ADAN

L'ASSOCIATION POUR LE DÉVELOPPEMENT DES ACTIFS NUMÉRIQUES

EU Regulatory Framework for Crypto-Assets

General Overview

Adan welcomes the unprecedented approach adopted by the European Commission, which recognises and takes into account the unique specificities of crypto-assets and their markets. Regulation is vital to guarantee legal certainty, investor protection, smooth functioning of markets, and financial stability. These are the regulatory building blocks expected by the crypto-asset industry. Even if perfectible, the bespoke approach that was successfully tested in France allows for rules tailored to this new assets class.

Crypto-assets are poised to improve the existing economic infrastructure worldwide, create new businesses, help financial inclusion and provide novel exchange opportunities both for public and private sectors. The open nature of the networks on which these assets are created allows any interested party, with no prior consideration of reputation, location, origin, to contribute freely and imagine pioneering use cases. This is the main factor that caters innovation and creates significant value. Transparency and integrity are key values that bring together sustainable ecosystems that will both improve traditional finance and see new use cases emerge for the greater good. Use cases are not limited to the financial field, as these networks also enable innovation in radically pioneering areas such as programmable coordination mechanisms, decentralized applications or storage, and new forms of privacy-preserving digital identities. **Innovation in these fields must be encouraged by the authorities and not hindered by regulation.**

In this context, Adan notably welcomes the ad-hoc crypto-assets regime, adapted to emerging practices, and the passporting, which will enable crypto-asset service providers (CASPs) to expand rapidly throughout the European Union. We also applaud the creation of a transitional regime for security token markets, allowing for adjustments in financial regulations to facilitate the development of these markets.

The propositions are an encouraging step towards strengthening and legitimising the French and European crypto-assets sector. They can, however, be significantly improved.

Main concerns regarding MiCA and the pilot regime

Adan finds that the current project does not fully deliver on its second stated objective to "support innovation". Three main issues arise from both MiCA and the pilot regime proposals.

First, MiCA and the pilot regime have detrimental, while possibly unintended, side effects on open and decentralized innovation. In general, both texts seem to lack consideration for the permissionless nature of the decentralised networks on which crypto-assets are built. MiCA effectively hinders or bans so-called decentralized use cases from the EU - Decentralized Finance (DeFi), Decentralized Autonomous Organizations (DAOs), decentralized identity and other use cases where the actual innovation is taking place in the field. The proposed Pilot Regime leaves no room for public networks as it only admits proprietary networks deployed by already regulated financial institutions.

Second, MiCA and the pilot regime need fine tuning regarding proportionality, and may favour established actors. One the one hand, the access to markets in crypto-asset markets is facilitated for regulated entities through many waiver mechanisms; credit institutions and e-money institutions even have a monopoly to issue "e-money" stablecoins while investment firms can solely benefit from the pilot regime. On the other hand, besides the advantages of being a traditional financial player that the EC's proposals bring to enter markets in crypto-assets, many barriers confront new entrants as they impose unnecessary limitations and obligations for crypto-asset market players and radically innovative use cases. As an example, the application of monetary regulatory provisions to all stablecoins without distinction, the restriction of their issuance to bank and payment firms, the prohibition of interest-bearing instruments, the idea of making emerging players bear the economic cost of supervision and the restricted access to the pilot regime for financial firms are likely to hinder any significant innovation in the old continent. **Equal opportunities for all must be restored within MiCA and the pilot regime.**

Finally, MiCA and the pilot regime has a tendency to overstate the risks and underestimate the potential; the resulting crypto-assets regulation is not competitive with regards to other jurisdictions. All available indicators show that the crypto-asset sector is booming worldwide. Regulated structures based in the United States[1] and Asia are opening up markets for radically innovative crypto-assets. . The DeFi and DAO sector is creating new companies and projects weekly. At the same time, the current proposals would render the operation of innovative activities from Europe non-competitive or even ban the most innovative ones. The contrast is striking. Because the

[1] The Office of the Comptroller of the Currency allowed US banks to issue and make payments with stablecoins based on public blockchain infrastructure - Interpretative Letter of the OCC, Jan. 4, 2021: https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2.html

crypto-asset market is global and the stage of an ongoing fight for market domination, the two regimes must have competition-friendly foundations.

General recommendations

The combined efforts of EU institutions, regulators and private actors must be focused on confirming and reinforcing MiCA and the pilot regime proposals as **proportionate, adapted and neutral regulations**. Regulation should be competitive and tailored to ensure a clear balance between, on one hand, consumer and investor protection and, on the other, the highest possible degree of innovation. This lays in three foundations:

- **Adapt the rules irrelevant to the functioning for markets in crypto-assets**. Crypto-assets markets can, at first glance, be likened to financial activities. The first reaction of regulators has often been to apply the same analyses as for the financial sector. However, actors and flows are very different and the public networks on which they are registered allow for innovative use cases (so-called "decentralized"). The regulatory framework should be adapted to those use cases.
- **Guarantee technology neutrality**. Regulation should not discriminate on the nature of technology and should only focus on defined security and resilience principles that should be core to the mitigation of technological risks. On the one hand, market participants should be accountable for reaching the security and resilience thresholds, notwithstanding their infrastructure choices. On the other hand, security and resilience thresholds should not be tailored to favour incumbents or a specific technology.
- **Enhance proportionality**. The regulatory regime shall consider the size, the nature, scope, complexity, and riskiness of the services offered by the players. In nascent markets, regulatory requirements should address the current and existing risks - which differ with activities - and not focus on hypothetical future threats. Efficient requirements - allowing the best level of consumer protection, market integrity and financial security - are antagonistic with unadapted and overloaded obligations.

If it cannot achieve an adapted, proportionate and neutral regulatory framework for crypto-assets, the EU will jeopardise the emergence of its crypto-asset champions. The importance of positioning the continent as a strong actor in this new digital economy is emphasised in the current economic context. Promising projects are emerging in Europe and new players are driving the digital finance revolution. The Commission needs to ensure that they can become the "leading innovative European companies", as it aspires. **That is why the attractiveness of the EU crypto industry must be carefully kept in mind in regulatory debates.**

Adan is firmly committed to finding the right balance to ensure investor and consumer protection while promoting and preserving open innovation that allows unprecedented value creation and deployment of financing for innovation. This document constitutes a contribution to the European commission's proposals.