

## REGULATORY INTELLIGENCE

## Busy times in fintech: EU and Financial Stability Board's proposal for regulation of stablecoin arrangements

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This second article continues to look at recent regulatory developments affecting the fintech industry. The first [article](#) looked at the UK Financial Conduct Authority's (FCA) ban on the marketing and distribution of crypto-derivatives to retail investors and its latest sandbox schemes. Here, we discuss developments in the EU and the Financial Stability Board's (FSB) proposal for the regulation of global stablecoin arrangements.

### New EU-wide rules for crowdfunding platforms

On October 5, 2020, the European Parliament [adopted](#) a new crowdfunding regulation which will give crowdfunding platforms the ability to become authorised in one EU member state and passport throughout the EU, complying with only one set of rules. EU member states will not be able to impose additional requirements on platforms operating under the regulation nor require them to have an establishment in that member state.

The new rules, which will take effect on November 10, 2021, apply to all European Crowdfunding Service Providers (ECSPs) that raise up to 5 million euros per project (calculated over a period of 12 months per project owner) and ECSPs will need to comply with certain governance requirements and be of 'good repute'. There are also provisions to ensure investor protection and the fair treatment of clients, for example:

Key investment information sheets and risk warnings;

- requirement to give investors clear indications of the financial risks and charges that they may incur, including insolvency risks and project selection criteria;

- "entry knowledge tests" every two years and 'appropriateness' assessments (with warnings if an investment is deemed inappropriate);

- limits on how much non-sophisticated investors (i.e retail investors) can invest;

- ability for non-sophisticated investors to undergo a "reflection period" during which they can change their minds about an investment and get their money back; and

- complaints handling, client asset and conflicts of interest requirements.

The new rules will come in after the UK leaves the EU and will not therefore apply in the UK. There is no equivalence regime in the final EU rules. However, under a report to be compiled by the European Commission 24 months after the rules come into force, there is a commitment to consider the appropriateness of allowing entities established in third countries (such as the UK post-December 31, 2020) to be authorised as ECSPs under the regulation. The UK government has said it will review that report, and that it will consider whether similar changes in UK law would enhance the competitiveness of the UK's crowdfunding and peer-to-peer lending sectors.

### Proposal for EU pilot to encourage DLT market infrastructures

On September 24, 2020, the European Commission proposed a pilot regime for market infrastructures based on distributed ledger technology (DLT). The pilot is part of the EU's Digital Finance Strategy which aims to support the potential of digital finance in terms of innovation and competition while mitigating the risks. One of the strategy's priority areas is ensuring that the EU financial services regulatory framework does not pose obstacles to the application of new forms of technology.

The DLT pilot would see the creation of an EU-wide 'sandbox' that would include temporary derogations from rules for market infrastructures that wish to experiment trading and settling transactions in financial instruments in crypto-asset form. The idea is that the DLT pilot would help regulators gain experience of DLT in market infrastructures, while ensuring they can deal with risks to investor protection, market integrity and financial stability.

The DLT pilot would be open to:

- authorised investment firms and market operators who would be eligible to apply to operate a DLT multilateral trading facility (MTF); and

- authorised central securities depositories (CSDs) who would be eligible to apply for permission to operate DLT securities settlement system.

Under the DLT pilot, supervisory authorities would be able to grant exemptions from provisions which currently restrict trading venues and settlement systems from using DLT in their frameworks. Examples of exemptions would include:



investors being admitted to DLT market infrastructure without an intermediary;  
instant settlement of transactions using DLT payment systems, resulting in simultaneous transfer of money and securities; and  
transferable securities traded on DLT MTFs which do not need to be recorded with CSDs.  
The DLT pilot would last five years. The European Securities and Markets Authority would then produce a detailed report evaluating the success of the DLT pilot. The pilot is expected to be implemented by 2024.

DLT is expected to make the entire system of trading and post-trading of financial instruments more efficient. The DLT pilot allows for experimentation with emerging technologies within a more certain framework, disrupting traditional market infrastructure.

### **Proposed regulation on markets in crypto-assets**

On September 24, 2020, the European Commission issued a draft proposal for a potential Regulation on Markets in Crypto-assets (to be known as "MiCA"). This is the first time the Commission has proposed legislation for crypto-assets.

MiCA proposes to harmonise the rules on crypto-assets across the EU. It would allow issuers to offer their crypto-assets across the EU, benefiting from greater legal certainty whilst at the same time providing for investor protection and reducing market fragmentation.

The proposal also includes safeguards to address risks to financial stability and orderly monetary policy that could arise from potentially disruptive crypto-assets, such as stablecoins. Safeguards include capital requirements, custody of assets, a mandatory complaints-handling procedure for investors and rights of the investor against the issuer. Issuers of significant asset-backed crypto-assets (such as global stablecoins) would be subject to more stringent requirements (e.g. in terms of capital, investor rights and supervision).

MiCA aims to boost innovation while preserving financial stability and protecting investors from risks. It has four main objectives:

- legal certainty for crypto-assets not covered by existing legislation;
- uniform rules for crypto-asset service providers and issuers at EU level;
- replacement of existing national frameworks applicable to crypto-assets not covered by existing legislation;
- establishment of specific rules for stablecoins, including when these are e-money.

Although MiCA will not be directly applicable in the UK, the government will be consulting on the UK's approach to crypto-asset regulation, including stablecoins, later this year and it remains to be seen to what extent the UK's approach will follow the EU's.

### **FSB publishes recommendations for global stablecoin arrangements**

On October 13, 2020, following a public consultation, the Financial Stability Board (FSB) published its high-level recommendations for the regulation, supervision and oversight of global stablecoins (GSCs).

Stablecoins (a class of crypto-asset that ties its value to one or more other assets, such as sovereign currencies) seek to offer the benefits of cryptocurrencies (such as efficient cross-border payments and increased financial inclusion) while avoiding the volatility that is often associated with them. However, the FSB believes that they may also generate risks to financial stability, particularly if they are adopted at a significant scale.

The FSB points out that a widely adopted stablecoin with a potential cross-border reach (a GSC), could become systematically important across different jurisdictions and the risks of growing GSC use could span across banking, payments, and securities/investment regulatory regimes both within jurisdictions and across borders.

The FSB believes that the emergence of a GSC could challenge the comprehensiveness and effectiveness of existing regulatory and supervisory oversight. It has therefore put forward ten high-level recommendations addressed to authorities at a jurisdictional level which aim to address this. It advises national authorities to clarify their regulatory powers and address potential gaps in their domestic frameworks to ensure that the risks posed by GSCs are adequately addressed.

To keep pace with the evolution of GSC arrangements and market developments, the FSB has said it will review its recommendations on a regular basis to ensure they remain relevant and continue to promote effective regulation and oversight of GSC arrangements.

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