

Tethering the Crypto-Asset Market: The Regulation Of Stablecoins In the European Union And United States

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ABSTRACT

Cryptocurrencies are likely to disrupt the traditional financial system and alter how we pay for goods and services. While first-generation cryptocurrencies fail to maintain a stable value, making it a less attractive alternative to traditional money, their second-generation counterpart may fulfil the promise of digital payment.

Stablecoins can maintain stable value and therefore function as a more secure alternative. This disruptive means of payment has suddenly attracted considerable attention after the publication of the Libra (now Diem) Whitepaper. Regulators all over the world are faced with the challenge of regulating this ledger-based means of payment.

This article provides the first comparison and assessment of the EU and US proposals to regulate this technology: the Markets in Crypto-Assets Regulation (MiCA) and the US Stablecoin Tethering and Bank Licensing Enforcement (STABLE) Act. The core problems present in these proposals are highlighted and compared and possible solutions outlined.

Using the sliding scale of consumer protection and innovation as a yardstick to assess these proposals, it becomes clear that neither the EU nor the US proposals fully grasp the complexities of DLT and the reality of Stablecoins while offering a proper level of consumer protection. This article highlights the deficiencies present in these legislative instruments and proposes solutions to these core problems.

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I. INTRODUCTION

Since its genesis, cryptocurrency has been lauded as a possible alternative to traditional payment methods. Cryptocurrencies are built on a blockchain and can be accessed via mobile wallets that allow users to easily send, receive and secure their tokens. Payment via blockchain has become much easier, faster and cheaper. While the most well-known cryptocurrency Bitcoin was designed to be decentralised to ensure peer-to-peer transactions without government or corporate intervention, Stablecoins move away from the libertarian roots of crypto. In contrast to cryptocurrencies such as Bitcoin, Stablecoins are pegged to an external reference point such as (a basket of) assets, fiat currency, or even algorithms. While Stablecoins may not be as true to the cypherpunk ideology of the 90s, they are better equipped to deal with the core problem that reduces the utility of first-generation cryptocurrencies: extreme volatility. Due to this difference in design, Stablecoins could, theoretically, be a viable alternative means of payment fit to launch us into the future of digital payment.

On the flip side, the rapid rise of Stablecoins can potentially impact the global financial market and global financial stability. In 2021, the market capitalisation of Stablecoins has quadrupled to more than USD 120 billion.¹ This means that right now, it is comparable to US high-yield bonds—a well-established asset class. Moreover, trading volumes have also increased exponentially, which makes exposure to spillover effects because of these (un)Stablecoins a dangerous possibility. Different from US high-yield bonds is that Stablecoins are not properly regulated. This lack of regulation exposes our global financial system to the risk of spillover effects and crises as Stablecoins have become the centre of the crypto-storm. Most of today's crypto-trading is done via Tether, the US dollar of the cryptocurrency world. If Tether were to fail, the entire crypto-market would be affected and the markets backing the token would be severely impacted.² The enormity of the spillover effects this would cause has already been compared to the crisis following the collapse of the Lehman Brothers bank in 2008.³

¹ Parma Bains and others, 'Global Financial Stability Report: Covid-19, Crypto, And Climate: Navigating Challenging Transitions', (IMF 2021).

² Mathijs Rotteveel and Pim Brasser, 'Op zoek naar de mysterieuze Nederlander achter de controversiële cryptomunt tether' *Financieel Dagblad* (Amsterdam, 4 January 2022); Financial Stability Board, *Assessment of Risks to Financial Stability from Crypto-Assets* (2022 FSB report) [4](#).

³ *ibid.*

The risks posed by Stablecoins suddenly became clear to regulators all over the world when Facebook announced the launch of Libra (now “Diem”), a Stablecoin offered to their 2.8 billion active users. Both the US and the EU have taken a stand against Diem and prevented the launch of the token in its proposed form but are now faced with the inevitable challenge of regulating the crypto-world. This boils down to the challenge of unbundling the centuries-old system of banking, money, and payments or choosing to stay behind in the innovation race. New FinTech products provide the opportunity of unbundling banks and allowing room for innovation in a centuries-old system. Laws that further entrench and bundle these three will only present bigger challenges to innovation and stop progress in payment.⁴ Safely unbundling while ensuring consumer protection as well as furthering innovation is the complex balance that must be struck in the process of legislating cryptocurrencies and primarily Stablecoins.

The two frontrunners in the field recently published their legislative proposals to make up for the lack of all-encompassing crypto regulation. In December 2020, the US *Stablecoin Tethering and Bank Licensing Enforcement* (“STABLE”) Act was published. The European Union published their proposed *Markets in Crypto-Assets Regulation* (“MiCA”) in September 2020. These unprecedented proposals which aim to make up for the myriad of laws that are partially but never fully applicable to crypto are at the centre of this study. The key problem in any proposal aimed at regulating new technology is striking a productive balance between consumer protection and innovation. This article demonstrates that both MiCA and the STABLE Act do not strike the right balance by analysing and comparing the key components of these proposals through the balancing act between consumer protection and innovation.

II. METHODOLOGY

The most recently proposed US bill at the time of writing (the STABLE Act) and the EU Markets in Crypto-Assets Regulation were chosen for this comparative study as most Stablecoin projects originate from Europe or the USA. The proposals aim to form the core of crypto regulation and clear up the mosaic of laws that are currently (partially) applicable to crypto. For this reason, this article will not focus on the applicability of (among others) the PSD II, MiFID II, AMLD5, EMD II, and UCITSD to Stablecoins.

Instead, the focus of the discussion will be to see if the proposals provide the right balance between consumer protection and innovation. Due to the enormous risks to the global financial system, it is necessary to ensure that consumers are protected, service providers can provide a

⁴ Dan Awrey, ‘Unbundling Banking, Money, and Payments’ (2021), 110 *Georgetown Law Journal* 1, 5.

certain level of service, and issuers are regularly checked and audited. Although the importance of this component of the proposals cannot be overstated, it is also relevant to make sure that it is not simply regulated out of existence due to a lack of focus on the benefits of this innovation.

The relevant dimensions of comparison are therefore consumer protection and innovation. By their very nature, these dimensions can be considered strengths when taken into account by regulators, yet the moment the balance tips mostly toward one, it becomes a weakness. Allowing room for innovation may leave the consumer vulnerable yet implementing safeguards for consumers may stifle innovation. Striking a productive balance between these dimensions is among the greatest challenges for regulators when faced with technological innovation. This has been recognised by the drafters of MiCA as well as the STABLE Act as they aim at fostering innovation while at the same time protecting consumers.⁵ These dimensions and the balance that must be maintained were chosen as the core components of description and analysis in this study. The Cambridge Dictionary defines them as “the protection of buyers of goods and services against low quality or dangerous products and advertisements that deceive people”⁶ and “(the use of) a new idea or method”.⁷

These dimensions are subdivided into three subcategories. The dimension of consumer protection is divided into (a) the rights of token holders; (b) supervision of the token issuers and service providers; and (c) liability and enforcement of token requirements. The three subdimensions were chosen as all three aim at protecting the consumer. Innovation as a dimension is subdivided into (a) technological neutrality; (b) suitability of the proposal to regulate the technology; and (c) administrative impediments. This section is followed by a comparative analysis of the weaknesses of the proposals along these dimensions.

III. STABLECOINS AND CRYPTOCURRENCIES

Stablecoins are defined as “cryptocurrencies maintaining a stable value against a target price, generally US dollars.”⁸ These cryptocurrencies are built on a blockchain, “an open and

⁵ Proposal for the Stablecoin Tethering and Bank Licensing Enforcement (STABLE) Act <https://tlaib.house.gov/sites/tlaib.house.gov/files/STABLEAct.pdf?utm_campaign=BitDigest&utm_medium=email&utm_source=Revue+newsletter> accessed 11 September 2021. ; Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-Assets (MiCA), and amending Directive (EU) 2019/1937 [2020] COM/2020/593.

⁶ Cambridge Dictionary, ‘Consumer Protection’ (*Cambridge Dictionary*) <<https://dictionary.cambridge.org/dictionary/english/consumer-protection>> accessed 10 September 2021.

