

The Cryptocurrency Market and The Regulatory Framework of EU Legislation

Blerina Muskaj

Faculty of Political Sciences and Law, Aleksandër Moisiu”
University of Durrës, Albania

Email: blerina_muskaj@yahoo.com

Abstract

Cryptocurrencies belong to a global market without national or regional boundaries, the location of whose users is often unknown. In most jurisdictions, they do not fall within the regulatory scope in force and in any case there are no specific provisions. The EU is the first legal system that defines a framework for cryptocurrencies, a complete and timely legislation even though it does not fully achieve all the objectives it sets itself. On crypto-asset markets the European Commission published the proposal for a Regulation of the European Parliament and of the Council on 24 September 2020 as part of the broad digital finance strategy package, which is destined to have significant and long-term effects on the system global financial as it aims to provide regulatory certainty for companies offering financial services of this type in the European legal space. Overall, the package deals with the retail payments strategy and digital finance. The first includes four legislative proposals, including MiCA2, where the Retail Payments Strategy sets out a series of specific measures for payments which, taking into account the pace and scale of technological change in the sector, go beyond the horizontal scope of the digital finance strategy. This is the first legislative initiative at European level which describes a market with ethical and secure boundaries, capable of achieving innovation and responsible competition among financial service providers by introducing a harmonized and comprehensive framework for the issuance, application and provision of crypto-asset services.

Keywords: European Parliament, Cryptocurrencies, MiCA, European Commission, Digital Finance, European Central Bank.

Introduction

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The cryptocurrency market is creating an ongoing popularity which now represents a fundamentally global reality with characteristics that increasingly resemble traditional financial markets. Crypto-assets pose a threat to financial stability but also represent high-risk speculative investments, and in this sense must be included within a regulatory perimeter in accordance with the prevailing standards in the financial system.

The Treaty on the Functioning of the European Union has the power to establish appropriate provisions regarding the institution and functioning of the internal market (Article 114 TFEU) assuming that crypto-assets represent one of the most important applications of blockchain in the financial world. The aim of the European action is to define a regulatory framework in which a cross-border market can be developed by nature by defining an applicable legislation for the issuance, trading, clearing and regulation of financial instruments being harmonized mainly at EU levels.

The wave of public interest in cryptocurrency investments has led the Union to take responsibility for the risks that unregulated virtual assets pose to investors and markets and, among these, in particular, the risks of money laundering and terrorist financing. On June 29, 2022, the Council of the European Union and the European Parliament reached a provisional agreement on the proposal aimed at expanding the scope of application for cryptocurrency transfers¹⁸. The European Central Bank on October 2, 2020, published a comprehensive report, approved by the Governing Council, on the possible issuance of a Central Bank Digital Currency (CBDC)(F. Panetta 2021).

Cryptocurrencies are digital assets that depend on cryptography and DLT Distributed Ledger Technology. This technology, and blockchain in particular, has the potential to revolutionize the way financial assets are issued, accessed and shared via digital networks. (Blockchain is a form of distributed ledger where transaction details are stored on the ledger in the form of blocks of information. A block of new information is attached to the chain of pre-existing blocks via a computerized process by which transactions are validated. It is a technology that has proven to be excellent at preserving large databases while allowing widespread access and preventing malicious attacks.)

It is involving small investors connecting with the financial system, which is becoming a source of concern for the regulators since, in the Member States, the risks of the uncontrolled development of virtual currencies are important both from a macroeconomic point of view and from a microeconomic point of view, since they have to do, on the one hand, with consumers and investors(P. Cipollone 2020), and on the other hand with financial and political monetary stability. The stability of

global finance can also be affected by their distribution in the savings of small investors and by the inclusion, in particular, of cryptocurrencies in the assets of investment funds. Given that autonomous private decisions regarding the monetary supply can reduce the ability of banks central to effectively implement monetary policy all cryptocurrencies are controlled by private individuals, therefore the issue of influence on the monetary system becomes very important.(S. Lucarelli 2019)

In the case of cryptocurrencies that fall outside the scope of the proposed regulation, national regimes that aim to regulate the cross-border provision of cryptocurrency services may, due to different approaches, harm the level playing field, as some risks will be mitigated in Member States that introduce a specific regime for crypto-assets, consumers, investors and market operators, while, in other Member States, the latter may be exposed to more significant risks in terms of, for example, fraud, cyber-attacks, market manipulation. The definition of a single digital market presupposes, on the other hand, the reduction of risk related to the interconnection and stability of financial systems

