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International regulation of crypto-asset activities: a proposed framework

Overview of responses to the consultation

1. Introduction

On 11 October 2022, the FSB published a proposed framework for the international regulation of crypto-asset activities. The core components of the framework were proposals for recommendations that promote the consistency and comprehensiveness of regulatory, supervisory and oversight approaches to crypto-asset activities and markets; and revised high-level recommendations for the regulation, supervision, and oversight of "global stablecoin" arrangements to address associated financial stability risks more effectively.

The FSB received 54 responses to the consultation which ended on December 15, 2022. Respondents included trade associations representing regulated financial institutions (14), crypto-asset companies (13), trade groups representing crypto-asset companies (9), regulated financial institutions (7), centres of research (3), individuals (2) and others (6).[1]

Overall, respondents mainly agree with the findings and conclusions presented in the two consultative reports, including the activity taxonomy, material risks and key regulatory challenges. There is also a broad recognition of the two sets of proposed recommendations. While respondents generally acknowledge that the FSB reports and the recommendations reflect the 'same activity, same risk, same regulation' principle, a few responses sought more clarity on details, with divergent directions due to the different perspectives and interests of different sectors. Some commenters requested clarifications for the intention of using different languages in areas common to both stablecoins and other crypto-assets, and asked for consistency to avoid confusion. On stablecoins, many respondents welcomed the revisions to the high-level recommendations for GSCs, including the disclosure template and considerations for cross-border cooperation. However, some commenters raised concerns with the broad definition of "could become GSC," while stablecoin issuers asked the FSB to clarify or explain its analysis of existing stablecoins, arguing their own stablecoins already meet the high-level recommendations.

On DeFi, many respondents asked to clarify whether DeFi is in scope of the high-level recommendations. Many crypto-asset respondents argued that DeFi is fundamentally different from other crypto-asset activities and should have a more bespoke regulatory framework or no regulation at all. On intermediaries, many commenters highlighted the failure of FTX and the need to strengthen aspects of the high-level recommendations, such as improving client asset

[1] Available here.

segregation, more detailed guidance on custody and wallet functions, and removing modifiers in the text on fundamental elements such as governance and risk management. However, other respondents highlighted the benefits of the combination of functions to offset risks (such as settlement) while requesting further work and analysis before determining which functions must be separated.

Having considered the feedback and suggestions received, some amendments and clarifications were made to the final reports and high-level recommendations, including the following:

- With regard to consistency between the two sets of recommendations, some parts of the report have been revised to align the texts in similar areas, however relevant differences in wording between the two sets of recommendations exist to account for the differences between stablecoins and crypto-assets.

- In light of the lessons learned from recent failures of crypto-asset service providers, the FSB has strengthened both sets of high-level recommendations in three areas:

  - **Safeguarding off client assets**. The high-level recommendations have been strengthened by stating that authorities should require that crypto-asset service providers maintain adequate safeguarding of customer assets and protect ownership rights, including in insolvency.

  - **Conflicts of interest.** The FSB has strengthened the high-level recommendations by stating that authorities should have in place requirements to address the risks associated with conflicts of interest.

  - **Cross-border cooperation.** The FSB's high-level recommendations have been strengthened on information sharing, including about the level of compliance of activities spanning multiple jurisdictions, especially those in jurisdictions that have not implemented international standards.

- The GSC report has been strengthened to require reserve-based stablecoins to ensure safe custody and proper record-keeping of reserve assets and that ownership rights of reserve assets are protected at all times.

- Finally, given crypto-assets and crypto-asset market structures continue to evolve rapidly, and the intended high-level and flexible design of the two sets of recommendations, the final report does not propose a more granular taxonomy of crypto-asset activities.

Set out below is a summary of the responses received to the 15 questions asked in the consultation.

2. Summary of feedback received

2.1. Scope and coverage of entities and risks (Q1,4,5)

While most respondents agreed that the FSB reports capture comprehensively the types of activities and market participants relevant for financial stability, there is a wide range of responses that expect more details on the taxonomy of crypto-assets and related participants. This includes a global terminology of types of crypto-assets, the classification of crypto-assets in terms of their functions, and differentiation of crypto-asset participants (especially intermediaries). On this basis, some respondents further requested clarification on what assets are and are not subject to the framework, such as CBDCs, NFTs, tokenised traditional financial assets. Banks are particularly keen on distinguishing bank-issued tokenised deposits from crypto-assets and suggest they be exempt from the FSB framework because they are already subject to prudential regulation. Most respondents did not propose a detailed taxonomy, but one suggested that an international definition can leverage from existing jurisdictional definitions, such as that provided by the MiCA.

