



FSB Consultative Report on International Regulation of Crypto-asset Activities: A proposed framework – WFE response

15th December 2022

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent the operators of over 250 market infrastructures, spread across the Asia-Pacific region (37%), EMEA (43%) and the Americas (20%), with everything from local entities in emerging markets to international groups based in major financial centres. In total, member exchanges trade around \$100 trillion a year and are home to some 60,000 companies, with an aggregate market capitalisation of around \$120 trillion. The 50 distinct central counterparty (CCP) clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up \$1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to invest, raise capital and manage financial risk.

Founded in 1961, the WFE seeks outcomes that maximise financial stability, consumer confidence and economic growth. We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Introduction

Over the last year, adoption of digital assets has continued to advance. Developments have included the growth of available products globally, large inflows into crypto products traded on exchanges, increasing investor interest and a heightened focus on crypto-asset trading platforms. Many services now facilitated by the underlying technology mirror those available in the traditional financial sector, including lending, exchange, investment management and insurance.

Despite the current crypto-asset activity being small compared to that of the overall financial sector, if the pace of growth seen in recent years continues, interlinkages with the traditional financial sector seem likely to increase. Moreover, the new technology has the potential to reshape activity currently taking place in the traditional financial sector, through either the migration of that activity (especially if it is possible to carry out those activities to a lower regulatory standard) or the widespread adoption of the technology.

The technology underpinning this innovation could bring a number of benefits including lower transaction costs, faster settlement and more choice for investors when choosing which assets to invest in. Those benefits can only be sustainable and realised if activity is undertaken safely and accompanied by effective public policy frameworks that mitigate risks and maintain broader trust and integrity in the financial system. As such, the WFE appreciates the opportunity to respond to the FSB's consultation on International Regulation of Crypto-Asset Activities. We appreciate the regulatory certainty that this should provide and encourage all proposals to be agreed in full co-ordination with securities regulators at international level. We lay out some suggestions to the proposed framework down below:

Q1. Are the FSB's proposals sufficiently comprehensive and do they cover all crypto-asset activities that pose or potentially pose risks to financial stability?

As the FSB has noted, crypto-asset markets currently do not present systemic risk to the existing financial system thus far. We agree but nevertheless, we welcome the FSB's proactive monitoring of the financial stability risks on an ongoing basis. We welcome the approach of "same business, same risks, same rules" principles which should apply to ensure the values of transparency, fairness, stability, investor protection, and market integrity are upheld.

Furthermore, again as noted by the FSB, crypto-assets and markets must be subject to effective regulation and oversight commensurate with the risks they pose. Therefore, we urge the FSB and prudential regulators to work in co-ordination with IOSCO and national securities and derivatives regulators which have mandates to ensure financial market integrity and stability and specifically note the aims of the EU MiCA framework especially in relation to the investor protection mechanisms employed and the protections of client assets.

Q2. 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?

The FSB defines crypto-assets as "a digital asset (issued by the private sector) that depends primarily on cryptography and distributed ledger or similar technology. Crypto-assets include, but are not limited to, a cryptoasset that is classified as a payment instrument in a jurisdiction and a crypto-asset that is classified as a security in a jurisdiction." We do not necessarily think this definition is helpful. The definition encompasses tokenised traditional assets, such as a security that utilises cryptography or DLT. By defining tokenised traditional assets as crypto-assets there is a danger

of conflating the risks more commonly associated with unregulated crypto-currencies to securities and other products which merely utilise DLT to deliver a traditional product.

