

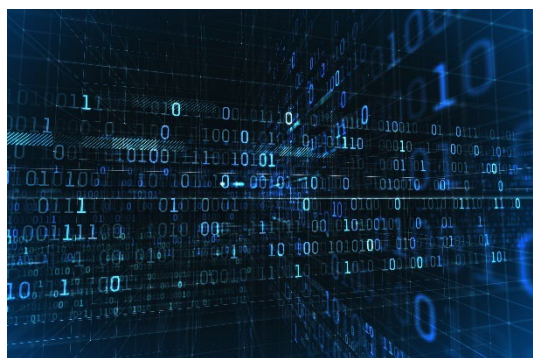
# Non-EU countries' regulations on crypto-assets and their potential implications for the EU

## SUMMARY

The EU adopted a comprehensive and innovative regulatory framework on markets in crypto-assets (MiCA) in June 2023 that will regulate crypto-asset markets. The regulation focuses on stablecoins, which are crypto-assets promising a 'stable value' against official currencies or values. The MiCA provides for strict transparency and governance rules, on the one hand, and prudential rules as per other financial institutions, on the other. By covering all aspects of the crypto-assets, MiCA is expected to enhance citizens' protection, financial stability, innovation and financial inclusion. However, EU Commissioner Mairead McGuinness has reiterated her concern over financial stability as regards the lack of regulation in third countries.

The United Kingdom has adopted comprehensive legislation on crypto-assets, with a strong commitment to become a 'crypto hub' and attract global activities. However, the new law does not enact detailed regulation which is left to the national financial authorities. In the United States, crypto-assets are subject to the financial markets supervisor, if they qualify as a security. However, the various cases have proved that such qualification could vary, creating legal uncertainty. Moreover, the applicable regulation is that for securities, not financial institutions. Recent debates have given rise to more stringent and protective regulation being envisaged by legislators.

Academics and international organisations have warned of the instability effects on the financial system of stablecoins, and the need for tight transparency requirements as well as effective international coordination and cooperation. However, tighter regulation in the EU as compared with that in third countries may have adverse effects on the development of crypto-asset markets. Overall, there is evidence that a tighter regulatory framework has limited but positive effects on crypto-assets markets. Therefore, the EU's regulatory action should bring benefits overall, while third-party policy action is still needed to complement and strengthen financial stability.



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## Introduction

The EU [Regulation](#) on markets in crypto-assets – also known as the [Markets in Crypto-assets Act \(MiCA\)](#) – was adopted in June 2023 and will come into application gradually up to December 2024. The MiCA defines crypto-assets as digital representations of values or rights, storable and transferrable electronically, using digital ledger technology (DLT).<sup>1</sup> The regulation is part of an overarching EU [digital finance strategy](#) comprising a complementary regulation for a [DLT pilot regime](#) for market infrastructure, which establishes a scheme to trade and settle transactions involving financial instruments in crypto-asset form.<sup>2</sup>

In this sense, the successful adoption of the MiCA is a part of the [Commission's agenda](#) to develop the European digital finance sector to 'reinforce the EU's open strategic autonomy in financial services', and reflects the goals of the EU's capital markets union (CMU) action plan of further financial integration between the Member States.

Among all crypto-assets, the MiCA focuses especially on those known as 'stablecoins', which are crypto-assets promising stable value against an official currency – e.g. US dollar, euro, British pound and Japanese yen – or a basket of currencies or values.<sup>3</sup> By removing price movements, stablecoins represent a serious alternative means of payment to be considered, especially in the international context.

The legislative package responds to regulatory gaps that became further [apparent](#) with the 2022 [collapse of the FTX](#) exchange. The collapse demonstrated the volatility and risk of fraud and manipulation present in crypto markets. The legislation is designed to protect consumers and investors, as well as the financial system, from instability. By harmonising the previously fragmented regulatory regimes into a sound and predictable legal environment, the EU law is also meant to create a larger market for crypto-assets that promotes issuance and operations within the EU.

The objectives sought [range from](#) fostering new sources of funding for European companies, especially small and medium-sized enterprises (SMEs) and providing EU consumers and investors with new means of exchange and investment opportunities to [promote](#) EU financial technology (FinTech),<sup>4</sup> safeguarding against the dominance of large technological companies in the FinTech industry and financial services at large in the EU, as well as developing EU-based DLT infrastructure through the pilot regime.<sup>5</sup>

### Box 1 – Definitions of crypto-asset in the EU's MiCA, Article 3

**'Crypto-asset'** is the generic terminology for a 'digital representation of value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology'.