Proposals and regulatory framework of services for crypto-assets

The provision of crypto-asset services within the EU can only be carried out by legal entities that have a registered office in the EU and are authorized as cryptocurrency service providers in accordance with Art. 55 of the MiCA proposal. In this regard, according to the article. 53, par. 3, an authorization of a crypto-asset service provider is valid throughout the single market and allows crypto-asset service providers to provide the services for which they are authorized throughout the Union, thanks to the right of establishment, by including through a branch, or through the freedom to provide services. In order to provide crypto-asset services, which include the operation of a trading platform or other crypto-assets, the relevant enterprise must be authorized according to a process that includes a significant control over the company's own activity, executive management and control systems.(G. CARELLA 2022)

A crypto-asset service provider is any person whose profession or activity consists of providing one or more crypto-asset services to third parties on a professional basis ensuring that the upcoming regulation applies to most crypto-asset companies. assets, especially in relation to market points that are not yet well defined and to buy all types of crypto-assets that currently fall outside the scope of EU financial services legislation. Investor protection remains a focal point and therefore additional obligations relating to safekeeping of funds, corporate structure and management qualification must be met. Crucially, providers offering cryptocurrency services on a cross-border basis are not required to have a physical presence in the host Member States or in the Member States where they wish to provide services if they are different from the home Member State. Therefore, the authorization must be mutually recognized and the competent authorities at national level ensure that it specifies the crypto-asset services that the providers are authorized to provide.

Based on the article. 54, par. 1 of the MKR proposal, legal entities intending to supply crypto asset services must apply for authorization as service providers from ESMA. Third country businesses due to the inherently digital nature of crypto-asset services are often able to provide services to clients without any physical or legal presence in the Union. This presents a significant risk of circumvention of the rules in the regulation, as well as a competitive disadvantage for crypto-asset service providers authorized in the Union compared to competitors from third countries. So, based on what paragraph 51 clarifies, no natural or legal person shall be authorized to offer crypto-asset services to citizens of the Union on a non-casual basis without having a legal representative in the EU and without being authorized under the proposed regulation, including when these services are provided exclusively at the initiative of EU customers. Regarding service providers for significant crypto-assets, ESMA, according to art. 53, par. 1 of the proposal requires that the suppliers themselves obtain the authorization before they start providing the services. In the same cases, ESMA is responsible for supervision in close cooperation with the competent authority of the Member State.

The proposed regulation also sets out the framework for regulated "crypto-asset services" in which a crypto-asset service is defined as any service and activities related to: custody and administration on behalf of third parties; for managing a trading platform; for the exchange of crypto-assets with a fiat currency that has the status of legal tender; for exchanging crypto-assets with other crypto-assets; for the execution of orders on behalf of third parties; for placement; after transfer; for receiving and transmitting orders on behalf of third parties; for providing consultancy; for the exchange of crypto-assets with financial instruments.(F. Annunziata 2022)

The Regulation aims to create a comprehensive regulatory framework, continuous monitoring will remain necessary as a system, through new models and risks. Consequently, it evolves rapidly, possibly requiring further regulatory interventions over time, which may be modified under the influence of new knowledge. For example, a more widespread adoption of cryptocurrencies could expand the interrelationship between the cryptocurrency market and the traditional financial market.

Conclusions

The cryptocurrency market has raised concerns especially regarding high price volatility, abuse and risk of money laundering, and, in fact, much of the growth of crypto markets in recent years can be attributed to exponential growth of decentralized finance (N. Borisov 2021).The EU is the first legal system that defines a framework for cryptocurrencies, a complete and timely legislation even though it does not fully achieve all the objectives it sets itself. In most jurisdictions, they do not fall within the regulatory scope in force and in any case there are no specific provisions.

Cryptocurrencies belong to a global market without national or regional boundaries, the location of whose users is often unknown. With the entry into force of the act, we will have the hypothesis of regulated and unregulated decentralized finance, with the risk of "leakage" to countries outside the EU where the EU market appears more punitive than others.

However, despite the highlighted limitations, the proposed legislation seems fair and balanced, especially after the changes made by the European Parliament since the year which harmonizes the European cryptocurrency market, creating a level playing field for issuers and service providers. Given the size and importance of the single market, the proposal, by setting regulatory standards, has the potential to create an innovative market and, with the reported adjustments in terms of greater proportionality, to attract non-EU market participants. These positive consequences also benefit consumers, guaranteeing them protection and choice from competition.

By introducing a mandatory licensing regime for providers offering services for crypto-assets together with a European-level passporting mechanism, the text envisages regulation similar to that applicable to the financial instruments market. Regarding the objective of the regulation, for defining the limits with other financial instruments, there remain areas of uncertainty and overlap.

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