EUROPEAN
COMMISSION

Brussels, 24.9.2020
SWD(2020) 202 final

COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a Regulation of the European Parliament and of the Council

on a pilot regime for market infrastructures based on distributed ledger technology

{COM(2020) 594 final} - {SEC(2020) 308 final} - {SWD(2020) 201 final}

Executive Summary Sheet

Impact assessment on an EU framework on crypto-assets

A. Need for action

Why? What is the problem being addressed?

Crypto-assets are a type of digital asset that depend primarily on cryptography and distributed ledger technology (DLT)[1]. Some crypto-assets can qualify as financial instruments under the Market in Financial Instruments Directive – MiFID II or as 'e-money' under the Electronic Money Directive – EMD2), while the majority of them fall outside the scope of existing EU financial regulation.

Where crypto-assets are not covered by EU financial regulation, the absence of applicable rules to services related to such assets (such as exchanges, trading platforms, custodial wallet providers) leaves consumers and investors exposed to substantial risks. There are also substantial market integrity risks (e.g. market manipulation) in the secondary market of crypto-assets. Some Member States have put in place bespoke rules at national level for all – or a subset of – crypto-assets that fall outside current EU regulation. This leads to regulatory fragmentation, which distorts competition in the Single Market, makes it more difficult for crypto-asset service providers to scale up their activities cross-border and gives rise to regulatory arbitrage. While the crypto-asset market remains modest in size and does not currently pose a threat to financial stability, daily trading volumes have been steadily increasing. So-called *'stablecoins'* (a subset of crypto-assets that have features to stabilise their price) can raise additional challenges if they are widely adopted by consumers (e.g. financial stability and monetary sovereignty). To avoid regulatory arbitrage and ensure adequate protection for consumers, the regulatory treatment of these 'stablecoins' should depend on their specific design. In the absence of an EU framework for crypto-assets, the lack of users' confidence in crypto-assets will hinder the development of this market, leading to missed opportunities in terms of fast, cheap and efficient payment instruments or new funding sources for EU companies.

Where crypto-assets are covered by EU financial services legislation, there is a lack of legal certainty on how to apply existing EU financial regulation (e.g. the Prospectus Regulation, MIFID II and the Central Security Depositary Regulation). This situation leads to only sporadic security token issuances in the primary market, and limits the potential use of DLT in financial markets, as demonstrated by a lack of DLT-based market infrastructures (such as trading venues or central security depositaries) enabling the trading of security tokens and the settlement of transactions.

What is this initiative expected to achieve?

The overall objective of the initiative is to provide clarity as regards the applicability of the EU financial regulation to crypto-assets (and related activities). The initiative should support innovation and fair competition by creating a framework for the issuance, and provision of services related to crypto-assets. It should ensure a high level of consumer and investor protection and market integrity in the crypto-asset markets. It should address financial stability and monetary policy risks that could arise from a wide use of crypto-assets and DLT-based solutions in financial markets.

What is the value added of action at the EU level?

For crypto-assets not covered by EU financial regulation, action at EU level would lay the foundation on which a larger cross-border market for crypto-asset issuers and service providers could develop, thereby reaping the full benefits of the Single Market. It would significantly reduce the complexity and the financial and administrative burdens for all stakeholders. Harmonising operational requirements on crypto-asset service providers as well as the disclosure requirements on issuers could also bring clear benefits in terms of investor protection, market integrity and financial stability.

For crypto-assets covered by existing EU financial regulation, action at EU level would enhance legal clarity, thus enabling activities related to such assets to expand across the Single Market. This would address the risks

[1] DLT is a means of saving information through distributed ledger, i.e. a repeated digital copy of data available at multiple locations. DLT is built upon a cryptographic system: public keys, which are publicly known and essential for identification and private keys, which are kept secret and are used for authentication and encryption.

created by the proliferation of guidance and interpretations at national level that lead to fragmentation of the internal market and distortion of competition.

B. Solutions

What legislative and non-legislative policy options have been considered? Is there a preferred choice or not? Why?

