



A guide to stablecoins and the law in Ireland

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Given the recent surge in popularity of stablecoins, our Technology and Web3 experts explain more about this particular cryptocurrency and the regulatory challenges in Ireland.

What is a stablecoin?

Stablecoins represent a unique category within the cryptocurrency universe, distinguished by their value being 'pegged' to the value of another currency, commodity, asset or asset group. The purpose of a stablecoin is to provide an exchangeable virtual asset that maintains a relatively stable value commensurate to the value of the underlying currency, commodity or asset. Some of the more well known stablecoins include "USD Tether" and "USD Coin", both tied to the US Dollar. An example of stablecoins pegged to commodities are PAX Gold and Silver Token.

How is the stablecoin's value 'pegged'?

The way in which the value of stablecoins are pegged is achieved in a number of distinct ways:

1. **Fiat-collateralised:** these are stablecoins backed by commensurate reserves of the corresponding currency, for example, USD would be held 1:1 to the number of corresponding stablecoins in issue. This reserve currency would generally be held with third party custodians and / or banks. The central controlling entity would issue new stablecoins and / or destroy an amount in issue in order to ensure that the stablecoin value retains its parity to the underlying fiat currency
2. **Crypto-collateralised:** similar to their fiat counterparts, these stablecoins use other cryptocurrencies as collateral
3. **Asset / commodity collateralised:** as the name suggests, these stablecoins involve reserves of commodities or assets (e.g., gold) to uphold the stablecoin's value

4. **Non-collateralised (algorithmic) stablecoins:** these stablecoins represent some of the most complex stablecoins and do not rely on a reserve asset or pool of assets as collateral. Instead, they rely on centrally developed algorithms to retain their peg to the corresponding fiat currency, cryptocurrency, commodity or asset. Such stablecoins eliminate the necessity for substantial capital reserve but are dependent on consumer confidence. This dependency makes them susceptible to extreme volatility at the hands of a consumer market that often will trade on emotion

What are stablecoins used for?

Stablecoins have emerged as a perceived refuge for investors seeking stability within the crypto market. Recently, stablecoins have been seen as providing investors with an alternative to more traditional crypto holdings, which are associated with higher volatility. Currently, stablecoins are traded across a variety of crypto exchanges and provide investors with a quick and easy way to invest on platforms and exchanges without having to convert their holdings from traditional cryptocurrencies back into fiat currency.

Challenges

Stablecoins have found themselves the subject of increased scrutiny in recent times by regulators and the wider public. The collapse of Terra, an algorithmic stablecoin, was marked by a rapid loss of its peg to the US Dollar, leading to a significant devaluation. This was triggered by a loss of investor confidence and liquidity issues, this event resulted in extensive financial losses for investors who held their funds in Terra and raised serious questions about the stability and viability of algorithmic stablecoins in the cryptocurrency market.

Categorisation of fiat stablecoins in Ireland

Categorising stablecoins and particularly fiat collateralised stablecoins has proven to be a challenge.

Depending on the distinct features of any one specific stablecoin, it is possible for such a stablecoin to fall within one or more regulatory categorisations in Ireland including:

Stablecoins as Virtual Assets

Given the distinctly broad definition of a virtual asset under the Criminal Justice Act 2010 (as amended), it is very likely that any stablecoin, regardless of collateralisation method, would constitute a virtual asset. As such, any person or entity located in Ireland that undertakes to issue, trade in or otherwise provide services in respect of stablecoins may be required to register with the Central Bank of Ireland (CBI) as a virtual asset service provider (VASP).

The CBI have not yet expressed an opinion with regards to how they will address a VASP purporting to issue stablecoins. However, given the CBI will likely be aligned with the EU on Markets in Crypto-Assets Regulation (**MiCA**), it is likely that stablecoins will be dealt with primarily as set out in (d) below.

Stablecoins as e-money

Fiat-collateralised stablecoins might meet the criteria for electronic money, requiring e-money institution authorisation under the European Communities (Electronic Money) Regulations requiring an e-money institution authorisation. This requires an application and registration process with the CBI.

Stablecoins as financial instruments

While stablecoins do not immediately fall within any one particular category of 'financial instrument' under the European Union (Markets in Financial Instruments) Regulation 2017 (**MiFID Regulations**). Each stablecoin may exhibit features that would need to be assessed to determine if it falls within the scope of the MiFID Regulations, and so require an investment firm authorisation with the CBI.

Asset-collateralised stablecoins under MiCA

MiCA establishes a new EU legal framework for crypto-assets that were not previously covered by existing EU financial services legislation (some of which have been referenced above) (**Existing Legislation**). MiCA will cover offerors of crypto assets that are not 'financial instruments' under Existing Legislation. At present, the Existing Legislation covers security tokens but would for example, not cover exchange tokens, utility tokens and importantly, some stablecoins.

MiCA entered into force on 29 June 2023. MiCA will generally start applying after a transitional period of 18 months, meaning that MiCA will likely take effect no earlier than Q4 2024. However, the provisions relating to issuers of Asset-Reference Tokens (**ARTs**) (discussed below) and E-Money Tokens (**EMTs**) (discussed below) apply from 30 June 2024. The remaining provisions in MiCA apply from 30 December 2024.

| EMTs and ARTs

EMTs

EMTs are crypto-assets that purport "to maintain a stable value by referencing to the value of one official currency". Like traditional e-money, EMTs are electronic surrogates for coins and banknotes and are likely to be used for payment purposes.

ARTs

ARTs aim "to maintain a stable value by referencing to any other value or right or a combination thereof, including one or more official currencies". For example, ARTs could be backed by a basket of different fiat currencies, commodities or crypto assets.

While MiCA does not officially use the term 'stablecoin', both ARTs and EMTs are variants of stablecoins. Where the European Banking Authority (EBA) classify an EMT or ART as 'significant' (sARTs and sEMTs) based on a prescribed set of criteria (including a large customer base, a high market capitalisation, or a large number of transactions.), specific provisions and stricter regulatory requirements are applied (such as increased capital requirements). The EBA will have supervisory responsibilities for issuers of significant ARTs and EMTs.

Application

Issuers of ARTs and EMTs will be required to be authorised by the CBI and to publish a white paper which will contain key information for investors. Issuers of these assets will also be required to build up a sufficiently liquid reserve with a 1/1 ratio of local currency and meet other standard regulatory requirements including but not limited to maintaining an EU presence, minimum capital and reporting requirements, holding of client funds and custody of assets and general risk management.

Conclusion

The growing adoption and ongoing innovation in respect of cryptocurrency and blockchain technology continues to give rise to distinct legal and regulatory uncertainty. However, the fog appears to be clearing with the advent of MiCA over the coming year.

Entities involved with stablecoins must familiarize themselves with Irish/ EU regulatory requirements and secure the necessary authorisations and oversight. Moreover, any stablecoins issued or traded by an entity must be evaluated under the outlined regulatory frameworks to understand the legal and regulatory implications fully.

Our Corporate, Technology and Web 3 team has significant expertise in digital assets and MiCA, please contact one of our team via their contact details below.

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