

Position Paper

MiCA Halts Innovation in Crypto-Finance

The regulatory framework proposed by the Commission will make it impossible for European firms to innovate and diminishes Europe's chances at leading the transformation towards Digital Finance.

As part of the European Union's "Digital Finance" strategy, the European Commission published on September 24 highly-anticipated proposals aiming at regulating crypto-asset markets (MiCA), while creating a pilot regime for financial instruments issued and traded on blockchain networks (security tokens).

As stated in the Commission's *Work Program 2020*, the ambition of these texts was to **"move first on the future technologies with the most potential, while ensuring the European approach is human, ethical and values-based"** and **"reinforce the single market for digital and help provide smaller businesses with the legal clarity and level playing field they need."**

Executive Vice-President Valdis Dombrovski, expressly stated in June 2020:

*"Crypto-assets (...) have the potential to bring benefits to consumers, businesses as well as market participants. Cheaper and faster payments, for example – or new funding sources for smaller businesses. Lack of legal certainty is often cited as the main barrier to developing a sound crypto-asset market in the EU. We intend to change that – and here, **I believe that Europe is in a position to lead the way on regulation.** For this, we need a common approach: **one that supports and stimulates innovation.**"*

To anyone reading these statements, it would appear the main goal of these new regulations is to support and stimulate innovation.

However, in its current drafting, Adan, supported by industry players in France and across Europe, feels that MiCA will in fact make it near impossible for European firms to innovate and remain competitive in this fast-paced, global market.

At stake is the ability for Europe to lead the digital finance revolution, ceding the place to well established markets in the United States and Asia. However, with some changes as suggested below, Adan is of the view that MiCA could allow room for innovation, while protecting consumers and limiting risks.

The Good: A voluntary framework adapted to crypto

Adan welcomes the Commission's unprecedented approach to enshrine "crypto-assets" as a new asset class. With this framework, the Commission recognizes the unique specificities of these assets and their markets.

Regulation is vital to guarantee legal certainty, investor protection, smooth functioning of markets, and financial stability. However, the bespoke approach adopted by the Commission also shows a broad consensus that a tailor-made regime is the best solution to reach those objectives: the EU both understands and promotes the crypto revolution.

As MiCA pulls things together, the **harmonisation of regulations across the EU** will enhance legal clarity. Today, without such rules, each Member state has had to set its own national framework (i.e.: France and Malta) and there are no equivalences between jurisdictions. The resulting fragmentation hampers cross-border activities and fosters regulatory arbitrage. MiCA spells the end of such regulatory dissonance. **Combined with the MiCA's passport system**, which will enable authorised crypto-asset service providers (CASPs) in one Member state to operate with the entire EEA, the coming EU regime will facilitate the rapid expansion of the crypto-finance industry throughout the European Union.

Therefore, looking through a macro lense, MiCA is an encouraging step towards strengthening and legitimising the European crypto-asset sector. However, as usual, the devil is in the details.

The Bad: MiCA will halts innovation in its current form

The current project is far from delivering on its stated objective to "support innovation," as it blocks innovative use cases and defines burdensome obligations for crypto-asset market players.

The overall tone of the MiCA proposal is quite disheartening and innovation-unfriendly. Indeed all general principles of the MiCA framework are based on "prohibition unless...". It is as if innovative actors would not be welcome in the EU digital finance landscape, and would suffer from mistrust (e.g.: issuers must prove that their crypto-assets are not financial instruments).

Moreover, some provisions are worrying since, as currently drafting it will undoubtedly have side effects impacting negatively innovative initiatives.

MiCA has detrimental, while likely unintended side effects on innovation in decentralized finance, otherwise known as DeFi.

The fact is, should the current draft regulation enter into force, none of the innovative use cases permitted by blockchain technology could survive in Europe.

The current text is very strict regarding issuance of crypto-assets, and even stricter regarding stablecoins.

Side effect 1: MiCA bans permissionless use cases from the EU – DeFi, DAOs, decentralized identity and other innovative use cases, where we see the most disruptive innovation taking place.

Many MiCA provisions threaten the development - even the existence in the UE - of such innovative use cases: prohibition of interest for stablecoins holders, burdensome framework for stablecoin issuers, prohibition for trading platforms of listing any stablecoin that cannot apply some requirements (e.g all decentralized assets), etc.

Side effect 2: MiCA could regulate non-financial applications.

MiCA lacks proportionality, and favours established actors

Observation 1: MiCA is more accessible to incumbent actors

First, the access to markets in crypto-asset is facilitated for regulated entities through many waiver mechanisms. Investment firms can benefit from exemptions to comply with CASP requirements for “equivalent” investment services, while credit institutions do not need to comply to all MiCA's requirements to issue asset-referenced stablecoins, and has a monopoly to issue e-money stablecoins (along with e-money institutions). Generally speaking, we could question the existence of equivalence between crypto-asset services and investment services, especially in the case of pure crypto services such as the exchange of crypto-assets for others.

Second, such actors are already familiar with regulations that inspired MiCA, from MiFID2 to the E-Money Directive. This will accelerate their establishment within the crypto-asset market as they better and faster understand the package of rules that will apply to them. Moreover, they already have enough resources within their compliance teams to demystify the MiCA's 167 pages (without the appendices!).

This situation should be kept in mind when assessing the level playing field for all companies building the EU crypto-asset infrastructures. How do we want to build it? Only with incumbent players, pushing those who have the current knowledge of the sector and have built all the innovative use cases out of Europe? Or do we want to give a chance to creative entrepreneurs who think outside the box?

