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December 15, 2022

Financial Stability Board
Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: International Regulation of Crypto-asset Activities, A Proposed Framework – questions for consultation

Colleagues:

The American Bankers Association (ABA)¹ welcomes the opportunity to respond to the proposed framework for the international regulation of crypto-asset activities (Framework)² issued by the Financial Stability Board (FSB) on October 11, 2022. The Framework covers the recommendations issued in two FSB consultative reports: (1) Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets (CA Recommendations);³ and (2) Review of the FSB High-level Recommendations of the Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements (GSC Recommendations).⁴

Overall, we support both the CA Recommendations and the GSC Recommendations. In our view, they provide a useful, principles-based approach to guide the international community in applying existing market and prudential regulation to a novel category of financial activity, and in filling gaps by developing new standards and guidance, as necessary.

¹ The American Bankers Association is the voice of the United States’ \$23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$19.4 trillion in deposits and extend \$12 trillion in loans.

² Financial Stability Board, International Regulation of Crypto-asset Activities, A proposed framework – questions for consultation (October 11, 2022), (“Framework”), <https://www.fsb.org/2022/10/international-regulation-of-crypto-asset-activities-a-proposed-framework-questions-for-consultation/>.

³ Financial Stability Board, Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets (October 11, 2022), (“CA Recommendations”), <https://www.fsb.org/2022/10/regulation-supervision-and-oversight-of-crypto-asset-activities-and-markets-consultative-report/>.

⁴ Financial Stability Board, Review of the FSB High-level Recommendations of the Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements (October 11, 2022), (“GSC Recommendations”) <https://www.fsb.org/2022/10/review-of-the-fsb-high-level-recommendations-of-the-regulation-supervision-and-oversight-of-global-stablecoin-arrangements-consultative-report/>.

The crypto-asset marketplace is changing rapidly. Just over a year ago, in November 2021, the total market capitalization of all cryptocurrencies (including stablecoins) peaked at around US\$3 trillion.⁵ Since then, in the face of several high-profile events, the crypto-asset market has precipitously collapsed in value (total market cap is ~US\$855 billion as of December 13, 2022),⁶ and many consumers and investors have been adversely impacted. These events highlight the risk that the largely unregulated markets and entities that dominate this space today pose to investors and financial stability and further emphasize the value of a coordinated international framework for regulating crypto-asset activities.

Blockchain technology has potential for application in financial services that, over time, may lead to enhanced efficiencies, new products, and new ways to deliver traditional products. The fundamental characteristics of blockchain, including immutability and transparency, are relevant and valued in the financial services market, and many banks are exploring potential uses, including through tokenized deposits and recordkeeping. Importantly, the use of distributed ledger technology (DLT) for traditional banking activities, such as tokenized deposits, or for infrastructure does not constitute crypto-asset activity, and should not trigger additional regulation.

With that backdrop, we appreciate the FSB's continued, thoughtful approach to developing recommendations covering both general crypto-asset and global stablecoin regulation. Below we respond directly to several matters raised in the Framework.

We strongly support application of the principle of “same activity, same risk, same regulation” to crypto-asset activities. We agree with the FSB's conclusion that “effective regulatory and supervisory frameworks should be based on [the aforementioned] principle,”⁷ and we are encouraged to see it reflected in each of the recommendations. One challenge regulators have faced in developing crypto-asset regulations stems from the lack of clear definitions for various crypto-asset products and services. Taking an activities-based approach, supplemented by an understanding of unique risks presented by crypto-assets, can help identify applicable regulations in the absence of clear product-based definitions.

Banks are subject to a comprehensive regulatory framework and consolidated supervision that enables careful implementation of crypto-asset activities. Backed by a culture of risk management and compliance, and subject to supervision and examination, banks are well equipped to identify risks and remediate them in a timely manner that mitigates harm to consumers and other market participants. This level of oversight and supervision should be applied to banks and non-banks engaged in crypto-asset activities alike to ensure all customers are protected equally, regardless of where they engage with the financial marketplace.

We urge the FSB to adopt stronger, more affirmative language in the recommendations. As noted above, we support the recommendations overall and strongly support applying the “same activity, same risk, same regulation” principle, but would like to see a stronger bias toward regulatory action and clarity. In places, the use of modifiers, “strive to require” instead of “require” for example, or the use of caveats “as applicable” and “where appropriate,” weakens the recommendation.

⁵ <https://www.statista.com/statistics/730876/cryptocurrency-market-value/>

⁶ <https://coinmarketcap.com/charts/>

⁷ Framework, pg. 4.

Regulatory clarity that defines the rules of the road for bank and non-bank crypto-asset activity is critical to ensuring continued financial innovation. Given the regulatory uncertainty, banks have moved more carefully to market than many of the less regulated providers of these services. Such non-bank market entrants are not subject to prudential regulation and examination and are not subject to robust capital and liquidity requirements. As recent events have made clear, this unregulated activity can expose consumers and counterparties to harm.

We urge the FSB to explicitly distinguish bank tokenized deposits from global stablecoin arrangements and make clear that bank tokenized deposits are not captured by the CA Recommendations or the GSC Recommendations. Rather than representing a new financial product, bank tokenized deposits are a different technological means of evidencing and recording a deposit claim against a bank for fiat amounts on blockchain or using distributed ledger technology. Banks and bank deposits, including tokenized deposits, are already subject to comprehensive existing bank regulation that includes appropriate technology and operational risk management, as well as prudential regulation pertaining to capital and liquidity requirements.

