



Council of the European Union
General Secretariat

**Interinstitutional files:
2020/0265(COD)**

Brussels, 28 April 2021

WK 5680/2021 INIT

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WORKING PAPER

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From:	Presidency
To:	Working Party on Financial Services (Crypto Assets)
Subject:	MiCA: Question on ART/Monetary sovereignty (WK 4352/2021) and joint discussion paper - Replies from 15 MS - HR non-paper on systemic risks in the MiCA proposal

Question on ART/Monetary sovereignty

A. To continue the discussion on prudential requirements and central bank powers (in line with ECB proposals) for ART, including specific requirements for those with payment purposes; the issuance/use of ART with payment purposes would not be forbidden in MICA (without prejudice of powers at authorisation) and possible restrictions on the use of ARTs to prevent monetary substitution would be dealt at national level outside MICA (for instance as described in the Romania non paper); or
B. To start a discussion on restraining the use/issuance of subset of ART on the basis of the concerns from a group of MS (as previously explained the Presidency considers that requiring an ART to be redeemed at 1:1 of the initial price paid amounts to forbidding the issuance of ART as defined in the Regulation).

Q1 MS are invited to express their preferences, and flexibility, as regards the two approaches. In particular MS are invited to state whether they would object to any of the approaches.

The Presidency invites MS to focus the remarks on the overall policy/political objectives rather than on the specific proposals to implement those objectives.

CZ:

Our answer to Q1 and Joint discussion paper is following:

We support option A. We definitely do not support option B.

Joint discussion paper from the delegations of France, Germany, the Netherlands and Spain: “Asset-backed crypto-assets used as a means of payment”

We do not generally share the concern of ECB and some member states on threats of stablecoins on monetary sovereignty; however, we understand that private stablecoins might represent a direct competitor to digital euro. We think that private crypto assets shall not be restricted because of future plan of ECB to issue the similar asset.

We acknowledge all problematic issues concerning stablecoins and we agree both payment and investment purpose is possible in such crypto assets. Nevertheless, we are not in favour of complicated distinction, which would be difficult to perform at the real market. On the other hand we welcome some proposals presented in the Joint discussion paper.

Define the scope of ARTs

We agree with the idea of wider definition by including reference to any other value or right. Current definition needs some changes

Categorise ART by two functional subsets

In general, we agree that some stablecoins could potentially serve to the investment purpose, however we are not in favour of creating sub-categories of categories. From presented options we prefer Option 1 as we agree that ART shall be primarily deemed to serve the payment purpose.

We would like to re-mention our proposal of distinction of EMT and ART. For crypto assets backed only by fiat currencies (one or more) this crypto asset shall meet the definition of EMT regardless the purpose presented by the issuer. If there are any other assets different from fiat currency the crypto asset shall meet the definition of ART regardless the purpose.

Here it is also possible to create a mandate for NCA to monitor the use of such ART and if the payment purpose is proven, crypto assets would move from the category of ART to the category of EMT.

Statutory redemption right

The redemption right is important way to protect consumers. However we do not see the necessity to ban stable coins that do not allow exchange to the fiat currency. That shall be the decision of the issuer, who is of course obliged to inform about possible absence of redemption right in the white paper (advertising messages)

Align the rules for payment ART to EMT

We fully support this proposal. Payment ARTs backed by anything else than official currencies should not be deemed as EMTs.

Mechanism for re-qualification of ART

We agree with this idea of re-classification. We also support the mandate for NCA to inform publicly inform about investment ART being used for payment purpose. It should also be the competence of NCA to trigger the re-classification of ART.

RO:

{In that context the Presidency proposes to discuss two alternative ways forward:

A. To continue the discussion on prudential requirements and central bank powers (in line with ECB proposals) for ART, including specific requirements for those with payment purposes; the issuance/use of ART with payment purposes would not be forbidden in MICA (without prejudice of powers at authorization) and possible restrictions on the use of ARTs to prevent monetary substitution would be dealt at national level outside MICA (for instance as described in the Romania non paper); or

B. To start a discussion on restraining the use/issuance of subset of ART on the basis of the concerns from a group of MS (as previously explained the Presidency considers that requiring an ART to be redeemed at 1:1 of the initial price paid amounts to forbidding the issuance of ART as defined in the Regulation).}

Q1. MS are invited to express their preferences, and flexibility, as regards the two approaches. In particular MS are invited to state whether they

would object to any of the approaches.

The Presidency invites MS to focus the remarks on the overall policy/political objectives rather than on the specific proposals to implement those objectives.

RO: We do not strongly object to the first approach, but we consider that the option B addresses more categorically than approach A the issue of *holders protection and trust* and the *preservation of the monetary sovereignty*.

Non-Paper FR, DE, ES și NL: "Asset-backed crypto-assets used as a means of payment"

RO: Regarding the Joint discussion paper from the delegations of FR, DE, NL and ES, as a general remark, we consider that the coordinates drawn in it represent a safe path to continue the discussions regarding the regulatory regime of ARTs.

In terms of redefining the scope of ART by **revising the definition of ART** to include reference to any other value or right, we understand the both problematic perspectives, namely that if we do not revise the definition there is a risk of issuing ART with reference to other assets than those currently existing in the definition (and thus avoiding the ART regulatory framework) and also the existence of an open list of reference assets can create problems that currently cannot be envisaged. One solution would be to keep the definition as it is currently and to ban the issuance of ART that refers to assets other than those in the closed list.

We fully support the proposal of **categorising ART into Payment ART and Investment ART** since it brings more clarity and, in this manner, ARTs with payment purposes, which have many similarities with EMTs, could be subjected to requirements applicable to EMTs. Regarding the two options proposed, we prefer option 2 considering that an ART referencing at least in part one or more currencies has a higher probability of being used as a means of payment.

We support the introduction of a **statutory right of redemption** at par value (at a ratio 1:1 with the official currency of EU member states) for holders of EMT and Payment ART. Therefore, we propose that payment ARTs should only make reference to EU currencies.

