FSB consultation – International Regulation of Crypto-asset Activities

Cargio's response

Table of content

Summary

Cargio thanks the Financial Stability Board (FSB) for consulting stakeholders in the crypto-asset sector to build an effective regulatory framework that ensures that crypto-asset activities are subject to comprehensive regulation, proportionate to the risks they present, while exploiting the potential benefits of the technology behind them.

Since its creation in 2020, the Association has always supported the development of international standards around this new asset class whose activities are cross-border by nature.

As crypto-assets have seen exponential adoption by citizens around the world for several years, the FSB has a fundamental role to play in making the sector more virtuous and ensuring that the risks that this new asset class may pose to financial stability are effectively addressed through commensurate standards for the sector and effective coordination between all states around the world.

In summary, here are the main messages carried by Cargio:

- The *same activity, same risk, same regulation* principle should be approached with parsimony when it comes to crypto-asset markets, especially decentralised finance - mentioned several times in the report - which requires a new regulatory approach and whose risk assessment and regulation requires a paradigm shift.

- Cargio agrees that the requirements of the FSB's recommendations on crypto-assets should apply to all types of crypto-asset activities, including stablecoins, while some activities, particularly those related to global stablecoins, should be subject to additional requirements.
  The recommendations on crypto-assets are sufficiently broad and proportionate to be applied to these assets, while many of the requirements proposed by the GSB are already implemented at the European level, proving that they can be perfectly executed at the global level to ensure consistency in these inherently cross-border markets.

- However, the qualification of global stablecoin could be further developed to leave less room for interpretation by FSB member states. Indeed, while the recommendations are usefully broad and proportionate, it is necessary to have explicit criteria for definition - via thresholds in particular - to avoid regulatory disparity and to provide the same level of guarantees for financial stability in different jurisdictions.

- While the report deals fairly comprehensively with recent market events in the stablecoin markets, Cargio reminds that these events should not undermine their value proposition and the opportunities they offer for users. Furthermore, it would be

appropriate to examine the regulatory treatment of stablecoins backed by crypto-assets as well as new forms of hybrid algorithmic stablecoins in the report.

Cargio remains at the disposal of FSB members to discuss this paper and to organise technical exchanges with its members on the proposed recommendations.

~

Questions for consultation

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?

Given the relative maturity of the crypto-asset sector, it is - in our view - complex to determine precisely which types of crypto-asset activities pose significant risks to financial stability. But beyond that, the regulatory principles proposed by the FSB cover the most important activities related to crypto-assets.

From the above, we understand that the FSB did not want to be exhaustive in the scope of crypto-asset activities, but Cargio would like to clarify that other activities, notably in the section "Investment, leverage and risk management" could be considered, given their adoption (in terms of total value locked) as more important than some of the services mentioned such as insurance or derivatives:

1. Liquid staking: which provides liquidity for the validation of transactions on a proof-of-stake network without holding a node on this network. These services are more like investment services than infrastructure services falling into category "2" as, via these applications, users do not directly validate transactions but simply benefit from a return by blocking their assets in a pool so that the protocol can validate transactions for them.

2. Bridges: These are activities that link crypto-assets from one blockchain network to another. These activities can have a significant impact on the stability of the crypto markets as they ensure the interoperability of the blockchain networks between them and can be subject to attacks that can have quite significant consequences.

3. Reserve assets: These are activities that set up a store of value via crypto-assets and allow for decentralised cash management. This process guarantees a theoretical floor price for each token in circulation.

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?

Firstly, the principles adopted by the FSB are - rightly - broad as they will aim to provide a basis for the authorities to actively engage with stakeholders on the risks associated with the GSC and how they are addressed.

For this question, Adan would like to focus on two features related to the crypto-asset sector:

Firstly, decentralised finance (DeFi):

The desire to apply the "same activity, same risk, same regulation" principle to all crypto-asset activities — as set out in Recommendation 2 — may seem inappropriate at times, given that some crypto-asset activities offer a new paradigm that would not fit in well with these sector-specific primitives. This is particularly the case for decentralised finance, whose paradigm shift has already been identified by the FSB in 3.2.

[1]Traditional finance has given rise to regulation that focuses on the supervision of producers, distributors, and infrastructures. This regulation is usually sector-specific. Despite the variety of players, their regulation is generally focused on the same typology of rules, such as prudential standards, organisational requirements, and rules of conduct. The regulatory framework applicable to crypto-assets in Europe – with the Market in Crypto-Assets Regulation – has been largely inspired by the main principles of banking and financial sector regulation.

