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From:	General Secretariat of the Council
To:	Financial Services Committee Financial Services Attachés
Subject:	FSC 14 April - item 1 - ECB non-paper on EU and third country stablecoin multi-issuance

As per the revised annotated agenda, the numbering of the agenda items has been updated.

Non-paper on EU and third country stablecoin multi-issuance

Executive summary

EU and third country stablecoin multi-issuance schemes ("multi-issuance") involve an EU entity jointly issuing a stablecoin with a third-country entity, resulting in the issued tokens being fungible and indistinguishable across the two entities. Under such a scheme, EU stablecoin issuers could receive requests from third country token holders to redeem their tokens. In case sufficient reserves are not available in the EU to meet redemption requests, the third country entity is expected to transfer assets to the EU reserves.

A permissive interpretation of the EU Markets in Crypto Assets Regulation (MiCAR) would allow third country multi-issuance. As MiCAR contains several requirements on issuers that are generally not replicated in third country frameworks, such an interpretation would offer significant advantages to third-country stablecoin issuers, to the detriment of potential EU issuers. As such, multi-issuance schemes risk undermining EU strategic autonomy/sovereignty by biasing market outcomes in favour of third-country issuers.

In contrast to the objectives of the Savings and Investment Union agenda, the reserves of third-country issuers would likely be invested outside of the Union in dollar-denominated assets. At the same time, as the third-country issuers are not generally obliged to meet protections equivalent to MiCAR, multi-issuance would expose EU token holders and, potentially, the EU financial system as a whole, to material risks. From a legal perspective, the note makes the case for a reading that would not be permissive of third-country multi-issuance. This reading recognises that legislators deliberately set differing requirements for different types of stablecoin within MiCAR and reflects that recitals cannot create new legal rights or obligations under EU law.

Against this background, it is considered premature for the EU to set out a definitive approach on multi-issuance – particularly if said definitive approach appears to favour the interests of third countries over those of the EU. As such, it would be wise to hold back on firm decisions on the EU approach until greater clarity is achieved on the interpretation of MiCAR and the likely effectiveness (or otherwise) of possible safeguards. **In any event, a matter of this gravity is not suitable to be resolved via an administrative act such as a Q&A. Rather, the matter would be better addressed via the EU co-legislators.**

Were the EU to nonetheless pursue third country multi-issuance, safeguards should be defined and introduced at the EU level via legislation to ensure proper harmonization. Safeguards should impose pre-conditions to be met *before* EU market access can be authorised and mitigate risks to EU holders *after* authorisation. These safeguards would include (i) a framework to verify the equivalence of third countries' stablecoin regulation, (ii) reciprocity agreements to ensure EUR stablecoins issued from within the EU are assigned the same rights in the third country; and (iii) agreements between the EU and the third country to ensure that, in a going concern, recovery and/or resolution scenario, no legal barriers can be imposed to the transfer of assets.

1) Description of EU and third country stablecoin multi-issuance

Under an EU and third country stablecoin multi-issuance scheme, an EU stablecoin[1] issuer could receive requests from third country token holders to redeem the tokens issued by a third country stablecoin issuer (and vice versa). In case sufficient reserves are not available in the EU, it is expected that the two entities should rebalance their respective reserves. This scenario is presented in Figure 1 below as a generic example applied to the EU and the US as a third country. The size of the reserves indicated within this example are provided solely for illustrative purposes.