Several respondents identified areas where further deep-dives or expanded scope may be considered. These areas include applicability of regulation to DeFi, accounting standards of crypto-assets, resolution of large market players, as well as areas that may not be regarded as the main focus on the FSB framework due to its financial stability mandate, such as issues related to AML/CFT, cyber security, consumer protection and market integrity, and even social and ethical risks. Some respondents suggested that regulation should be enhanced on custody services and market concentration. Commenters also argued that specific GSC thresholds are consistent and easier to operationalise.

A few respondents expressed concerns on regulatory fragmentation, with lack of harmonisation of regulatory standards. One respondent highlighted the insufficiency of binding forces of international rules, as the sanctioning power exercised on countries failing to conform to the international rules remain weak.

2.2. Structure of the two reports (Q2-3)

Many commenters suggested the FSB consider greater categorization and apply more graduated requirements based on granular taxonomies. Other commenters urged the FSB to reduce duplicity between the two sets of recommendations. A few responses suggested merging the recommendations, with additional requirements for GSCs if there is no visible benefit or considerations of keeping them separate. They noted that the finalised recommendations should at least be consistent with each other as much as possible. Most other responses related to the questions address more broadly the classification of crypto-assets.

As for the boundary between the scope of GSC and CA recommendations, a few respondents noted the need to narrow the potential discretion for national authorities to identify GSCs. As to the notion of ‘early readiness to regulate’ adopted by the GSC recommendations to reach potential GSCs, some responses showed objection to this, while one respondent suggested

complementing for the current framework by creating a regulatory category of 'non-GSC' stablecoins.

In additional to the classification of assets as summarised above, some responses called for a distinction between services provided by centralised entities and those conducted through DeFi protocols. Besides, there are recommendations on a distinction between assets issued by regulated institutions (such as tokenised deposits as raised above) and those issued by unregulated entities.

2.3. Crypto ecosystem characteristics, activity patterns, and risks (Q6-7)

Most responses agreed with the activity patterns and the associated risks identified by the FSB report. A few responses identified aspects that are worth further investigation with potential more nuanced analysis of risks and considerations of regulations, including:

- liquidity risk is more extensive than that related to Proof of Stake as listed in the Annex 1. They can arise in a number of other ways, such as through failure to maintain enough assets to meet redemptions;

- risks related to staking, oracle exploits, underlying infrastructure such as cross-chain bridges, systemic risks arising from market participants not subject to regulation (such as private wallets), risks from coding, risks related to DAOs and DApps, risks from failure to properly account for crypto liability in the relevant fiat currency;

While most respondents supported the 'same activity, same risk, same regulation' principle, some responses again debated on the extent to which the principle is applied to crypto-assets. Non-traditional crypto players seemed to be eager to stay away from the traditional regulatory approaches. In general, they argued that crypto-assets may not necessarily require the same regulations as traditional financial products because they present different risks even when performing the same activities. Furthermore, some crypto players urged for more recognition of the benefits brought by the new technology. A small number of respondents claimed that often labelled traditional risks may be offset by the 'benefits', such as traceability and transparency, faster settlement times, and automated smart contracts. One commentator stated that crypto intermediaries may appropriately combine functions and that conflicts of interest among intermediaries can be managed. They argued that traditional financial intermediary structures should not automatically apply to crypto. One respondent suggested risks are different between activities deployed in public chains and private chains.

Wallets and custody were identified by several respondents as areas that should be further investigated. However, suggestions on regulatory approaches vary, especially when focussing on unhosted wallets where respondents had divergent views of their risk features. One respondent stated that unhosted wallets should not be classified as an intermediary and are thus not subject to relevant regulation. One commentator, in contrast, called for stronger language on unhosted wallets related to risk management and suggested tracking the language from the GSC consultation. Another respondent noted that unhosted wallets have different functions, some of which have asset-recovery abilities. In this regard, more nuanced discussion and differentiated regulation may be considered in light of their different functions.

One other respondent focused on the interaction with wallets of DeFi protocols and suggested further analysis is needed to understand the entity who has access to the keys. Contrary to the views from the crypto industry, one bank respondent believed that crypto custody regulation should be considerably strengthened by mirroring the bank custody practices and standards to ensure adequate customer protections.

In addition, DeFi is also identified by some respondents as an area that needs broader discussion (this is referred to in responses to other questions too).

2.4. Regulatory challenges and gaps (Q8)

Most respondents agreed that the FSB report correctly identified the key regulatory and supervisory challenges. Almost all responses to this question are either the reiteration of the importance of key areas that the FSB report has already included, or suggestions on further work by the FSB.

The urgency to promote cross-border regulatory coordination is again raised by a number of respondents. They noted the lack of the harmonisation of regulatory frameworks and supervisory practices among different jurisdictions especially those non-FSB member jurisdictions falling outside of the implementation scope, which may not only give rise to regulatory fragmentation, but also add to uncertainty of regulatory outcomes. One respondent pointed out the need of reciprocal and mutual recognition of regulation between national authorities.