**Stablecoins** are a crypto-asset backed by underlying assets, such as an official currency such as the euro, and promising a stable value against this asset.

The MiCA distinguishes between **'e-money tokens' (EMTs)**, which reference one official currency to maintain stable value, and **'asset-referenced tokens' (ARTs)**, which are non e-money tokens that reference another value or a right including one or more official currency.

Under the MiCA, most issuers of stablecoins will have to be incorporated in the form of a legal entity established and authorised in the EU in order to operate, and publish a crypto-asset white paper that explains what the product is and how they operate, approved by a competent authority. Similar requirements apply to issuers of EMTs within the meaning of Article 2(1) of [Directive 2009/110](#) ('the e-Money Directive'). The MiCA also distinguishes 'significant' ARTs from other ARTs which will be under the direct supervision of the European banking Authority (EBA). Although the MiCA already sets tighter management rules on crypto-assets, the details have still be designed by the EBA and the European Securities and Markets Authority (ESMA).<sup>6</sup>

Given the progress made by the EU in the form of the MiCA and the gap created with some other crypto-asset markets, European Financial Services Commissioner Mairead McGuinness has [called](#) on non-EU countries to pass legislation to regulate crypto-assets, [adding](#) that the EU's new regulatory framework will be 'useless' without global efforts.

## United States

In the United States (**US**), the Howey test (see Box 2), developed in 1946 following a Supreme Court decision,<sup>7</sup> is the legal test for determining whether an instrument qualifies as an 'investment contract' security under the [Securities Act \(1933\)](#). The [first application](#) of the Howey test (see Box 2) on an initial coin offering (ICO) took place in 2017.<sup>8</sup> In this context, the [Securities and Exchange Commission](#) (**SEC**)<sup>9</sup> has emerged as the key regulator in the US, introducing a [framework](#) for 'investment contract' analysis of digital assets in 2019 to help classify which digital assets are considered securities.

### Box 2 – Crypto-assets under US jurisdiction

An essential component of SEC jurisdiction has been the '[Howey test](#)', a 1946 Supreme Court decision applying to the Securities Act (1933), which declares a scheme to be an 'investment contract' under the Securities Act – implying SEC jurisdiction – if 'the scheme involves (a) an investment of money (b) in a common enterprise (c) with profits (d) to come solely from the efforts of others. If that test was satisfied, it is 'immaterial whether the enterprise is speculative or non-speculative, or whether there is a sale of property with or without intrinsic value.'

If a crypto-asset falls outside the scope of SEC supervision as defined by the Howey test, it may be considered a commodity, falling under the supervision of the [Commodity Futures Trading Commission](#) (**CFTC**), in charge of derivative instruments – i.e. instruments delivering assets in the future at some predetermined price. Crypto-assets falling under the commodity category are [supervised](#) by the CFTC when they are used in derivatives contracts, or when there is fraud and manipulation in interstate commerce.

Nevertheless, regulatory and supervisory ambiguities prevail in the US. For instance, while there is [consensus](#) among regulators that Bitcoin should not be considered a security, the approach to the second biggest token – Ether – varies. Ether was first regulated as a security, then it was considered sufficiently decentralised as to be deemed a commodity. Recently, SEC chair Gary Gensler [stated](#) that the possibility to earn interest on these tokens might bring it back under SEC jurisdiction. In short, the debate over which crypto-assets should be classified as securities is ongoing in the US.

The lack of a federal-level crypto-asset regime has allowed substantial divergence among states, which have adopted a variety of regulatory approaches, causing the US crypto-asset markets to be fragmented. For instance, the State of New York introduced a '[BitLicense](#)' in 2015, requiring crypto currency exchanges to share in-depth information about their operations with the New York State Department of Financial Services and to fulfil 'know-your-customer' requirements, for the purposes of combating money laundering. Following the introduction of the 'BitLicense', [many firms](#) left the state, which otherwise serves as a US financial centre, because of compliance costs acting as disincentives to crypto start-ups and also because of firms' and investors' disappointment at the lower anonymity levels. At the other end of the regulatory spectrum, the State of [Wyoming](#) sticks out as a 'crypto-friendly' state, opting for a beneficial legal status for blockchain technology firms in the form of 'decentralized autonomous organizations', a type of limited liability company, and enabling banks to provide blockchain-based services. Moreover, several states have introduced [regulatory sandboxes](#) of varying scopes, allowing authorised companies to test their crypto-asset services in intra-state markets.