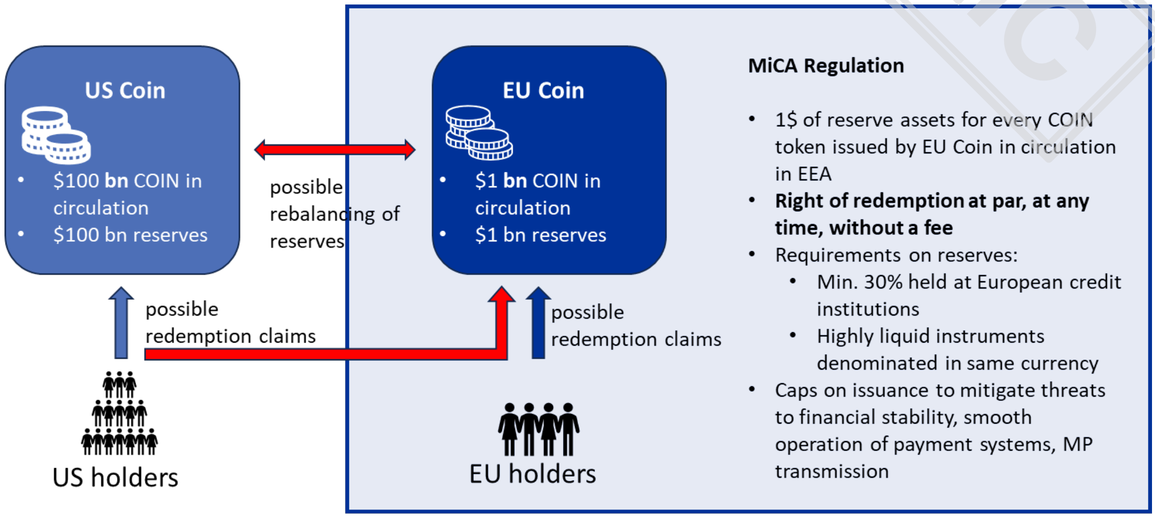

Figure 1 – Generic example of EU and third country stablecoin multi-issuance applied to EU and US.

2) Key concerns with EU and third country multi-issuance

An EU and third country stablecoin multi-issuance scheme would:

- ***significantly weaken the EU's prudential regime for electronic money token (EMT) issuers*** by increasing the likelihood of a run as EU issuers may not have enough reserve assets under the supervision of EU authorities to fulfil redemption requests by both EU and non-EU token holders. An insolvency of an EMT issuer may have further contagion effects: a *direct contagion* to the banking system may arise if the issuer is a credit institution or an *indirect contagion* may arise when the issuer is an e-money institution (EMI) and thus maintains deposits at EU credit institutions as required by MiCAR. The run on the EMT issuer could also trigger a run on other EU bank(s) or on the EU banks where the EMI maintained its deposits.
- ***weaken EU safeguards for EU (retail) stablecoin holders*** – the EU reserve assets which are intended to meet the liability of the EU undertaking would be (fully) available to meet the liability of the

[1] Please note that for the case of EU 'stablecoins' refer to asset-reference tokens and electronic money tokens within the meaning of the Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937, OJ L 150, 9.6.2023, p. 40–205, (MiCAR).

third-country firm. EU reserve assets may not be sufficient to cover both EU and non-EU redemption requests;

- ***allow for the circumvention of EU requirements intended to mitigate challenges to financial stability or the smooth operation of payment systems***. Examples of these requirements include caps on the issuance of foreign-denominated stablecoins and increased supervisory requirements when thresholds[2] are met. Ultimately, this would imply a spill-over of negative shocks coming from abroad to the EU financial sector;
- ***enable third country issuers to claim that they can offer to their clients MiCAR protections*** – although they are not subject to EU requirements and supervision.
- ***entail an unjustified and material deviation from traditional risk management and supervision standards***. For the first time, an EU entity and its prudential supervisor would be accountable, under their respective roles, to ensure the solvency and liquidity soundness of both the EU based issuer's and the third country issuer's liabilities – as the latter are fully fungible with the EU liabilities;
- ***set a dangerous precedent for all non-EU stablecoin issuers to gain access to the EU single market*** without sufficiently complying with the necessary protections and EU supervision that safeguard the interests and liabilities of EU holders.

Confidence that an EU and third country stablecoin multi-issuance scheme would operate smoothly is reliant on trusting that third country authorities allow rebalancing of reserves across the third country issuer and the EU issuer when needed, especially during stress periods. In this context, the lessons of the Global Financial Crisis should be heeded, including the experiences gained with third country authorities ring-fencing capital and liquidity during moments of such stress. Avoiding that ring-fencing would happen again in the case of a shock affecting third country stablecoin issuers or issuers whose assets are invested in third country securities, requires the establishment of robust trust mechanisms.

Mechanisms to robustly build trust would involve more than ad-hoc conditions and safeguards on individual stablecoin schemes, especially if such conditions and safeguards are reliant merely on a private contractual basis. Trust should rather be established via *inter alia* (i) a framework to verify the equivalence of third countries' stablecoin regulation, (ii) reciprocity agreements to ensure EUR stablecoins issued from within the EU are assigned the same rights in the third country; and (iii) agreements between the EU and the third country to ensure that, in a going concern, recovery and/or resolution scenario, no legal barriers can be imposed to the transfer of assets. Annex 1 further elaborates on such pre-conditions.

[2] Examples include Article 23 which limits the issuance of ART used for payments and EMT denominated in third-country currencies and Articles 43/56 regarding the classification as significant tokens.

