FSB FINANCIAL STABILITY BOARD

International Regulation of Crypto-asset Activities

A proposed framework – questions for consultation

11 October 2022

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Questions for consultation

The FSB is inviting comments on its proposed set of recommendations and on the questions set out below. Responses should be sent to fsb@fsb.org by 15 December 2022. Responses will be published on the FSB's website unless respondents expressly request otherwise.

General

1. Are the FSB's proposals sufficiently comprehensive and do they cover all crypto-asset activities that pose or potentially pose risks to financial stability?
2. Do you agree that the requirements set out in the CA Recommendations should apply to any type of crypto-asset activities, including stablecoins, whereas certain activities, in particular those undertaken by GSC, need to be subject to additional requirements?
3. Is the distinction between GSC and other types of crypto-assets sufficiently clear or should the FSB adopt a more granular categorisation of crypto-assets (if so, please explain)?
4. Do the CA Recommendations and the GSC Recommendations each address the relevant regulatory gaps and challenges that warrant multinational responses?
5. Are there any financial stability issues that remain unaddressed that should be covered in the recommendations?

Crypto-assets and markets (CA Recommendations)

6. Does the report accurately characterise the functions and activities within the crypto-ecosystem that pose or may pose financial stability risk? What, if any, functions, or activities are missing or should be assessed differently?
7. Do you agree with the analysis of activity patterns and the associated potential risks?
8. Have the regulatory, supervisory and oversight issues and challenges as relate to financial stability been identified accurately? Are there other issues that warrant consideration at the international level?
9. Do you agree with the differentiated requirements on crypto-asset issuers and service providers in the proposed recommendations on risk management, data management and disclosure?
10. Should there be a more granular differentiation within the recommendations between different types of intermediaries or service providers in light of the risks they pose? If so, please explain.

Global stablecoins (GSC Recommendations)

11. Does the report provide an accurate analysis of recent market developments and existing stablecoins? What, if anything, is missing in the analysis or should be assessed differently?
12. Are there other changes or additions to the recommendations that should be considered?
13. Do you have comments on the key design considerations for cross-border cooperation and information sharing arrangements presented in Annex 2? Should Annex 2 be specific to GSCs, or could it be also applicable to crypto-asset activities other than GSCs?
14. Does the proposed template for common disclosure of reserve assets in Annex 3 identify the relevant information that needs to be disclosed to users and stakeholders?
15. Do you have comments on the elements that could be used to determine whether a stablecoin qualifies as a GSC presented in Annex 4?

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Overview

Crypto-assets and markets must be subject to effective regulation and oversight commensurate to the risks they pose. The turmoil earlier this year highlighted a number of structural vulnerabilities in those markets. It exposed inappropriate business models, significant liquidity and maturity mismatches, the extensive use of leverage, and a high degree of interconnectedness within the crypto-asset ecosystem. These vulnerabilities were amplified by a lack of transparency and disclosures, flawed governance, inadequate consumer and investor protections, and weaknesses in risk management. While the limited spillovers outside the crypto-asset ecosystem reflect the still low interconnectedness with the traditional financial system, the situation could change rapidly as crypto-asset markets recover. If interconnections continue to grow, the failure of a major market player, in addition to imposing potentially large losses on investors, may have spillover effects on traditional finance such as short-term funding markets and on the real economy. Crypto-asset markets are fast evolving and could reach a point where they represent a threat to global financial stability due to their scale, structural vulnerabilities and increasing interconnectedness with the traditional financial system. The rapid evolution and international nature of these markets also raise the potential for fragmentation or arbitrage. Although the extent and nature of crypto-asset use varies somewhat across jurisdictions, financial stability risks could rapidly escalate, underscoring the need for both timely and pre-emptive evaluation of possible policy responses as well as regulatory action where existing requirements apply.

An effective regulatory framework must ensure that crypto-asset activities are subject to comprehensive regulation, commensurate to the risks they pose, while harnessing potential benefits of the technology behind them. Such regulation should ensure equivalent regulatory outcomes where they pose risks similar to those posed by traditional financial activities, while addressing novel features of crypto-assets. In some instances this may require the application of existing rules to crypto-assets, in others it may require new guidance or regulation specific to crypto-assets to deliver equivalent outcomes. Where crypto-assets and intermediaries perform an equivalent economic function to one performed by instruments and intermediaries in the traditional financial system, they should be subject to regulations in line with the principle of "same activity, same risk, same regulation". Crypto-assets are predominantly used for speculative purposes and many currently remain non-compliant with or outside the scope of existing requirements. Regulation should also take account of novel features and specific risks of crypto-assets and harness potential benefits of the technology behind them.