## Federal legislative proceedings

The March 2022 [Executive Order on Ensuring Responsible Development of Digital Assets](#) showed that crypto-assets had the attention of the Biden administration, setting out its policy objectives and commissioning a number of inter-agency reports on related topics ranging from the role of digital assets in fostering financial inclusion and central bank digital currency to the cybersecurity and anti-money-laundering implications of digital assets. [Key policy objectives](#) set out by the White House since the executive order have focused on financial stability and investor protection, not least in the light of turbulence on crypto-markets throughout 2022. Other priorities set by the Biden administration include expanding regulators' powers against misuse of customer assets by crypto exchanges, highlighting environmental effects of energy use by some crypto-assets, and raising cybersecurity concerns, particularly following significant [crypto hacker looting](#).

Pressure on Congress to pass legislation on crypto-assets has not been successful thus far. Stablecoin has been a [particular priority](#) set by the US Treasury, which has recognised their potential benefits as means of payments while urging Congress that more oversight is needed. An [unpublished stablecoin bill](#) drafted by a bipartisan group of lawmakers in September 2022 sought to ban the issuance of tokens not created by an approved subsidiary of an insured depository institution or by a licensed non-bank entity, requiring issuers to obtain a licence and keep reserve collateral, such as short-term government bonds (Treasury bills).

Another 2022 bipartisan bill, originating in the US Senate, is the [Lummis-Gillibrand Responsible Financial Innovation Act](#), which aimed to give jurisdiction over 'digital assets', principally stablecoins, to the Commodity Futures Trading Commission (CFTC) by amending the 1936 Commodity Exchange Act. In so doing, this proposed bill [would transfer nearly all](#) supervisory jurisdiction over stablecoins, some of which are currently considered securities in the US context, from the SEC to the CFTC. While giving legal certainty to the status of 'digital assets' and clarifying regulations for stablecoin issuers, the bill addressed environmental concerns only sparsely and left options open to state lawmakers for regulatory divergence, including giving stablecoins broader definitions and starting sandboxes.

Finally, a [draft bill](#) released in June 2023 by Republicans in the House of Representatives proposed to delineate responsibilities clearly between the SEC and CFTC, building on the Howey test as a determinant and ensuring that the most decentralised crypto-assets fall under clear rules.

## Stakeholder and expert opinions

Until the US Congress passes legislation, the US has a [fragmented regulatory landscape](#) with wide variation in state-level requirements and an evolving degree of clarity as to what is under the jurisdiction of the SEC. From the point of view of legal clarity and regulatory certainty, this is a drawback for the prospects of the US market and capacity of federal agencies to regulate, even as the vast majority of crypto-assets remain backed by the US dollar. To some US policymakers, the EU is a regulatory forerunner and SEC Commissioner Hester Peirce [has called](#) the MiCA a good starting point that could work as a model for the US, lamenting that the US is being penalised by the absence of a sound regulatory regime. US lawmakers behind the stablecoin bills presented in 2022 and 2023 [have also echoed](#) the opinion that the MiCA puts the EU a significant step ahead of the US, even though the timing of crypto-legislation in Congress remains uncertain.

The think-tank community in the US has echoed calls for federal regulation to be introduced to address the rise in crypto-assets. Some [experts](#) believe that the US must establish clear 'crypto guardrails or risk falling behind' other countries in innovation and market leadership, as the US is currently lagging behind. However, some US-based think-tanks, such as the [Center for American Progress](#), have expressed support for the regulatory status quo, advocating new legislation primarily to fill gaps. Since the SEC is [increasingly eyeing stablecoins](#) as potential securities, this approach would be a more stringent alternative.<sup>10</sup> Another US-based think-tank, the [Cato Institute](#), supported the federal legislative actions to harmonise the otherwise fragmented regulatory landscape across

the US. However, it proposes that federal legislation should respect the fact that stablecoins operate very differently from traditional banks and from money market mutual funds, since they operate in a substantially different manner. Moreover, regulating stablecoin issuers similarly to traditional financial institutions may at times result in taxpayers' emergency financial support provisions, for which there is no apparent justification. For the Cato Institute, a good regulatory framework would consist of ensuring basic asset-backing requirements and requiring a baseline for transparency.