Not exactly the same activities. While the services offered by PSANs are fully intermediated via platforms that custody their clients' funds, DeFi operates on a different methodology. It involves protocols hosted on one or more interfaces (i.e. front ends) and which users use without being considered as customers. These protocols are owned by a community (the governance token holders who provide the governance of the protocol).

Not exactly the same risks - and not the same risk management. Where DeFi mitigates some of the risks of traditional finance, it creates new ones, mainly technological. Via embedded regulation, DeFi can detect (via the transparency of blockchain networks) and block addresses from crypto-asset theft and scams, and it can also improve market integrity by preventing market abuse.

[1] *Cargio specifies that we support the principle "same activity, same risk, same regulation" but we consider that it cannot always be applied universally and without adaptation to the crypto sector, otherwise regulation will be difficult to adapt to the specificities of this asset class and to the potential it offers in terms of regulation — in particular to guarantee financial stability.*

Not exactly the same regulation. Decentralised finance requires a reconsideration of the traditionally accepted regulatory paradigm for centralised stakeholders. Regulatory initiatives should allow project developers to incorporate new compliance methods that take advantage of the opportunities offered by blockchain networks and its use cases.

According to Cargio, the FSB's recommendations on crypto-assets could take into account these existing fundamental differences between centralised and decentralised use cases in the crypto-asset sector.

With regard to DeFi, the FSB's recommendations (in particular recommendation 3) could be strengthened on cooperation and coordination, both at national and international level, as decentralised finance is a cross-border ecosystem by nature that does not have a territorial footprint. This cooperation will allow the implementation of an adapted and efficient framework for DeFi while providing real guarantees for financial stability. DeFi regulation without prior coordination will be at best ineffective and at worst destructive at the national level for those countries that would take the initiative to introduce legislation on this ecosystem.

But beyond these postulates that would improve what the FSB recommendations already provide. It would seem that the FSB recommendations can - given their broad interpretation - be applied without too much complexity to DeFi activities.

Secondly, stablecoins and GSC:

Cargio agrees that the requirements of the FSB's recommendations on crypto-assets should apply to all types of crypto-asset activities, including stablecoins, while certain activities, particularly in relation with global stablecoins, should be subject to additional requirements.

Indeed, the recommendations on crypto-assets are sufficiently broad and proportionate to be applied to these assets, while many of the FSB's proposed requirements are already being implemented at the European level, proving that they can be perfectly executed for stablecoins too.

Furthermore, the *ad hoc* recommendations on stablecoins will allow for comprehensive standards to be set to facilitate cooperation between states on the risks associated with stablecoins and especially GSBs. Recent market developments have shown the relevance of adopting an ad hoc approach for GSBs, given the domino effect that these types of crypto-assets can create in case of collapse. Fine-tuned and tailored supervision therefore seems proportionate to the risks they may pose to the stability of crypto-asset markets - and in a more global context, to financial stability.

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)?

Firstly, Cargio supports the dissociation of GSBs from other crypto-assets as these assets can cause significant financial or operational disruption to financial stability - independent of the disruption that crypto-assets can cause overall.

However, Cargio considers that the proposed classification elements could be adapted so that the boundary between stablecoins and CSGs can be better established by individual national authorities.

On the one hand, **by being more precise about the classification elements of global stablecoins**. Indeed, by adopting such a broad approach, the FSB leaves room for significant arbitration by national authorities, which could lead to significant disparities.

In this respect, the FSB could propose indicative thresholds to qualify a GSB. In this respect, MiCA already sets thresholds for qualifying asset reference tokens and e-money tokens as significant. The FSB could take up these thresholds, which seem pragmatic - or at least be inspired by them since Europe is a forerunner in this field.

Cargio's proposal:

Annex 3 would thus read as follows:
[...]They include factors and considerations for authorities to determine whether a stablecoin has the potential to expand reach and adoption across multiple jurisdictions and has the potential to achieve substantial volume. Such potential elements are:

- **A** number and type of stablecoin users **larger than 10 million** ;
- **A** number and value of transactions **higher than 2 500 000 transactions and EUR/USD 500 million respectively, per day** ;
- **A** size of reserve assets **higher than EUR 5 billion** ;
- **A** value of stablecoins in circulation **higher than EUR 5 billion** ;

[...]

On the other hand, **some elements of the classifications, while they would indicate - as a complement - whether a stablecoin is global, do not seem to be as relevant as other elements of the classification of a stablecoin as a GSB**.
This is particularly the case for the criteria below:

- Interconnectedness with the wider crypto-assets ecosystem, other crypto-asset services and decentralised finance ;

- Integration with digital services or platforms (e.g. social networks, messaging applications)
- Business, structural and operational complexity

Indeed, these conditions seem particularly broad and indeed complex to interpret (e.g. how interconnected must a stablecoin be with decentralised finance?) and we question the impact that these criteria would have in determining the risks that a stablecoin would have for financial stability (e.g. how would the integration of a stablecoin on a social network make it potentially more risky for financial stability over and above the issues related to the increase in the number of users or transactions that are already foreseen in the annex?).