The regulatory framework should reflect the relevance of crypto-assets for financial stability and support proper market functioning. Authorities should provide effective guardrails around crypto-assets and markets to address potential financial stability risks that could arise from the growing interlinkages between the crypto-asset ecosystem and the traditional financial system. High regulatory standards are required in particular for crypto-assets – such as stablecoins – that could be widely used as a means of payments and/or store of value, as they could pose significant risks to financial stability. Regulation should provide for adequate transparency, accountability, market integrity, investor and consumer protections, and AML/CFT defences across the crypto-asset ecosystem.

With these considerations in mind, the FSB is submitting to the G20 Finance Ministers and Central Bank Governors a comprehensive set of proposals for the regulation and supervision of crypto-asset activities. They consist of:

(i) proposed recommendations to promote the consistency and comprehensiveness of regulatory, supervisory and oversight approaches to crypto-asset activities and markets and to strengthen international cooperation, coordination and information sharing; and

(ii) a review of the FSB's high-level recommendations of October 2020 for the regulation, supervision, and oversight of "global stablecoin" arrangements.

The FSB is soliciting comments from the public until 15 December 2022 on its proposals and the questions set out below and encourages all interested stakeholders to participate in the consultation. The FSB's proposals, along with the work undertaken by the standard-setting bodies (SSBs), should provide a foundation for greater consistency and cooperation among authorities' approaches to the regulation and supervision of crypto-asset activities and markets. The following sets out

- key issues and challenges in developing a comprehensive and consistent regulatory approach that captures all types of crypto-asset activities that could give rise to financial stability risks (section 1);
- policy initiatives at jurisdictional and international levels (section 2);
- the FSB's proposed approach for establishing a comprehensive regulatory framework (section 3); and
- a way forward for finalising the proposals (section 4).

1. Issues and challenges for regulation and supervision

Many crypto-asset activities and markets are not compliant with applicable regulations or are unregulated. The applicability of regulations relies on the classification of crypto-assets in the jurisdictional legal framework. In some jurisdictions, certain crypto-assets qualify as regulated financial instruments whereas, in others, crypto-asset activities fall outside of the regulatory perimeter. Even where crypto-asset activities fall within the existing regulatory perimeter, market participants may be operating in non-compliance with applicable regulations.

Data gaps make the assessment of financial stability risks from crypto-asset activities challenging. Significant informational and data shortcomings persist, including the reliability and consistency of available data, given the failure of many participants in crypto-asset activities to comply with applicable laws and regulations, or, in some cases, that activities may fall outside the regulatory perimeter and the associated reporting requirements. Appropriate proxies to monitor on an ongoing basis the presence and extent of vulnerabilities are difficult to construct. The limited regulatory data currently available, including on interconnections between crypto-asset markets and the traditional financial system, offer only a partial and potentially inaccurate picture.

Jurisdictions' regulatory approaches need to capture the novel features of crypto-asset activities that can give rise to financial stability risks. Users of both stablecoins and other crypto-assets rely on critical services of issuers, wallet providers and other intermediaries, which can pose significant risks. The extensive use of distributed ledger technology as well as the decentralized nature of operations and/or governance have contributed to opaqueness and lack of accountability in governance of both stablecoin arrangements and other crypto-assets. It can be difficult to identify the entities or natural persons that should be held accountable for good governance and regulatory compliance. If non-compliant or unregulated, these operating modes and new types of services entail potential risks for financial stability. In addition, a notable feature in crypto-asset markets is the use of settlement assets (i.e., stablecoins) that may be neither central bank money nor commercial bank money[1].

Crypto-asset activities require comprehensive cross-sectoral regulation. Crypto-asset intermediaries and service providers often combine activities that could fall under different sectoral regulatory regimes. For example, crypto-asset trading platforms often offer a vertically integrated suite of services, such as marketplace trading, order pairing, settlement and clearing, lending, proprietary trading, matched trading, custody, and brokerage services. Some trading platforms also act as intermediaries for the issuance of stablecoins and their promotion and market making. They may issue their own native crypto-assets or develop blockchain-based products. While most of these individual functions exist in traditional finance, typically regulations require that such activities be conducted by different entities and, in some cases subject them to different sectoral standards. By contrast, various crypto-asset activities are often bundled together within a single entity, sometimes in non-compliance with existing regulations. This may require the disaggregation and separation of certain functions and activities or the cumulative application of sectoral regulations requirements in order to fully address the risks arising from the compounding effects of different functions.

