems, namely the fiat on/off ramps, as well as compliance (AML/KYC) requirements anticipated to accompany the future increase in digital asset wallets. This is particularly vital for scenarios where stablecoins are used for micropayments— excessive regulation could render their use economically unviable. Switzerland serves as an exemplary model in this regard. Its position as one of the most innovative countries and a leading hub for the Web3 industry can be attributed to its risk-based regulatory approach towards the economy and distributed ledger technologies. To strike a balance between preventing illicit transactions and promoting the economic benefits of an 'internet for payments', Swiss web3 companies are permitted to manage crypto-to-fiat transactions without KYC obligations for amounts under CHF 5,000 per 24 hours (CCN, 2024). This threshold is sensibly set to meet the majority of mass-market requirements.

6. Conclusion

The implementation of MiCAR marks a pivotal moment in the regulation of digital financial assets within the European Union. By establishing a comprehensive framework for stablecoins and other crypto-assets, MiCAR aims to integrate traditional financial institutions with the burgeoning digital finance sector, offering both challenges and opportunities. While the rigorous requirements set forth by MiCAR may present significant hurdles, particularly for smaller entities and innovators, they also provide a foundation for market stability, consumer protection, and enhanced investor confidence.

The success of MiCAR will depend on its ability to strike a balance between fostering innovation and imposing necessary regulatory safeguards. Proportional and flexible regulations are crucial to avoid stifling the very innovation the framework seeks to support. Policymakers must ensure that compliance costs do not disproportionately burden smaller issuers, thereby maintaining competitive diversity within the market.

Globally, MiCAR positions the EU as a leader in digital asset regulation, potentially setting standards that other jurisdictions may follow. This leadership role comes with the responsibility to foster international cooperation and harmonize regulations to support a cohesive and secure global financial system. The potential introduction of a digital euro, alongside well-regulated stablecoins, could further cement the EU's role in shaping the future of digital finance.

MiCAR's journey from regulation to implementation will be closely watched by global stakeholders. Its impact on the digital financial landscape will serve as a critical case study in balancing innovation with regulation. Ultimately, the framework's ability to adapt to evolving market conditions and technological advancements will determine its long-term success. As MiCAR unfolds, its lessons will offer profound insights into the integration of digital and traditional financial systems, guiding future regulatory efforts worldwide.

7. Recommendations

To address the challenges identified in our analysis, we propose several key recommendations. These recommendations aim to balance regulatory oversight with the need to foster innovation and support smaller issuers.

- Design proportional and flexible regulations to foster innovation and consumer protection, avoiding one-size-fits-all rules and adopting a risk-based approach like Switzerland's.

- Simplify authorisation processes and reduce capital requirements for smaller issuers to encourage competition and innovation in the stablecoin market.

- Align definitions in MiCAR with other relevant EU regulations, such as AMLD5, to avoid conflicts and provide clear guidance to issuers.

- Allow issuers to use existing custodial partnerships with equivalent regulatory standards to reduce barriers for non-EU issuers and enhance international competitiveness.

- Adjust thresholds for significant issuers to more proportionate levels, such as EUR 100 billion, to balance regulatory oversight with industry growth.

- Reassess the significance criteria for stablecoins to ensure they foster innovation and introduce incremental, proportionate measures to avoid deterring issuers from operating in the EU.

- Encourage issuers to invest reserves in government bonds to safeguard liquidity and manage risk, instead of imposing complex reserve segregation requirements.

- Align MiCAR's requirements with international standards to facilitate cross-border operations and attract global stablecoin issuers to the EU market.

- Provide regulatory clarity and support for stablecoins in cross-border payments and tokenized trade to enhance the EU's role in global financial markets and promote financial innovation.

- Ensure AML/KYC regulations are practical and not excessively burdensome on small transactions or micropayments to maintain the feasibility of stablecoins for everyday use while ensuring compliance.

- Conduct regular reviews of regulatory measures to adapt to market developments and technological advancements, using interim reports to reassess and refine concepts like the significance of asset-referenced tokens.

- Adopt a risk-based regulatory approach, akin to Switzerland's model, to balance oversight with economic benefits and provide flexibility for the evolving crypto-asset market.

- Ensure that all legal terminology is precisely defined to prevent ambiguity and inconsistencies in application across different jurisdictions.

- Implement measures to monitor and mitigate the risk of forum shopping, where issuers may seek out jurisdictions with more lenient regulatory interpretations, to maintain regulatory integrity and uniformity.

- Avoid imposing excessive regulations on emerging use cases like DeFi, micropayments, and tokenized assets, when conceptualized.

- Encourage the use of stablecoins for P2P transfers, programmable transactions, and other innovative features that are not achievable with traditional payments.

By considering and potentially implementing these recommendations, policymakers can improve the MiCAR regulations to foster a balanced, innovative, and competitive stablecoin market in the EU, better supporting the broader goals of financial innovation and consumer protection.

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