⁷ Cambridge Dictionary, ‘Innovation’ (*Cambridge Dictionary*) <<https://dictionary.cambridge.org/dictionary/english/innovation>> accessed 10 September 2021.

⁸ Marco Dell’Erba, ‘Stablecoins in Cryptoeconomics. From Initial Coin Offerings (ICOs) to Central Bank Digital Currencies (CBDCs)’ (2019) New York University Journal of Legislation and Public Policy <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385840> accessed 10 September 2021, 6.

distributed ledger (“DLT”) that can (manually or automatically) record transactions between users.”⁹ In contrast to first-generation crypto, Stablecoins are often centralised instead of decentralised. This allows for the implementation and enforcement of a stabilisation mechanism that gives this cryptocurrency its name. Stablecoins can be subdivided into three types depending on their stabilisation mechanism, namely stablecoins that use (a) traditional collateral (off-chain backed); (b) algorithmic; or (c) crypto collateral (on-chain backed).¹⁰

Off-chain, fiat-backed Stablecoins are directly backed by a fiat currency or basket of currencies, as the name suggests. The issuer of this token must hold and store a reserve (or basket of currencies) to make sure that their Stablecoin is redeemable and maintains stable value. The second type is the on-chain backed Stablecoin, tokens backed by other cryptocurrencies. These fully decentralised Stablecoins do not require one central issuer to regulate the maintenance of the stabilisation mechanism which is in line with the core thought of the underlying blockchain technology.¹¹ On-chain-backed Stablecoins are not the focal point of this study as these tokens only move the volatility problem experienced by the first generation cryptocurrencies to the Stablecoin-level as they are backed by volatile tokens. Algorithmic Stablecoins, the third type, are also not the focal point of this study. These tokens need an Oracle to maintain the exchange rate of the cryptocurrency, more commonly referred to as exchange-rate targeting, a practice National Banks used in the past.¹² The system interferes the moment the price of the Stablecoin dips below the set amount of dollars or is worth more than the set amount. If the price dips below the set value, the amount of Stablecoins held must be decreased to maintain a stable value. The inverse is true the moment the price increases.¹³ This simple mechanism has been used by central banks but was abandoned after failures in the past.¹⁴

This study will only focus on the regulation of (off-chain) asset- and fiat-backed Stablecoins as these are the most viable option to provide the much-needed stability as well as to allow room for consumer protection.

⁹ Thibault Schrepel, ‘Collusion by Blockchain and Smart Contracts’ (2019) 33 (1) Harvard Journal of Law and Technology, 117, 119.

¹⁰ Aaron Wright and Primavera De Filippi, *Blockchain and the Law: The Rule of Code*, (1st edn, HUP 2018), 10; Jeremy Clark, Didem Demirag, and Seyedehmahsa Moosavi, ‘Demystifying Stablecoins’ (2020) 18(1) ACM Queue, 5.

¹¹ *ibid.*

¹² *ibid.* 14.

¹³ *ibid.* 15.

¹⁴ *ibid.* 14.

IV. CONTRASTING MiCA AND THE STABLE ACT

Both proposals have their strengths and weaknesses and can foster or stifle innovation in this field. The balancing act between safeguarding consumer protection and allowing room for innovation is among the biggest challenges for regulators when faced with (technological) innovation. If the balance tips the wrong way, it might mean taking oneself out of the race to become a market leader or allowing too much room for potential risks to global financial stability. Consumer protection and innovation together form the balance that must be kept and form an ever-present trade-off in legislation. These dimensions of comparison are used to describe and analyse the weaknesses and suitability of the proposals in the following sections. This section will first describe the definitions used in MiCA and the STABLE Act before outlining their weaknesses relating to consumer protection and innovation.

A. DEFINING STABLECOINS

(i) *Definitions in the STABLE Act*

The Federal Deposit Insurance Act (“FDIA”) provides the definition of a *bank* in the United States. Section 3 (1) of the Act defines banks as “(A) any national bank and State bank, and any Federal branch and insured branch, and (B) includes any former savings association.”¹⁵ These entities are engaged in “the business of receiving deposits, other than trust funds (as defined in this section).”¹⁶ The STABLE Act proposes to amend these provisions by adding “Stablecoins issued by such bank or savings association; and” after the aforementioned clause.¹⁷ Stablecoins are defined as

any cryptocurrency or other privately-issued digital financial instrument that (a) is directly or indirectly distributed to investors, financial institutions or the general public; (b) is (i) denominated in United States dollars or pegged to the United States dollar; or (ii) denominated in or pegged to any other national or state currency; and (c) is issued (i) with a fixed nominal redemption value; (ii) with the intent of establishing a reasonable expectation or belief among the general public that the instrument will retain a nominal redemption value effectively fixed; or (iii) in such a manner that, regardless of intent, has the effect of creating a reasonable

¹⁵ The Federal Deposit Insurance Act of 1950, Pub.L. 81–797, 64 Stat. 873, s 3(1).

¹⁶ *ibid.*

¹⁷ *Tlaib* (n 5).

expectation or belief among the general public that the instrument will retain a nominal redemption value that is so stable as to render the nominal redemption value effectively fixed.¹⁸

(ii) *Definitions in MiCA*

While the STABLE Act approaches the regulation of cryptoassets narrowly, MiCA makes use of a catch-all definition of crypto-assets to make sure that those outside of the scope of one of the previously mentioned directives are covered by the framework proposed. MiCA defines crypto-assets as “a *digital representation of value or rights which may be transferred and stored electronically, using DLT or similar technology*”¹⁹ and introduces three different regulatory sub-regimes corresponding to three sub-types of crypto-assets: (a) *Asset-Referenced tokens (“ARTs”)*, ‘a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets’²⁰; (b) *E-Money tokens (“EMTs”)*, “a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender”²¹ and; (c) *utility tokens*, a type of crypto-asset which is “intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.”²²

Stablecoins will, dependent on their technical properties, fall either within the definition of E-Money or Asset-Referenced tokens. The third category, utility tokens, does not apply to Stablecoins but forms a catch-call clause that allows room for innovation within the field of crypto yet at the same time ensures a regulated environment. Due to the limited scope of this article, only Asset-Referenced and E-Money tokens will be discussed in-depth.

A. CONSUMER PROTECTION IN MICA

(i) *Rights of token holders*

The issuance of crypto-assets must be preceeded by the publication of a Whitepaper, an information document detailing (among others) the project, rights and obligations concerning the crypto-asset, and the risks involved. These Whitepaper requirements differ to cover token-specific risks involved and grant token holders different rights dependent on the type of crypto-

¹⁸ *ibid.*

¹⁹ *MiCA* (n 5) art 3(1)(2)).

²⁰ *ibid* 3(1)(3)).

²¹ *ibid* art 3(1)(4).

²² *ibid* art 3(1)(5).

asset issued. Holders of E-Money tokens and Asset-Referenced tokens have many similar rights under MiCA that take into account the core difference between the two: they are issued by private parties or by credit institutions. It is surprising to note that these two regimes that together aim to regulate Stablecoins differ with regard to the right granted to holders to redeem their tokens. Issuers of ARTs have no obligation to grant holders a redemption right whereas issuers of EMTs are obligated to grant this right.²³ To ensure a certain level of protection for holders of ARTs, “mechanisms must be put in place to ensure the liquidity of the Asset-Referenced token”.²⁴

This means that the level of protection offered to consumer-holders is different depending on the token and its technical specification. Differentiating between EMTs and ARTs does not provide consumers with the same level of protection and may even be considered regulatory arbitrage. It could be argued that it would be beneficial to consumer protection to offer the same rights to consumers.²⁵ Revising the proposed framework to include an obligatory redemption right for ARTs as proposed by the ECB may, at face value, strengthen the safeguards in place for consumers. Such a revision may not have been implemented in the first place for two reasons which will be set out below.