Cross-border cooperation, coordination and information sharing are essential given the inherent global nature of crypto-asset activities. The cross-border nature of crypto-assets raises regulatory, supervisory and enforcement challenges. Jurisdictional differences in legal and regulatory frameworks and supervisory and enforcement outcomes underscore the potential for regulatory fragmentation and arbitrage without cross-border cooperation and information sharing consistent with authorities' respective mandates and jurisdictional requirements.

2. Policy initiatives at international and jurisdictional levels

Jurisdictions are making progress towards ensuring that crypto-assets and crypto-asset activities are subject to robust regulation and supervision, but much work remains.[2] In some jurisdictions legislative initiatives are underway to provide authorities with bespoke powers to regulate crypto-asset activities. In other jurisdictions, authorities can apply existing regulatory powers to regulate the evolving crypto-asset landscape, including both crypto-assets and service providers such as platforms. Several jurisdictions have proposed, and some have recently adopted, specific rules to address the risks stemming from stablecoin arrangements while others

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1 CPMI-IOSCO (2022): *Application of the Principles for Financial Market Infrastructures to stablecoin arrangements*, July.

2 In June 2022 the FSB conducted a stock-take of existing regulatory and supervisory policies and approaches to crypto-assets in 24 FSB member and 24 non-FSB member jurisdictions represented on FSB Regional Consultative Groups (RCGs).

have amended, plan to amend, or have applied existing rules to bring stablecoin arrangements within their jurisdiction's regulatory perimeter. Regulation motivated by financial stability considerations complements other regulation to ensure adequate transparency, accountability, market integrity, investor and consumer protections, and AML/CFT defences across the crypto-asset ecosystem.

The FSB and the standard setting bodies have made progress in their review of whether and how existing international standards can apply to crypto-assets including stablecoin arrangements. In July 2022, the Bank for International Settlements' Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published guidance on the Application of the Principles for Financial Market Infrastructures (PFMI) to stablecoin arrangements. In June 2022, the BCBS published its second consultative document on the prudential treatment of banks' exposures to crypto-assets.[3] In March 2022, IOSCO published its "Decentralized Finance Report,"[4] which offers a comprehensive review of the fast-evolving DeFi market, including its products, services and principal participants. In June 2019, the Financial Action Task Force (FATF) extended its anti-money laundering and counter-terrorist financing (AML/CFT) measures to virtual assets (VAs) and virtual asset service providers (VASPs) to prevent criminal and terrorist misuse of the sector[5], and updated its 2019 Guidance for a Risk-Based Approach to VA and in October 2021 to cover stablecoins and DeFi.[6]

3. The FSB's proposed approach for establishing a comprehensive regulatory framework

Effective regulatory and supervisory frameworks should be based on the principle of "same activity, same risk, same regulation". Where crypto-assets and intermediaries perform an equivalent economic function to one performed by instruments and intermediaries of the traditional financial sector, they should be subject to equivalent regulation. This is true regardless of how a particular crypto-asset is characterized (e.g., as a payment, security or other instrument). For example, crypto-assets intended to serve as settlement assets for payments (such as stablecoins) may replicate functions that require oversight from central banks and payment system regulators. Meanwhile, the issuance and distribution of such crypto-assets or stablecoins in a manner that mirrors traditional bank-like functions should be subject to regulation, consistent with global standards and regulation applying to commercial bank activities (such as the BCBS standards), in order to deliver the same level of protection. In addition, the issuance and trading of crypto-assets or stablecoins mirroring activities in the traditional capital markets should be subject to market regulation that seeks to provide the same level of investor protections and market integrity outcomes. Where crypto-assets have particular features or specific risks, regulation should also take account of them.

3 Basel Committee on Banking Supervision (2022): *Prudential treatment of cryptoasset exposures - second consultation*, June.

4 IOSCO (2022), *Decentralized Finance Report*, June.

5 FATF (2019): *The FATF Standards: FATF Recommendations (Amended in 2019)*.

6 FATF (2022): *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers*, July.

Regulatory and supervisory guardrails must address the potential sources of financial stability risks around different types of crypto-assets and markets. Crypto-asset issuers, intermediaries, and service providers must be subject to adequate requirements for governance, risk management, reporting and disclosure proportionate to the size, complexity, and risks of their respective activities. Authorities should, consistent with their respective mandates, have the capacity to identify and monitor interlinkages between the crypto-asset ecosystem and the traditional financial system and cooperate and exchange information with their foreign counterparts to identify and address cross-border spillovers and risks. Stablecoins that may be widely used as means of payments and/or stores of value, could pose significant risks to financial stability if not subject to robust regulatory and supervisory policies. Therefore, they should be held to high regulatory standards, including in relation to availability of legal claims for users, stability of value and redemption guarantees.