We strongly support the incorporation of custodial wallet service providers into GSC Recommendation 2 and the inclusion of custodial wallet service providers in CA Recommendation 5 (risk management), and we suggest strengthening the language. A comprehensive regulatory framework for the custody of crypto-assets, including corporate governance controls, audit standards, capital and liquidity requirements, and disclosure requirements, is critical to ensuring financial stability, as well as appropriate consumer and investor protections. It also helps to level the playing field between banks and nonbanks.

- GSC Recommendation 2 includes, “Regulations and oversight should strive to require the adequate safeguarding of customer keys and tokens, including where appropriate segregation requirements.”⁸ To strengthen this recommendation, **we suggest removing the phrase “strive to,” expanding the reference to what is safeguarded by adding the word “assets,” removing the phrase “where applicable,” and adding a limitation on the comingling funds.** As such, the revised sentence would read, “Regulations and oversight should require the adequate safeguarding of customer assets (e.g., customer keys and tokens), including segregation requirements and limitations on comingling customers’ funds.”
- CA Recommendation 2 references crypto-asset service providers generally, but does not include specificity around custodial wallet service providers. **While these entities are included in CA Recommendation 5, we recommend also referencing them specifically in CA Recommendation 2.**
- CA Recommendation 5 includes, “Regulations and oversight should assess the adequate safeguarding of customer assets, for example, through segregation requirements (including in the case of default/bankruptcy of the custodial wallet service providers).”⁹ **We suggest replacing the phrase “assess” with “require,” and adding a limitation on comingling funds.** With these changes, the revised sentence would read, “Regulations and oversight should require the adequate safeguarding of customer assets, for example, through segregation requirements (including in the case of default/bankruptcy of the custodial wallet service providers) and limitations on comingling funds.”

⁸ GSC Recommendations, pg. 13.

⁹ CA Recommendations, pg. 26.

We strongly support the functional separation of custody activities from trading and other similar market activities. CA Recommendation 9 addresses the need to ensure that crypto-asset service providers that combine multiple functions and activities are subject to regulation that “comprehensively address the risks associated with individual functions and the risks arising from the combination of functions.”¹⁰ We need look no further than the recent collapse of FTX, where the combination of unregulated and unsupervised activities within a single corporate structure contributed to the resulting consumer harm. In particular, the combination of custody activities with trading and exchange activities at FTX enabled a situation where customer funds were not segregated and were misused. The proper safekeeping of customer assets is foundational to the protection of the customer, and the mitigation of financial stability risk and cannot be safely undertaken if commingled with market facing activities.

We suggest incorporating a broader view of third-party risk management into GSC Recommendation 5 and CA Recommendation 5. GSC Recommendation 5 covers several policies that should be in place related to risk management, including a requirement for proper due diligence on individuals involved in the management and control of the GSC arrangement. The recommendation also specifies that “Risk management measures and technical standards should cover relevant activities performed by providers of activities in the GSC arrangements, paying particular attention to compliance by permissionless or anonymous networks.”¹¹ In addition to these specific third parties, we recommend including a general requirement for robust third-party risk management. CA Recommendation 5 does not include any references to third-party due diligence or risk management, and we recommend its inclusion.

We urge the FSB to clarify in its CA Recommendations that the use of distributed ledger technology for traditional banking activities, such as tokenized deposits, or for infrastructure uses does not constitute crypto-asset activity. Banking institutions and financial market infrastructure have recognized that DLT is a secure method of recordkeeping. Innovation such as the use of DLT for improved internal recordkeeping and trade settlement should not trigger additional regulation that is intended to address risk associated with novel crypto-asset activity. Banks operate within a regulatory framework that ensures appropriate management of risks, including risks that may result from the use of technology for standard recordkeeping functions. As noted throughout this letter, banks are already subject to comprehensive regulatory oversight and supervision that includes appropriate technology and operational risk management, as well as prudential regulation pertaining to capital and liquidity requirements.

We urge the FSB to include a recommendation cautioning against adoption of rules that inhibit regulated entities from participating in crypto-asset markets when their participation can be accomplished in a safe and sound manner. Banks are subject to a comprehensive regulatory framework and consolidated supervision that enables careful implementation of crypto-asset activities. Backed by a culture of risk management and compliance, and subject to supervision and examination, banks are well equipped to identify risks and remediate them in a timely manner that mitigates harm to consumers and other market participants. As banks seek to serve customers who want exposure to crypto-assets, national regulatory authorities must permit prudent innovation within the regulatory perimeter to accommodate those customer desires. Authorities should be careful to avoid excluding banks from innovation, or preempting technological progress, by being overly prescriptive. Technological evolution

¹⁰ CA Recommendations, pg. 28.

¹¹ GSC Recommendations, pg. 16.

is rapid, and highly prescriptive regulation cannot be adjusted quickly enough to remain current. Inflexibility would constrict financial inclusion and other benefits of emerging technology.

The ABA appreciates the opportunity to provide comments on the Financial Stability Board's proposed framework for international regulation of crypto-asset activities. We are encouraged by the development of these recommendations and look forward to staying engaged as the recommendations are finalized.

Thank you for your consideration of the matters discussed. Should you have any questions, please do not hesitate to contact the undersigned at bybarra@aba.com.

Sincerely,

/s/

Brooke Ybarra
SVP, Innovation & Strategy