Firstly, the core differences between these regimes are the type of party issuing the token and their respective stabilisation mechanisms. Issuers of these tokens differ as one is a private party and the other a credit or E-Money institution. The latter is somewhat similar to a bank and is subject to a number of additional prudential safeguards laid down in the E-Money Directive.²⁶ Such safeguards flow from the E-Money Directive as well as from MiCA. Among them are for example capital requirements, initial capital requirements, and specific insurance arrangements. These stringent safeguards ensure that issuers can cover the redemption of tokens without liquidity risk. Issuers of ARTs are private parties who, contrary to their EMT counterparts, are not subject to such extensive prudential requirements. Meeting demand for redemption of tokens may be difficult for these parties as it can massively impact the liquidity and solvability of their business. Ensuring longevity and liquidity of these businesses can be facilitated by not granting a redemption right to holders.

²³ *ibid* art 17(1).

²⁴ *ibid* art 35(4).

²⁵ Opinion of the European Central Bank of 19 February 2021 on a proposal for a regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (CON/2021/4) 2021/C 152/01 (2021) 4.

²⁶ Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (2009, OJ L 267 10.10.2009, 7, arts 3–9).

The second and perhaps more convincing argument is best made by considering the hypothetical scenario in which an issuer of Asset-Referenced tokens is obligated to offer the right to redeem the tokens at par value at any given time. A liquidity risk will occur the moment an issuer of ARTs cannot meet the outstanding redemption requests. Such a maturity mismatch occurs when the holders cannot liquidate their tokens because the issuer does not have enough short-term assets. Traditional financial services (and credit or E-Money institutions) are subject to a number of prudential safeguards put in place by banking regulations to make sure this mismatch does not occur and redemption requests can be met. Issuers of ARTs are not subject to these safeguards, leaving them vulnerable to liquidity risk in case a large number of redemption requests are made at the same time. This risk can be mitigated and demands met through the rapid liquidation of the highly liquid financial instruments in the basket of assets stabilizing the ART (as per article 34 MiCA). Rapid liquidation of a large number of assets may result in an adverse impact on the markets of these reserve assets and spillover effects in other markets as well as negatively impact the stability of the Asset-Referenced token offered. Attempting to meet demands through rapid liquidation may destabilise the stabilisation mechanism in place and detract from the use of and trust in the money substitute.

What may therefore resemble an inconsistency in the framework governing Stablecoins may function as a prudential safeguard. This seemingly inconsistent approach should therefore not be dismissed out of hand without weighing the possible consequences first.

However, if MiCA is amended to include an obligatory redemption right for holders of Asset-Referenced tokens, as per the ECB's wishes,²⁷ it would be beneficial to mitigate the liquidity risk that may ensue in a manner similar to how open-end funds cover this risk. Managers of these funds can gate or suspend the redemptions until the fund can meet the requests. A similar approach should be allowed for issuers of Asset-Referenced tokens to take up a provision in their Whitepaper that functions as a gate or suspension provision, similar to those used in open-end funds. These provisions should, together with the rest of the Whitepaper, undergo scrutiny before issuance to ensure they do not impact the holders of the tokens disproportionately. Allowing the incorporation of such a provision in the Whitepaper would mitigate the liquidity risks that may occur if issuers of ARTs are obligated to grant a right of redemption. It will also cushion any spillover effects that may occur in the markets of the basket of assets stabilizing the token.

²⁷ *Opinion of the ECB* (n 25) 4.

(ii) *Supervision*

Significant Asset-Referenced Tokens (“SARTs”) are supervised at the European level by the European Banking Authority (“EBA”) to guarantee the same level of supervision and prevent supervisory arbitrage.²⁸ The supervisory regime for Significant E-Money Tokens (“SEMTs”) is different, even though similar risks are cited for these two types of tokens. SEMTs are subject to a more stringent supervisory regime compared to SARTs for which no economic reason seems to exist. These significant tokens are supervised by both the EBA as well as the National Competent Authority (“NCA”) and both are exclusively responsible to carry out their specific task.²⁹ The EBA must ensure compliance concerning custody requirements and investment of the reserve assets as stipulated in articles 33 and 34. Proper liquidity management, effective risk management, and that different Crypto-Asset Service Providers (“CASPs”) can hold tokens in their custody as per article 41, the establishment and maintenance of a wind-down plan as meant in article 42, and increasing the percentage of reserve assets to be kept by the issuer as outlined in article 41(4) must be ensured. The NCA is in charge of ensuring compliance with the other obligations flowing from MiCA. Not only does this difference seem arbitrary due to the similar risks attached to these tokens, but dual supervision also has enormous drawbacks. Dual supervision by the national and the European authorities is overly complex and may lead to redundancy at the cost of overlooking other obligations. All significant tokens should be supervised at the European level to provide a level playing field as well as guarantee holders the same level of supervision.

A dual supervisory regime would also further complicate the applicable regulatory framework for issuers of significant E-Money tokens.³⁰ Not only would the aforementioned dual regime apply once an E-Money token is classified as significant, if the issuer is classified as a significant credit institution as per article 6(4) of the Significant Supervisory Mechanism Council Regulation (“SSM Regulation”), he would be subject to supervision by yet another authority.³¹ If this were the case, the NCA, EBA, and the ECB would share the burden of supervising the issuer. This would make the supervisory regime too complex and blur the lines of competence even further. Moreover, both MiCA, as well as the SSM Regulation, require cooperation between the national and the European authorities.³² MiCA imposes the creation

²⁸ *MiCA* (n 5) recit. 66.

²⁹ *ibid* arts 52 in conjunction with 98(4).

³⁰ *Opinion of the ECB* (n 25) 9.

³¹ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (2013) OJ L 287, 29.10.2013, 63–89, art 6(4). ; *Opinion of the ECB* (n 25) 9.

³² *ibid* art 6; *ibid* 9.

of a Supervisory College consisting of among others the NCA and the EBA for a SEMT and the SSM Regulation establishes Joint Supervisory Teams established for each significant credit institution consisting of staff from the ECB as well as the NCA. To further complicate matters, the EBA's Board of Supervisors consists of the National Banking Supervisors of the Member States, that is, the NCAs. Establishing such a supervisory regime would make delineating responsibilities extremely difficult and might make the system prone to leveraging by an NCA.³³

The dual supervisory regime as proposed in MiCA should be replaced by a similar regime as suggested for SARTs. That would create certainty and avoid regulatory arbitrage. If this approach is taken and an E-Money token issuer is classified as a significant credit institution and his tokens as significant, both the EBA and the ECB would play a role in the supervision of the issuer. Their respective responsibilities and competencies still warrant further clarification to ensure no conflicts arise and no supervisory requirements are overlooked. Ensuring the same level of regulatory supervision at the European level will offer the large group of holders of significant tokens sufficient protection and ensure compliance with the additional requirements issuers of significant tokens are subjected to.³⁴

(iii) *Liability and enforcement*

The regulatory regime in place for crypto-assets other than ARTs differs in many regards, but the most surprising matter relates to the approval and authorisation to issue crypto-assets. Those wishing to issue crypto-assets or EMTs (other than ARTs) do not have to wait for ex-ante approval of their Whitepaper. It merely has to be submitted and notified to the NCA 20 days before the crypto-asset or EMT is offered. Although these authorities can intervene and supervise the issuer according to article 82 of the regulation, no check beforehand takes place. This leaves the matter of accountability and enforcement regarding any misleading, incomplete, or unfair information provided in the Whitepaper to be determined *ex post* via claims for damages.

The mere *ex post* accountability and enforcement were chosen to avoid an undue administrative burden on the competent authority.³⁵ Yet, this approach leaves too much room for uncertainty and does not offer sufficient protection to the holders of these crypto-assets and EMTs. To create certainty and ensure a sufficient level of protection for holders, an *ex ante*

³³ *Opinion of the ECB* (n 25) 9.

³⁴ *MiCA* (n 5) 68.

³⁵ *ibid* recit. 19.

system of approval and authorisation is necessary—even though it might be burdensome. Especially in the crypto-sphere in which Ponzi schemes and scams still occur, such *ex ante* approval and authorisation is no unnecessary luxury to protect consumers.³⁶ As reviewing and approving Whitepapers can be time-consuming, it may be beneficial to allow an NCA more time to do so—a mere 20 days may not be sufficient.