## United Kingdom<sup>11</sup>

In 2016, the United Kingdom (UK) established a [regulatory sandbox](#) for FinTech under the [Financial Conduct Authority \(FCA\)](#).<sup>12</sup> It allows firms to test innovative propositions in the market with real consumers. The Bank of England is also strongly committed to setting up the [Future of Finance](#) project to keep track of new financial services technologies and look at how they might evolve over the next decade. The [Financial Services and Markets Act \(FSMA\)](#) was enacted in June 2023 to amend the 2000 Financial Services and Markets Act. It will replace and amend the EU law and give greater responsibilities to regulators. It also introduces [new chapters](#) on crypto-assets.

### Political positions and legislative proceedings

The UK government has made its intention to become a global crypto hub very clear, as initially [set out](#) by Rishi Sunak in 2022 when he was still Chancellor of the Exchequer. This commitment has led to the [development](#) of a new UK regulatory framework for scaling up and growing the stablecoin industry, adopting the principle of 'same risk, same regulatory outcome' and thus treating crypto-assets equivalently to other financial instruments.<sup>13</sup> In April 2022, the UK's government announced its [plans](#) to make the UK a 'global hub' for crypto-asset technology and investment. To that end, stablecoins would be recognised as a valid form of payment. Sunak announced measures to ensure that firms could invest, innovate and scale up in the UK. He argued that this needed effective regulation, to give firms the confidence they needed to 'think and invest long-term'.

In a May 2023 report, responding to the government's approach, the [House of Commons Treasury Committee emphasised](#) that the extent of the future benefits of the crypto-asset industry remained unclear, and that the government should seek a moderate approach towards it. The committee expressed scepticism about public resources being spent on developing crypto-asset activities, and argued that retail trading and investment activities in unbacked crypto-assets should be regulated in the same way as gambling. Nevertheless, the political landscape in the UK seems positive towards legislation in support of a growing crypto-asset industry, with Scottish National Party lawmaker Lisa Cameron, chair of a parliamentary group focused on crypto-assets, [predicting](#) that all major parties share an interest in a UK-based crypto industry developing.

Rather than pursuing a bespoke regime for a broadly defined group of crypto-assets as provided for in the EU through the MiCA, the UK has opted for [initial regulation](#) of a few specific crypto-assets, principally stablecoins under the term 'digital settlement assets'. This is part of the government's Financial Services and Markets Act (FSMA). FSMA [defines](#) 'crypto-assets' (see Box 3). The [focus](#) of the FSMA as regards crypto-assets is stablecoins, which it places under the supervision of the Financial Conduct Authority, the Bank of England, the Prudential Regulation Authority and the Payment Services Regulator at the request of HM Treasury. Additional measures support innovation

#### Box 3 – Crypto-assets in the UK's 2023 Financial Services and Markets Act

' "Cryptoasset" means any cryptographically secured digital representation of value or contractual rights that—

- (a) can be transferred, stored or traded electronically, and
- (b) that uses technology supporting the recording or storage of data (which may include distributed ledger technology).'

Moreover, 'The Treasury may by regulations amend the definition of "cryptoasset".'

in financial services utilising blockchain, such as a formalised digital sandbox programme, similar to the EU's DLT pilot regime.

The UK approach to testing the application of DLT technologies is channelled through the UK Financial Market Infrastructures sandbox (see Box 4), allowing participating firms to test their technologies and products by letting regulators temporarily suspend or amend laws, if not applying new ones. This has been welcomed by the [Association for Financial Markets in Europe](#), claiming that it has the potential to reach much broader participation than the EU's DLT pilot regime.

#### Box 4 – UK financial market infrastructure sandbox

The UK Financial Services and Markets Act (FSMA) was adopted in June 2023 and envisages the establishment of a financial market infrastructure (FMI) sandbox. Just as for the EU DLT pilot regime, the intention of the FMI sandbox is to facilitate the development of homegrown market for DLT infrastructure. It would allow the government to permanently implement successful sandboxes even before their expiry, converting the sandbox's temporary regulations into law. The regulatory changes would be applicable not only to the registered participant in the sandbox, but also to overseas providers. This considerable degree of flexibility goes further than the EU DLT pilot regime. However, the success and scope of the law will also be determined by the Treasury's application of the powers granted to it. Finally, some [observers](#) believe that the FMI sandbox would promote innovation.

