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Crypto assets – reaping the benefits while addressing the risks

The ongoing digital transformation of the financial system brings along with it innovative classes of assets or products relying on new technologies. One of these are crypto assets built on distributed ledger technologies (DLT).

The market for crypto-assets is very small compared to the market for traditional financial assets. It has historically been prone to leverage, operational risks and high volatility. While stressing the potential of DLT, many authorities have therefore issued warnings about the risks related to certain crypto-assets.[1]

Even so, crypto assets could deliver many benefits.They could increase efficiency, as DLT offers a way to record key information in a safe, immutable format and can make that information widely accessible.It could also increase the efficiency of payments, by reducing cost, increasing speed, security and user-friendliness.It could enhance competition in payment markets, also by encouraging incumbents to improve.

However, there are also challenges. Price volatility undermines their utility as a means of payment, exchange or store of value. However, some crypto assets – so-called "stablecoins" – address this by stabilising their value against an underlying pool of assets.If this is credible and effective, they are more likely to be used for payments. This could be particularly promising for cross-border payments, notably remittances, where there is indeed margin for improvement.

Beyond price volatility, there are also important operational challenges related to e.g. the ability to scale up DLT.A key challenge, however, relates to the lack of certainty about the rules that apply, as many crypto assets are likely to fall outside existing financial services legislation.

While for all these reasons, the market for crypto assets has remained small, the market is developing rapidly notably in the stablecoin area. This heralds the possibility of such instruments becoming more widely used, notably as a means of payment. This would come with additional challenges and risks that need to be addressed.

The European Commission in September 2020 adopted a proposal for a regulation on markets in crypto assets (MiCA). It creates a new bespoke framework for crypto assets that currently fall outside EU financial services legislation. MiCA also sets more stringent regulation and supervision of stablecoins.This will allow crypto asset markets and related private sector initiatives to develop on a safe and sound foundation.

As these markets will grow, it remains to be seen how they contribute to more efficient payment arrangements. Stablecoins could potentially become a widespread digital means of payment. As set out in MICA, they should therefore be subject to the same rules as other digital means of payment, so as to ensure a high level of consumer protection and a sound retail payments market.In parallel, the Retail payments strategy will foster the development of instant payment solutions, in a pan-European fashion, which will further improve the efficiency of cross-border payments in the EU and beyond.

[1] See e.g. the 2018 joint warning of the European Supervisory authorities on the risks for consumers of buying virtual currencies. https://www.eba.europa.eu/esas-warn-consumers-of-risks-in-buying-virtual-currencies