In conclusion, Narrowing the criteria and refining them could, in our view, be more effective to determine which stablecoins pose real risks to financial stability, and more precise conditions would also leave less room for interpretation to qualify a GSB.

4. Do the CA Recommendations and the GSC Recommendations each address the relevant regulatory gaps and challenges that warrant multinational responses?

By framing the main important issues such as recovery plans, stablecoin governance processes, redemption right and AML-CFT measures, the recommendations cover the gaps and challenges relevant to the supervision of stablecoins.

5. Are there any financial stability issues that remain unaddressed that should be covered in the recommendations?

In our view, the main financial stability issues relating to the crypto-assets industry are covered in the FSB recommendations.

Firstly, the willingness of authorities to provide themselves with the appropriate tools to regulate, supervise and control activities related to crypto-assets demonstrates the FSB's innovative approach. Indeed, the authorities must be able to use the opportunities offered by blockchain technologies - traceable and programmable - to supervise these activities.

Furthermore, the recommendations are not limited to the crypto-assets sector alone by addressing the risks associated with the interconnection between crypto-assets and the wider financial system.

Beyond covering the most important issues for financial stability, the recommendations offer an interesting level of discretion for authorities (sometimes a little too broad which can be problematic — see above), which we support.

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?

Part 1.1. of the report covers most of the essential functions and activities in the crypto-asset sector.

As mentioned on page 5, these activities could still be extended as bridges, liquid staking or currency reserves in DeFi have a higher total value locked than some activities mentioned in the report such as insurance[2].
Finally, Annex 1 is a useful supplement to Table 1.

7. Do you agree with the analysis of activity patterns and the associated potential risks?

We consider that the vast majority of financial and technological risks have been identified by the FSB in Annex 1.

In addition, Cargio considers that another technological risk could be added: the risk linked to an oracle exploit.
Oracles allow the integration of so-called off-chain information (external to the network) within DeFi protocols. On decentralised lending protocols, oracles allow the price of tokens borrowed by the protocol's users to be given, which is decisive for liquidating those who have deposited their funds as collateral.
However, if the oracle indicates the wrong price of a token, the smart contract can dramatically liquidate borrowers who had not taken a risky position.

8. Have the regulatory, supervisory and oversight issues and challenges as related to financial stability been identified accurately? Are there other issues that warrant consideration at the international level?

Yes, the regulatory, supervisory and control issues and challenges related to financial stability have been identified by the FSB. The emphasis on cooperation and proportionality are two prerequisites for the recommendations to work. Firstly, cooperation because crypto-asset activities are inherently cross-border and require information sharing and joint working between national authorities, and secondly proportionality because crypto-asset markets are still developing and do not have the same maturity as traditional financial players.

These two requirements have been widely reiterated by the FSB, which, in addition to being very transversal, makes the recommendations attractive.

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?

Cargio fully agrees with recommendations 5, 6 and 7 and would like to make some recommendations available below.

On Recommendation 5: Risk management

The FSB - via its Recommendation 5 - requires that authorities should understand the different risk profiles of crypto-asset issuers and service providers and require them to put in place a risk management framework commensurate with their risk, size, complexity and systemic importance, as well as the risk to financial stability that may be posed by the activity or market in which they participate . Cargio supports this premise , which places - once again - a strong emphasis on pragmatism and proportionality.

Furthermore, the FSB requires providers to identify, manage, prevent and disclose any conflicts of interest . Cargio fully agrees with this and would find it useful to make some additional remarks to ensure that this requirement can be implemented . These additions would make it possible to specify in a practical way how to fight against conflicts of interest by defining these con flicts , giving criteria for identifying con flicts of interest internally and explaining the measures to take to prevent conflicts of interest.

In addition, the FSB requires authorities to ensure that crypto-asset issuers and crypto-asset service providers implement appropriate AML/CFT measures in line with FATF standards, including the FATF "travel rule". Cargio also agrees with these requirements but recalls the operational difficulties of implementing the travel rule, which will require significant cooperation between the crypto industry and national authorities - See Cargion's position on the FATF updated guidance.

On Recommendation 6: Data collection, recording and reporting

The FSB requires crypto-asset issuers and service providers to have robust frameworks for the accurate and timely collection, storage, safeguarding and reporting of data, including the necessary policies, procedures and infrastructure, in each case proportionate to their risk, size, complexity and systemic importance.

