

**Sella Group's response to Consultation "International Regulation of Crypto-asset Activities: A proposed framework" – Financial Stability Board.**

Sella Group thanks for the opportunity to provide comments on the above-mentioned Consultation, which addresses crucial topics for a sound development of crypto-assets regulation.

## **Background**

The definition of a sound, proportionate and fair regulation is a primary objective in order to achieve the full potential of DLT, crypto-assets and tokenization, and at the same time a high level of consumer protection while maintaining financial stability.

However, any territorially limited legislation is destined to be irrelevant and ineffective when it comes to regulate the provision of services that are global by definition. Services involving crypto-assets are based on technology (DLT) that finds in distribution and decentralisation its strengths. Therefore, regulation should be based on new paradigms, promoting cooperation between jurisdictions and the establishment of common global supervisory practices; for these reasons, we believe that the initiative in this consultation is particularly worthy of interest.

That said, DLT is just a technology which doesn't pose risks in itself; Instead, regulation should focus on the use of that technology to the extent that crypto-asset services pose the same – or equivalent – risks compared to financial ones.

For this reason, we consider of paramount importance the principle expressed in Recommendation No. 2, according to which "Authorities should apply effective regulation (...) in a manner proportionate to the risk to financial stability that they pose or may pose, in line with the principle of 'same activity, same risk, same regulation'". Authorities should have as comprehensive as possible regulatory frameworks and policies, but, at the same time, always proportionate to risks, complexity, uses and systemic importance of the specific type of crypto-asset provided.

In line with the FSB's Recommendations, when crypto-assets and intermediaries perform an economic function, equivalent to that offered by traditional instruments and intermediaries, they should be subject to an equivalent – technology neutral - regulation.

Technological neutrality is another of the principles that, together with those of 'global consistency', 'level playing field', and 'same activity, same risk, same rules' should always be placed at the basis of regulation in this field. Indeed, on closer inspection, the last principle could be changed to 'same activity, same risk, "equivalent" rules' precisely in order to emphasize the

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technological neutrality to which regulation should aspire from a substantial standpoint. For example, we should consider a reference model the way of experimental regulation followed by the European Union's 'DLT Pilot Regime', aimed precisely at defining a regulatory regime for security-token trading and settlement equivalent to the one provided for traditional financial instruments, but respectful of the peculiarities of the technology used.

This is specifically discussed in Section 2.2.1. "*Application of existing regulation vs. adoption of specific regulation*", which states that "*Most authorities are so far applying existing regulation to crypto-asset activities based on the crypto-asset's economic function(s), i.e., whether it serves as a means of payment, security, commodity, and/or derivative, or the nature of the activities in which the crypto-asset is used, such as its offer and sale to investors. The applicability of existing financial regulation relies on whether the activities and underlying functions are regulated activities or assets under a jurisdiction's regulatory framework*".

That said, we agree with the need to regulate the provision of services involving crypto-assets in order to ensure appropriate regulation, supervision and oversight of crypto-asset activities and markets as far as they determine the same risk of traditional finance. In general, regulation should not be punitive, but aimed at consumer and market protection: this is basically reflected in the FSB's proposals, as well as being one of the underlying principles of the MiCA Regulation, which is at the moment the most advanced proposal and should be used as a role model in other jurisdictions in order to achieve a globally coherent and consistent framework. Given the increasing number of market participants, issuers of crypto-assets and entities which make crypto-assets available to the public should be regulated. Similarly, as highlighted by recent events, entities providing the core services for the crypto-asset market (custody, trading, etc.) should also be regulated. Following the MiCAR example, crypto-asset service providers (CASPs) should be subject to licensing, conduct, transparency, and prudential supervision requirements, but even the mentioned European framework has some weaknesses and contradictions that should be taken into account by the FSB's recommendations in order to encourage the evolution of what is still a valid and worthy starting point.

For example, the FSB's Recommendations should lead to regulatory regimes depending on the specific type of crypto-asset and on the specific risks they entail. In our view, MiCAR's solution of providing the same – investor protection-type - regulatory regime for the provision of crypto-assets services, regardless of their classification and specific features, should be revised. Indeed, according to the 'same activity, same risk, same (or equivalent) regulation' principle, only crypto-assets which satisfy investment needs and purposes should be subject to investor protection-type requirements. By contrast, in the case of stablecoins, they should be subject to different regulation, inspired by payment services, not by investment services. For example, we don't consider justified MiCAR's requirement that in the case of advice involving stablecoins the suitability assessment should be carried out as if it were an investment token.