Other areas that receive attention from respondents include intermediaries combing functions, DeFi and technical risks.

Specifically, as for the intermediaries combining functions, the responses came from two centralised crypto exchanges. These responses strived to push against the potential application of common traditional regulation. In particular, the crypto exchange respondents expressed concern of mandatory segregation of functions implied in CA recommendation 9. They indicated that despite the existence of conflicts of interest between certain functions, they may be effectively managed by appropriate asset segregation, supported by internal systems and controls and external audit. One centralised exchange argued that they can facilitate real-time settlement and reduce the number of intermediaries involved in a transaction, thus reducing transaction costs. The respondent believed that adoption of separate governance and management will ensure keeping decisions independent to mitigate conflicts of interest.

A few respondents raised DeFi as an area with significant regulatory challenges. One respondent is of view that the building blocks of FSB recommendations, including governance, accountability and other compliance requirements, are also relevant to DeFi but are not practical nor appropriate to be applied directly given the different nature of DeFi. One bank respondent, while also noting the challenges of regulating DeFi, expressed scepticism of relying on the issuer as regulatory anchor point because issuers themselves confront the same challenges as regulators, such as the absence of legal entities for ecosystem players and no legal instruments available to impose any requirements. They further indicated that to only focus on issuers will lead to disadvantages for regulated traditional institutions. One

respondent specifically mentioned that some DeFi protocols are operating as FMIs and are not adequately regulated.

Respondents also drew attention to the technical risks of crypto-assets. One respondent introduced the various efforts of the technical communities and companies to protect assets of unhosted wallets from technical risks, including scams, phishing, and cyber-attacks, and noted technical risks relating to the quality of software or a technical product are not, and should not be, addressed through regulation. Another respondent highlighted the importance of code auditing and the need to set expectations, for example, about the frequency with which the codebase for platforms is audited and the expected content and conduct of such audits.

Some other responses include: the need for CDBCs to be covered by the recommendations, the need to consider the potential of GSCs to enhance financial stability for crypto-asset markets by allowing for sophisticated market participants engaging in crypto-asset markets to efficiently shift and rebalance capital across global markets, as well as the potential for innovation across the traditional financial and crypto markets to help solve supervisory and oversight challenges. A group response from lawyers noted the need for a separate recommendation for having in place appropriate mechanisms for consumer and investor protection.

2.5. CA recommendations (Q9-10)

Respondents generally supported the differentiated requirements between issuers and service providers. However, there is a strong appeal from the crypto respondents not to introduce too prescriptive requirements. Several of them proposed the notion of ‘voluntary adoption’ of risk management and data disclosure, and argued against applying risk-based regulation to crypto industry. Crypto industry respondents are also dissatisfied with disclosure requirements. One commenter proposed that the FSB and national authorities should leverage blockchain data to increase transparency in crypto-asset activities. Several respondents advised international standard setters to help with further work, including detailed taxonomy and how to apply regulation to DeFi, or respond to activities where the issuer is not traceable or identifiable.

In contrast, some traditional institutions, especially banks, stressed that risk management and data standards for crypto-asset activities should not be lower than those in traditional finance. For example, one bank respondent suggested that authorities should adopt third-party risk management requirements for non-bank crypto-asset service providers consistent with those that apply to banks. One other respondent stressed that policymakers should ensure that data protection and cybersecurity requirements are applied consistently to those providing crypto-asset related services between banks and non-bank service providers.

Some respondents again referred to the need for a granular taxonomy as a basis of differentiated treatment of different activities or market participants. One respondent suggested the distinction. However, there are very few details or concrete suggestions on how to further differentiate activities or entities. At a high-level, a few respondents noted the need to differentiate between DeFi and other crypto-asset activities (or between DeFi and CeFi), which is again consistent with responses to other questions. Specifically, one respondent suggested that trading through a centralised exchange is very different from interacting unhosted wallets with DeFi protocols usually in Automated Market Maker (AMM) mode.

A few respondents urged for more international consistency given the borderless nature of crypto-assets. One respondent noted that existence of crypto disclosure requirement in some jurisdictions (e.g., the EU's white paper requirements under MiCA) but there is lack of standardised disclosure requirements globally.

2.6. Stablecoin developments (Q11)

Respondents were generally supportive of the analysis of recent market developments and existing stablecoins. Some commenters emphasised the need to update the analysis in light of recent market events and various market developments. While other commenters requested the analysis provide more differentiation between various types of stablecoins. A few commenters requested the FSB provide the rationale for stating "most existing stablecoin arrangements do not meet the FSB's high-level recommendations." These commenters stressed the difference in reserve assets and stabilisation mechanisms (e.g., stablecoins backed by fiat currencies, stablecoins backed by crypto-assets, and algorithmic stablecoins) would lead to different risks. Another commenter noted the different risks of stablecoins backed by crypto-assets affiliated with the promoter (e.g., Terra) and those backed by crypto-assets unaffiliated with the promoter (e.g., DAI). Commenters associated with stablecoin issuers noted their compliance programs and claimed they meet the FSB high-level recommendations.

