EC consultation on the digital euro

Adan's additional note

Table of contents

Introduction

The European Commission has launched a public consultation on the digital euro to explore the potential problems of the digital euro such as privacy, anti-money laundering and other issues considered to be of greatest concern with this new technology. The paper is a likely precursor to a bill that could be in the pipeline early next year.

Adan - which federates the blockchain industry in France - welcomes this initiative by the European Commission to focus on the issue of a central bank digital currency (CBDC) in the European Union.

Adan wanted to draw the attention of the European Commission to several issues related to the crypto-asset industry.

NB: this note serves as a supplement to the questionnaire filled in by the Association. It aims to specifically draw the attention of the European Commission to the issues related to the issuance of the digital euro for the crypto-asset sector in Europe.

Executive summary

Adan supports the conduct of experiments by Central Banks with the digital euro, whether it is the ECB or the French Central Bank; in July 2021, the Association already welcomed the project initiated by the European Central Bank to conduct an investigation phase on the launch of the digital euro.

According to Adan, the digital euro must be designed to embrace all financial uses, including the crypto-asset sector:

1. The deployment of the digital euro must be complementary and interoperable with the stablecoin sector. While stablecoins and the digital euro will neither fulfil the same functions nor the same timetable objectives (the issue of the digital euro is not expected before the next few years), it is necessary to encourage all initiatives at the heart of the digital economy.

2. Adan highlights the specificities of blockchain technologies and their advantages for the issuance and management of a digital euro, as well as for end users.
   Adan draws the attention of the European Commission to the need to study all available blockchain solutions, including those with the highest possible degree of openness.
   Thanks to the opportunities of blockchain and crypto-asset technologies, the digital euro would indeed offer a wide range of new opportunities in the monetary, banking and financial sector in terms of transparency, reliability, programmability, resilience, privacy and efficiency

The necessity to integrate crypto-assets markets into the digital euro issuance policy

The complementary role of stablecoins and the digital euro

In general, CBDCs and privately initiated stablecoins provide complementary services and do not have the same purpose or timing:

- Stablecoins provide an alternative to the risk associated with the volatility of the crypto-asset market, facilitate arbitrage techniques and provide a level of liquidity that is essential for the functioning of decentralised finance (a set of peer-to-peer, interoperable protocols offering a variety of financial services: lending, exchanges, derivatives, aggregators). However, they are not intended to compete with legal tender currencies such as the euro. They facilitate access to on-chain exchange platforms and allow crypto-assets to be converted without using a legal tender.

- While the ECB's digital euro project has not yet entered its investigation phase and, if adopted, would not be adopted for the next five years, the total capitalisation of privately initiated stablecoins already amounts to more than USD 112 billion. These tools therefore do not share the same timeframe and will not be deployed in the same way in the future.

Stablecoins and the digital euro: issues of competitiveness and European sovereignty

According to Adan, the issuance of a digital euro only makes sense if the EU also supports the development of the crypto-asset industry as a whole: the strong competitiveness of the United States on private forms of currency and the advance of Asia on its digital currency are widening the gap in the global currency competition.

Stablecoins function as currency-indexed assets and contribute to the international influence of the Euro. According to Adan, the role of modernising the currency in order to ensure the international influence of the Euro is also fulfilled by private initiative stablecoins. It is of crucial importance that their interoperability with the digital Euro is ensured in order to counterbalance the hegemony of the dollar. According to the latest studies, more than 99% of the stablecoins issued are backed by the dollar.

Stablecoins allow us to remain competitive in digital finance and maintain a talent pool in Europe. Ultimately, these assets have a positive impact on European growth: participation in the inclusive global economy and the creation of a European technology hub (job creation, attraction of talent, attraction of income and foreign investment).

The necessity to support the crypto sector

The launch of the digital euro involves issues of European sovereignty and economic competitiveness which must also be supported by stablecoins, whose development must therefore be supported. To this end :

> *Observation 1*: Their regulatory framework must be proportionate, adapted and favourable to innovation and competition. The proposed MiCA regulation raises many doubts as to whether stablecoins can be issued in the European Union in the future.
>
> *Observation 2*: A regulatory paradigm shift needs to take place with regard to decentralised stablecoins (and finance). The digital euro will not be allowed to encroach on such use cases.
>
> *Observation 3*: Interoperability between different stablecoins should be encouraged to facilitate the emergence of a true monetary unit and supervision of risky stablecoins should be carried out to limit any risk.

In this context, and beyond the necessary questions relating to legal tender, the limits of ownership by citizens and AML/CFT issues, the EU must support the development of the crypto-asset industry as a whole. The strong competitiveness of the US on private forms of currency and the advance of Asia on their "digitised" currency is widening the gap in global currency competition. The development of private stablecoins and the opening up of competition in means of payment with the help of innovative players are an effective way of dealing with these challenges.