Surprising to note is that MiCA provides a specific liability regime for the information presented by the issuer in its Whitepaper but does not offer an overarching European approach toward other forms of mismanagement, instability of tokens, or loss other than resulting from malfunction or hacks. Instead, articles 14 and 22 of MiCA merely state that further civil liability based on national law cannot be excluded. At face value, this may seem a proper approach that offers sufficient redress for those seeking damages. However, if one of the core benefits MiCA offers is taken into account, it does not make sense to settle this at the Member State level. As issuers of crypto-assets can get a European passport to offer their services in the Union and make use of the internal market, claiming damages at the national level would be burdensome and may not provide the same level of redress for every consumer. Regulating this at the European level may provide the consumer with compensation and a road to redress. This must be addressed in a manner different than the liability regimes currently in place at the European level such as the Product Liability Directive³⁷ or the E-Commerce Directive³⁸ as those parties issuing or offering services relating to crypto-assets do not fall within the scope of either due to the complex nature of the underlying DLT.

B. INNOVATION IN MICA

(i) *Suitability of the proposal to regulate the technology*

The proposed MiCA Regulation regulates issuers and crypto-asset service providers. These parties, whether they are private parties or credit institutions as meant in the E-Money Directive, are the addressees of most provisions of the proposal. This seems suitable to regulate Stablecoins such as Tether and TrueUSD as they have a centralised issuer. Yet, the DLT system has been created to cut out the middleman and to provide a decentralised means of payment.

³⁶ Aleksander Berentsen and Fabian Schar, 'The Case for Central Bank Electronic Money and the Non-case for Central Bank Cryptocurrencies' in Antonio Fatas (ed) *The Economics of Fintech and Digital Currencies* (CEPR Press 2019), 65.

³⁷ Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products OJ L 210, 7.8.1985.

³⁸ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (2000) OJ L 178, 17.7.2000, 1–16.

The deliberate choice to do so stems from distrust in the traditional financial system evidenced by the text in the first block on the Bitcoin blockchain stating “Chancellor on brink of second bailout for banks”- a reference to the financial crisis of 2008.³⁹ However unorthodox the organisational structure of these Stablecoins may be in light of the foregoing, the technological reality is that several Stabecoins are centralised while others are decentralised.

Dai for example is such a decentralised Stablecoin, issued by the MakerDAO and the Ethereum protocol. No centralised issuer can be identified as the MakerDAO and the Ethereum smart contracts cannot be considered “a legal person who offers to the public any type of crypto-assets or seeks the admission of such crypto-assets to a trading platform for crypto-assets.”⁴⁰ The quoted definition aims to capture those bringing crypto-assets (in the broadest sense of the word) on the market, yet disregards the complexity and possibilities of DLT. Due to the decentralised nature of Dai, no legal entity can be considered the issuer which means, as a result, that no party is obligated to submit a Whitepaper before launch, no authorisation is needed to issue tokens, and the other supervisory and liability provisions provided by MiCA are applicable. Although recital 26 of the proposal establishes that tokens such as Dai cannot be considered as ARTs, other obligations flowing from MiCA may still apply to Dai. Yet again, this requires a centralised issuer instead of a token generated by smart contracts. Disregarding the nature of the technology underlying Stablecoins and other types of crypto-assets in this way means leaving tokens unregulated which can have a major impact on the financial system. Not taking the decentralised nature of DLT into account and the possibilities of creating a protocol generated (Stable)token makes the bespoke MiCA framework unfit to regulate the crypto-sphere as it does not encompass the technological reality of a number of these tokens.

(ii) *Technological neutrality*

The principle of technological neutrality was introduced in 2002 and has been recognised as a key principle of European internet regulation in 2011.⁴¹ This principle has been interpreted in different manners yet covers the notion that regulation should not create technological silos aimed at providing a framework for one single technology. Instead of letting the technology used define the scope of regulation, a legal framework must subject the regulatory focus to the

³⁹ ‘What is the Genesis Block?’ <https://coinmarketcap.com/alexandria/glossary/genesis-block> accessed 10 September 2021.

⁴⁰ *MiCA* (n 5) art 3(1)(6).

⁴¹ Organisation for Economic Cooperation and Development, *OECD Council Recommendation on Principles for Internet Policy Making* (2011) 6; Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions. COM (99) 539 final, 10.11.1999.

same set of principles, rules, and obligations to make sure that overarching legislation is created. This principle also ensures that a regulation such as MiCA does not become obsolete the moment DLT or crypto is no longer in use as it is focused on mitigating and steering the effects of crypto or similar technology.

The current MiCA proposal does not conform to this principle. MiCA's definition of crypto-asset refers to "using DLT or similar technology"⁴² which might not be suitable to cover the crypto-asset field due to the many different crypto-projects that are built and the different designs that have already come up in DLT itself (consider for example Holochain, Polkadot, and Hashgraph). If this definition is limited to DLT or similar technologies, it might not be future-proof or provide the much-needed robust regulatory framework that is sorely lacking. Opting for a technologically neutral definition would ensure that this regulation will not be outdated in a few decades if a new type of technology is created upon which crypto-assets can rely. Adhering to this key principle to make sure that MiCA and its elaborate bespoke framework is not one of these technological silos would greatly improve the proposal as well as ensure that innovation in the field of crypto-assets can continue.

(iii) *Administrative Impediments*

MiCA imposes a large number of obligations on issuers and CASPs, aimed at regulating this market and protecting investors and consumers. One of the most demanding requirements is the own funds requirement in place for issuers of Significant Asset-Referenced Tokens. Tokens can be classified as significant based on their market capitalisation, customer base, interconnectedness with the financial system, the significance of cross-border activities, and the size of the reserve of assets.⁴³ Articles 41(4) read in conjunction with 31(1)(b) of the proposal stipulate that issuers of SARTs must have funds equal to 3% of the average amount of the reserve assets.

The most prominent Stablecoins currently in existence would immediately be classified as significant under MiCA as these already exceed 1 billion market capitalisation.⁴⁴ The requirement to maintain 3% own funds would mean maintaining a massive amount of own funds which will only increase when the token becomes more successful and mainstream. This

⁴² *MiCA* (n 5) art 3(1)(2). ; *Opinion of the ECB* (n 25) 3.

⁴³ *MiCA* (n 5) art 39.

⁴⁴ Patrick Hansen, 'New Crypto Rules in the European Union – Gateway for Mass Adoption, or Excessive Regulation?' (*Stanford Law School* 12 January 2021) <<https://law.stanford.edu/2021/01/12/new-crypto-rules-in-the-eu-gateway-for-mass-adoption-or-excessive-regulation/>> accessed 11 September 2021.

will effectively harm the innovation and progress of Stablecoins as alternative means of payment.

C. CONSUMER PROTECTION IN THE STABLE ACT

(i) *The rights of token holders*

Under the Act, token holders are guaranteed a redemption right at par value. This guarantees security for holders as they can always get the amount of US Dollars they invested in the Stablecoin back from the issuing party. This issuer must be an insured depository institution and member of the Federal Reserve which also provides the holder of the tokens with an additional safeguard in the form of deposit insurance. Traditionally, this would only apply to the holder of a bank account for a maximum amount of USD 250,000. Deposit insurance guarantees account holders this amount in case of bank failure.⁴⁵ This fund and the fact that issuers must be insured depository institutions provide holders with the certainty that even in case of bank failure, they will be able to redeem their tokens for dollars. Holders are also protected through rules and standards set by Federal Banking Agencies as they are charged with setting the appropriate standard for capital adequacy, leverage and liquidity. As long as these agencies create a level playing field regarding the prudential safeguards and allow some room for Stablecoin-related activities, consumer-holders will benefit.

As the STABLE Act aims to embed the issuance of Stablecoins in the existing frame of bank legislation, the further lack of additional rights for token holders flowing from the Act seems sound. Holders are already protected by the myriad of obligations and rights flowing from the patchwork of banking legislation including privacy laws and bank secrecy and are essentially not treated any different than holders of bank accounts.