For crypto-assets not covered by EU financial regulation, two options have been assessed: an EU opt-in regime and a fully harmonised regime for crypto-asset issuers and service providers that would benefit from an EU passport to expand their activities cross-border. While the first option could be less burdensome for small issuers and service providers that can decide not to opt-in, the second option would ensure a higher level of legal certainty, investor protection, market integrity and financial stability and would reduce market fragmentation across the Single Market. Therefore, the second option is the preferred option.

For crypto-assets that qualify as MiFID II financial instruments (i.e. security tokens), three options have been considered: 1) non-legislative measures; providing guidance on whether and how existing legislation applies to crypto-assets; 2) targeted legislative changes removing provisions acting as a barrier to the issuance, trading and post-trading of security tokens and the use of DLT-based solutions; and 3) a pilot regime (for a three-year period) creating a new DLT market infrastructure allowing for the trading and/or settlement of security tokens. While soft-law measures would assist in clarifying the application of EU law to security tokens and related activities, they cannot remove legal obstacles embedded in existing legislation. Targeted legislative adjustments provide legal certainty and remove legal hurdles but would be applied only in limited areas that have been identified in recent assessments. While the third option can provide a clear experimental framework for the trading and/or settlement of security tokens, its benefits could disappear if the experimental regime is not extended after the three-year period. As these options complement each other, the preferred approach would be to proceed cautiously by way of a combination of the three options. This would be consistent with the need for a gradual regulatory approach in the context of a nascent market and the vast difference between fully permissionless and persmissioned networks where some control is centralised.

For 'stablecoins', Commission services envisaged three options: 1) bespoke legislative measures on 'stablecoin' issuers; 2) regulating 'stablecoins' under EMD2, as some 'stablecoins' are close to the e-money definition and are used as payment instruments; 3) measures aimed at limiting issuances and services related to 'stablecoins' in the EU (except if they comply with existing frameworks). By following a strict risk-based approach, the first option would address vulnerabilities to financial stability, while supporting innovation. By contrast, the second and third options might not adequately address significant risks to consumer protection (for example those raised by wallet providers). Furthermore, option 3 could leave some financial stability risks unaddressed, if EU consumers widely use 'stablecoins' issued in third countries. Therefore, the preferred option as regards 'stablecoins' is a combination of option 1 and 2.

Who supports which option?

For crypto-assets that are not covered by EU financial regulation, a large majority of the respondents (68%) to the Commission's public consultation held the view that an EU bespoke regime for crypto-assets would enable a sustainable crypto-asset ecosystem in the EU. For crypto-assets that qualify as financial instruments, a large majority of respondents underlined the need for a common EU approach when a crypto-asset qualifies as a financial instrument. The majority of respondents also favoured a gradual regulatory approach, first providing legal clarity as regards the use of permissioned DLT (i.e. only allowing registered members) in the trading and post-trading areas rather than accommodating permissionless networks (in which any entity could participate without registration) as these DLTs are still at an early stage of development. On the issue of 'stablecoins' and 'global stablecoins', the majority of respondents were in favour of imposing several requirements on the issuers and/or managers of the reserve. A minority of stakeholders considered an extension of EMD2 to be the most appropriate regulatory approach.

C. Impacts of the preferred option

What are the benefits of the preferred options?

First, the measures would allow crypto-assets to develop, as fast and cheap means of payment able to compete, especially for cross-border transactions, with existing payment instruments. Cost savings would be particularly important in the remittances area. Based on estimates, these could range from €220 to 570 million per year. This will also contribute to enhancing financial inclusion within the EU. Second, the framework will also enable the take-up of crypto-asset and security token issuances by EU corporates in the EU, as a complementary financing