## Stakeholder and expert opinions

The [Financial Conduct Authority \(FCA\)](#), whose current regulatory powers are centred on making sure that crypto-asset firms operating in the UK comply with anti-money-laundering and counter-terrorism legislation, has called on the government to give it more power to regulate crypto-assets. FinTech founders have [levied criticism](#) against the FCA's crypto-asset practices, characterising its licensing approvals as slow, leading to low confidence in the goal set by the government to be a world leader in crypto-assets. According to a UK-based crypto-asset lobby group as reported by the [Financial Times](#), four in five firms that applied to register with the FCA have withdrawn their applications and moved offshore, but are still able to service UK clients from abroad, meaning that regulatory power is lost. This consequence is one of many difficult trade-offs faced by UK lawmakers in pursuing their goals of being a global crypto-asset growth hub. The FCA, [countering claims](#) that it is against crypto-assets, stated that it had supported more than 800 firms by April 2023, noting that it had greatly reduced its backlog of authorisations for crypto-asset firms and emphasising the UK's 'relative regulatory freedom' following its withdrawal from the EU.

Table 1 – Overview of crypto-asset regulation in place in the EU, the UK, and the US

|                          | European Union                                                                       | United Kingdom                                                            | United States                                                 |
|--------------------------|--------------------------------------------------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------|
| Crypto-securities        | Yes, MiFID and MiFIR                                                                 | Yes                                                                       | Yes, Securities Act, schemes qualifying under the Howell test |
| Other crypto-assets      | Yes, MiCA 2023                                                                       | Yes, FSMA 2023                                                            | No                                                            |
| Regulation on stablecoin | Yes, the MiCA established the regulatory framework. More details to be ruled by EBA. | Yes, FSMA provides that the regulator will establish the whole framework. | No                                                            |

Source: Compiled by the authors.

According to a study conducted for the European Parliament, [significant divergence](#) can be expected over the coming years between the UK and the EU in terms of how crypto-assets are identified. For the authors, given the emphasis by the UK government on digital finance and crypto-

assets as a growth area for the UK financial centre, and given recent failures and fragility in the crypto space, this is certainly an area where divergence, uneven level playing fields and regulatory arbitrage should be carefully watched. A particular source of potential future regulatory divergence vis-à-vis the EU is the [common law](#) principles-based approach the UK is increasingly applying to financial regulation, producing less certainty with regard to final regulatory outcomes than the EU bespoke regime.

## Other jurisdictions

Zooming out to look at the [global regulatory landscape](#), countries are taking a great variety of approaches to the rise of crypto-assets; at least 19 sovereign jurisdictions have taken action on them so far. Extremes range from China's comprehensive ban on all non-state activities, including the provision of trading services and private DLT infrastructure, to the previously discussed gradual and uncertain application of existing regimes to these novel instruments, as in the US. In providing a bespoke regime, however, the EU is taking a unique regulatory approach to crypto-assets, but one of many pursuing the potential gains of crypto-assets such as stablecoins while hoping to strike a balance between mitigating risk and incentivising innovation.

Table 2 – State of regulation on stablecoins in the world

| Jurisdiction                | State of regulation                  |
|-----------------------------|--------------------------------------|
| <b>United States*</b>       | Final legislation pending            |
| <b>United Kingdom**</b>     | Final legislation pending            |
| <b>Australia</b>            | Process initiated/plans communicated |
| <b>Bahamas</b>              | Stablecoin regulation in place       |
| <b>Canada</b>               | Final legislation pending            |
| <b>Cayman Islands</b>       | Stablecoin regulation in place       |
| <b>European Union***</b>    | Stablecoin regulation in place       |
| <b>China (mainland)</b>     | Prohibition/ban                      |
| <b>Gibraltar</b>            | Stablecoin regulation in place       |
| <b>Hong Kong</b>            | Final legislation pending            |
| <b>Japan</b>                | Stablecoin regulation in place       |
| <b>Mauritius</b>            | Stablecoin regulation in place       |
| <b>Qatar</b>                | Prohibition/ban                      |
| <b>Saudi Arabia</b>         | Prohibition/ban                      |
| <b>Singapore</b>            | Final legislation pending            |
| <b>South Africa</b>         | Final legislation pending            |
| <b>Switzerland</b>          | Stablecoin regulation in place       |
| <b>United Arab Emirates</b> | Final legislation pending            |

\* Draft bills introduced in Congress, but no progress made in committee as of yet. \*\* Adopted in June 2023; \*\*\*MiCA adopted, to enter into force in 2024.

Source: Bank for International Settlements, [Crypto, tokens and DeFi: navigating the regulatory landscape](#), 2023.

