## Impact of MiCA restrictions on E-Money Tokens referencing USD
Joint letter by Blockchain for Europe and the Digital Euro Association

Key messages

- The three largest stablecoins by trade volume are at risk of being banned in the EU from 2024, due to quantitative limits on issuance and use of EMTs denominated in foreign currency under MiCA.

- USDT, USDC, and BUSD account for almost 75% of crypto trade volumes globally by pair denomination. Restricting their use in the Euro area would cause crypto markets hereto seize up, with potentially destabilizing effects and a major outflow of crypto activities outside of the EU.

- EU crypto investors would likely face extreme short-term volatility in prices driven by dislocation effects. In the medium- to long-term, fragmented liquidity would make trading more expensive, reduce competition and drag down on innovation in the EU.

- Despite the momentum behind the EUR stablecoins, they account for a negligible fraction of trading volumes. It is unrealistic to expect them to replace USD-referencing stablecoins in crypto trading, never mind doing so in a smooth manner by January 2024.

- To avoid these negative consequences, there needs to be a clarification of the concept of 'uses as means of exchange' under MiCA to protect the role of USD-referencing stablecoins in enabling crypto trading and in providing liquidity to DeFi pools.

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This paper analyses the impact of restrictions on the issuance and use of e-money tokens denominated in a foreign currency and makes the case for a clarification or a sensible interpretation of the concept of 'uses as means of exchange' in MiCA.

**Legal provisions**

The draft agreement on MiCA[1] imposes restrictions to the issuance and use of e-money tokens (EMTs) denominated in a currency that is not an official currency of an EU Member State.

This is done through Article 52(3), which extends the scope of the quantitative limits for Asset-Referenced Tokens[2] widely used as a means of exchange to EMTs.

According to Article 19b, restrictions apply when the transactions per day associated with uses as means of exchange, within a single currency area, are higher than:
- 1 000 000 transactions
- and EUR 200 million

When in breach of the thresholds, issuers need to stop issuing and introduce a plan to reduce the use of its crypto asset.

The concept of uses as 'means of exchange' is partially defined in Article 19a:
- 'Transaction' refers to any change of the natural or legal person entitled to the token by transfer of an asset-referenced token (and EMT denominated in a foreign currency) to another DLT address or account;
- The necessary distinction between the use of crypto-assets for payment (as a means of exchange) and as an investment device is not sufficiently clear in Article19a.
- Transactions that are associated with the exchange with other crypto-assets, or funds with the issuer, or with a crypto asset service provider should not be considered to be associated to uses as 'means of exchange' <u>unless there is clear evidence that the asset-referenced token (and EMT denominated in a foreign currency) is used for settlement of transactions in other crypto-assets.</u>

Recital 42a and 42aa (which remain 'parked' in the latest version of the text) reiterate these key elements of the definition, while adding a new concept of transactions associated with means of investment.

**Which crypto assets are affected?**

The restrictions on issuance and use were originally intended to prevent and mitigate the risk of ARTs, such as Facebook's Libra project, becoming widely <u>used for payments</u>. In practice, if the restrictions to the issuance and use of EMTs as means of exchange are interpreted in a way to

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[1] 20 July version of the 4 column document circulated for comments until 19 August.
[2] MiCA distinguishes between two types of stablecoins: asset-referenced tokens are crypto assets that reference a basket of assets; e-money tokens reference a single fiat currency.

also capture stablecoins <u>used for trading</u> (i.a. as trading pairs for transactions in and out of crypto), they would only affect USD-referencing EMTs.

<u>According to our analysis, the three largest stablecoins, USDT, USDC and BUSD, are at risk of breaching both thresholds[3].</u>

The trading volume per day globally using USDT is about $53bn, $9bn for USDC and $7bn for BUSD[4]. Figures for the Euro Area are estimated to be a quarter of that, exceeding the €200m threshold by an order of magnitude[5].

There is no public source of detailed information for the number of transactions in the Euro Area. However, based on exchanges' internal data, we estimate the figure for all the three stablecoins will be a multiple of the 1 million per day limit.

**Trading vs payments**

The high trading figures are explained by the 'enabling' function that stablecoins, in particular USD-referencing stablecoins, play:
1. The gateway fiat - crypto;
2. A safe "parking space" from crypto volatility;
3. Liquidity providers for DeFi.

