PROJECT VELLIR

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TL;DR

- The final text of the EU's MiCa bill is out, with last minute changes on stablecoins and NFTs. The regulations will come into effect in mid-2024.
- The Financial Stability Board (FSB) released a report proposing a new comprehensive framework for regulating crypto-assets, with recommendations for breaking up some crypto firms, centralising stablecoin governance and banning algorithmic stablecoins.
- The US Financial Stability Oversight Council (FSOC) called on Congress to provide greater clarity over what should be regulated as a security vs commodity, and to legislate on stablecoins.

MiCa

The EU's Markets in Crypto-Assets (MiCA) regulation achieved EU political agreement in June 2022. Technical 'trialogues' – discussions between the European Parliament, Council and the EU Commission – have also now concluded. The full legal text is here. The next step is a vote in the European Parliament in November or December before the bill is formally adopted, which starts the clock on implementation of provisions by national regulators. The regulation will take effect from mid 2024, eighteen months after formal adoption.

There were two last minute changes worth highlighting.

1. **Non-Euro-dominated stablecoins.** There has been a debate over whether these posed a risk in terms of challenging the sovereignty of a potential future digital Euro, and whether they should be left uncapped in the bill. New recitals (42c and 42d) were added into the bill which now place a cap on 'asset-referenced stablecoins' (those assets pegged to the value of several fiat currencies, one or several commodities, or one or several crypto-assets, or a combination of such assets). It highlights the concern among regulators about the challenge posed by stablecoins to fiat currencies.
2. **NFTs.** NFTs had been out of scope of MiCa, with the European Commission intending to conduct a review over the next 18 months. However, there was a last minute addition to the text: "The fractional parts of a unique and non-fungible crypto-asset should not be considered unique and not fungible. The issuance of crypto-assets as non-fungible tokens in a large series or collection should be considered as an indicator of their fungibility." There isn't much clarity on the implications, and there will be considerable focus on future guidance to shed some light on what 'a large series or collection' means in this context.

FSB Report on Crypto Regulation

The Financial Stability Board (FSB) – established after the 2008 financial crisis – sets standards for the global financial system with the backing of central banks and finance ministries.

In a new report on crypto regulation, the FSB suggested that some crypto companies already break the law by combining traditionally separate activities like trading, lending, custody and brokerage. It said that such firms should be broken up by national authorities in cases where there were specific risks or conflicts of interest.

It also proposed a new comprehensive regulatory framework for crypto-assets, suggesting that "effective regulatory and supervisory frameworks should be based on the principle of 'same activity, same risk, same regulation'. [...] Where crypto-assets and intermediaries perform an equivalent economic function to one performed by instruments and intermediaries of the traditional financial sector, they should be subject to equivalent regulation." The report makes nine core recommendations, which are open to public comment until 15 December.

Klaas Knot, the Dutch central banker who chairs the FSB wrote to G20 finance ministers saying that "The current 'crypto winter' has reinforced our assessment of existing structural vulnerabilities in these markets".

A separate FSB report on stablecoins highlighted deficiencies around governance, risk management and regulatory disclosures. It proposed centralising governance: "Authorities should require that GSC [global stablecoin] issuance be governed and operated by one or more identifiable and responsible legal entities or individuals", as well as preventing algorithmic stablecoins like Terra/Luna: "A GSC [global stablecoin] should not rely on arbitrage activities to maintain a stable value at all times and it should not derive its value from algorithms."

The FSB is a standard setting body and therefore does not have enforcement powers. It relies on its recommendations being carried out by national authorities.

FSOC Report on Digital Asset Risks and Regulation

The US Financial Stability Oversight Council (FSOC) – a group made up of Treasury Secretary Janet Yellen, Federal Reserve Board Chair Jerome Powell, Acting Comptroller of the Currency Michael Hsu, Consumer Financial Protection Bureau Director Rohit Chopra, Securities and Exchange Commission Chair Gary Gensler, Commodity Futures Trading Commission Chair Rostin Behnam, Federal Deposit Insurance Corporation Acting Chair Martin Gruenberg, and a few others – released a report on digital asset financial stability risks and regulation. The report concludes that "crypto-asset activities could pose risks to the stability of the U.S. financial system and emphasizes the importance of appropriate regulation, including enforcement of existing laws".

The FSOC report suggests that federal agencies have the authority to oversee most digital assets already. However, it requests that Congress does provide greater clarity over what should be regulated as a security vs a commodity. Specifically, “the Council recommends that Congress pass legislation that provides for explicit rulemaking authority for federal financial regulators over the spot market for crypto-assets that are not securities”. The other core recommendation was to pass legislation over risks posed by stablecoins.

Quick fire

- The EU Commission has put out a tender to study ‘embedded supervision’ of DeFi protocols → interesting move that signals that they are thinking more creatively about how regulatory bodies could automatically monitor compliance by reading public blockchain data; it’s likely to feed into the wider DeFi review which will take place over the next 18 months.
- In Portugal, a new budget draft is proposing a levy of 28% on capital gains from crypto-assets held for less than a year (gains held for longer would be unaffected). This signals a change of stance in Portugal on tax, even if this proposal still has to go through the full legislative process.
- The OECD has released a new tax reporting framework, the Crypto-Asset Reporting Framework (CARF), designed for the automatic exchange of information between countries on crypto-assets. More global coordination on tax and transparency has been coming, so it’s no great surprise.
- Indonesia has plans to develop an export market for local crypto tokens, which are classified as commodities, as a tax generating initiative.
- A new EU sanctions package will place a full ban on providing crypto wallets, accounts, or custody services to Russian persons and residents.
- The Reserve Bank of Australia (RBA) and the Digital Finance Cooperative Research Centre (DFCRC) published a white paper exploring use cases for an Australian central bank digital currency (CBDC). There will be a pilot from January-April 2023, followed by a report in mid-2023.
- Ahead of its October meetings, the IMF released two reports: regulating unbacked crypto-assets - the Fund doesn’t support a blanket ban but balanced regulation; and regulating stablecoins - again supporting a balanced approach not bans, with regulation that is flexible enough to evolve over time. Largely sensible.
- The US SEC is investigating Yuga Labs, the creator of the Bored Ape Yacht Club NFT collection, over whether sales of its digital assets violate federal law, including in relation to the distribution of their $APE coin to BAYC holders.
- Coinbase has been granted a licence by the Monetary Authority of Singapore.
- US Treasury’s Office of Foreign Assets Control (OFAC) and Financial Crimes Enforcement Network (FinCEN) announced settlements with cryptocurrency exchange Bittrex for over $24 million and $29 million respectively. It was the first parallel enforcement action.

To discuss any of the topics covered in the Monitor, or wider policy and regulatory issues, please get in touch with Jonno Evans: je@epsilonap.com