One example of a more stringent approach is that taken by Japan, which adopted a new regulatory framework on crypto-assets that has been in force since June 2023. The [Japanese framework](#), like that of the UK, does not provide for a bespoke regime, instead utilising existing legislation to guarantee investor rights by holding intermediaries of stablecoins responsible for promising redemption at par and complying with anti-money-laundering and user data protection laws. The stringency comes from the Japanese [Financial Services Agency's](#) indication that overseas issuers of electronic payments instruments would need to maintain assets in Japan equivalent to the

stablecoins in circulation in the country. These requirements, if implemented, would make it more difficult for overseas issuers to operate in Japan.

## International coordination

The [International Organisation of Securities Commissions](#) (IOSCO)<sup>14</sup> is proceeding with developing global standards. In May 2023, IOSCO issued 18 principles-based and outcomes-focused [recommendations](#) covering six key areas, namely:

- 1) conflicts of interest arising from vertical integration of activities and functions;
- 2) market manipulation, insider trading and fraud;
- 3) cross-border risks and regulatory cooperation;
- 4) custody and client asset protection;
- 5) operational and technological risk; and
- 6) retail access, suitability, and distribution.

The G7 has mostly been concerned with digital currencies. The Group's [communiqué](#) of October 2021, recognises that strong international coordination and cooperation would help to promote innovation that delivers domestic and cross-border benefits. It expresses a shared commitment to regulate crypto-assets such as stablecoins, observing that hardly any convergence on the regulation of crypto-assets is taking place. On this occasion, the G7 also published [public policy principles](#) for digital currencies, setting out general principles divided into 'foundational issues' and 'opportunities'.<sup>15</sup>

The [Bank for International Settlements](#) (BIS) has noted that crypto-assets by nature lend themselves to regulatory and supervisory 'arbitrage' – i.e. opting for more favourable and less stringent regulatory and supervisory environments – given that their function and purpose is closely linked with cross-border financial transactions.

## Potential implications for the EU

In a 2020 analysis, Saule Omarova of Cornell Law School [argued](#) that FinTech is working as a disrupting force to the currently dominant technocratic model of financial regulation. In the FinTech area, the financial system as a whole is growing ever bigger, moving ever faster, and getting ever more complex and difficult to manage. While these changes operate on the 'macro level', responses continue to operate primarily on the 'micro level'. She thus suggests that reform options should target the core macro-structural, as opposed to micro-transactional, aspects of the FinTech challenge – and do so in a more 'assertive, comprehensive, and normatively unified manner'. The EU's renewed efforts combined with third parties' regulatory actions are likely to contribute to assertive, comprehensive and unified regulation. Nevertheless, there are yet several channels through which the EU's financial system and autonomy is still at risk as it remains dependent on non-EU countries' policy actions in the context where the MiCA is applicable.

## Financial stability

Current regulation in non-EU countries raises questions about financial stability, since the global financial institutions may be unable to cope with large price variations – volatility – and the losses incurred by shocks in crypto-asset markets.

The interconnectedness of global financial markets, the potential for regulatory arbitrage and the decentralised features of certain crypto-assets do create the necessity for a degree of convergence in regulation between key jurisdictions. Commissioner Mairead McGuinness has highlighted the need for such interconnectedness, [urging](#) non-EU countries to legislate on crypto-assets as the EU has. A [paper](#) published in 2020 by the Crypto-Assets Taskforce of the European Central Bank (ECB)<sup>16</sup> showed that if stablecoins were to become a large scale means of payment, the fragility of the stablecoin system could give rise to [financial stability risks](#), with liquidity runs and contagion effects being the most notable effects. Runs on stablecoins, which could occur if users lose confidence in

them, would result in the halt of exchange, similar to the phenomenon observed in 2007 in the interbank markets. The paper concludes that crypto-assets markets could thus create risks on sovereign debts through large price volatility, since stablecoins are essentially backed by sovereign short-term debts. Banks may also experience deposit withdrawals and reputational risks, with potential contagion effects. For the ECB, efforts to regulate and supervise stable crypto-assets must be complemented by international coordination and cooperative oversight.

There is growing scientific evidence of the volatility spill-over from stablecoins to other classical markets. Using the case of the Tether stablecoin, a recent paper in the academic journal [Economic Letters](#) provides empirical evidence of the contagion effect from stablecoins to other markets.<sup>17</sup> Its authors conclude that there is a need to strengthen disclosure by and liquidity management of stablecoins to avoid market movements with unpredictable consequences as crypto-asset markets grow in size. The International Monetary Fund (IMF) [has found evidence](#) that spill-overs between crypto and equity markets are increasing, highlighting the degree of interconnectedness that may be rising among markets exposed to crypto-assets.