<u>USDT, USDC and BUSD together account for more than 75% of crypto trade volumes by pair denomination worldwide[6]. In contrast, crypto trading with USD is less than 15% and trading with EUR is less than 4% (see chart).</u>
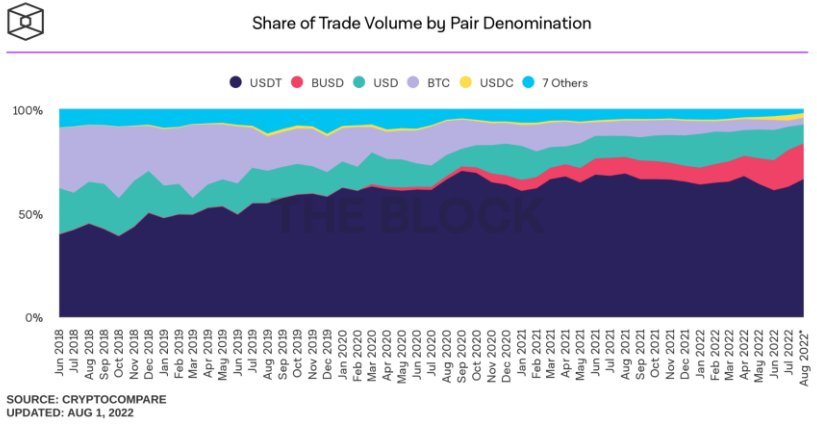
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[3] To illustrate the potential negative impact, we assumed here that most recorded transactions could be classified as uses as 'means of exchange' if the definition of means of exchange is interpreted in a way to also capture stablecoins used for trading (i.e. as trading pairs for transactions in and out of crypto). A different interpretation of the definition of uses as means of exchange would lead to different conclusions, as advocated in the final section of the paper.

[4] Data retrieved from CoinMarketCap (here), on 2 August

[5] Chainalysis (here) estimates that Europe accounts for about ¼ of global crypto trading volumes

[6] Data retrieved from The Block (here)

**Share of Trade Volume by Pair Denomination**

● USDT  ● BUSD  ● USD  ● BTC  ● USDC  ● 7 Others

100%

50%

0%

Jun 2018 ... Aug 2022*

SOURCE: CRYPTOCOMPARE
UPDATED: AUG 1, 2022

The use of an EMT in payments is the key determinant to assess the extent to which stablecoins undermine the transmission of monetary policy and monetary sovereignty. Importantly, the use of USD-referencing stablecoins in payments in the real economy in the EU is negligible and there is no reason to think this would change.

In a recent report[7], the European Central Bank (ECB) said that European payment service providers 'are not very active in stablecoin markets and offer limited stablecoin payment services'.

**Consequences: markets in the EU and beyond to seize up, investors to lose out, regulated entities side-lined**

The imposition of restrictions on the use of USD-referencing stablecoins would have severe negative effects, in particular in the short-term.

With over 75% of crypto trading volumes at risk, the restrictions would cause crypto markets to seize up. We would expect to see extreme price volatility and mass redemptions.

In the medium- to long-term, the fragmented liquidity will make it more expensive for EU crypto investors to trade and will make it harder to shield themselves against volatility, undermining consumer protection.

Furthermore, competition and subsequently innovation would be hampered, as small and medium exchanges struggle to attract sufficient liquidity. Small crypto projects will face higher barriers to getting their tokens listed, which would slow down the pace of innovation.

The restrictions would create incentives for users to move away from regulated service providers in the EU and into the unregulated space outside of the EU, whenever liquidity is more abundant, and would compromise the EU's efforts to take advantage of the potential of crypto and blockchain.

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[7] Macroprudential Bulletin (here)

Simply put, the restrictions stand in the way of achieving the key policy objectives of MiCA.

It is worth noting that irrespective of the application of restrictions on the use, USD-referencing stablecoins would have to comply with rules on reserves, investment, capital and liquidity, which are intended to ensure users' redemption rights and preserve financial stability.

**EUR-referencing stablecoins are not an alternative yet**

We are supportive of efforts to increase the number of stablecoins referencing the EUR and its take-up and use in trading. Several members of the industry have recently unveiled plans to issue and list EUR-referencing stablecoins[8]. We expect this trend to gather speed with the normalisation of monetary policy. Negative interest rates have been the key drag on growth of EUR-referencing stablecoins.

But it is unrealistic to expect EUR-referencing stablecoins to catch up with USD-referencing stablecoins in trading volumes and replace them in trading pairs in the foreseeable future, never mind within a 12 month timeframe of MiCA.

For reference, the daily trading volume of EURS, the most widely used EUR-referencing stablecoin, stands at $21m, compared to $53bn for USDT, and EUR-referencing-backed stablecoins only make up 0.2% of the market[9].

**Proposal: sensible interpretation of the concept of uses as a means of exchange**

We propose that the concept of uses as means of exchange be clarified, or interpreted in a way that recognises the role of stablecoins in trading and in DeFi pools.

This would mitigate the negative effects of the measure, while preserving the tools the EU wants to avail itself of to protect its monetary sovereignty.

The most straightforward solution would be to clarify the concept in the text of the regulation, currently being finalised (Art. 19a and the related recitals 42a and 42aa). The objective would be to clarify that the restrictions to the issuance and use of EMTs as means of exchange exclude transactions in and out of unbacked crypto assets using stablecoins, in particular in exchanges, and in DeFi pools.

It might be possible to achieve an equivalent result through level 2 / RTS, where the European Supervisory Authorities will set out a methodology to estimate the average number and value of those transactions.

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[8] Circle, which issues USDC, announced its plans to launch a 1:1 backed EUR stablecoin in June (here)
[9] Findings from the European Central Bank's 21st annual review of the international role of the euro (here)

We believe this creates unnecessary legal risk. If it is legislators' preferred approach, it would be important for it to be communicated clearly to the market and regulators well in advance.

We remain ready to contribute to this work, as well as to provide information on the various industry initiatives designed to increase the availability and use of EUR-referencing stablecoins.