But, in our opinion, the aspect on which the greatest attention should be focused for the regulation of the crypto-assets market is that set out in Recommendation No. 3, according to which "*Authorities should cooperate and coordinate with each other, both domestically and*

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*internationally, to foster efficient and effective communication, information sharing and consultation in order to support each other as appropriate in fulfilling their respective mandates and to encourage consistency of regulatory and supervisory outcomes."* Indeed, current regulatory projects, such as MiCAR, as well as current regulation, being territorially limited, don't allow for a common global supervisory activity, nor resolve the risk of regulatory arbitrage except in cases of obvious solicitation in EU territory. In fact, reverse solicitation phenomena cannot be prevented, so that a crypto-asset service provider that doesn't intend to submit to the regulation of one State only needs to establish itself in another and refrain from direct solicitation in order to be able to provide services also to subjects resident in one of the regulated States. This poses risks for consumer protection and undermines the level playing field between crypto-assets service providers. In fact, without a precise and enforceable strategy against regulatory arbitrage, regulation could be an element of penalisation for countries, such as those belonging to the EU, that will soon be subject to a much more restrictive regulatory regime than that in force in other countries. On the one hand, the lack of equivalent regulatory regimes in other countries, and on the other, the inability of current regimes to prevent reverse solicitation will likely lead to an inevitable exodus of crypto-assets service providers to countries with weaker regulation (or no regulation at all). It will be sufficient for these CASPs to refrain from transmitting promotional and marketing communications specifically addressed to customers established in countries with an appropriate regulatory regime in order to be able to provide services also in the territory of these countries.

In conclusion, the FSB's proposals should encourage dialogue and adoption of common supervisory practices at the global level, although they appear to be excessively high-level and not conducive to effective regulatory convergence. In fact, more detailed proposals, regulatory standards (possibly inspired by the most advanced regulatory frameworks, such as MiCAR) and penalising mechanisms for states that actually deviate from the principles expressed and, above all, encourage regulatory arbitrage phenomena through regulatory and supervisory inertia are needed.

The Sella Group believes that the FSB's proposals should largely be inspired by the MiCA Regulation, but without renouncing to correct its deficiencies. Therefore, in our opinion, it's not only opportune, but also crucial to define common standards upon which to base regulation also in states not included in the FSB. We agree with the FSB's proposed initiative to have several regulatory frameworks that are as uniform and globally coordinated as possible.

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## Questions

### - 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?**

The Sella Group believes that the FSB's proposals are sufficiently comprehensive and cover all activities involving crypto-assets, but we suggest the use of the same services' taxonomy provided by MiCAR in order to promote global consistency and coherence from the beginning. However, recommendations don't solve some application problems, e.g. they don't identify appropriate ways to regulate services provided through DeFi or DAO-related platforms.

At the same time, as highlighted above, the proposal is insufficient in regulating cooperation obligations and penalising mechanisms (including sanctions) for countries that don't comply with FSB standards.

By way of example, the MiCA Draft Regulation, being territorially limited to the provision of services within the EU, in no way resolves the risk of regulatory arbitrage except in cases of evident solicitation in European territory (see MiCAR Art. 53b *Provision of services at the exclusive initiative of the client*). In these hypotheses, in fact, it's sufficient for a CASP that doesn't wish to submit to EU regulation to establish itself in a non-EU state and refrain from direct solicitation to be able to provide services also to EU residents. In these respects, a starting point from which the FSB framework should be inspired is to prevent regulatory arbitrage to the extent MiCAR (and other local regulation) does not.

#### **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?**

We agree that the requirements set in the CA Recommendations should be applied to all crypto-assets, including stablecoins, if they pose the same or equivalent risks compared to regulated assets. However, specific requirements should be proportionate to the risks that each type of crypto-asset may entail, as can be deduced from the principle 'same activity, same risk, same regulation'.

