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EU's proposed crypto regulations are flawed

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As the crypto world goes through yet another bout of turmoil, it is clear that stronger regulatory oversight of digital assets is needed.

The EU will soon roll out a specific regulatory framework for cryptocurrencies and markets. The move comes as digital assets are plunging and a crisis has engulfed some of the world's biggest 'stablecoins'.

Cryptocurrencies have become popular despite the fact that there is very limited or no oversight. Whether they are Ponzi schemes, money-laundering shells or stablecoins pegged to real-world assets, it is difficult for ordinary investors or users to know which is which. Where they are based, how they are organised and who is backing them is often an enigma. This is a cause of concern.

But there are reasons why EU proposals are not the right remedy. Under the planned regulations, only crypto coins authorised in the bloc can be offered to investors. But crypto assets and exchanges will have a very light supervisory regime, much less than what is in place for financial instruments and other exchanges. That raises the question about why distinct rules are needed.

The industry is divided into three different forms in the proposed EU Markets in Crypto-Assets Act: Non-fungible tokens (NFTs), or virtual gadgets; stablecoins, whose value is meant to be linked to a real-world asset; and digital currencies, which always represent a fixed exchange rate to a hard currency.

Digital currencies can be issued only by banks or fintech companies that already have a license to do so, while issuers of stablecoins must have a minimum level of reserves.

The EU is the first international organisation to propose a specific regulatory framework. Certain Member States already have special legislation for tokens and crypto, but there is no agreement on this at a multinational level. Outside the bloc, countries such as the UK and US and territories including Hong Kong are reluctant to impose dedicated rules and apply existing securities legislation.

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This has led to an unclear framework for a digital product that has become an international phenomenon. Consumers have at present little idea of their rights to protection or redress, especially if the transactions take place outside the EU.

Non-EU crypto currencies, such as bitcoin or ethereum, will have to register under one of these forms to gain admission to the EU market. A system of mutual recognition is unlikely, given that regulations vary too widely internationally. The brunt of the risks will be borne by the consumer, who will see no difference between EU or international crypto but will still be besieged on social media with adverts for unregulated cryptos, or even flat-out scams.

The EU's Mica proposal raises many more problems. Supervision is very limited and split between national or European regulators. Under the proposed rules, it is much easier to start a crypto exchange than a traditional exchange, which is governed by the European financial markets rule book known as MiFID.

Provisions against market manipulation and insider trading are very light, hardly comparable with existing EU law. And accounting standards and tax rules for crypto companies do not exist. On the other hand, some EU countries also apply existing consumer protection or market regulation to crypto publicity. How that interaction will work in practice remains a big question.

The EU would have been better off considering crypto under existing laws, rather than creating a new regulatory framework. This means applying MiFID for cryptoassets, considering them financial instruments. Electronic money or banking rules could be used for digital money. NFTs do not require sperate rules, but can be covered under existing consumer or intellectual property legislation.

Market and business conduct rules should apply regardless of the packaging. Start-ups in the crypto sector will say that this will make the market unattractive, but why should they be subject to lighter supervision for their financial operations?

An international framework is required to regulate crypto with a common approach. Diverse regulatory approaches enable regulatory arbitrage and a race to the bottom, where providers are the winners, and investors the victims. And an unregulated crypto sphere just encourages misunderstanding and potential abuse of a fundamentally interesting innovation.

Even more important is to inform consumers adequately about the dangers of investing in crypto, and the need to distinguish between fraudulent and well-intentioned schemes.

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