Also, we consider appropriate the **alignment of the rules for Payment ART with the EMT regime** and the **introduction of a mechanism for re-qualification of ARTs**.

SK:

Position:

We do not support approach proposed in Joint discussion paper from the delegations of France, Germany, the Netherlands and Spain: "Asset-backed crypto-assets used as a means of payment"

Stablecoin market is still in its development phase and different models of stablecoins emerge every year. In our opinion, it would be a big mistake to overregulate this market, therefore we do not support alignment of the rules for Payment ART with the EMT regime.

We especially disagree with proposal that that holders of EMT and Payment ART should be entitled to claim redemption at par value, i.e. at a ratio of 1:1 with official currency of EU member-states. In our opinion, it should be decision of issuer, what kind of redemption it offers to its clients. Redemption right might differ for ART backed by crypto-assets/ fiat currency/ commodities. We support market competition and therefore in our opinion MiCA should allow for different models of

stablecoins to co-exist.

NL:

- It has been our position from the very start that the requirements for ARTs should be aligned with those for EMTs, in order to ensure 'a same product, same risks, same rules'-approach, and to prevent regulatory arbitrage.
- In the non-paper that we have drafted together with our colleagues from Germany, France and Spain, we propose measures to align the two regimes more and further reduce the risks associated with ARTs. They are inherently less stable than EMTs and therefore pose greater risks to consumers in particular, and financial stability and monetary policy in general.
- We wish to point out that it is still our view that the measures proposed by France, Germany, Spain and ourselves in itself do not ban the issuance of ARTs.
- Following on from the Commission's initial proposal, there are still many issues and risks surrounding ARTs that are not yet properly addressed and managed. This view is broadly shared by the Member States. We have serious concerns that the current Commission proposal does not sufficiently mitigate the risks that ARTs pose.
- It is of course difficult to find the right balance between innovation and regulation because we simply haven't seen true global stablecoin arrangements in practice up until now, because in 2019 the G7 and we ourselves made clear statements that we do not want to have such arrangements in place before an appropriate legal framework is established. It is therefore entirely logical that we do not yet observe any arrangement that we are trying to regulate.
- We would also like to stress that it is not always the best approach to take a liberal stance towards initiatives that potentially have enormous adverse consequences. While we are fully supportive of innovation, not every innovation is a holy grail. We should therefore not be steered too much or misguided by the innovation argument.
- Having said this, we very much encourage a proper discussion on the issues raised in both options A and B, as we believe that a smart combination of the two could result in the establishment of a framework that mitigates the risks posed by ARTs in an adequate manner.

LV:

As a general way forward we support discussion on restraining the use/issuance of subset of ART on the basis of the concerns from a group of MS (option B from the discussion note).

We would be open to separating ARTs with payment purpose, including a mechanism for re-qualification of ARTs and alignment of rules for payment ART with the EMT regime. Regarding classification, we believe that the proposed approach of assuming outright that any ART is a payment ART unless proven otherwise (option 1 from the joint discussion paper) would be excessive.

We are cautious regarding a possible 1:1 redemption requirement due to possible fluctuations in value of reserve basket that consists of multiple currencies, other assets. Need to consider how likely it is that a product with significant value fluctuations would be widely used for payments in the first place.

AT:

In our view the essential outcome of the negotiations needs to be the establishment of a robust framework for issuers of crypto-assets, consumers and investors, while creating an innovation-friendly environment. As the fields of crypto-assets is a highly complex topic, MiCAR should be a tailor-made regulatory framework and most importantly future-proof. Therefore, sufficient time should be foreseen in order to be able to fully and profoundly assess the valid proposals put forward by the Presidency. Concerning the two proposals, we believe that they do not significantly differ from each other, bearing in mind that both options would for instance include subcategories for ARTs with stricter rules. Consequently, we are flexible and open to proceed with the discussions along the proposals put forward.

We acknowledge the objective of four delegations to resolve the current situation amongst member states. In this regard, we believe that the proposals brought forward are a valid starting point. Nevertheless, in our view potential implications on the market need to be thoroughly assessed and the right conclusions need to be drawn. We would therefore need more information on the impacts on the crypto market sector, especially with regard to the proposed statutory redemption right at a ratio of 1:1 with an official currency of the EU member states for Payment ARTs.

Furthermore, almost fully aligning Payment ARTs provisions with the EMT regime would have as stated in the non-paper the consequence that only credit institutions or e-money institutions could issue Payment ARTs. In this context, we are not quite sure which prudential consequences were triggered if Payment ARTs would be issued by credit institutions or institutional investors under the proposed restrictions. Genuinely, we wonder which impact the proposed rules could have on innovation and the FinTech sector within the European Union. Having said that, we are open to discuss these proposals further, while not losing sight of the overall objectives of MiCAR of promoting an innovation friendly environment on the one hand and of ensuring a safe regulatory framework for issuers of crypto-assets and investors as well as consumers in the European Union on the other hand.

At this point, we would like to emphasize that the political topic on monetary policy, which is indeed paramount for the outcome of this file, should accompany the discussions in future meetings. In this context, we need to make sure that both monetary sovereignty and financial stability are being preserved at any time.

EE:

[Estonia is in favour of option A.](#)

SE:

We share the concerns that a stablecoin with significant uptake has the potential of having far-reaching consequences for financial stability and monetary policy, and we fully support a continued discussion on how these risks are most adequately addressed. We think that these discussions

overall are headed in the right direction, with more safeguards in place and more alignment between ARTs that are used for payment and EMTs. From a consumer perspective, whether the token they use for payments is classified as an ART or an EMT will make little difference to them, as long as the appropriate protection is in place.

Giving authorities appropriate powers to intervene is essential. In that respect, further strengthening of central banks' powers to issue binding opinions on authorisation of ARTs, as regards the conduct of monetary policy and the promotion of smooth operation of payment systems, would in our view be appropriate tools to add. We understand the rationale for proposing statutory redemption rights at par value, and such feature could potentially be justified, but the stability concerns that were raised during the last working group meeting requires further analysis and reflection. The proportionality argument also warrants further consideration.