2.7. GSC Recommendations (Q12-15)

The majority of respondents agreed with the recommendations put forward in the report. Some commenters asked the FSB to clarify or strengthen certain recommendations. Some of the points raised may warrant further consideration by CWG members. For example, a few respondents emphasised the need for segregation requirements on reserve assets to ensure reserve assets are available to coinholders if needed (with one respondent suggesting further guidance on dealing with insolvency). Similarly, a few respondents suggested the FSB should strengthen recommendation 2 with respect to custody services, notably concerning the segregation of client assets and clients' ownership rights. Two respondents requested additional clarity about the regulatory responsibilities of each function involved in a GSC. A few respondents also noted that the risks stemming from the combination of functions should be more explicitly covered in the GSC recommendations. And a couple of respondents noted FSB recommendations could include broader third-party risk management requirements.

With respect to governance arrangements and algorithmic stablecoins, a few respondents suggested more flexibility, while others supported a more cautious approach by authorities as suggested in the recommendations. For instance, whilst one respondent noted that Recommendation 9 "effectively bans" algorithmic stablecoins, another one would instead welcome "a more explicit ban" of these stablecoins due to significant risks of deviation from the peg. With respect to governance, a couple of respondents challenged the need to have in place a comprehensive governance body applying to "all functions of the GSC arrangement" (with one respondent noting this could lead to the pooling of risks), but another respondent noted the importance of ensuring accountability for managing all functions and activities within a stablecoin arrangement. One respondent also called for the FSB to permit a tiered redemption model, where GSC issuers would only be held accountable for redemptions of

customers of the issuer, provided all other token holders have “reasonable avenues for timely redemption” through other providers.

In addition, a number of respondents noted the need for clarifications or further guidance in areas that may be particularly relevant for SSBs and international organisations to consider (and where international policy coordination would be useful). For instance, many respondents encouraged further consideration and/or clarification of the treatment of tokenized traditional assets, and, in particular, tokenized commercial bank deposits, which are already subject to existing regulation. Some respondents noted bank tokenized deposits should be more explicitly distinguished from GSC and should not be captured by the CA or the GSC recommendations. A few respondents emphasised the need for clarifications on the treatment of unhosted wallets and peer-to-peer crypto-asset transactions, including on alignment with the FATF travel rule. Additionally, one respondent emphasised the need for further clarification from the FSB or the International Accounting Standards Board (IASB) around accounting for crypto-assets, while two respondents noted code auditing standards would also be helpful.

A few respondents were of the view that the recommendations for CAs and for GSCs involved some duplication and required harmonisation of language and coverage. One of the respondents recommended a few ways some of the recommendations that apply to GSCs could be extended to cover all crypto-assets.

About half of the respondents either agreed with the proposed disclosure template for reserve-backed GSC or did not make specific comments. A number of respondents provided suggestions as to how the disclosure template could be designed. Some examples are set out below:

- mirror the template to e-money and money market mutual funds or use the existing format on collateral reporting by custodians;
- disclosure requirements should be proportionate to the potential risk they represented;
- disclosures are made public akin to a prospectus;
- expand the scope of application of disclosure template to other non-global stablecoins; and
- further data points would be needed for specific types of stablecoins, depending on the use case and composition of the reserve.

Some respondents also proposed that more granular information could be included in the disclosure template, such as distinctions between types of asset classes, haircuts, name and location of accounts, mechanisms to determine values, among other details.

Several respondents sought clarification on how crypto-assets held by the GSC should be disclosed; whether wallet addresses of relevant holdings of need to be disclosed; whether the template covers partially reserve backed stablecoins; and whether “daily average over month” should be used instead of "daily average over month-end” for the breakdown of market value.

On a related note, respondents sought clarification and elaborations in relation to FSB high-level recommendation 8 of the regulation, supervision and oversight of GSC arrangements. Examples include clarifying who the "relevant stakeholders" are in respect of a GSC arrangement, and elaborating what is meant by "mechanism to ensure protection of interests of users and counterparties"; and the framework for audit and assurance of reserve assets.

About one third of the responses explicitly address Question 15 of the consultation, which sought feedback on the elements that could be used to determine whether a stablecoin qualifies as a GSC (annex 4). Respondents provided suggestions in two broad areas. First, the FSB should provide more clarity on how the suggested criteria will be applied in practice. In some cases, respondents asked for quantitative thresholds used to define GSC; and second, the FSB should narrow down the number of criteria used to define GSC, focusing in particular on the use of stablecoins for cross-border payments and interconnections with the financial system. In general, respondents did not provide any evidence to support their suggestions.