(ii) *Supervision*

Section 1(f) concerning oversight by Federal Banking Agencies stipulates that all insured depository institutions engaged in Stablecoin-related activities are supervised by a Federal Banking Agency. The Act does not specify which Agency is tasked with this supervisory role which must be done if this proposal ever becomes law. No Agency is created to take up this

⁴⁵ Federal Deposit Insurance Act, 12 U.S.C. 1813, s 11(E).

role which also means that this forms an additional competence next to the general supervisory obligations relating to the business of the institution not related to Stablecoins.

Due to the complex nature of DLT, Stablecoin, and related instruments, it may be beneficial to create an Agency tasked with supervision of Stablecoin-related matters and institutions to ensure that this complex instrument and the underlying technology are subject to proper oversight.

(iii) *Liability and Enforcement*

As the Act essentially aims to implement the issuance of Stablecoins and activities related to it in the existing legal framework applicable to banks, it was expected that the Act itself would not contain a separate liability and enforcement regime. If claims for damages or taking an insured depository institution to court are not contractually excluded, it would be possible to do so.

D. INNOVATION IN THE STABLE ACT

(i) *Technological Neutrality*

The Act does not provide a complete framework aimed at regulating the crypto-asset market in the USA as MiCA does for the EU. Instead, it aims at regulating Stablecoins and defines them as “cryptocurrency or other privately-issued digital financial instrument (...)”⁴⁶. This definition takes the technological reality into account that, DLT-based cryptocurrencies may not exist in the future if a more suitable technology is created. The longevity of the Act was ensured by adding the last clause. Although the proposed Act is neutral as it does not refer to the ledger technology underlying cryptocurrencies, it is not neutral in itself as it only refers to tokenised instruments denominated in or pegged to a currency with a nominal redemption value.⁴⁷ In American parlance, “regulation should not prejudice technological choices, by picking the winners and the losers”.⁴⁸

As expected, Stablecoins are the biggest losers. The strict regulation does not provide a framework for FinTech products as it only entrenches the existing banking system. Consider the landscape for other non-bank FinTech companies such as Venmo, PayPal, Cash App and Stablecoins. These platforms offer alternative non-bank payment platforms and are illustrative

⁴⁶ *Tlaib* (n 5) s 3(aa)(1), 8.

⁴⁷ *ibid* s 3(aa)(1)(B).

⁴⁸ Winston J. Maxwell and Daniel L. Brenner, ‘Confronting the FCC Net Neutrality Order with European Regulatory Principles’ (2012), 1 *Journal of Regulation and Compliance*, 6.

of development toward unbundling banking, payments and money.⁴⁹ Unsurprisingly, the US proposal does not allow such unbundling as it places issuers in the pre-existing banking framework. What is more, this Act only regulates Stablecoins and does not include other providers of payment platforms. It allows room for these platforms to thrive in a relatively unrestricted manner. The reason for this may be that providers of these platforms still rely on traditional banks to send and receive payments. These payments will later end up in the traditional bank account of the customer of the platform service. This shows that banks still have the power. Although Stablecoins are, in their very nature, similar instruments, this lack of a connection to a traditional bank may be the core concern. Stablecoins, as well as Cash App and Venmo provide dollar-denominated liabilities. These liabilities only differ in their embodiment: a token.⁵⁰ These tokens represent a claim on dollars held in a bank by the issuer of the Stablecoin and are not inherently different from mobile banking applications such as Cash App and Venmo. Both applications are peer-to-peer mobile payment apps that allow users to link their account to their bank account.⁵¹ The user can send and receive money through this application which acts as a middleman between the banks of the sending and receiving parties. Stablecoins do not differ from this core set-up as the DLT-based token forms a claim on the dollars held by the issuer in a bank account, which, on the side of the issuer, is a liability. The mere manifestation of the liability relies on the ledger-based token while the liability in itself remains the same.⁵² Perhaps the key difference between these platform payment service providers is the proximity to a traditional bank account. Reliance on the bundled system of banking, payments and money will enhance the role of banks while at the same time picking the winners and losers in FinTech—simply based on their proximity to the traditional system.

The similarities outlined above raise the question as to why the Act merely focuses on the regulation of Stablecoins instead of attempting to cover FinTech dollar-denominated liabilities as a whole. The proposal would bring Stablecoins and their issuers under the purview of the FDIC and scope of the FDIA which would significantly hamper innovation in this sphere. Moreover, it arbitrarily regulates dollar-denominated liabilities in token form. Picking the technological winners by creating a regulatory silo such as this Act limits innovation, is not neutral in its focus, and displays regulatory arbitrariness.

⁴⁹ *Awrey* (n 4) 5.

⁵⁰ Larry Cermak, Lars Hoffmann, and Mike Rogers, *Stablecoins: Bridging The Network Gap Between Traditional Money and Digital Value* (The Block Research 2021) 59-61; Peter van Valkenburgh, 'The Unintended(?) Consequences of the STABLE Act' (Coindesk 3 December 2020) <<https://www.coincenter.org/the-unintended-consequences-of-the-stable-act/>> accessed 11 September 2021.

⁵¹ *Awrey* (n 4) 5.

⁵² *ibid.*

(ii) *Suitability of the proposal to regulate the technology*

The key weakness of the proposal with regard to innovation is a misunderstanding of how DLT-based instruments work. The key characteristic, decentralisation, makes the regulation of this technology very complex as one cannot simply regulate one centralised legal entity and thereby regulate the technology. The distributed nature and code underlying the ledger allow the issuance of tokens through the protocol or smart contracts instead of by one centralised entity.

The proposal in its current form assumes the existence of a centralised issuer that would be suitable to regulate several Stablecoins currently in existence, such as Tether. Tether Limited is the centralised party responsible for the issuance of the token and maintenance of the reserve of assets. This party could, theoretically, apply for a banking license and conform to the obligations as laid out in the Act. Yet the moment the technological setup of a Stablecoin is not as clear-cut and straightforward as Tether's, the Act falls flat. The distributed nature of the Ledger technology used for cryptocurrencies was not taken into account in this proposal nor was the possibility of Stablecoins generated by a Decentralised Autonomous Organisation ("DAO"), a decentralised community that makes use of a blockchain to register its (financial) interactions and is able to generate its own tokens. MakerDAO's multi-collateralized Dai Stablecoin system is an example of such a token that aims to maintain a stable peg yet is not governed or managed by one single party. This Stablecoin with a 24-hour trading volume of USD 460.309.862 is one of the products of MakerDAO, an open-source software placed on the Ethereum blockchain as a Decentralised application ("Dapp") and is governed and created by the "Maker" DAO in a decentralised manner by all holders of the Dai tokens.⁵³ This MakerDAO allows anyone to generate tokens named "Dai" "by leveraging Ethereum as collateral through smart contracts known as Collateralized Debt Positions" and maintains a soft peg to the US dollar.⁵⁴ Stablecoins such as Dai would not be suitably regulated by the Act as no single centralised issuer can be identified. Regulating the issuer and enforcing *ex ante* approval before issuance in the manner proposed is impossible for those Stablecoins issued through a DAO or code (for example, a protocol or smart contracts). The complexity and core characteristic of the underlying technology are disregarded in the Act which makes it unsuitable to effectively cover and regulate DLT-based instruments.

⁵³ CoinMarketCap, 'DAP' (*CoinMarketCap*) <<https://coinmarketcap.com/currencies/multi-collateral-dai/>> accessed 12 August 2021.

⁵⁴ MakerDAO, *The Maker Protocol: MakerDAO's Multi-Collateral Dai (MCD) System*, (Whitepaper) 2.

Even though the MakerDAO and the Ethereum smart contracts cannot be regulated in the manner proposed in the Act, its provision on Stablecoin-related commercial activities can still impact the DAO and the Ethereum blockchain. The Act prohibits “any person to issue a Stablecoin or Stablecoin-related product, to provide any Stablecoin-related service, or otherwise engage in any Stablecoin-related commercial activity, including activity involving Stablecoins issued by other persons”—without prior authorisation.⁵⁵ This broad provision would, as a result, prohibit all participation in Stablecoin-related activities, including the MakerDAO and the Ethereum blockchain by parties without prior authorisation to engage in these activities.