IT:

We are in favour of continuing the discussion on prudential requirements and central bank powers for ART, including specific requirements for those with transactional purposes, as suggested under option A. At the same time, we share the concerns on monetary sovereignty and we believe that potential measures to address monetary sovereignty concerns should be dealt directly in MiCA. Indeed, even if MiCA does not interfere with the right to regulate the use of domestic currency provided by some national frameworks, the approach of option A to address monetary sovereignty concerns at national level outside MiCA could lead to fragmentation across national borders and regulatory arbitrage.

With regard to the monetary sovereignty issue, we consider that it is fundamental to take into account all the potential impacts of the proposal to grant the holders a redemption right at par value (1:1). At first glance, this proposal seems to solve the problems related to monetary sovereignty. However, in practice, it may be ineffective in addressing it and it may generate new issues, for example, in terms of financial stability, and consumer protection.

In particular, imposing the obligation of a redemption right at par value (1:1) for issuers of payment ARTs backed by assets that are volatile and not HQLA does not imply per se the effective convertibility. In fact, there could be situations in which the market value of those assets reduces to a level that would make redemption at par so costly that the issuer of "Payment ARTs" would not be able to maintain its obligation.

To reduce this risk, it would probably not be enough to have a very stringent set of prudential rules. It would also be necessary to have an institution that would act as a lender of last resort. In other words, there would be costs necessary to preserve financial stability that would have to be weighed against the benefit of imposing redemption at par of those payment ARTs.

The fact that imposing the obligation of a redemption right at par value (1:1) for issuers of payment ARTs backed by assets that are volatile and not HQLA does not imply per se the effective convertibility, may also (i) generate an excessive reliance by the holders on the ability of the issuer to meet at all time the redemption claims; and (ii) induce holders into thinking that they are covered by the same safeguards provided for EMTs (and in general traditional payment instruments).

This issue is exacerbated by the choice of the legal denomination of this sub-category of ARTs as "Payment ARTs". The term payment associated with ART may induce the holders to believe that these instruments share the same (or very similar) features of more familiar means of payments (in

particular, e-money), thereby blurring the necessary distinctions between different categories of instruments. Also the white paper and all relevant marketing documentation should clearly highlight all material risks associated with the value stabilization mechanism and that there is no guarantee that the ARTs can be always converted back into cash at the initial value.

Having said this, in order to avoid the concerns of the potential emergence of any new “unit of account” due to a widespread use of transactional ARTs as means of payment, ongoing supervision would play a crucial role and should be aimed at assessing whether a transactional ART is likely to become a new unit of account, on the basis of criteria and thresholds established in L1 and further specified in L2 as indicators of the potential emergence of any new unit of account. In this case, measures to preserve the monetary sovereignty should be adopted (i.e. the withdrawal of the authorization, but it could be worth exploring whether other measures could be prescribed).

We reserve to further explore this approach.

IE:

In relation to the question set by the presidency, here are our preliminary thoughts:

1. In relation to option A), “To continue the discussion on prudential requirements and central bank powers (in line with ECB proposals) for ART, including specific requirements for those with payment purposes” is a position we could support, notwithstanding further comments in 2) below.
2. In relation to “the issuance/use of ART with payment purposes would not be forbidden in MICA”, we would like the presidency to reconsider other MS’ comments in relation to the proposed definition of ART’s, particularly in light of recent discussions on monetary sovereignty and the ECB legal opinion on MICA.

ART:

“a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets”.

EMT:

“a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender”.

Our observations are such that:

- i. The ART definition does not include the “purpose of which is to be used as means of exchange”.

ii. The ART definition does not include the ability to stabilise its value with “a fiat currency”, but the definition only refers to “several fiat currencies”.

Considering these two elements, which can be considered sine qua non conditions for a payment purpose to exist, we would like to explore further, and gain clarity, as to how the ECB legal opinion may be applied to ART’s, and how discussions can progress, in relation to payment purposes, when these conditions are not present in the definition of ART.

3. In relation to the sentence “possible restrictions on the use of ARTs to prevent monetary substitution would be dealt at national level outside MICA”, we would welcome the Presidency’s clarification that this statement is the response to the Romanian non-paper re local restrictions required to protect the national currency’s sovereignty, when that currency is not the Euro.

4. In relation to option B) “To start a discussion on restraining the use/issuance of subset of ART on the basis of the concerns from a group of MS”, we welcome the joint MS paper’s statement: “...it is key to establish regulatory equivalency between [...] token categories and to address possible concerns on monetary policy, market integrity, financial stability, consumer protection and technological neutrality.”

5. However, and considering the EU’s strategic aim and necessity to provide a safe and workable regulatory perimeter for payment mechanisms based on DLT technology, we may be less supportive of option B), as it would lead to possible extensive delays in MiCA, despite the very significant progress made to date. A review of the ART definition, instead of further fragmentation into subcategories, may be a more optimal way forward considering the ECB legal opinion and the strategic aim of the draft regulation.

6. To summarise:

a. We do not object to either approach

b. We could support a way forward that represents a smart combination of elements of both options, particularly considering current discussions and work underway towards a digital euro; or perhaps where option B is the natural progression or outcome of the work undertaken under option A.

c. We reiterate our commitment to provide the following for a European Market in Crypto Assets:

- i. Legal certainty
- ii. Support innovation
- iii. Consumer protection
- iv. Strong market integrity

- v. Financial stability
- vi. Mitigation of monetary policy and monetary sovereignty risks.

d. We would be more supportive of a path that focusses on current risks (e.g. stablecoins used for payment purposes) than in trying to capture future risks in potential innovation scenarios (e.g. ART's used for investment purposes).

