

FESE response to the FSB consultation on regulation, supervision, and oversight of crypto-asset activities and markets

9th December 2022

General

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?

FESE Members are committed to the highest standards of transparency, resilience, and investor protection to support safe and stable financial markets. Exchanges play an important role in supporting the stability of the financial system and they perform numerous functions to ensure efficient risk management and financial stability.

FESE welcomes the FSB's technology neutrality approach where the "same business, same risks, same rules" principles should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity. This is also underlined in the FSB proposals, namely in Recommendation 2 on the General Regulatory Framework in proposed recommendations for the regulation, supervision and oversight of crypto-asset activities and markets, as well as in an explanatory note to high-level Recommendation 2 of GSC Arrangements.

To safeguard the integrity of financial markets and to guarantee investor protection, FESE believes that if a category of crypto-assets falls within the definition of a financial instrument, it has to be regulated through financial regulation. In case a category of crypto-assets does not satisfy the definition of a financial instrument, it could be regulated by a bespoke regime, such as the regime established by the Markets in Crypto-Assets Regulation (i.e. MiCA) in the EU.

However, FESE believes that regulating crypto-asset activities is becoming more crucial. Whilst the direct links with the financial ecosystem remain thin, crypto markets are attracting an ever more growing retail investor community.

Therefore, whilst we welcome FSB High-level recommendation, we believe that the FSB should further consider strengthening its paragraph specific to "Trading platforms and other intermediaries and service providers" in its GSC Recommendation 2 and CA Recommendation 9, most notably by referring to the EU's MiCA.

More specifically, the FSB should consider:

1. the combination within crypto-exchanges of potentially **conflicting activities** which raise issues in terms of investor protection but also systemic resiliency (retail brokerage, execution of orders, trading on own accounts, custody of end investors assets, etc.) which are operated within the same entity with no clear activity segregation.

For example, in the recent case of the FTX bankruptcy, there are strong suspicions that investors' assets were used by the exchange's proprietary trading arm. These investors assets' withdrawal have been frozen under the current liquidity crunch faced by FTX.

The EU's MiCA framework provides provisions for the safekeeping of clients' crypto-assets and funds, in Article 63, which are expected to prevent the use of clients' funds for their own account.

2. a need for clear **pre- and post-trade transparency rules**, as we believe that it is vital to ensure a similar level of information on the transaction of crypto-assets as of financial instruments in the interest of market integrity and investor protection. For example, it has been recently reported that close to 50% of volumes on Bitcoin (the largest crypto-asset) has been assessed as fake due to the mis-reporting of crypto-exchange or 'wash trading' activities (Source from [Forbes](#)). MiCA is expected to introduce a mandate for the European Securities Market Authority (ESMA) to specify the offering of pre-trade and post-trade transparency data as well as the content and format of crypto-assets' trading venue order book records in Article 68.
3. a need for resilient **prudential requirements** for crypto-exchanges and providers who engage in banking type of activities (most notably the custody of investor's assets), lending and borrowing. For example, in the case of Celsius lending, a borrowing network collapse occurred with \$4.5bn owed to Celsius clients according to bankruptcy filings. The MiCA framework is expected to introduce prudential requirements, in its Article 60, depending on the nature of the crypto-asset services provided.

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?

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)?

Q4 Do the CA Recommendations and the GSC Recommendations each address the relevant regulatory gaps and challenges that warrant multinational responses?

As mentioned earlier, FESE highlights that technology neutrality and "same business, same risks, same rules" principles should apply to uphold the values of transparency, fairness, stability, investor protection, and market integrity, as also underlined in the FSB proposals.

With regard to operational resilience mentioned in the high-level Recommendation 5 of GSC Arrangements, FESE believes that the proposed security risk management framework should be based on internationally developed standards (e.g. the National Institute of Standards and Technology Cybersecurity Framework (CSF)). Additionally, in our view, technological innovation provides many benefits and is of utmost importance for the future development of the financial sector to be competitive and to offer better services to consumers. Consequently, to reap those benefits, the international regulatory framework for new technologies should be designed in such a way as to keep the balance between innovation and safety for financial markets. From an operational perspective, a potential approach should be more detailed but avoid recommending technology-specific parameters.

Q5 Are there any financial stability issues that remain unaddressed that should be covered in the recommendations?

FESE would like to underline that Financial Market Infrastructures (FMIs), such as Trading Venues, CCPs and CSDs, provide important functions to markets as they ensure resilient and transparent markets, and deliver the highest levels of investor protection and ensure market integrity. It is crucial to recognise the status of FMIs as highly regulated entities and the fact that they can manage and operate markets for several forms of “digital assets” in a more secure way. Consequently, it would foster trust in public capital markets in a new digital environment.

Crypto-assets and markets (CA Recommendations)

Q6 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?

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To safeguard the integrity of financial markets and to guarantee investor protection, FESE believes that if a category of crypto-assets falls within the definition of a financial instrument, it has to be regulated through financial regulation. In case a category of crypto-assets does not satisfy the definition of a financial instrument, it could be regulated by a bespoke regime, such as the regime established by the MiCA Regulation in the EU.

Q7 Do you agree with the analysis of activity patterns and the associated potential risks?

Q8 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?

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Q9 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?

Q10 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)

Q11 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?

Q12 Are there other changes or additions to the recommendations that should be considered?

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?

Q14 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?

Q15 Do you have comments on the elements that could be used to determine whether a stablecoin qualifies as a GSC presented in Annex 4?