Reflecting these considerations, the FSB is proposing:

(i) recommendations for the regulation, supervision, and oversight of crypto-asset activities and markets ('CA Recommendations'). The proposed recommendations seek to promote the comprehensiveness and greater international consistency of regulatory and supervisory approaches to crypto-asset activities and markets. These recommendations apply to any type of crypto-asset activities and associated issuers, service providers (including intermediaries such as crypto-asset trading platforms) that may pose risks to financial stability;

(ii) revisions to its High-level Recommendations for Global Stablecoin Arrangements to address associated financial stability risks more effectively ('GSC Recommendations'). The revised recommendations emphasise the need for authorities to be ready to apply relevant regulations to any stablecoins that could become GSCs. They include guidance to strengthen the governance framework by clearly defining the responsibilities of the actors and the redemption rights of single fiat-referenced GSC by requiring these stablecoin issuers to provide robust legal claim, guarantee timely redemption at par into fiat, and maintain effective stabilisation mechanisms, among other revisions. The revised recommendations clarify that reliance on algorithms and arbitrage activities are not effective stabilisation mechanisms. Indeed, as the report describes, many existing stablecoins, including Terra/Luna, would not meet the FSB's high-level recommendations.

With these two sets of recommendations, all crypto-asset activities that pose or potentially pose risks to financial stability should become subject to comprehensive and globally coordinated regulation, supervision, and oversight. Whereas the CA Recommendations cover all crypto-asset activities and associated issuers, intermediaries and service providers, crypto-assets that meet the definition of GSC should also be subject to the regulatory and supervisory recommendations set out in the revised GSC Recommendations. The FSB's proposed recommendations taken together seek to achieve consistent and comprehensive regulatory coverage of crypto-assets and markets, including stablecoins. The two sets of recommendations are closely interrelated, reflecting the interlinkages between stablecoins and the broader crypto-asset ecosystem. They have been developed as stand-alone documents but are intended to work together in light of these interlinkages and to be consistent where they cover the same issues and risks (see table).

Table: Coverage of the CA and GSC Recommendations

Regulatory principle	Coverage in GSC recommendations	Coverage in CA recommendations
Regulatory Powers	GSC Rec 1	CA Rec 1
Comprehensive oversight	GSC Rec 2	CA Rec 2
Cross-border cooperation	GSC Rec 3 with an Annex	CA Rec 3
Governance	GSC Rec 4	CA Rec 4
Risk management	GSC Rec 5	CA Rec 5
Data management	GSC Rec 6	CA Rec 6
Recovery and resolution planning	GSC Rec 7	CA Rec 5
Disclosures	GSC Rec 8 with an Annex	CA Rec 7
Monitoring of interconnections within the crypto-asset ecosystem and with the wider financial system		CA Rec 8
Compliance before operation	GSC Rec 10	CA Rec 1
Redemption rights and stabilisation mechanisms	GSC Rec 9	
Multiple functions		CA Rec 9

4. Way forward

The FSB will finalise the proposed recommendations by mid-2023 in light of feedback from the public consultation. The FSB is soliciting comments from the public until 15 December 2022, on the questions set out below. The FSB is encouraging all interested stakeholders to participate in the consultation.

The FSB will continue to monitor developments and risks in crypto-assets and markets and to set out a clear approach for the coordination of international regulatory and supervisory approaches for crypto-asset activities to ensure that they are comprehensive, consistent and complementary. In addition, the FSB is analysing developments and potential risks to financial stability stemming from decentralized finance (DeFi) and will consider in 2023 whether additional policy work is warranted based on the findings from this work.

The SSBs will continue to examine and make revisions as needed to their standards and principles or provide further guidance supplementing existing standards and principles in light of the FSB recommendations once these have been finalised. The BCBS, CPMI, IOSCO and FATF will continue to examine regulatory, supervisory and oversight issues and coordinate with each other and with the FSB to ensure that crypto-assets and markets are subject to effective regulation and oversight commensurate to the risks they pose.

The FSB will review progress in the implementation of its final recommendations by end-2025. The review involves taking stock of the regulatory measures adopted by FSB member jurisdictions and their outcomes, including analysis of relevant developments in crypto-asset markets. The findings from this exercise may help inform a further review of the recommendations or development of implementation guidance as necessary.