HR:

Presidency discussion note on Title III/ART

We do not fully understand what these two options actually represent and how they correspond to the current COM proposal. **Considering that MiCA is intended to regulate a new area where there is still a lot of vagueness, we object to the introduction of a huge amount of discretion at the national level. Furthermore, we object to the introduction of a new category – payment ART.** We think that introducing a new "functional based" category is not a sound approach and it could make this Regulation even harder to implement by NCAs than is the case with the current proposal.

To better present the problem we see in the approach MiCA takes with respect to EMTs and ARTs (also including under option A), please find attached a HR non-paper on Systemic risks in the MiCA proposal:

- There are functional similarities between asset-referenced tokens (ARTs) and electronic money tokens (EMTs) on one hand, and Money Market Funds (MMFs) and Exchange traded Funds (ETFs) on the other. While the risks displayed by these new instruments are similar to well-established financial instruments, the mitigating policies for these well-known risks are not present in the proposed regulation, or are, at the very least, insufficiently developed. It appears that the proposed framework **fails to address known weaknesses in terms of procyclicality of redemptions and contagion through fire sales** which are well understood in very closely related instruments like ETFs and MMFs, without providing sufficient safeguards. **This has material implications in terms of financial stability.**
- There is an apparent policy mismatch between the MiCA proposal for ARTs/EMTs and what is being discussed when it comes to MMFs (in the upcoming MMF review).

- By **dictating revenue models** the MiCA proposal incentivises moral hazard and creates distorted incentives.
- The MiCA proposal creates **regulatory arbitrage**, and also may unnecessarily limit the use of DLT infrastructure by currently established financial instruments.

On the FR/DE/NL/ES non-paper

- **We object to the introduction of a new category – payment ART.** We think that introducing a new "functional based" category is not a sound approach and it could make this Regulation even harder to implement by NCAs than is the case with the current proposal.
- Although we agree that we should aim for future proof regulation, the suggested further extension of the ART definition to any crypto-asset that purports to maintain a stable value against **any variety of assets**, seems to be **premature and not sufficiently thought out**. In addition, this distances ARTs even more from the concept of a “stablecoin”, involving a variety of instruments that do not aim to maintain a stable value because they refer to assets which can be extremely volatile. It should be noted that we currently do not even have a clear picture on what is meant by “stable” – stable compared to what? We need to have a common understanding of this before we can decide on how to regulate ARTs.
- **Regarding Investment ARTs** and the following part of the non-paper: “... *without prejudice to such assets falling under existing regimes such as MiFID II, UCITS and AIFMD, which would take precedence*”, **it is still very unclear which ART could have an investment purpose and not fall under any of the existing regulations**. This is a concern because the requirements under the two regulations are incompatible and mutually exclusive, making the application to MiFID/UCITS instruments impossible. It would be more than useful to see more than one example of such an ART before deciding to go further with this approach. We would not consider it to be good policy to adopt key definitions in MiCA based on non-existing real life examples. Otherwise, investment ART will most likely be used as a way to achieve regulatory arbitrage in relation to MiFID, UCITS, AIFMD... and exclusively for instruments based on DLT, which introduces regulatory arbitrage exclusively based on the technology that is used. This in no way helps to establish a level playing field.
- The proposal to have ex post mechanism of re-classification in case an Investment ART is regularly used for payment purposes seems somewhat vague from a legal certainty standpoint and more so in the context of the still extremely unclear relationship of Investment

ARTs and the existing regulations for financial instruments (MiFID, UCITS, AIFMD...). Besides, it could trigger unintended consequences should an ART be misclassified for reasons not depending from the issuer.

- The proposal to **bail in depositories and distributors** if the issuer of a Payment ART does not fulfil legitimate redemption requests also seems questionable in terms of its feasibility.

Please also check HR paper at the end of this table

LU:
Concerns, such as those expressed in the joint discussion paper from the delegations of France, Germany, the Netherlands and Spain: “Asset-backed crypto-assets used as a means of payment” should duly be taken into account, but the approach chosen in the non-paper is, at the current juncture, disproportionate. Indeed, we fear that this focus on ART with payment function and stablecoins risks creating a bias in the regulatory framework that will be detrimental to the general aim of the Commission’s proposal to set a new framework for the potential whole space of crypto assets. Therefore, we are open to continue the discussion on prudential requirements and central bank powers for ART as proposed under option A of the Presidency Discussion note.

Furthermore, the threat that ART may cause to monetary sovereignty may materialize in case such ART fulfill simultaneously the three functions of money (a medium of exchange, a store of value and a unit of account). As currently designed in MiCA, ARTs aim at being a store of value, ARTs used for payment purposes can be used as a medium of exchange. However, a particular ART would become a unit of account only in the scenario that the trust in this product is settled and its usage becomes widespread in the single market. Only in such a case, could ARTs have an impact on the ECBs’ and non-euro NCBs’ monetary sovereignty.

The widely usage of an instrument will depend on its adherence by the market which seems to us highly unpredictable at the time of the issuance, in particular as the market of crypto assets is still in its initial phase of development, where crypto assets with stabilization mechanisms or payment function only represent a very limited portion of the whole market. The features of the ART and its designed purpose cannot determine beforehand the market acceptance and the way or purposes for which the holders will make use of it. Furthermore, not all ART used as means of payment may cause a threat to the financial stability, monetary policy transmission or monetary sovereignty. Therefore, we do not see the added value of applying an *a priori* different treatment at issuance to investment purpose or payment purpose ART.

In order to contribute to the discussion on prudential requirements and central bank powers for ART, we would like to share some reflection on a more proportionate, incremental system that could be designed along the following preliminary principles:

MiCA would provide for two distinct regimes, i.e. one general regime for ART (“general regime”) and a more stringent regime for ART used as

means of payment and which may cause an established threat to the monetary sovereignty subject to a more stringent regime (“stringent regime”).