For example, it makes no sense to have the same requirements for the provision of services on tokens that can also be purchased for investment purposes and tokens that can only be used for payment purposes (such as stablecoins). As regards GSCs, we think it's right to apply additional requirements, but it must be clearly defined in detail when a stablecoin is to be considered GSC. By way of example, reference can be made to the requirements and obligations outlined in the MiCA Regulation, provided that GSCs could raise specific issues in terms of financial stability, monetary policy transmission, or monetary sovereignty. Uniformity of interpretation and application must also be guaranteed at a global level because it cannot be allowed the risk (of regulatory arbitrage, of unlevel playing field, of circumvention)

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that for some countries a stablecoin is GSC and in others, one token with the same characteristics, is not.

### **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)?**

The FSB's 2020 report, "Regulation, Supervision, and Oversight of 'Global Stablecoin' Arrangements" described three characteristics that distinguish a GSC from other crypto-assets and stablecoin. These characteristics include (1) the existence of a stabilisation mechanism, (2) usability as a means of payment and/or store of value, and (3) potential reach and adoption in multiple jurisdictions. The first two characteristics and the specific risks they entail distinguish stablecoins from other crypto-assets. The third differentiates GSCs from other stablecoins. However, in our view, it's necessary to clearly define in detail when a stablecoin should be considered a GSC. At the same time, uniformity of interpretation and application at a global level must be guaranteed, as we cannot afford the risk (of regulatory arbitrage, of a unlevel playing field, of circumvention) that for some countries a stablecoin is GSC in others, with the same characteristics, it's not. We, therefore, suggest that the FSB specify quantitative parameters as done by MiCAR, in which GSCs are defined as "Significant asset-referenced tokens" and "Significant e-money tokens" (see Recital 41B): to be considered "significant", they must (also potentially) satisfy certain criteria, including a large customer base, high market capitalisation and high number of transactions.

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

Yes. The CA and GSC Recommendations address the problems and challenges for regulation and supervision in this area. Recommendation No. 3 is crucial and, especially from the perspective of an EU service provider, is the key to determine the cooperation and coordination role of the authorities, both nationally and internationally, as services on crypto-assets are global by nature. The authorities' activities should aim to support each other in fulfilling their respective mandates and to ensure a common supervisory practice and regulatory framework. However, phenomena of reverse solicitation and regulatory arbitrage have never been fully resolved even with Web2 and even within EU countries. National regulation is insufficient and, standing alone, only increases the risk of regulatory arbitrage in favour of countries with softer regulatory and supervisory approaches, which is a risk for customers (less protected) and service providers based in more and better regulated countries (unlevel playing field). In the crypto market, this is even more evident and penalising mechanisms (and possible sanctions) should be provided for States that don't bring their supervisory practices into line with those defined by the FSB and that don't withdraw authorisation from entities that have been found to have engaged in non-compliant solicitation conducts in other countries (maybe even in case of notification by the supervisory authority of third regulated countries or in case of investigation by the regulator of the country responsible for the CASP).

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

Yes. The Sella Group believes that there are financial stability issues not yet addressed that should be addressed in the Recommendations.

As stated in response No. 1 above, the FSB proposal covers all activities involving crypto-assets but has some weaknesses. First, it doesn't solve some application problems, e.g. it doesn't identify appropriate ways to regulate services provided through DeFI or DAO-related platforms. On this point, the FSB proposes that governance mechanisms should be made public in these cases as well, but governance transparency is nothing more than just another obligation without a clearly identifiable responsible entity. What is proposed in the Consultation raises doubts, since the problem with the legislation is precisely that of identifying an entity clearly responsible for the services provided and, therefore, for the transparency obligations also. Moreover, as mentioned above, the proposal falls short in regulating cooperation obligations and penalising mechanisms (including sanctions) for member countries that don't comply with FSB standards.

### **- 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?**

See answers to questions 1 and 5. In our opinion, the functions and activities within the crypto ecosystem that pose or could pose risks to financial stability are sufficiently comprehensive and adequately valued. In particular, these are generally in line with the provisions of the MiCA Draft Regulation.

The provisions of Table 1 also include certain assets that are not included in MiCAR or have been classified differently.

## **7) Do you agree with the analysis of activity patterns and the associated potential risks?**

Yes. In our opinion, the table in Annex I is sufficiently clear in representing activities, risks and potentially relevant international standards.