On an [IMF blog](#) post, some scientists insist that the links between crypto-asset markets and the regulated financial system are rising. The financial stability risks posed by these assets could soon become major risks for the whole financial system – also known as 'systemic risk'. The lack of coordination of regulatory measures is a risk factor because it facilitates potentially destabilising capital flows. For the authors, it is essential that the global regulatory framework provide a level playing field with three elements, including the licensing of service providers,<sup>18</sup> tailored to the main utilisation purposes of stablecoins,<sup>19</sup> and authorities should provide clear requirements for other financial institutions subject to regulation as regards their exposure to crypto-assets.

## Crypto-asset market attractiveness

The second effect of uneven regulatory approaches of crypto-assets is that issuers will take decisions to issue and trade in jurisdictions according to their regulatory regime. They may opt for a more lenient regulatory environment or become more active in environments where the investor/customer base is broader thanks to more protective regulatory standards and supervision. In their seminal [empirical analysis](#) of the 2015-2018 period, researchers at the Bank for International Settlements showed how valuations and transaction volumes reacted to regulatory action announcements. They showed that news pointing to the establishment of specific legal frameworks gave rise to strong market price gains. These results suggest that cryptocurrency markets rely on regulated financial institutions to operate and that these markets are segmented across jurisdictions, bringing cryptocurrencies within reach of national regulation.<sup>20</sup> In another empirical study published in 2020 in the [Journal of Financial Regulation](#),<sup>21</sup> two academics from the Wharton School of the University of Pennsylvania found no empirical evidence that regulation had an impact on market activity. They analysed a wide range of policy announcements worldwide and found that regulatory measures did not generate any capital flight nor inflows of trade. According to the authors, the results contradicted the idea that implementation of protective measures cause fear. Therefore, the MiCA is tending to have expected positive effects by having formed a crypto-asset enhanced business environment with market appeal.

## Digital currencies

An additional effect of stablecoins relates to their growing utilisation as a means of payment. Think-tanks such as Bruegel [have noted](#) that digital currencies issued by central banks constitute a potential response to the rise of crypto-assets as means of exchange, signalling concern over both financial stability and sovereignty of the monetary system. Almost a hundred central banks, including the ECB, are actively exploring digital currencies to leverage the potential gains from DLT while maintaining control over digital payments. [Academics](#) from the Frankfurt School Blockchain Centre have also predicted that a digital euro could meet the needs of EU customers interested in crypto-assets as a means of exchange, whereas US demand could be served by existing stablecoin

instruments. Their argument relies on the observation that euro-denominated stablecoins are 'quasi non-existent' as opposed to the dollar-denominated stablecoins that represent the vast majority of these assets, and that blockchain infrastructure in the EU is lagging behind both China and the US. However, a [survey](#) conducted by the Cato Institute indicated that while 16 % of Americans want digital currencies, nearly half of the interviewees expressed no opinion, which would support this hypothesis. However [public consultations](#) on the digital euro have also shown scepticism from citizens, so it is not clear whether stablecoins would more appropriately be replaced by digital currencies in the EU than the US.

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## ENDNOTES

- <sup>1</sup> The MiCA defines DLT as 'a type of technology that support the distributed recording of encrypted data'. [Blockchain](#) is a type of DLT made of chains of blocks, where each block contains a pool of transactions. The Bank for International Settlements [specifies](#) that DLT refers to the 'protocols and supporting infrastructure that allow computers in different locations to propose and validate transactions and update records in a synchronised way across a network'.
- <sup>2</sup> The pilot regime follows the 'sandbox' approach that allows for temporary derogations from some specific requirements. [Regulatory sandboxes](#) are defined as 'concrete frameworks which, by providing a structured context for experimentation, enable where appropriate in a real-world environment the testing of innovative technologies, products, services or approaches – at the moment especially in the context of digitalisation – for a limited time and in a limited part of a sector or area under regulatory supervision ensuring that appropriate safeguards are in place'. The pilot regime was [launched](#) in March 2023.
- <sup>3</sup> For clarity, Bitcoin is not a stablecoin.
- <sup>4</sup> FinTech, also spelled Fintech, stands for 'financial technology' and is a [term](#) used to refer to technology-based systems – and by extension, the firms providing such systems – that deliver innovative and cheaper financial services directly to end users or make traditional financial business more efficient. Fintech services and products include cashless payments, peer-to-peer lending platforms, robotic trading, crowdfunding, and virtual currencies.
- <sup>5</sup> In addition to these DLT based assets, central banks are considering the issuance of DLT official currencies, known as 'digital currencies'. The Commission has launched an [initiative](#) for a [digital euro](#) and tabled a [proposal](#) in June 2023. Although based on DLTs, digital currencies should not be confused with crypto-assets.
- <sup>6</sup> The regulatory technical standards will be designed by EBA and ESMA and implemented with [implementing acts](#).
- <sup>7</sup> US Supreme Court, [SEC v W.J. Howey Co., 328 U.S. 293 \(1946\)](#).
- <sup>8</sup> For more detail about ICOs, see, A. Delivorias, [Understanding initial coin offerings: A new means of raising funds based on blockchain](#), EPRS, European Parliament, July 2021.