One example of such hinderance is the recent work of the Basel Committee on Banking Supervision's (BCBS) proposal on the prudential treatment of crypto-asset exposures which conflates the risks of crypto-currencies with tokenised traditional assets.¹ Amongst other things, the BCBS proposal attempts to apply an additional capital charge to all crypto-assets using the FSB's definition. This fails to achieve the same activity, same risk, same rules principles that the FSB and IOSCO have all agreed to as it treats tokenised and non-tokenised securities differently and without clear justification. The source of this problem is largely caused by a failure to define the problem. Instead of using the FSB's current definition the FSB, in conjunction with IOSCO and the other standard setters, should adopt a more precise set of terminology to accurately describe the different assets that depend on cryptography and distributed ledger or similar technology. This could build upon IOSCO's [work](#) in 2020 and its ongoing commitment to develop a taxonomy in its [Crypto-Asset Roadmap for 2022-23](#). Crucially, it is important to look at the underlying characteristics and use cases of different types of assets that utilise cryptography and DLT. The focus of this FSB report should therefore be on unregulated, unbacked crypto-assets and unregulated crypto trading platforms.

Traditional assets, tokenised or not, are already subject to vast amounts of regulation. These are set out in principle in IOSCO's [Principles of Securities Regulation](#). They include requirements on issuers, service providers, intermediaries, secondary markets, clearing and settlement providers. These assets do not need to be treated any differently to their non-tokenised counterparts.

Therefore, the FSB should clarify that the proposed recommendations apply only to those crypto-assets that are, as of yet, unregulated. In other words, tokenised traditional assets (which are subject to existing regulation) ought to be carved out from the general definition of "crypto-assets" and the purpose of the FSB's work should be to capture the largely unregulated sphere of crypto-currencies and trading platforms and not to undermine or re-write established principles.

On that basis, the WFE broadly supports the idea that the FSB's recommendations should apply to unregulated crypto-assets and trading platforms.

The WFE would welcome regulation that goes further than the FSB proposal and seeks to apply the same standards of regulation and supervision over tokenised non-traditional assets, such as crypto-currencies and service providers.

For example, the FSB correctly identifies that in a typical trading environment, certain commercial activities that are frequently carried out by crypto-trading platforms (CTPs) would not be allowed or would be closely regulated. CTPs often serve as (i) venues of exchange, operating the platform on which buyers and sellers trade virtual and fiat currencies; (ii) in a role similar to a traditional broker-dealer, representing traders and executing trades on their behalf; (iii) as money-transmitters, transferring virtual and fiat currency and converting it from one form to another; (iv) as owners of large virtual currency holdings; and, in some cases, (v) as issuers of a virtual currency listed on their own and other platforms, with a direct stake in its performance.

The FSB should therefore strengthen its stance in requiring separation of activities. In other words, the same standard of regulation should apply as applies to authorised exchanges

Any proposal in this space should be in full co-ordination with international securities regulators.

¹ <https://www.world-exchanges.org/our-work/articles/wfe-response-prudential-treatment-cryptoasset-exposures>

Q3. 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)?

As set out in the answer to question 2, the FSB, alongside IOSCO, should develop a more granular categorisation of crypto-assets.

Q13. 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?

As highlighted in the paper, given the cross-border nature of global stablecoins, it will be important that markets regulators and other financial supervisors co-operate amongst themselves to reduce the risk of regulatory arbitrage through fragmentation. These regulatory cooperation tools, both with other securities regulators and with banking and payments regulators, can strengthen the ability of authorities to protect their domestic investors and ensure stablecoin market transparency.

In this context, the IOSCO Principles covering Cooperation in Regulation could be important when assessing global stablecoin arrangements, by encouraging a broad range of cross-border cooperation and information sharing. The relevant principles are:

- IOSCO Principle 13 – The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
- IOSCO Principle 14 – Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
- IOSCO Principle 15 – The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

However, the WFE also advocates going further and explicitly detailing the need to share information, not just on GSC or crypto-assets but on their issuers and the platforms on which they are traded. Without formalised co-ordinated approaches to enforcement and oversight in general, issues around market integrity and consumer protection will not be fully addressed. This approach would also support and better facilitate regulatory deference and ought to be conducted in co-operation with IOSCO and securities regulators internationally.