## **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?**

Regulatory, supervisory, and oversight aspects and challenges related to financial stability are precisely identified in the CA and GSC Recommendations. As previously stated in response No. 4, Recommendation 3 is crucial and, especially from the perspective of an EU service provider, is the key in order to determine the role of cooperation

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and coordination of authorities, both nationally and internationally, as services on crypto-assets are global by nature. Activities involving crypto-assets could pose consumer protection and/or financial stability issues, which should be addressed by competent authorities to ensure a common supervisory practice and regulatory framework. However, phenomena of reverse solicitation and regulatory arbitrage have never been fully solved even with Web2 and even within EU. National regulation is insufficient and, standing alone, only increases the risk of regulatory arbitrage in favour of countries with softer regulatory and supervisory approaches, with consequent harm to customers (less protected) and service providers based in more and better regulated countries (unlevel playing field). It may be useful to specify that the MiCA Regulation provides for the EBA and ESMA to be able to exercise all their powers and tasks to achieve their objectives of protecting the public interest by contributing to the short and medium-term stability and effectiveness of the financial system for the Union's economy, its citizens and businesses, and those crypto-asset issuers and crypto-asset service providers are covered by Regulations (EU) No. 1093/2010 of the European Parliament and the Council and Regulation (EU) No 1095/2010 of the European Parliament and the Council. While the Proposed European Regulation is a virtuous example, it's, due to its nature, territorially circumscribed.

Another issue to take into account is interpretative discrepancy. For example, MiCAR doesn't properly address this risk and doesn't clarify when a crypto-asset should be considered a financial instrument or a "other-than" token. It would therefore be necessary to supplement the MiCA Regulation by providing a sample list of tokens considered to be 'other-than' (residual class of MiCAR), possibly in an Annex, starting with the most representative ones. In this way, it would be possible to provide a rough indication of which tokens are certainly subject to MiCAR, allowing the same interpretation to be applied to tokens like those listed. Moreover, the adoption of European Regulator Guidelines in which clarification is provided on the differences between tokens classified as financial instruments and 'other-than tokens'. Concrete examples should be given, with a clear European position on the classification of at least the most relevant tokens, starting with Bitcoin. Only in this way can interpretative uniformity and a level-playing field be guaranteed, avoiding regulatory arbitrage.

The FSB's proposals should therefore effectively foster dialogue and the adoption of common supervisory and interpretative practices on a global 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?**

In our view, the differentiated requirements for crypto-assets issuers and service providers in the proposed recommendations on risk management, data management, and disclosure are appropriate. The Sella Group agrees with the provisions of Recommendation No. 9, according to which each service presents specific risks that should be addressed by the regulator both individually and concerning the combination with other services at a single CASP. In particular, as recent events have made clear, entities providing those services that are fundamental to the crypto-assets market (custody, trading, etc.) should be regulated.

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For instance, consider that an approach consistent with this recommendation is that of MiCAR, which provides specific requirements for each service provided to prevent or mitigate risks arising from each. Conflict of interest management policies are also provided for.

However, we don't consider sufficient the provision on differentiated requirements between issuers and service providers. The FSB's Recommendations should also lead to different regulatory regimes depending on the specific type of crypto-assets and on the specific risks they entail. In our view, MiCAR's solution of providing the same – investor protection-type - regulatory regime for the provision of crypto-assets services, regardless of their classification and specific features, should be revised. Indeed, according to the 'same activity, same risk, same (or equivalent) regulation' principle, only crypto-assets which satisfy investment needs and purposes should be subject to investor protection-type requirements. By contrast, in the case of stablecoins, they should be subject to different regulations, inspired by payment services, not by investment services.

**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.**

Yes, as mentioned in answer 9, recommendations should specify the need to provide for differentiated requirements in national regulations depending on what services are provided, but also on which type of crypto-asset is offered. As an example, within the MiCA Regulation the different disciplinary regimes of intermediaries and providers are adequately elaborated upon. The EU regulations provide for a further distinction between intermediaries and providers of the two classes of stablecoins provided for (asset-referenced tokens and e-money tokens), with differentiated requirements. On the contrary, it doesn't take into account the different nature and risks of specific type of crypto-asset, providing same requirements for payment and investment token services.