Once again, this recommendation is pertinent and - properly implemented - will provide a satisfying level of protection for users while being economically acceptable for the crypto industry worldwide.

While some regimes already provide for the necessity to ensure the protection of users' data (i.e. in France, the Pacte law and in Europe, the MiCA regulation) coordination on data protection — especially in the context of the application of the travel rule — is necessary.

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.

According to Cargio, not all players in the crypto-asset sector present the same risks - even within CASPs/VASPs which offer a wide variety of crypto-asset activities.

While the emphasis is often placed on proportionality and the necessity to address actors according to the risks they pose, an increased granularity on how the recommendations should be implemented according to the risk profile of the actor concerned and its activity would be very clearly relevant.

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?

The report effectively provides an accurate analysis of recent events in the stablecoin markets, including the collapse of the stablecoin UST in May 2022.

As such, while the crash of the UST and the entire TERRA ecosystem has put the crypto asset sector in trouble, it should not be overlooked that crypto-assets are a major innovation, which will not end in 2022. Indeed, crypto-assets are based on fundamentals that have already proven themselves - inclusivity, transparency, programmability, interoperability, etc. - and which must continue to be supported.

On stablecoins, one subject has not been discussed much or at all: indeed, given the current limits of first generation algorithmic stablecoins, another approach has successfully emerged, the hybrid one. These stablecoins are also based on algorithms that nevertheless include a reserve of stablecoin (different from the native one) used to maintain the peg.

The main example of this is the Frax stablecoin which - sells FRAX for USDC when it trades above the dollar and buys back with this accumulated store of value when the peg falls to bring the price back to one dollar.

These innovative new initiatives - especially in a context of widespread inflation - should be observed and supported, although they present risks like all other crypto-assets.

Other initiatives deserve to be taken into consideration in the stablecoin markets beyond the issues of stabilisation or transparency. Faced with the hegemony of the dollar on the crypto markets, we are seeing the emergence of euro stablecoins such as EURL from Lugh, agEUR from Angle Protocol, or EUROC from Circle.

12. Are there other changes or additions to the recommendations that should be considered?

On several occasions, Cargio has noted significant FSB reluctance towards decentralised stablecoins.

For example, Recommendation 4 states that "*authorities should require that GSC issuance be governed and operated by one or more identifiable and responsible legal entities or individuals ('governance body'). The governance structure should allow for timely human intervention, as and when needed or appropriate. Fully permissionless ledgers or similar mechanisms could pose particular challenges to the accountability, and governance and authorities should ensure that appropriate regulatory, supervisory and oversight requirements be effectively applied to such arrangements.*"

Cargio is increasingly concerned about the potential developments on algorithmic stablecoins in the FSB recommendations while most of these initiatives remain experimental and have no direct impact on financial stability (of course some decentralised stablecoins have proven to be significant like the UST, but most algorithmic stablecoins have a very low capitalisation).

According to the objectives of the FSB, Adan understands the necessity to address this category of stablecoins in order to:

- Ensure legal certainty for crypto-assets markets;
- Protect financial stability — and as a consequence consumers;
- Enable authorities to coordinate with proportionate rules.

When a stablecoin - algorithmic or not - retains an element of centralised control and can therefore affect users' assets (like the UST case), Cargio agrees with the necessity to regulate the issuer like other centralised entities. However, it is essential that stablecoins with a true degree of decentralisation do not have to be a legal entity as they are protocols, deployed in an open source manner, for the benefit of a community. As such, the protocol is not a company, it has no customer, and is not owned by that company but by a community.

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?

Due to the cross border nature of crypto-assets, cooperation, which has been widely reiterated in both FSB reports, will be key to effective regulation and supervision by different authorities around the world.

For this cross-border cooperation to be effective, the supervision of these assets and the implementation of recommendations cannot be done without coherence, in which case the level playing field would not be ensured from one geographical area to another. This would lead to some projects being redirected to jurisdictions that are less concerned about the risks of stablecoins for financial stability, which would cooperate more opaquely with others.

On the other hand, a single information sharing system could also be an interesting opportunity to ensure this coordination. However, it could only be successful if it takes into consideration the necessity to respect the privacy rights of stablecoin users through built-in privacy mechanisms - native to the crypto-asset sector .

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?

The proposed template identifies the relevant information that needs to be disclosed. This will allow the quality of the reserve assets to be assessed and compared in a consistent manner and address the issues of opacity of some stablecoins in the sector.

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?

The Association's contribution is detailed in Question 3.

~