3) Legal considerations

Views on the proposed legal basis for a stablecoin multi-issuance scheme under MiCAR

A permissive interpretation of MiCAR would extend, by analogy, the EU legal regime applicable to the issuance of asset-referenced tokens (ARTs), as per Recital 54 of MiCAR, to e-money tokens (EMTs)[3]. The following concerns are noted with such a reading:

- ***Under EU law, recitals cannot create new legal rights/obligations***. Their narrower purpose is, rather, to help with the interpretation of the substantive provisions of the EU legal acts of which they are a part.

  The EU legislator has established two distinct regimes under MiCAR; one for ARTs and a different one for EMTs. This follows from Recitals 18 and 19 of MiCAR.[4] Therefore, the ART-related rules cannot apply to EMTs (much less to *significant* EMTs) unless this is explicitly stipulated in the legal text. This is not the case for Recital 54 of MiCAR, which only refers to ARTs.[5] This approach is also consistent with the legislator's intent to apply a more stringent regime for EMTs, as underscored in Recital 19 of MiCAR,[6] considering the very different risks that ARTs pose compared to EMTs. In other words, although the use-cases overlap to some extent, ARTs and EMTs serve different purposes and are subject to different redemption rules[7]. ARTs can reference *any* assets and, thus, serve similar purposes as existing financial instruments, while EMTs are legally equivalent to funds and, thus, are meant to be used for payments (not investments). Moreover, Recital 18 of MiCAR states that EMTs are '*electronic surrogates for coins and banknotes and are likely to be used for making payments'.*
- ***Whilst the multi-issuance concept exists within MiCAR (for fungible crypto-assets), it is applicable only between Union-based issuers and under certain precise conditions about the***

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3 '*Issuers of asset-referenced tokens that are marketed both in the Union and in third countries should ensure that their reserve of assets is available to cover the issuers' liability towards Union holders. The requirement to hold the reserve of assets with firms subject to Union law should therefore apply in proportion to the share of asset-referenced tokens that is expected to be marketed in the Union.'*

4 Recital 18 states that '*This Regulation classifies crypto-assets into three types, which should be distinguished from one another and subject to different requirements depending on the risks they entail*'. In Recital 19 the legislator has clearly set that '*At present, despite their similarities, electronic money and crypto-assets referencing an official currency differ in some important aspects.'*

5 Furthermore, Recital 54 refers to "marketed" EMTs and not "issued" EMTs. Even in the case that Recital 54 could be used as a legal basis for multi-issuance scheme, the term "marketed" used by the legislator entails that the ARTs and EMTs are commercialised and does not necessarily imply that the token being commercialised is fungible.

6 Recital 19 when stating that "strict conditions on the issuance of e-money tokens should be laid down, including an obligation for e-money tokens to be issued either by a credit institution authorised under Directive 2013/36/EU of the European Parliament and of the Council, or by an electronic money institution authorised under Directive 2009/110/EC".

7 Redemptions are at the market value of referenced assets for ARTs, whereas they are always at par value for the EMTs.

management of reserves and their custody.[8] Given this explicit restriction, it appears that the legislator never intended to extend the multi-issuance concept beyond the Union. Consistently with this, the EU legislator did not establish any procedure for recognizing the equivalence of a third country's regime; rather it gave a mandate to the Commission to present an assessment about the need for an equivalence regime by 30 June 2027.

4) Potential safeguards to protect EU citizens from risks of a multi-issuance scheme

Below, a list of possible safeguards that have been mentioned in this debate and an assessment of their (in)effectiveness is provided.

- *Segregation of funds received from EU holders in a credit institution established in the EU.* This is, strictly speaking, a requirement for MiCAR compliance, not a safeguard/additional measure to be put in place at the discretion of a supervisory authority. MiCAR requires that at least 30% of funds are held at EU credit institutions– which increases to 60% in the case of significant issuers. It is one of the reasons why third country stablecoin multi-issuance is concerning: a run by non-EU holders could deplete the funds reserved for EU holders and the run could spread to credit institutions in the EU.
- *Limitation of redemption rights to EU holders.* MiCAR sets an unconditional right of redemption in favour of all token holders. There is no provision in MiCAR that permits to restrict redemption rights on the basis of nationality, country of residence, etc. As a general principle, all token holders rank *pari passu*. Even if allowed by MiCAR, in practice, redemption rights could be hard to restrict to EU holders (a concept not defined under MiCAR, but merely mentioned in a recital) and difficult to enforce.
- *Effective rebalancing mechanism between the reserves held in the EU and in the third country to ensure at any time that the reserves held in the EU back estimated EU holdings of the token.* A rebalancing mechanism is a private law agreement, relying on assumptions that may hold true in a fair-weather situation, but likely not in a stressed situation. As such it does not constrain the ability of third country supervisors to impose restrictions on the transferability of reserves under business as usual, stress or crisis scenarios. In a stress or crisis scenario, third-country authorities are likely to restrict or altogether suspend the rebalancing mechanism with a view to ringfence the reserves of the third-country issuer to protect their interests, at the detriment of EU holders.
- *Possible additional capital and liquidity measures for the EU stablecoin issuer.* MiCAR mandates requirements against a higher level of risk. It is however difficult to assess the effectiveness of increased liquidity and capital requirements, which fundamentally cannot address the above-mentioned risk of