Not only would the MakerDAO be prohibited in itself as its participants and its smart contracts issue Stablecoins, running a node on the Ethereum blockchain that run the smart contracts and ensure block creation will be prohibited too. The nodes on the Ethereum blockchain occupy themselves with block creation and verification. These blocks consist of several transactions and smart contracts govern the condition(s) whereby a transaction can take place. In case a block would contain a smart contract or transaction related to Dai or MakerDAO, the node occupied with verification and creation of the block could be penalised as he does not have prior authorisation to be involved in activities involving Stablecoins issued by others (in this case, the MakerDAO).

Effectively, the STABLE Act would make it illegal for a node to participate in the Ethereum blockchain. It is impossible to select the transactions and smart contracts a node wishes to validate which, in light of this proposed Act, would be an enormous risk if one is not authorised. A node cannot pick and choose but validates all transactions or none at all. If the Act were to become law, it would mean that nodes on the Ethereum blockchain would have to cease validating transactions out of fear that one of them may relate to Dai or Maker.⁵⁶ These severe consequences of this broad prohibition will therefore not merely target Stablecoins but stifle innovation in the DLT sector. This Act may aim to promote innovation yet seems to miss its mark through a misunderstanding of DLT and the issuance of Stablecoins through a DAO, smart contract or protocol.

⁵⁵ *STABLE Act* (n 5) s 52(2)(a)(2), 12.

⁵⁶ *van Valkenburgh* (n 50).

(iii) Administrative Impediments

As described above, the Act would require an issuer of Stablecoins to obtain a banking charter, become a member of the Federal Reserve, and an insured depository institution placed under the purview of the Federal Deposit Insurance Corporation (“FDIC”). These are not mere administrative burdens to bear for issuers wishing to comply with the proposed legislation, but massive financial burdens to bear. If an issuer would, for instance, attempt to obtain a banking charter in the state of New Jersey, they would have to pay a non-refundable filing fee of \$15,000 to merely have his application considered.⁵⁷ The issuers of the largest Stablecoins currently in existence will probably be able to afford this fee but the smaller players will most likely not be able to meet this financial threshold. The Act does not provide smaller actors with any form of regulatory sandbox from which they could benefit. Instead, this requirement is placed at the forefront of the Act which will not allow small (future) disruptive players a chance to innovate and grow. This lack of regulatory flexibility and the high financial burden does not benefit this exponentially growing market which, in May 2021, broke 100 billion US dollars.⁵⁸ Administrative impediments as created by this proposal will, if adopted, likely result in a decrease of United States-based crypto innovation, result in innovation migration, denomination in other currencies, and deflate US competitiveness in the innovation race. If adopted in its current form, the United States would be acting to its detriment.

V. INNOVATION AND CONSUMER PROTECTION: MiCA AND THE STABLE ACT

Striking a productive balance between consumer protection and innovation is essential to a legislative proposal aimed at regulating a FinTech product. Both MiCA and the STABLE Act aim to balance both dimensions to ensure that fostering innovation does not open the gates to abusive practices while at the same time making sure that safeguarding consumers does not stifle innovation.⁵⁹ The analysis and description provided above show that both proposals have not successfully struck this balance. They lean too much toward the consumer protection dimension which could massively impact innovation in the crypto-sphere as well as the competitiveness of the United States and the European Union on the FinTech/DeFi market. The

⁵⁷ State of New Jersey Department of Banking and Insurance, *Requirements for Organizing a New Jersey State Chartered Bank or Savings Bank*, NJAC 3:1-2.2a(4).

⁵⁸ Joe Weisenthal, ‘The US\$100 billion stablecoin question’ (*BnnBloomberg* 28 May 2021) <<https://www.bnnbloomberg.ca/the-100-billion-stablecoin-question-1.1609865>> accessed 11 September 2021.

⁵⁹ *MiCA* (n 5) para 1; *Tlaib* (n 5).

imbalance will be illustrated further by means of the two dimensions and the weaknesses present in the proposals. For the sake of clarity, E-Money Tokens and Asset-Referenced Tokens under MiCA as well as Stablecoins under the STABLE Act will collectively be referred to as Stablecoins, cryptocurrencies maintaining a stable price against a currency. If the separate provisions on EMTs, ARTs or Stablecoins are discussed, the distinction will be made clear.

A. CONSUMER PROTECTION

Under MiCA, a CASP custodian is “liable to their clients for loss of crypto-assets as a resulting [sic] from a malfunction or hacks up to the market value of the crypto-assets lost.”⁶⁰ The CASP is liable for any damages, including ICT-related incidents such as cyberattacks, malfunctions, and theft.⁶¹ This strict approach, although beneficial to consumer-holders, shows that CASPs are regulated in a strict manner unsuitable to foster innovation and provision of these services. Incidents as such are commonly considered force majeure events that cannot be considered a ground for a damages claim. Moreover, it is not in line with the approach generally taken for depositaries and custodians of transferrable securities. Article 19 of Regulation 2016/438 supplementing the Undertakings for Collective Investment in Transferable Securities Directive (“UCITS Directive”), states that a depositary/custodian is not liable for damages in what are traditionally considered to be force majeure events.⁶² As long as the custodian can prove that the damages occurred due to an external event that could not have been avoided even though reasonable efforts were made to prevent such an event from resulting in loss, they are not held liable. Surprisingly, this standard is not implemented for their crypto-asset counterparts who essentially provide the same or similar services. If a crypto-asset custodian makes reasonable efforts to protect himself against ICT-related incidents and it happens nonetheless, they should not be held liable for all damages resulting from it. All damages arising from incidents beyond their reasonable control must be limited and this matter must be approached in a manner similar to the commonly accepted approach for force majeure events.⁶³ This strict approach toward liability for what could be qualified as force majeure events may make

⁶⁰ *ibid* art 67(8).

⁶¹ *ibid* recit. 59.

⁶² Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries (2009) OJ L 78, 24.3.2016, 11–30, art 19; Dirk Zetsche and others, ‘The Markets in Crypto-Assets Regulation (MiCA) and the EU Digital Finance Strategy’ (2020) 2020/77 European Banking Institute Working Paper Series <<https://ssrn.com/abstract=3725395>> accessed 10 September 2021, 20.

⁶³ *ibid*.

crypto-custodianship unattractive and even incredibly risky business.⁶⁴ Instead, MiCA should conform to the UCITS Directive's approach and limit liability for force majeure events. Mitigating this risk for CASPs would level the playing field between them and their traditional colleagues as well as stimulate innovation in the provision of crypto services.

Contrary to the MiCA regime, the STABLE Act does not include a separate liability provision. As the Act aims to implement these tokens in the banking system, it is practical not to create an additional obligation specific to these tokens and their issuers. What must be noted is that many insured depository institutions now include a mandatory arbitration clause in their contracts, preventing consumers from going to court to claim damages as well as preventing class-action suits.⁶⁵ Claiming damages from insured depository institutions issuing Stablecoins will therefore be a difficult if not impossible reality. The debate on the appropriateness of these clauses is an entirely different topic altogether but must not be forgotten in the evaluation of the rights of consumers under the STABLE Act.

While MiCA allows private parties to issue ARTs, the STABLE Act obligates an issuer to become an insured depository institution—a type of institution that already covers the risk of bank failure and illiquidity through their backing by the faith and credit of the US government.⁶⁶ These institutions are required to redeem the Stablecoins at par value at any point in time. MiCA, as mentioned earlier, only grants this right to holders of EMTs. MiCA does not provide a mandatory right to redeem ARTs and while it may be argued that this does not offer sufficient protection to consumer-holders, this provision prevents liquidity squeeze and spillover effects in other markets. Tokens such as Stablecoins are vulnerable to bank runs and the only way to prevent liquidity problems from occurring is by establishing a gating provision or creating a lender of last resort able to meet all redemption demands as was done in the STABLE Act.⁶⁷ Although MiCA allows room for private parties to issue Stablecoins and does not contain a mandatory right of redemption for ARTs, if this right were to be implemented in the proposal as per the ECB's wishes, it must be supervised, guided, and gated properly to prevent liquidity risks. If not done properly, history will repeat itself and test if the tokens are

⁶⁴ *ibid.*

⁶⁵ *Discover Bank v Superior Court* [2005] 113 P.3d 1100, 36 Cal. 4th 148, 30 Cal. Rptr. 3d 76.; J. Maria Glover, 'Beyond Unconscionability: Class Action Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements' (2006) 59(5) *Vanderbilt Law Review* <<https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2888&context=facpub>> accessed 11 September 2021.