- <sup>9</sup> The SEC was established by the [Securities and Exchange Act](#) of 1934 in the aftermath of the 1929 stock market collapse and during the Great Depression that followed. The SEC is an independent federal administration [tasked](#) with monitoring markets, enforcing securities laws, and developing new [regulations](#). The SEC has a [three-pronged mission](#): protect investors, facilitate capital formation, and maintain fair, orderly and efficient markets.
- <sup>10</sup> Similar [concerns were raised](#) in the EU ahead of the MiCA. The 'special set of rules' created a regime exempting assets that would have fallen under SEC jurisdiction in the US context and could make the EU national competent authorities struggle to regulate the more than 10 000 different crypto-assets that could potentially be registered in the EU.
- <sup>11</sup> The United Kingdom withdrew from the EU on 1 February 2020, and after the transition period, EU law ceased to apply to the UK on 1 January 2021. The Trade and Cooperation Agreement (TCA) governs EU-UK relations, but includes hardly any provisions regarding financial regulation. The [EU-UK memorandum of understanding on financial services cooperation](#) was [signed](#) in May 2023, providing for a bilateral exchange of views on regulatory developments as well as on transparency and cooperation. A detailed analysis of financial divergence can be found in: C. A. Petit and T. Beck, [Recent trends in UK financial sector regulation and possible implications for the EU, including its approach to equivalence](#), Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, February 2023.
- <sup>12</sup> The FCA regulates financial services firms and financial markets in the UK. It was [created](#) in 2013 taking over from the Financial Services Authority (FSA).
- <sup>13</sup> The same principle is in MiCA: 'Union legislative acts on financial services should be guided by the principles of "same activities, same risks, same rule" and of technology neutrality' ([Recital 9 MiCA](#)).
- <sup>14</sup> IOSCO is an [international body](#) that brings together regulators from around the world in the securities sector. It works intensively with the G20 and the Financial Stability Board (FSB) on the global regulatory reform agenda. [Board](#) comprises 35 members, chairs of domestic securities supervisory authorities.
- <sup>15</sup> The foundational issues cover the monetary and financial stability as well as the legal and governance framework, among other things. The opportunities focus on supporting the digital economy and innovation as well as the financial inclusion, among other things. In April 2023, the G7 [reiterated](#) its interest in digital currencies, while diverging views surfaced among countries despite general consensus about the need for more regulation.
- <sup>16</sup> The ECB Internal Crypto-Assets Task Force (ICA-TF) was established in 2018 with a mandate to deepen the analysis around virtual currencies and crypto-assets.
- <sup>17</sup> The volatility spill-over is due to the reserve adjustment mechanism implemented by stablecoins. As stablecoins are redeemed by its holders, the issuer has to adjust its backing assets accordingly causing market price volatility.
- <sup>18</sup> Services include storage, transfer, settlement, and custody of reserves and assets, among others. These are consistent with other financial services providers.
- <sup>19</sup> For instance, services and products for investments should have requirements similar to those of securities brokers and dealers, overseen by the securities regulator. Services and products for payments should have requirements similar to those of bank deposits, overseen by the central bank or the payments oversight authority.
- <sup>20</sup> The price discrepancies on bitcoins between national markets, especially that between Korea and the US – known as the [Kimchi premium](#) – brings evidence of crypto-assets markets segmentation.
- <sup>21</sup> Feinstein B.D. and K. Werbach, [The impact of crypto-asset regulation on trading markets](#), *Journal of Financial Regulation* 7(1), 2021.

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