[8] See Article 36(5), according to which '*Issuers that offer two or more asset-referenced tokens to the public shall operate and maintain segregated pools of reserves of assets for each asset-referenced token. Each of those pools of reserves of assets shall be managed separately. Where different issuers of asset-referenced tokens offer the same asset-referenced token to the public, those issuers shall operate and maintain only one reserve of assets for that asset-referenced token*.' And Article 37(2) MiCAR providing that '*Issuers of asset-referenced tokens that issue two or more asset-referenced tokens in the Union shall have a custody policy in place for each pool of reserve of assets. Different issuers of asset-referenced tokens that have issued the same asset-referenced token shall operate and maintain a single custody policy*.'.

non-EU holders seeking to redeem their liabilities at the expense of EU holders (with potential risks for the stability of EU credit institutions). Similarly, such requirements do not address the risk of third country supervisors restricting the transferability of reserves to the EU issuer under business as usual, stress or crisis situations.

- *Level of application of safeguards.* While we acknowledge the principle of proportionality, we consider that such safeguards should neither be decided at the national level, nor on an ad-hoc basis. Safeguards should be defined and introduced at the EU level via legislation to ensure proper harmonization. Safeguards should impose pre-conditions to be met *before* EU market access can be authorised and mitigate risks to EU holders *after* authorisation. To avoid fragmentation and regulatory arbitrage within the EU, supervision of all EMTs and ARTs (regardless of their significance) should be exercised at EU level by the European Banking Authority.

5) Allowing stablecoin multi-issuance may undermine European blockchain innovation and economic interests

Hosting third-country stablecoin issuers and providing them with an attractive legal environment for pursuing a business model involving multi-issuance may be tempting from an industrial policy perspective. However, there are strong reasons to doubt whether pursuing such a policy in this form will deliver the desired benefits. Such a policy may ultimately undermine European blockchain innovation:

- *A multi-issuance scheme would hinder the competitiveness of EUR-denominated stablecoins and could prevent EUR-denominated stablecoins developing as settlement assets for EU tokenisation platforms.* The multi-issuance scheme favours existing non-EU stablecoin issuers who have already established an oligopolistic market position, allowing them to benefit from the EU MiCAR stamp of approval without fulfilling EU requirements and safeguards. Taking USD stablecoins as an example: by issuing a USD-denominated stablecoin in the EU that is MiCAR compliant, while at the same time providing sufficient liquidity and the ability for holders to use it in the same way as the corresponding US issued stablecoin, allows for the USD-denominated stablecoin to attract substantial further interest in the EU market. This could reinforce the already dominant position of USD-denominated stablecoins as the respective issuers could use their network effects and knowledge to further drive innovation in that field and deploy it widely. At the same time, this could hinder the growth of EUR-denominated stablecoins (including currently existing or future European solutions) as they may not have the possibility to grow and provide sufficient liquidity. Moreover, the stablecoin issuers using the multi-issuance scheme could use their knowledge also for other innovative areas, such as tokenisation. For example some stablecoin issuers are already developing their own tokenisation platform (See e.g. Hadron by Tether, Circle smart contract platform). In general, stablecoin issuers are promoting stablecoins as settlement assets for tokenised transactions and could thus use their market dominance further. This could put EU based or EU-developed tokenisation platforms at a competitive disadvantage, in particular if there are no alternative settlement assets denominated in euro, requiring such platforms to use USD-denominated stablecoins. Multi-issuance could further hinder EU strategic autonomy in the crypto market by favouring non-EU crypto-asset service providers that have an advantage in promoting these stablecoins. Stablecoins issued under the multi-issuance scheme could reinforce the role of large crypto-asset service providers operating in several jurisdictions and performing multiple functions. Such crypto-asset service providers are often non-EU entities having an oligopolistic position, which could be further strengthened by a wider adoption of multi-issued USD denominated stablecoins.