The established threat to the monetary sovereignty subject to a more stringent regime would be assessed and monitored as followed:

- At the time of the authorization in art 16 or of the classification as significant (art 39) ARTs shall not be classified *a priori* as general ART or payment ART subject to the stringent regime. Nevertheless,
 - as already provided for in the Commission’s proposal, the threat to financial stability, monetary policy transmission or monetary sovereignty through mainly payment ARTs shall be assessed. For this purpose, the ECB would be granted powers to release a binding opinion¹ with regard to these matters on the basis of transparent and objective methodology and criteria established in MiCA. This opinion would include three elements: i) classification or not of the ART as payment ART, if it is not yet the case (for example through the opt-in process described below) and its consequent submission to the stringent regime, ii) assessment by the ECB of threats to the monetary sovereignty and monetary policy transmission channels; iii) based on ii), decision by ECB to impose a top up of requirements to the stringent regime or even a ban of activity if the threat is so sensible that the ECB would recommend its prohibition.
 - in addition, issuers of ART would be given the opportunity to opt-in in the stringent regime as payment ART already in article 16 similarly to what is foreseen in article 41.
- Post authorization, a continuous monitoring by the ECB, in coordination with competent authorities, would be done through annual reports, on i) the developments in the markets of CA with payment functions, ii) risks to monetary policy and monetary transmission channels of such ART. In view of this reporting, the same transparent and objective methodology or criteria should be fulfilled, as the ones for the opinion realized at the authorization.
 - based on this reporting, ECB would be granted the power to release binding opinions at any moment following the authorization, on three issues: i) classification of general ARTs as monetary sovereignty threat ART or declassification of monetary sovereignty threat ART as general ART², ii) additional requirements for ARTs given monetary sovereignty concerns; and iii) ban of activity for ART that poses a serious threat to monetary sovereignty

These primarily thoughts need deeper assessment and analysis as regards their feasibility and implementation but we believe that such an approach would be more fit-for-purpose in encompassing the whole potential space of crypto assets. This would be a balanced framework leaving the necessary flexibility in view of supporting innovation, encouraging the development of new solutions, including new means of payment, while

¹ In line with the opinion of the European Central Bank of 19 February 2021, amendment 4 to recital 29, amendment 6 to article 18 (4), amendment 7 to article 19 and amendment 8 to article 21 (3) (b).

² In line with item 5 of the joint discussion paper from the delegations of France, Germany, the Netherlands and Spain: “Asset-backed crypto-assets used as a means of payment”.

benefiting from multiple safeguards at different stages of development of the ARTs, ensuring a solid monitoring system of potential risks to the monetary sovereignty and monetary policy transmission centered around the powers of the ECB (and national central banks outside the Eurozone). Such a proportionate approach would also ensure that we give European citizens the opportunity to participate in the full potential of the development of crypto asset markets. Any too rigid and restrictive framework would imply to push European citizens, especially the younger generations that are more tech-friendly and less risk averse, out of European markets.

In particular, in order to foster innovation, we are thus of the opinion that a sufficient amount of proportionality should be included in MiCA so that non-significant ART shall comply with less stringent requirements and being regularly monitored during their life time. Only the few ones scaling up to a significant use among the EU market, when becoming a threat for the monetary sovereignty, should be given the required attention and be subject to the appropriate requirements.

We shall not forget that we are currently at the emergence state of the stablecoins market without a clear view on the future evolution of this market. We shall decide the position that the European Union wants to follow and thus whether we prefer already to disrupt its development through disproportionate regulation or rather, as we support, promote its development through the creation of a framework providing sufficient room for innovation and competition enabling the legislator to have a better picture of the required regulatory adjustments through a continuous monitoring of the development of the market.

Furthermore, we should also not forget that through the retail payment strategy of the European Commission, the whole European payment ecosystem will be soon assessed and revised so that any major issues concerning ART used as payment means can also be addressed in this context and included as appropriate in the renewed European payment ecosystem. This would enable the creation of a consistent, harmonized payment environment in Europe.

In the light if this position, we have the following comments on the joint discussion paper from the delegations of France, Germany, the Netherlands and Spain: “Asset-backed crypto-assets used as a means of payment”:

1. Definition of ART

The definition of asset-referenced token proposed in the joint paper referring to “any other value or right”, although aiming at extending the scope of MiCA to prohibit any circumvention thereof will create a tremendous level of legal uncertainty and will blur even further the distinction with financial instruments covered under the scope of MiFID and excluded from the scope of MiCA.

We are also opposed to negative definitions (i.e. defining an instrument in opposition to another instrument.)

2. Categorise ART by two functional subsets

We reiterate our opposition to classify the ART based on their purpose at issuance and we would rather favor a long life monitoring of the usage made of the instrument.

We thus object to a prima facie exemption which in some case would be irrefutable (option 1). Regarding option 2, we would support an ex-post requalification mechanism for ART that would be widely used as payment and would likely cause a threat to the monetary sovereignty in the Union where a greater role should be given to ECB to assess such threat.

We do not agree that option 1 would lead to the alignment with the same activities, same risk, same rules principle since the risks that may be caused by the ART with payment purpose and in particular the risk toward the monetary sovereignty will fluctuate with the usage that the market will make of it. Prohibiting or limiting its usage will hamper any potential risk but also at the same time innovation and competition of the European market in the global economy. This will thus neither lead to contribute to make European financial regulation future-proof.

3. Introduce a statutory right of redemption for holders of EMT and Payment ART

We do not share the view that EMT and Payment ART that do not include a redemption right should be prohibited. Our position is that sufficient room and flexibility should be given to non-significant EMT and ART in order to foster the development of the market, of innovation and competition. We would support to leave room to different business models (i.e. some including a redemption right and other without redemption right) and leave the market adhere to the instrument that suit their needs.

In our view, requiring each unit of payment ART to be pledged at a ratio of 1:1 with official currency, would lead the issuer to put in place financial engineering for hedging instruments to preserve the currency risk on the reserve which will exclude some small actors not being able to put in place such robust financial mechanism and will create an important stability risk to the market.