tool for EU corporates, including SMEs. Third, creating a bespoke regime for crypto-assets that are not financial instruments, would extend consumer protection rules to these and ensure market integrity and stability. The preferred options will therefore contribute to the objectives of the Capital Markets Union, by diversifying the sources of financing of EU companies away from bank lending. It is not possible to estimate the overall additional funding made available through crypto-asset issuances as this depends on various external factors (such as issuers' need for funding, current market sentiment and competitive reaction of other funding channels). However, the funding costs for crypto-asset issuances are expected to be 20-40% lower than for a comparably sized initial public offering of traditional securities. Third, the preferred option should have a positive impact on the trading and post-trading of security tokens, by providing legal clarity on how existing legislation apply, removing regulatory obstacles and creating a dedicated framework on DLT market infrastructures. Potential efficiency gains due to a wide use of DLT and security tokens in EU cash equity markets have been estimated at €540 million per year. However, beyond regulatory issues, the full deployment of security tokens and DLT in the entire trading and post-trading chain will also depend on the resolution of technological issues (such as scalability and interoperability of different DLT networks). Therefore, the envisaged measures will only form a stepping-stone to reaping these efficiency gains in the medium to long run by facilitating innovation and enabling a gradual EU standard setting process.

What are the costs of the preferred option (if any, otherwise main ones)?

The preferred options will impose compliance costs on 'stablecoin' issuers as well as providers of services related to crypto-assets that currently fall outside EU financial regulation. The application of the envisaged new regime for currently unregulated crypto-assets service provider is expected to give rise to one-off compliance costs between €2.8 – 16.5 million and on-going compliance costs between €2.2 – 24 million, depending on the number of entities seeking an authorisation. Legal clarifications and the launch of the pilot regime for security tokens will imply only small compliance costs for trading venues opting to list these tokens. The authorisation and ongoing compliance costs for new DLT market infrastructure operators is expected to lie in a similar range as for MiFID II-authorised multilateral trading facilities. Additional costs falling on issuers of global stablecoins could not be estimated given that no such tokens exist in the market today. Issuers of crypto-assets that are outside the current regulatory perimeter will have to publish an information document. The overall costs (including legal fees) are estimated to range between €35.000 – 75.000 per issuance, including potential legal and other costs.

How will businesses, SMEs and micro-enterprises be affected?

The preferred options should have an overall positive impact on SMEs. They should increase non-bank funding sources for SMEs, through the development of initial coin offerings (ICOs) and securities token offerings (STOs). ICOs can offer an opportunity for start-ups to raise substantial amounts of funding at an early stage of development, with potential cost savings compared to IPOs., The funding costs of crypto-assets under the regime should be 20-40% lower than those of initial public offerings of similar size. The preferred option would also impose some compliance costs on SME issuer of crypto-assets that can be estimated at around €35,000 per issuance.

Will there be significant impacts on national budgets and administrations?

The preferred options would impose some supervisory costs on National Competent Authorities (NCAs) of Member States. This supervision of crypto-asset issuers and service providers subject to the new requirements would entail one-off costs estimated at around €140,000 and ongoing costs estimated to range between 350,000 and 500,000 per year. The new DLT market infrastructure would also impose costs on NCAs estimated at between €150,000 and 250,000 per year. The costs involved for the supervision of 'stablecoin' issuers are difficult to estimate at this stage, as they will depend on the business models at stake. The fees levied on supervised entities by the NCAs will partially offset these costs.

Will there be other significant impacts?

The preferred options would foster EU competitiveness, by enabling new market entrants to develop DLT-based market infrastructures for the trading and/or settlement of security tokens competing with the legacy infrastructures in the medium to long term. The pilot regime on DLT market infrastructure will also allow EU market participants to compete with entities established in third countries that have put in place favourable regime for the take-up of DLT. The preferred option should limit the negative impact on the environment. The traditional financial sector mainly use permission-based DLT that consume less energy. Furthermore, some permissionless DLT used for some crypto-asset issuances are planning to shift to different consensus mechanisms (that allow for the validation of transaction on DLT) that require substantially less energy.

D. Follow up
When will the policy be reviewed?
The Commission will monitor the impact of the preferred option and will evaluate whether they are effective in achieving the stated objectives (enhancing legal certainty, ensuring consumer protection, market integrity, financial stability and supporting innovation) on the basis of a list of precise indicators.