- *Multi-issuance could lead to less financial resources being available in the EU.* As explained previously, the multi-issuance scheme may increase interest from EU investors for USD-denominated stablecoins at the expense of EUR-denominated stablecoins and potentially EU banking deposits. Since USD-denominated tokens have mostly US Treasuries as reserve assets, an increase in the holding of USD-denominated stablecoins by EU residents could lead to EU savings being indirectly invested mostly in US treasuries rather than in the EU capital markets, EU bank deposits or Member States' sovereign bonds, as would instead happen with EUR denominated stablecoins. Current stablecoin market capitalisation is around 240bn USD and dominated by USD stablecoins which have a 99% market share. Should this market continue to grow globally, a possible redirection of EU savings to non-EU assets would run contrary to the Savings and Investment Union objectives. Global stablecoins generate significant profits (the largest stablecoin, Tether, has profits roughly in line with Goldman Sachs profit). In case of a multi-issuance scheme, a large part of such profits may not be subject to EU taxation. Stablecoin issuers with a global model could likely seek to shift profits to the third country where they are based, with the lowest tax rates. For example, this could be the US, due to the generally lower US corporate tax rates compared to EU Member States.
- *Multi-issuance is unlikely to create jobs in the EU in general.* Most functions of multi-issued stablecoins are likely to be outsourced to the third-country entities, with the EU entity being largely an empty shell. Businesses prefer to avoid having duplicated risk management and compliance functions in multiple jurisdictions and MiCAR would not prevent issuers from concentrating their risk management functions in their home/HQ jurisdiction.

6) Conclusion & way forward

A high degree of uncertainty exists around multiple key aspects relating to stablecoin multi-issuance schemes. These uncertain aspects include: the detailed nature of forthcoming stablecoin regulations being brought forward in third country jurisdictions, clarity on the interpretation of MiCAR, and the likely effectiveness (or otherwise) of possible safeguards. In this context, it would be premature for the EU to set out a definitive approach on multi-issuance - particularly if said definitive approach appears to favour the interests of third countries over those of the EU. As such, it would be wise to hold back on firm decisions on the EU approach until greater clarity is achieved in these areas of outstanding uncertainty. **In any event, a matter of this gravity is not suitable to be resolved via an administrative act such as a Q&A. Rather, the matter would be better addressed via the EU co-legislators.**

Annex 1 – Possible pre-conditions to be met *prior* to multi-issuance being potentially permitted

i. EU law should cater for a clearly defined procedure for assessing equivalence of a third-country regime.[9]

ii. The third country stablecoin regulatory regime should be assessed by the EU as equivalent to MiCAR as per the – yet to be defined – EU equivalence regime criteria.

iii. MiCAR NCAs in charge of the supervision of parties involved in the joint issuance should have full access to reliable data on the tokens issued and the reserves of assets in and outside the EU.

iv. A reciprocity agreement should be in place between the third country and the EU, ensuring that the third country allows the issuance of EUR-denominated stablecoins by EU firms under the very same terms as in the EU.

v. The EU and third country should have in place an agreement ensuring that in a going concern, recovery and resolution scenario, there are no legal barriers that can be imposed by authorities or the issuers between the EU and the third country for the transfer of assets between the two jurisdictions' issuers – thereby full mobility of resources needed to fulfil redemption requests is possible at all times (financial support agreement underpinning the rebalancing mechanism).

Annex 2 – Requirements that the competent authorities may require electronic money institutions to comply with in accordance with Article 58(2)

Article 58 (2) MiCAR states that '*Competent authorities of the home Member States may require electronic money institutions issuing e-money tokens that are not significant to comply with any requirement referred to in paragraph 1 where necessary to address the risks that those provisions aim to address, such as liquidity risks, operational risks, or risks arising from non-compliance with requirements for management of reserve of assets*.'

Paragraph 1 requires electronic money institutions issuing significant e-money tokens to be subject to:

(a) the requirements referred to in Articles 36, 37, 38 and Article 45, (1) to (4) of MiCAR , instead of Article 7 of Directive 2009/110/EC;

(b) the requirements referred to in Article 35(2), (3) and (5) and Article 45(5) of MiCAR , instead of Article 5 of Directive 2009/110/EC.

Articles 36, 37,38 MiCAR contain relevant provisions for the composition and management, custody, management of reserve assets. Article 45 MiCAR sets out specific additional obligations for issuers of significant ARTs (applicable also to EMTs), including additional requirements for management of liquidity risk. Article 35 sets out own fund requirements.

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[9] Art. 140(2)(v) of MiCAR requires the Commission, having consulted EBA and ESMA, to prepare a report for the EU legislators, accompanied by a legislative proposal where appropriate, on whether an equivalence regime should be established under this Regulation for entities providing crypto-asset services, issuers of asset-referenced tokens or issuers of e-money tokens from third countries.