4. Align the rules for Payment ART with the EMT regime

In order to support innovation and sufficient room for development to this emerging market, we do not see the need to align the rules for Payment

ART with the EMT regime and neither to require issuers of payment ART to be granted with a CI or EMI authorization. We support the development of a variety of business models and only once these instrument reach a level of criticality which can, in particular be caused by the potential threat to the monetary sovereignty, then an appropriate regulation should be applied with similar requirements (which is already mainly the case in the Commission's proposal.).

5. Introduce a mechanism for re-qualification of ARTs

We are of the opinion that the use made a certain instrument can only be assessed through a prudential supervision so that the classification as payment or investment purpose ART could not be made at the time of the issuance of the ART but only at a later stage. We can thus support an **ex post mechanism of re-classification**, in case an investment ART is regularly used for payment purposes.

Competent authority, in coordination with the ECB or the non-euro central banks, shall have the power to monitor these ART and shall have the corresponding supervisory powers therefor. We are also in favor a (non-) binding opinion from the ECB to be issued when classifying an ART as having a potential threat for the monetary sovereignty. Appropriate regulation should apply to such ART, including a transition period to ensure the continuity of the activity and to enable the issuer to comply with the relevant requirements.

DK:

Non-paper on asset-backed crypto-assets as means of payment

We support the Presidency's option A posted in the beginning of the non-paper from DE, FR, ES and NL. In addition to this, our central bank have declared an interest in including arrangements to ensure appropriate involvement of central banks, if needed, after the authorization process. This would address the situation where a binding opinion at the time of authorization might not be a genuinely effective monetary tool since the vast majority of 'stablecoins' cannot be deemed influencing, and more rarely threatening, monetary policies at the point of authorizing of the issuer – even before the time of issuance of the given 'stablecoin'. To this end, we foresee on-going involvement in the oversight from central banks to be more suitable and effective in ensuring monetary policy transmission.

Regarding the non-paper from DE, FR, ES and NL, we are positive towards the intention and efforts to further align EMTs and Payment ARTs—specifically on the redemption rights. Not necessarily because of monetary sovereignty issues, but due to the need to ensure appropriate customer protection. We do not believe that the average consumer will be able to distinguish between the use of different ‘stablecoins’ with payment characteristics in the future. Therefore, we believe the central consumer protection mechanisms in payment ARTs and EMTs should be aligned.

However, we do not believe that the redemption rights for Payment ARTs should be set at 1:1 to the initially paid price, but should be allowed to fluctuate and follow the price of the underlying assets. In addition, we are also hesitant in our support to further widening the scope of ARTs through amendments of the definition. We are not convinced that inclusion of all assets and rights in the definition of ARTs provides for a proportionate level of regulation. Rather such a route creates a generalised legal definition which should be weighed against the possible implications of such a broad rule. We would therefore advise that there will be done an assessment of the implications of such amendment containing specific (hypothetical) examples of propositions that would not be covered by the current definition, prior to any adoption.

Also, we believe that for tokens to qualify as a payment ART there should be set quantitative thresholds of fiat with no discretion for Member States, and that the threshold should be proportionate in a manner that not only considers currency substitution issues, but also leave room for innovative business models of the future. The alternative will be that such business models will establish themselves outside the European Union but still have reach of the consumers inside the Union or it could lead to a push to more decentralized business models – both situations will lead to weaker consumer protection for European consumers and would not per default prove effective in mitigating currency substitution risks.

We support the efforts of further alignment on consumer rights for tokens with fiat-reserves, but it is important that we find the right balance. If not, we fear that we will be pushing towards a more fragmented market, and in turn lead to less oversight, supervision and insufficient scope for the regulation, thereby leaving out certain activities.

Discussion note on ART and monetary sovereignty

DK supports continued discussions on prudential requirements, central bank competences and supervision – option A. A balance should be struck between innovation, consumer safeguards and maintaining the competences of central banks to fulfilled their role as central bank – well-described in the RO non-paper. We believe this balance merits further discussions, especially since MiCA regulates and frames a new sphere within the financial sector. As ‘stablecoins’ potentially could have an influence on monetary sovereignty, they call for a role for central banks. However, this should not jeopardize the separation of roles between supervisory authorities and central banks. One ensures financial stability through financial regulation and inspections and the other through monetary policy – these should not be mixed since it would set an unfortunate precedent and an arbitrary approach to supervision.

PL:
WK 3312/2021 - Subject: MiCA: Markets in Crypto-Assets - Non-paper from the RO delegation on monetary sovereignty

Poland agrees that the use of crypto-assets as provided by MiCA proposal should not interfere with the right to regulate the use of domestic currency provided by the national framework. For this reason we strongly support the notion of including in MiCA Regulation a specific provision which would confirm this fact.

WK 4352/2021 - Subject: MiCA - Presidency discussion note following up on 18th March meeting on Title III/ART

We have the following objectives in mind regarding this issue:

- Crypto assets to be used for payment should have a construction that is as simple and transparent as possible in order to minimise the risks for the holders. Therefore the CAs that are most suitable for use as means of payment are the EMTs.
- Supervisory authorities and central banks should have tools at their disposal to react during the life of a crypto-asset if the crypto asset in

question starts to fulfil the functions of money (payment, saving, unit of account) at a scale that impairs monetary transmission and/or monetary sovereignty. Such impairment may result if the use of the CA in question amounts to a currency substitution phenomenon (a “dollarization” phenomenon).