⁶⁶ Andrés Velasco, 'Preventing a Stablecoin Liquidity Crisis' (*Project Syndicate* 2 August 2021) <<https://www.project-syndicate.org/commentary/preventing-a-stablecoin-liquidity-crisis-by-andres-velasco-2021-08>> accessed 11 September 2021.

⁶⁷ *ibid.*

properly backed once a bank run or confidence crisis comes up. Lessons must be learned from the case of the Argentine peso in the 90s which was supposedly backed by the US dollar. The peso was not fully backed which resulted in the collapse of the Currency Board charged with the maintenance of the peg and even the Argentine government.⁶⁸ If a Stablecoin (in the form of an (S)ART) becomes too big to fail without proper gating or a lender of last resort structure, consumers will not be sufficiently protected and the consequences for the (global) economy will be incalculable. The MiCA proposal in its current form adequately tackles this issue and changes in this structure to allow holders of ARTs the same rights as holders of EMTs should not be made without first considering the major risks and mitigation thereof.

Both MiCA and the STABLE Act leave a lot to be desired when it comes to supervision of Stablecoins. While the European proposal consists of an elaborate supervision regime including Supervisory Colleges, the STABLE Act hardly regulates supervision at all. Neither strikes the right balance between protecting consumers through suitable supervision while creating clarity for these issuer-institutions as to what rules they have to adhere to and under whose supervisory authority they are placed. While MiCA must reduce the complexity of their supervisory system, the Act, on the other hand, would benefit from the further specification of the Federal Banking Authority charged with oversight. While some may say that the Office of the Comptroller of the Currency (“OCC”) should be charged with this task, it has become clear that Tlaib, García, and Lynch did not have them in mind for this task as they wrote a pointed letter in response to the OCC’s recent plans to offer special-purpose payment charters. It was clear that they were concerned about the OCC’s overreach their letter stated that

The decisions of your agency have the potential to adversely affect banking and financial activities well beyond your jurisdiction. In particular, decisions regarding the classification and regulation of “crypto assets” and crypto-related payments services may have secondary effects on the entire hierarchy of financial assets denominated in U.S. dollars, as well as the more traditional means by which retail and wholesale payments are made in the United States and abroad.⁶⁹

⁶⁸ Letter to the OCC on Fintech Charters (10 November 2020) <https://tlaib.house.gov/sites/tlaib.house.gov/files/Letter%20to%20the%20OCC%20on%20Fintech%20Charters_Tlaib_Lynch.pdf> accessed 11 September 2021, 2.

⁶⁹ Michael Bleaney, ‘Argentina’s Currency Board Collapse: Weak Policy or Bad Luck?’ (2004) 27(5) *The World Economy* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=538213> accessed 11 September 2021.

The STABLE Act would benefit from some elaboration or clarity as to what agency will be involved. Among eligible agencies, the one most likely to be involved based on the Gramm-Leach-Bliley Act would be the FTC. Its involvement would ensure that financial institutions can explain how they share and protect customer data. Another agency that is likely to be involved is the Consumer Financial Protection Bureau (“CFPB”), which came into existence through the Dodd-Frank Wall Street reform. This agency aims to protect consumers against deceptive practices by financial institutions through supervision and enforcement.⁷⁰ This patchwork of supervisory financial agencies, although typical for the United States’ financial oversight regime, may not be beneficial to supervise the issuers of Stablecoins due to the complex nature of the underlying technology. Creating a clear supervisory overview or reducing the number of agencies involved would benefit these agencies, the issuers themselves, and consumers as they can rely on a cooperative collaboration between agencies. Mitigating these weaknesses in both proposals would strengthen the safeguards they aim to offer for consumers while maintaining the balance needed to allow room for innovation.

B. INNOVATION

The core weaknesses of both proposals are also present in the innovation dimension. Regulating DLT in a way that encompasses all the core characteristics and complexities of this technology seems to have been the greatest challenge for the lawmakers. Both proposals take a stringent approach which still leaves a lot to be desired with regard to the regulation of DLT.

In MiCA, the complexities of DLT are simply dealt with by stating that algorithmic Stablecoins that aim to maintain a stable value through a protocol cannot be considered ARTs.⁷¹ The proposal does not include the possibility of decentralised, protocol-generated Stablecoins pegged to a single currency. While it does not regulate these tokens as Stablecoins, obligations for crypto-assets other than ARTs or EMTs may still apply. While it may be beneficial for consumers that even these tokens do not escape the reach of MiCA, it is problematic that holders are not granted the same level of protection as EMT or ART holders. This discrepancy seems to stem from an inadequate understanding of protocol-generated tokens backed by currency or a basket of assets. Lack of centralisation should not mean a lack of suitable legislation to cover technological progress. Regulating this type of token will help promote innovation while protecting consumer-holders. While MiCA does not offer sufficient consumer protection for

⁷⁰ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010), Title X.; Gramm-Leach Bliley Act, Pub.L. 106–102 (1999), Title II s 201.

⁷¹ *MiCA* (n 5) art 26.

holders of these tokens, the STABLE Act does not fare any better with regard to innovation. Mitigating these risks and addressing this imbalance can only be done by engaging with the technology, its complexities, and the experts in the field and amending the legislation accordingly. Creating room for a regulatory sandbox to gain insight into the way this technology works may be a good starting point for both the US as well as the Union. The EU has taken steps to include a pilot regime for DLT-based instruments. This regime allows DLT market infrastructures to be temporarily exempt from specific requirements of the EU financial legislation to provide the European Securities and Markets Authority (“ESMA”) with a chance to gain experience and insight into the risks, technology, and opportunities of DLT.⁷² The EU is already moving in the right direction and will hopefully implement the lessons learned from this pilot regime in the MiCA framework. The US would benefit from a similar approach and should take note.

The point raised regarding technological neutrality also warrants further analysis. The core problem visible in MiCA lies with the central definition of crypto-assets, which was not formulated neutrally. The STABLE Act, on the other hand, has bigger problems to tackle. While the definition used for Stablecoins does not include an explicit reference to DLT, it mentions cryptocurrencies. These are inherently ledger-based which makes the definition not entirely neutral. However, it also refers to other privately-issued digital financial instruments, providing room for non-ledger based instruments. The definition used incorporates other instruments as such and does not make reference to similar technologies or ledger-based instruments, thus ensuring its adequacy to regulate future innovation in the DeFi sphere as well. What is problematic about the STABLE Act is not the definition in itself but the fact that it does not apply to cryptocurrencies that do not fit the definition of Stablecoin. The US does not have one overarching DLT framework in place, even though Congress has been urged to create one on numerous occasions and an increasing number of states have adopted DLT-related resolutions and acts.⁷³ Merely regulating Stablecoins is no longer sufficient and leaving out other dollar-denominated liabilities clearly shows a preference toward instruments that are not DLT-based. Changing this to an overarching framework would be beneficial for innovation as

⁷² Proposal for a Regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology [2020] COM/2020/594 final, recit. 5.

⁷³ Kevin Helms, ‘SEC Urges Congress to Pass Cryptocurrency Legislation to Protect Investors’ (*Bitcoin* 28 May 2021) <<https://news.bitcoin.com/sec-congress-pass-cryptocurrency-legislation-protect-investors/>> accessed 11 September 2021; Christopher Giancarlo, ‘Written Testimony of J Christopher Giancarlo, chairman of the CFTC before the Senate Banking Committee’ <<https://www.banking.senate.gov/imo/media/doc/Giancarlo%20Testimony%202-6-18b.pdf>> accessed 11 September 2021.

well as for consumer protection. Surprisingly, it seems as though this thought has finally been put to action as in May 2021, Congressman Beyer introduced the *Digital Asset Market Structure and Investor Protection Act*, an overarching regime for digital assets.⁷⁴ This Act allows the Federal Reserve to issue their own Central Bank Digital Currency (“CBDC”) and requires the SEC and CFTC to delineate the crypto-assets that fall within their respective purview. It remains uncertain if it will gain enough traction yet seems a step in the right direction.