The necessity to exploit opportunities offered by blockchain technology for the design of the digital euro

To exploit the maximum functionality and opportunities, the deployment and issuance of a digital euro should be based on public blockchain networks. Indeed, beyond the practical interest of such an initiative, the use of blockchain technology is an opportunity for Europe to solidify its position as an innovation leader on the world stage.

Public blockchain networks are open-source decentralised ledgers that are freely accessible to participants who comply with the rules defined by the protocol of said blockchain. As such, they are perfectly compatible with the underlying requirements set by the European

Commission in their Report on a digital euro (Annex 1). They have key features that can help build a digital euro under the EC's specifications:

- **Transparency and trustworthiness**. Smart contracts enable the automatic and trusted execution of operations when (and only when) all conditions are met. All parties may access the ledger to verify which operations have been executed. They may also verify and audit the smart contract code, which is key to ensuring correctness and robustness of the code. More eyes on the underlying application (smart contact) code is a substantial confidence enhancer for all, including end-users.

- **Open source**. Public blockchains are open source projects, developed by a large and expert community which constantly strives to improve protocols and their functionalities, develop innovative use cases and resolve issues. Code repositories and their version histories are freely available and usable on dedicated developer platforms such as GitHub. This provides great efficiency in permanently addressing the needs of end-users and project holders – prompting the creation of standards and ensuring a steady stream of ideas and innovation.

- **Available technological ecosystem and composability**. Public blockchain networks have become proven open technologies. An entire ecosystem of tried and tested technological building blocks (standards, applications, infrastructure, developer tools, etc.) are readily available for anyone to use and build upon. These components can also be combined to create advanced use cases. On the contrary, implementing closed networks requires deploying the supporting infrastructure from scratch (nodes, block producers, etc.) and recruiting validators. To this end, considering the issuance of the digital euro, public blockchain networks would induce considerable time and cost savings and have a significant competitive advantage compared with proprietary technologies **.**

- **Resilience**. Due to their larger number of participants (nodes), public blockchain networks are more resilient than closed, private networks . There is a positive correlation between the number and diversity of participants (decentralization) on a blockchain network and its resilience to cyber-threats and breaches. With no single point of failure, incentive systems that allow actors to be rewarded when they bring safety and value, and a large number of observers auditing network performance and its code, decentralized blockchain networks have proven to be highly resilient and nimble in the face of attacks. Moreover, public networks enable the creation of advanced permissions and rulesets necessary for large-scale applications such as CBDCs.

- **Interoperability and synergies facilitator**. Crypto-assets, stablecoins, and the coming digital euro must be built using the same technologies to allow full interoperability between the current financial and monetary systems and the nascent decentralized economy. Therefore, as private sector initiatives run primarily (and increasingly so)

on public blockchain networks, interoperability, value creation and global mass adoption will be heavily enhanced if the digital euro is deployed on public networks.

- **Environmentally friendly**. Despite many preconceived ideas, the ecological footprint of public blockchains is reasonable. First, not all consensus mechanisms require the same level of energy consumption. New consensus mechanisms like Proof of Stake (e.g. : Tezos, Ethereum 2.0) therefore appear much more environmentally-friendly than earlier generation algorithms like Proof of Work (used by Bitcoin). Secondly, public blockchains have been integrating the energy transition imperative for years: that is why the mining industry is strongly shifting to renewables.

- **"Financial" inclusion**. Contrary to private networks which run on consortia and limit their participants, public blockchain networks are open for anyone to participate. In the context of euros, which must be usable by billions of individuals, public networks appear much more convenient and user-friendly. They are likely to optimise an efficient accessibility to the digital euro for both current and prospective holders. In the long-term context of financial markets, substantial liquidity and market depth will be easily achievable on open networks while private ones will be limited by governance and rivalry considerations.

- **Privacy**. Public blockchain networks offer an interesting mix of public and private features that make them suitable for both institutionally-backed and community-supported use cases. Accounts on public networks are pseudonymous, which allows each user to keep a certain level of privacy, while at the same time, all the transactions are publicly recorded allowing for reliable auditability (see Transparency). In addition, cryptographic primitives allow, when required, for public networks to support higher levels of privacy, and notably, making some transactions entirely private.

Adan remains fully available to discuss these issues with the European Commission and to put interested parties in touch with the crypto-asset industry professionals concerned by this consultation on the digital euro.

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About Adan

Adan (Association for the Development of Crypto-Assets) brings together crypto-assets and blockchain professionals in France and Europe. Its members cover many activities: markets, custody, payments, management, analysis tools, project and user support. Adan's mission is to unite the digital asset industry and promote its development in the service of a new digital economy. To this end, the Association has technical expertise in digital assets and maintains a close dialogue with public authorities and industry associations.

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