- The tools mentioned in the previous bullet should be able to generate economic burdens that can limit the scale of issuance. Such tools can include capital add-ons.
- Supervisory authorities should have the ability to react if a particular crypto asset becomes used as a means of payment and be able to impose additional requirements, in order to bring the regulatory treatment of that crypto asset in line with the treatment of other CA which are treated as used of payment purposes since their creation (reclassification power).
- The national powers, which aim to implement regulatory measures requiring certain payments to be made in national currency only, should not be impaired by the introduction of MICA (in comparison to the current EU acquis).
- Both options presented by the presidency should be further explored and the discussion should proceed based on more detailed proposals.
- In our view option B (also in the context of the Joint discussion paper – Asset-backed crypto-assets used as a means of payment) remains unclear and requires further explanation.
- For example, it seems to us that requiring an ART (asset referred token) to be redeemed at 1:1 of the initial price paid (in single currency) would in fact forbid the issuance of ART with payment purposes. With such requirement in place holding reserve assets denominated in many currencies wouldn’t make sense (not to mention the operational complexity stemming from hedging) and any potential issuer of crypto-assets designed for payment purposes would simply issue EMT. If this is the underlying idea behind the option B, then we suggest to explicitly allow only EMT to be used as a means of payment.
- We are of the view that ARTs used for investment purposes should not be forbidden to refer in part to official currencies.
- Moreover, it is also unclear, whether options A and B are mutually exclusive. Bearing this in mind, in order to comment on the latter a more detailed explanation of such option is required. Nonetheless, for the time-being we prefer the approach A. In our view empowering central banks or competent authorities with tools generating incentives for the issuer to limit the scale of CA issuance could be sufficient to safeguard monetary

sovereignty.

- Nevertheless, having in mind current trends in payments and development of innovative payment solutions, ARTs with payment purposes should be taken into account in MiCA, together with central bank powers to specify requirements for these ARTs. It has to be mentioned that there is ongoing ECB framework on payment schemes and arrangements which focuses on other payment assets than funds (i.e. PISA framework). In view of that, central banks do recognize these trends and appropriately address risks and regulatory efforts to ensure confidence in money and safety of users. Furthermore, the potential prohibition of issuance/use of ART with payment purposes could not be achievable, bearing in mind that differences between specific payment solutions (allowed and prohibited) may be blurred, consequently providing to circumvent this prohibition.

HU:

- Regarding the proposed two ways forward in the discussion note on ART, we support Option A.
- We welcome and overall support the joint discussion paper on asset-backed crypto-assets used as a means of payment. Our comments are as follows:
 1. Regarding the scope of ARTs, we initially thought that the definition was too broad, but the arguments detailed in the non-paper convinced us to support the proposed approach that is clear and can be indeed future-proof.
 2. We support to distinguish payment ART and investment ART as we did that in the previous meetings too. On the option proposed, we have not yet formed our position at the meeting as we were still analysing them. We would like to indicate our preference now, we support Option 2.
 3. Regarding the redemption right, we agree that EMT and payment ART should be redeemed at par value as they have payment functions. However, we would like to highlight that in case of investment ART the redemption should be performed at market value, because its primary purpose is investment.
 4. We support aligning the rules for payment ART with the EMT regime.
 5. We support introducing a mechanism for re-qualification of ARTs since it seems to be a good safeguard, and we think that the transitional regime is an important point which should be elaborate in details in level 1.

End

Non-paper by Croatia
Systemic risks in the MiCA proposal

Key remarks

- There are functional similarities between asset-referenced tokens (ARTs) and electronic money tokens (EMTs) on one hand, and Money Market Funds (MMFs) and Exchange traded Funds (ETFs) on the other;
- While the risks displayed by these new instruments are similar to well-established financial instruments, the mitigating policies for these well-known risks are not present in the proposed regulation, or are, at the very least, insufficiently developed;
- It appears that the proposed framework fails to address known weaknesses in terms of procyclicality of redemptions and contagion through fire sales which are well understood in very closely related instruments like ETFs and MMFs, without providing sufficient safeguards
- This has material implications in terms of financial stability;
- There may be an apparent policy mismatch between the MiCA proposal for ARTs/EMTs and what is being discussed when it comes to MMFs (in the upcoming MMF review);
- By dictating revenue models the MiCA proposal incentivises moral hazard and creates distorted incentives.
- The MiCA proposal creates regulatory arbitrage, and also may unnecessarily limit the use of DLT infrastructure by currently established financial instruments.

1. Introduction – the purpose of the non-paper

One of the key objectives of the Markets in Crypto-Assets Regulation (“MiCA”) is to **develop a sound legal framework**, clearly defining the regulatory treatment of all crypto-assets that are not covered by existing financial services legislation and to **support innovation**, thereby **increasing**

the competitiveness and attractiveness of EU. However, any new legislation will introduce various incentives into the financial system and these incentives need to be carefully balanced.

This non-paper focuses on the functional similarities between asset-referenced tokens (ARTs) and electronic money tokens (EMTs) on one hand, and Money Market Funds (MMFs) and Exchange traded Funds (ETFs) on the other. It argues that while the risks displayed by these new instruments are similar to well-established financial instruments, the mitigating policies for these well-known risks are not present in the proposed regulation, or are, at the very least, insufficiently developed. This constitutes a regulatory gap, which has material implications in terms of **financial stability**.

This non-paper **describes the nature of the perceived inherent risks**.

2. What are the risks?

The MiCA proposal defines 'crypto-asset' as a *digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology*. This seems to imply that suggests that the medium of custody (not the functional characteristics) are the defining aspects of these instruments; that somehow the fact that they are recorded on a DLT changes the nature or risks of said instrument, compared to the recording on a traditional ledger. While this may be relevant in terms of settlement processes, it hardly applies to the nature of the financial obligations encoded in the instruments.

From a functional perspective, ARTs are equivalent to a promise to deliver to the investor the performance of a predefined index. From this perspective – and with all the due legal differences – an ARTs behaves like units of listed indexed funds, i.e. ETFs. Similarly, EMTs are units of a vehicle invested cash-like instruments, with primary objective of capital protection, which appears to be closely related in nature to transferable units of Money-Market Funds (MMFs).

ARTs are a of crypto-asset that mirrors the performance of an index constituted of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets³. ARTs must be backed at all times by 'reserve assets', meaning the basket of fiat currencies that are legal tender, commodities or crypto-assets, backing the value of an asset-referenced tokens, or the investment of such assets⁴. Issuers of asset-references tokens shall at all times constitute and maintain a reserve of assets⁵, in segregated custody arrangements; the value of which must be in line with the value of the ART units.

