Informal ECOFIN, September 7-8 2018

The economic potential and risk of crypto-assets

PRESIDENCY ISSUES NOTE

I. Introduction

Crypto-assets have become a global phenomenon in the financial services sector in recent years, with increasing awareness among the broad public. Crypto-assets are based on the so-called blockchain technology, providing a decentralised, safe and cost-efficient transaction system in many cases. More and more established financial service providers signal their willingness to explore the potential of crypto-assets and the underlying technology.

There is a broad consensus that crypto-assets at this stage do not pose major risks for financial markets' stability, since overall volumes still remain relatively low. However, Finance Ministers and Central Bank Governors have already underlined several times - most recently at the G20 meeting in Buenos Aires - that further developments and potential risks of crypto-assets should be carefully assessed and monitored.

Important issues raised in this context relate to consumer and investor protection, market integrity, money laundering and terrorism financing, tax evasion, data protection and cyber security. Other causes for concern are the lack of transparency regarding companies using initial coin offerings (ICOs) as well as the lack of institutions which could be held accountable by users or regulators in case of irregularities.

Against this background, the Austrian Presidency considers it useful to put this topic on the agenda of the informal Ecofin. The aim is to allow a more in-depth discussion on these issues and to provide possible guidance for further work.

II. Initiatives at the EU-Level

In the recent past, a number of measures have been already initiated on both the national and European level. A roundtable on opportunities and risks organised by the European Commission concluded that a future regulatory framework should strengthen consumer protection, the integrity of financial markets and financial stability on the one hand and make full use of the technological developments on the other hand. Furthermore, the Commission presented a FinTech Action Plan which includes a "European Financial Transparency Gateway" and an "EU Observatory and Forum on Blockchain", among other things. Last but not least, there is already a comprehensive set of regulatory and supervisory provisions in place covering certain aspects of the new technology. Hence, it is still to be assessed if changes to the existing regulatory landscape are required.

III. Opportunities

The use of crypto-assets and the underlying blockchain technology provide highly innovative opportunities. They are already used in many ways, especially in the financial sector, i.a. for the purpose of clearing, money transfers (e.g. remittances) or transactions including smart contracts. Blockchain technology may reduce transaction costs significantly. Moreover, ICOs have established an effective and efficient way to raise capital. This could contribute to more dynamic markets and provide companies with alternative ways to swiftly access financial means for innovative ventures. Against this background, technical developments may also contribute to a deeper integration of capital markets in the European Union.

To create the appropriate environment for fully exploiting the potential of new technologies it is important to take account of the needs of all stakeholders and ensure a level playing field for all market participants. Consumers need to be protected without creating excessively burdensome regulation. A practical example is the regulatory sandbox which provides a 'safe space' to foster innovation while ensuring consumer protection.

IV. Challenges

As already mentioned, crypto-assets touch upon a range of different regulatory fields:

- A major issue concerns **money laundering, terrorist financing and tax evasion**. The revision of the Anti-Money Laundering Directive (AMLD5; adopted by the Council and the European Parliament recently) already includes an expansion of the scope to virtual currency exchanges and wallet providers. Whether the definition of crypto-assets[1] under the AMLD 5 is sufficient for combatting money laundering, terrorist financing and tax

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[1] "*A digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency, and does not possess a legal status of currency or money, but is accepted by natural or legal persons, as a means of exchange, and which can be transferred, stored and traded electronically.*"

evasion will have to be evaluated. Furthermore, it is necessary to consider not only present but also possible future developments in the area of crypto-assets to be covered.

- Further issues concern the **regulatory classification** and **lacking transparency** regarding the identity of issuers or underlying business plans of companies using ICOs. ICOs have become increasingly popular, with capital raised amounting to more than USD 7bn in March 2018. Since then, ICO-based funding has decreased dramatically, however.

- **Risks of information and communications technology** (ICT) are already an important issue in many areas of financial services. As recent fraud cases and other related issues have shown, this is also of paramount importance for crypto-asset related services.

- A lack of clarity refers to **data protection issues**. The newly implemented *General Data Protection Regulation (GDPR)* stipulates the right to delete and correct data which seems nearly impossible in a system based on a public blockchain.

- Finally it is necessary to carefully monitor **potential risks for financial stability**. Since the underlying technology is not bound by borders, global coordination on key regulatory questions is required.

V. Conclusion

Crypto-Assets may lead to significant changes in the financial world. In order to foster the innovative potential and at the same time combat misuse, it is necessary to examine and enhance existing legislation in a way that takes into account this new phenomenon adequately. This will add legal certainty for market participants on the one hand and a more effective closing of blind spots on the other hand.

VI. Issues for discussion

1) **In your view, are there missing elements in the EU regulatory framework when it comes to adequately addressing potential risks posed by crypto assets?**

2) **What specific provisions might be required in order to fully exploit the crypto-industry´s potential, in particular to act as a finance raising tool for companies?**

3) **Could you share your ideas and experiences on the potential and risks of crypto-assets and on national regulatory initiatives adopted or in preparation, respectively?**

4) **How do Central Bank Governors view crypto assets and their potential impact on monetary policy?**