MiCA gives existing regulated entities a head start and creates an unfair playing field at the expense of existing and new crypto-finance firms.

Observation 2: MiCA sets obstacles to newcomers

Besides the advantages of being a traditional financial player that MiCA brings to enter markets in crypto-assets, many barriers confront new entrants. A preliminary list can be established:

- Procedures to get authorised is very long, up to 6 months if you want to issue asset-referenced tokens! Obviously this goes with lots of exchanges and red tape.
- The authorisation of stablecoin issuers, and the supervision of issuers of significant ones, involves the EBA. However the EBA is not familiar with the crypto-assets, and its analytical framework will likely be copied on the banking system. This would be a mistake¹.

¹ Please refer to the Adan's position paper [Towards a suitable AML/CFT regime for markets in crypto-assets](#) published in July 2020.

- Some rules are not proportionate to the stage of development of the main innovative actors, like prudential requirements (e.g up to 2 % of e-money tokens issued!) and the possible administrative pecuniary sanctions.
- The additional costs supported by issuers of stablecoins to finance their own supervision will be significant regarding the weaker financial strength of newcomers compared with those of incumbent actors.
- The proportionality and thresholds for exemptions are set extremely low, and most actors will fall fully into the scope of the regulation from day 1.
- Payment services related to the crypto-asset service that CASP offers must be provided by a payment institution: MiCA does not set an adapted framework allowing CASP to do it.
- Some MiCA's requirements are dependent on the willingness of banks to provide them with their services. However long-lasting barriers to access banking institutions and some non-competitive behaviours prevent crypto-actors from using banking and payment services². MiCA should play a role to provide them with a right of access to the accounts.

Demystifying and complying with MiCA and other regulations (like the AML-CFT regime and the GDPR) combined with aforementioned comparative disadvantages will involve substantial compliance costs for already less financially-resilient firms. **Once again, equal opportunities for all are not guaranteed by MiCA.**

MiCA aims at bringing legal clarity but some provisions remain obscure, leaving room for uncertainty, .

By clarifying the regulatory treatment of markets in crypto-assets, MiCA is a huge step forward in giving a better long term visibility to actors for the launch and the conduct of their crypto business. However, MiCA leaves some room for questioning. The following non-exhaustive list illustrates this idea:

- Crypto-portfolio management is not a crypto-asset service that falls in the scope of MiCA. Why? How to deal with it?
- Cryptocurrencies are never explicitly mentioned in MiCA, but the crypto-asset definition is likely to include them. Then do cryptocurrencies fall in the MiCA scope? If so, why not define them whereas utility tokens and stablecoins are? If so, why not taking their specific features into account with tailor-made requirements?
- The prohibition of listing assets which have "inbuilt anonymisation function" unless "the holders of the crypto-assets and their transaction history can be identified" by the CASP is self-contradicting.
- Crypto-custodians are liable to their clients for the loss of their crypto-assets for any "malfunction". However there is no definition of what a "malfunction" nor any possible event deemed "non-attributable" to the custodian. However custodians cannot be liable if the loss of their client's crypto-assets is due to a "non-attributable" event, like a problem inherent in the operation of the ledger or a smart contract which runs on a blockchain on which the custodian has no control.

Clarifications of MiCA's provisions concerned will be crucial to really help actors to understand the entire implication of the new EU regulation.

² Please refer to Adan's [response to the French Competition Authority](#) that describes such issues.

MiCA overstates the risks and underestimates the potential, and is therefore not competitive with regards to other countries

All available indicators show that the crypto-asset sector is booming worldwide. Regulated structures based in the United States and Asia are opening up markets for radically innovative crypto-assets. The DeFi and DAO sector is creating new use cases weekly. At the same time, the current proposal would shut down any innovative activity from Europe. The contrast is striking. **Because the crypto-asset market is global and the stage of an ongoing fight for market domination, the regime must find proportionality and have competition-friendly foundations.**

The Solutions

We feel these issues are quite easily solvable. **The general idea of the following proposals are to make the MiCA regime clearer, more competitive, innovation friendly, and proportionate.**

Proposal I: Adapt the scope by exempting permissionless use cases that provide some guarantees from the MiCA regime

I.A) Add an exemption: Where the assets are permissionless in nature (i.e.: where no control is kept by the issuer) there should be no requirement of a legal entity for the emission to take place and the CASPs should be allowed to list them. In order to ensure that this would not open the gate to the listing of bad assets, the CASP would be responsible for the due diligence process and should ensure that the protocol is sufficiently decentralized.

I.B) Add an exemption: Where the stablecoin is permissionless in nature (i.e.: where any individual can create those assets with a smart-contract and is responsible for the emission) don't apply the e-money token regulation and allow CASP to list those assets with no limitation, under the same condition as Proposal I.A.

Proposal II: Adapt the rules - bring more proportionality and less oversight

Raise all the thresholds:

- exemptions on bigger issuance amounts (e.g. 1 000 000 to 8 000 000 € for ICOs)
- bring proportionality in the application of obligations and increase the level of obligations in proportions with the size of the service provider

To be completed

Let's help the EU embrace the digital finance revolution!

About Adan

Adan (Association pour le développement des actifs numériques) is a nonprofit bringing together and representing digital assets and blockchain professionals in France and Europe. Adan's members cover a wide range of activities: digital asset markets, custody, payments, investment management, blockchain analysis tools, support for crypto/blockchain projects, IT security, etc. Adan's mission is to promote the development of the crypto-assets industry in favour of a new digital economy.

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