In operational terms, the issuer will issue ART units against cash, use the cash to purchase the underlying assets (the value of which underpins the value of the ART units), and keep those assets in custody at all times, exactly like an asset manager managing an indexed fund.

The main difference is that whereas asset managers of traditional funds act in an agency capacity, meaning that any and all capital gains or losses are borne by the investors, ART issuers are mandated to issue units as liabilities against own capital, and therefore to underwrite in full any shortfall between the value of the reserve assets and the indexed value of the ARTs units⁶. This forces the unit issuer to act in a principal capacity, in the same way a bank is required to do with regards to deposits. To cover the contingent liabilities from investment losses crypto-asset issuers are required (like banks) to hold CET1 capital to the amount of 2% of ART assets⁷.

Finally, Art 35.4 bis clarifies that: *Where the market value of asset-referenced tokens varies significantly from the value of the reference assets or the reserve assets, the holders of asset-referenced tokens shall have the right to redeem the crypto-assets from the issuer of crypto-assets directly. In that case, any fee applied for such redemption shall be proportionate and commensurate with the actual costs incurred by the issuer of asset-referenced tokens.* ART issuers must disclose value of ART units and reserve assets every month, and

³ Art 3.3

⁴ Art 3.21

⁵ Art 32.1

⁶ Art 34.3 specifies that: All profits or losses, including fluctuations in the value of the financial instruments referred to in paragraph 1, and any counterparty or operational risks that result from the investment of the reserve assets shall be borne by the issuer of the asset-referenced tokens.

⁷ Art 31

set own funds to the 6-months rolling average of the reserve assets⁸. Furthermore, they are not allowed to pass on to investors any form of treasury income⁹, and can (must) actually keep all and every investment income. This requirement by itself precludes the running of traditional funds on the blockchain.

These requirements are troubling: rapidly growing reserve assets, due to the rolling average mechanism, can easily determine a significant shortfall in own funds, at a time where poor investment returns (or execution shortfall) on reserves cause a loss to the crypto-asset issuer, which becomes apparent at the time of the monthly NAV publication, triggering widespread redemptions, the collapse of the issuer (and with it any other ART issued), loss of confidence by investors on ARTs in general, and fire sale of assets in the market.

The prohibition on the rehypothecation of reserves makes the use of repos and derivatives unviable to manage liquidity strains, further complicating the liquidity, execution shortfall, and liquidation problems.

Additionally, the framework introduces significant moral hazard by **setting clear economic incentives for issuers to increase the investment risks related to the asset reserves to generate treasury income**, against very thin own funds. This is due to the fact that, unlike for traditional funds, there is no room for ongoing management fees or equivalents, only transaction fees; and therefore treasury income from reserves becomes the main source of revenues¹⁰.

In other words, ARTs appear to be fragile by construction, and prone to strong procyclicality in the event of investment losses, mismanagement, or simply liquidity demands.

⁸ Art 26 & 31

⁹ Art 36

Incidentally, **this business model is threatened by the current low interest rate environment**. For example, in the case of a Euro-linked ART the issuer would need to maintain a valuation at par with the Euro, but most likely all investible instruments would yield negative returns. Without a steady income from management fees the issuer would need to either run increased credit risk, or soon face losses.

EMTs are like ARTs *the main purpose of which is to be used as a means of exchange by maintaining a stable value by referring to the value of a fiat currency that is legal tender*¹¹. These have the same functionalities as zero-interest, transferable bank drafts which can be converted into cash at any moment. For this reason they have even more stringent limitations on the type and investment of reserve assets. As ARTs they share all the risks highlighted above; but as quasi-bank drafts they have additional risks. The first is the very limited tolerances in terms of acceptable valuation slippage by consumers, in terms of unit value; which in turn will make mass-redemptions more likely in the event of a shortfall, even small. This is exacerbated by the requirement of multiple listings, which will increase the likelihood of sub-par pricing somewhere, and therefore multiplies triggers to redemptions. The second is the further heightened vulnerability to low rate environment from the very restrictive reserve management rules. Finally, the bail-in of service providers linked to the tokens only spreads the contagion¹².

Concerns could also emerge if banks become issuers of EMTs in terms of deposit protection. A deposit in a bank is covered by the deposit protection scheme up to €100,000. But an EMT issued by a bank would with not be covered by the deposit protection scheme

¹¹ Art 3.4

¹² Art 44.7:

Where issuers of e-money tokens does not fulfil legitimate redemption requests from holders of e-money tokens within the time period specified in the crypto-asset white paper and which shall not exceed 30 days, the obligation set out in paragraph 3 applies to any following third party entities that has been in contractual arrangements with issuers of e-money tokens:

- (a) entities ensuring the safeguarding of funds received by issuers of e-money tokens in exchange for e-money tokens in accordance with Article 7 of Directive 2009/110/EC;
- (b) any natural or legal persons in charge of distributing e-money tokens on behalf of issuers of e-money tokens.

(making it prone to runs), or according to another interpretation, exposing the bank capital to the full volume of issued EMTs, circumventing the limits of the €100.000 cap.

3. Conclusion

In conclusion it appears that the proposed framework fails to address known weaknesses in terms of procyclicality of redemptions and contagion through fire sales which are well understood in very closely related instruments like ETFs and MMFs, without providing any additional safeguards.

Furthermore, by dictating revenue models it incentivises moral hazard and creates distorted incentives. Finally, by defining assets based on the technology supporting the custody, it creates regulatory arbitrage, on the one hand, but also precludes the use of DLT infrastructure by currently established financial instruments on the other as an existing MMF or ETF could not use DLT because the MiCA investment policies are incompatible with UCITS or MMFR.

This means that they would rely exclusively on the DLT Pilot Regime, which is insufficiently developed to address the issue.