As stated before, both MiCA and the STABLE Act create several requirements for their issuers and service providers. Under MiCA, issuers of significant tokens will have to maintain 3% of the average value of the reserve assets in own funds. To illustrate the impact of this requirement, the 3% obligation will be applied to Tether. Tether would, after the enactment of MiCA, be classified as significant. As mentioned above, this would also mean that the issuer of Tether, Tether Limited, must abide by the 3% rule of articles 41(4) and 31(2)(b). This rule requires Tether to maintain USD 1,509 billion in own funds as in April 2021, USD 50.3 billion backed Tether.⁷⁵ This is disproportionate toward those issuing significant tokens and cannot be used to regulate the crypto-sphere. If adopted, this requirement will essentially make it impossible to meet the demands imposed on issuers of significant tokens. Such a high threshold would effectively kill significant Stablecoins as issuers can hardly meet these financial requirements. The STABLE Act does not fare much better as it requires issuers of Stablecoins to become banks. This includes obtaining a banking charter, having sufficient capital to support its risk profile, and starting capital. Filling a request for a banking charter alone will already cost more than \$15,000 and starting capital needed can be over \$20 million.⁷⁶ Moreover, the bank must meet the minimum capital requirements in place dependent on its tier. Fitting Stablecoins into the existing framework would create too big an administrative burden as well as pose a massive financial burden. The most relevant Stablecoins currently in existence may be able to meet these financial requirements yet they may get entangled in the STABLE Act’s strict approach towards all those engaged in Stablecoin-related activities.

Zooming out, it is evident that both MiCA and the STABLE Act exacerbate the bundled banking system without questioning the underlying system of money, payments, and banking. The STABLE Act proposes to bring the threat of this new, unbundled means of payment within

⁷⁴ Proposal for a Digital Asset Market Structure and Investor Protection Act
<https://beyer.house.gov/uploadedfiles/beyer_028_xml.pdf> accessed 11 September 2021.

⁷⁵ Olga Kharif, ‘Crypto’s Shadow Currency Surges Past Deposits of Most U.S. Banks’ (*Bloomberg* 1 May 2021)
<<https://www.bloomberg.com/news/articles/2021-05-01/crypto-s-shadow-currency-surges-past-deposits-of-most-u-s-banks>> accessed 11 September 2021.

⁷⁶ *State of New Jersey Department of Banking and Insurance* (n 57).

the purview of banks while MiCA allows some unbundling to take place with regard to the provisions on issuers of (S)ARTs. Their E-Money counterparts, (S)EMT issuers, are still regulated in a similar manner as banks are. (S)EMT issuers are obligated to become credit institutions under the E-Money Directive and are placed within a similar regime as traditional banks. This indicates that both proposals privilege and protect the system currently in place and allow it to maintain an advantage over FinTech. The law serves as a means to exacerbate the existing business and setup of banks, however inefficient and not inclusive they may be. To illustrate, banks are the sole claimants on the Federal Reserve or the ECB, thereby providing a safety net in case of crises or bankruns that Stablecoin-issuers would not have.⁷⁷ In case a run on Stablecoins happens, the issuer will almost always face bankruptcy. By design, banks have an enormous advantage compared to other non-bank entities. Secondly, banks are the only entities in the US permitted to become members of the Federal Reserve and in the EU of the ECB. This legal arrangement only further exacerbates the entrenchment of traditional banks and makes them almost impossible to compete with. Opening up membership or a specific form of membership to non-bank entities would help issuers of Stablecoins (or other FinTech products) by providing a ‘lender of last resort’ structure. It would ensure the protection of consumers in case of crises and ensure that new players on the market who only wish to provide either money, payments or banking have room to innovate. This would decrease our reliance on banks and provide access to faster, more inclusive and less costly means.⁷⁸

The last observation regarding the STABLE Act relates to innovation as well as consumer protection. One of the core aims of the STABLE Act is to protect vulnerable communities and low- and middle-income households from bad actors as well as tackle the barriers presented by traditional financial services and institutions. Although it is acknowledged that the underlying technology is different and presents unique challenges, the drafters claim that the core fair lending risks are the same as in the past.⁷⁹ The drafters addressed these risks in the Act by placing Stablecoins in the pre-existing financial legal framework. Instead of breaking down the barriers in place that make it difficult for members of these communities to gain access to financial institutions, the drafters placed this alternative instrument in the system that created these barriers in the first place. As elaborated upon in the 2019 FDIC survey of unbanked and

⁷⁷ *Anvey* (n 4) 24.

⁷⁸ *ibid* 37.

⁷⁹ Rashida Tlaib, ‘The Stablecoin Tethering and Bank Licensing Enforcement Act: One pager’ (*Tlaib House* 2020) <https://tlaib.house.gov/sites/tlaib.house.gov/files/STABLE_Act_One_Pager.pdf> accessed 10 September 2021.

underbanked households, 7.1 million households were unbanked in 2019.⁸⁰ One of the most cited reasons for being unbanked is the costs involved in opening and maintaining a bank account. Bank account fees, minimum deposits and minimum balances all amount to millions of households without access to financial services, loans, lines of credit, and savings accounts. The (perceived) lack of access to these institutions and services as well as distrust in the system lies at the core of this problem.⁸¹ Instead of truly solving the core problem underlying these barriers to access, the STABLE Act merely proposes to make Stablecoins part of the entrenched bundled banking structure that results in vulnerable communities looking elsewhere to have their financial servicing needs met.⁸² This Act will not help vulnerable (unbanked) communities at all as it will merely result in maintaining the status quo with regard to consumer protection and it will further hamper innovation.

VI. CONCLUSION

It has come to light that both EU and US regulators aim to regulate Stablecoins in an entirely different manner even though they share the same concerns regarding financial stability, consumer protection, and innovation. While the STABLE Act solely focuses on Stablecoins and places these tokens in the existing financial system, MiCA aims to provide a bespoke framework for all crypto-assets. Both approaches, however different they may be, do not strike a productive balance between innovation and consumer protection and do not take the complexities of this technology into account.

The balance has tipped too far to the side of consumer protection and the importance of fostering innovation in this field seems sidelined by regulators. Both proposals would benefit from rebalancing the scales to foster innovation while at the same time offering sufficient protection to consumers. Involving subject-matter experts as well as creating regulatory sandboxes should be considered in order to help further the understanding and proper regulation of this technology. It is necessary to take some weight off the consumer protection side by aligning the obligations for issuers and service providers with common practice and (liability) standards in the field of traditional financial services. Furthermore, this dimension would benefit from the creation of a clear and comprehensible framework of supervision that does not blur responsibilities between agencies and is not prone to leveraging by a single actor. Mending

⁸⁰ Federal Deposit Insurance Corporation, *How America Banks: Household Use of Banking and Financial Services* (2019 FDIC Survey), [1](#).

⁸¹ *Tlaib* (n 5).

⁸² *ibid.*

these core issues and rebalancing these proposals can help prevent outward innovation migration while at the same time ensuring consumer protection. Moreover, striking the right balance will help ensure that this innovative instrument can be used safely without further concerns for global financial stability. As the Stablecoin market has quadrupled in 2021, it is necessary to take action now and ensure that these new financial instruments are properly regulated. Rebalancing these proposals and allowing room to unbundle the system of money, banking, and payments could also kickstart the secure trade and use of Stablecoins, ensure US and EU competitiveness on this market, foster innovation in the financial sector and allow it to step out of the regulatory shadows. Perhaps more importantly, it could help ensure that financial stability will not be at risk in the scenario that one of these Stablecoins becomes the centre of the crypto-trading system and launches us into the future of payment.