Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

14 December 2022

Re: International Regulation of Crypto-asset Activities: A Proposed Framework

Dear Sir/Madam,

Binance welcomes the Financial Stability Board (FSB) work on a global framework for regulating crypto-asset activities. The industry is spread across jurisdictions, and disintermediates financial services using technologies that operate across the globe 24/7, with less emphasis on traditional supervision structures. Given this, the importance of global standards increases. The ideal regulatory response should be coordinated, consistent and comprehensive. Regulation must be proportionate to the nature, scale and complexity of the risks.

All regulatory frameworks should provide certainty and a safe space for innovation, driving consumer trust, market order, clarity and impact. The framework also needs to provide guardrails that are necessary to ensure financial stability and consumer protection and to provide the confidence that users need.

Our detailed response is attached, however we highlight the following key points:

- **The same activities, same risk, same regulations principles are not consistent with the stock-take survey performed by FSB among global regulators**, which emphasises that in certain areas crypto presents different challenges and opportunities as compared to the traditional financial industry. These need to be considered properly, and therefore require tailoring and bespoke regulation.

- **Legal separation of activities of crypto-asset service providers** undertaking a variety of services similar to traditional financial services may require a different approach to segregation of risks in practice. While crypto exchange businesses may need to be segregated from certain business functions (such as crypto lending for example) in the future, other business functions (such as custody) might effectively coexist with a core crypto exchange function supported by robust governance, effective risk procedures and adequate internal control mechanisms.

- **Overlaps between the sets of recommendations should be minimised**. The recommendations on GSCs should be 'additional' in nature and focused on addressing risks that are specific to stablecoin arrangements, in particular the mechanism of stabilisation and the conditions for redemption.

- **The list of activities and the list of core and critical functions in a stablecoin arrangement should be clarified and more narrowly defined**. On the basis of that, the need and justification and the range of competences given to the 'governance body' should be reviewed.

- It would be appropriate to consider the regulatory treatment of stablecoins backed by crypto assets that are exogenous to the stablecoin arrangement in the context of ongoing discussions on the **regulation and supervision of DeFi.**

Finally, given the significance of the proposals on the industry, we would appreciate the FSB undertaking roundtables early next year to discuss feedback, as the recommendations are finalised.

Please do not hesitate to contact us if you have any questions about our response or require any further information.

Yours faithfully,
Binance.

BINANCE

Response to questions

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 proposed regulatory principles are extensive and cover key areas expected when applying a mature financial services regulatory framework to a sector on the basis of "same activity, same risk, same rules". However, the crypto-asset sector is still in its infancy when compared to traditional financial services, and it remains to be seen how the principles will apply to crypto-asset products and services as the market matures. As a consequence, this points to the application of proportionality.

Where definitions and terminology differ there should be a clear articulation of the reasons why to avoid legal and regulatory uncertainty and to help all operating entities meet their responsibilities.

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?

The regulatory requirements in general are extensive and how they will be implemented practically across the globe to a sector that is new to regulators and continues to evolve will be challenging for both regulators and firms.

Binance agrees with the strong emphasis on proportionality and cooperation throughout the recommendations to ensure successful implementation at the national level given the inherent differences in markets, consumers and regulators' remits globally.

In keeping with a risk-based and proportionate approach the key differences in approach to GSC and the wider CA market are to be expected e.g. the emphasis on recovery and resolution plans and redemption rights and stabilisation mechanisms for GSC relative to generic risk management for the wider crypto-assets class. Following recent events, particularly the TerraUSD collapse, it is prudent to stipulate additional requirements for GSCs which genuinely present systemic risk, particularly where these stablecoins are widely used as a means of payment or a store of value.

It is important to avoid duplication between the two sets of recommendations. Recommendations for GSC should be additional; they should build on recommendations for crypto-assets and markets and not overlap with them, as seems to be the case in a number of areas.

Binance welcomes the tacit acknowledgement of managing the risks arising from a combination of functions. We strongly encourage engagement with the industry when determining how to practically and safely approach requirements regarding the separation of certain functions and activities, as appropriate.

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 proposed elements to determine where a stablecoin is classified as a GSC are extremely broad and convey a lot of discretionary power to the domestic authority as to whether a stablecoin should be treated as a GSC. Any of the 13 different elements could be used to support the domestic authority's view.

There are also no clear thresholds, allowing domestic authorities to set their own levels. This may result in a scenario where a stablecoin is treated as a 'standard' crypto-asset in some jurisdictions, and a GSC in other jurisdictions.

Clearer definitions would have the advantage of permitting the scope of the recommendations to focus on those crypto-asset activities that are truly systemic (i.e. wide use in payments and as store of value, and interconnectedness with the wider financial system) and global in nature. This would enable the objectives to be achieved without increasing the risk or undermining the policy intent.

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

The recommendations broadly cover the relevant gaps and challenges. The complexity of GSCs may necessitate a level of cooperation and information sharing amongst supervisory bodies internationally that justifies explicit recommendations. Consistent and coordinated cross-border supervision of large crypto-asset service providers, where the service provider may operate across multiple jurisdictions globally, would be mutually beneficial if done proportionately and effectively.

It is worth considering whether the "Key design considerations for cooperation and information sharing arrangements" adequately covers the coordination of global crypto-asset service providers, and who, amongst the regulatory community, would ultimately lead on such matters globally. This clarity has helped enhance cooperation and information sharing in traditional finance.

Binance would support the creation of an FSB Working Group seeking to align regulatory collaboration and coordination, ensuring that regulatory frameworks are proportionate and suitable.

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

The recommendations in general are catch-all statements with the CA recommendations broadly covering financial stability risk. For example, "Authorities should apply effective regulation, supervision, and oversight to crypto-asset activities and markets – including crypto-asset issuers and service providers – proportionate to the financial stability risk they pose, or potentially pose, in line with the principle 'same activity, same risk, same regulation'."

As a consequence, these recommendations ensure that rather than identifying financial stability risks individually, they are captured as a whole, with domestic authorities having discretion to determine what exactly constitutes a risk. They further outline that financial stability risks should be addressed proportionally by authorities and identify the interconnectedness between crypto-assets and the wider financial system as a primary driver of such financial stability risks.

The GSC recommendations outline "consistent and effective regulation, supervision and oversight of GSCs and stablecoins with the potential to become GSCs across jurisdictions to address the financial stability risks posed, both at the domestic and international level, while supporting responsible innovation and providing sufficient flexibility for jurisdictions to implement domestic approaches." Similarly, financial stability risk is captured as a whole, while responsible innovation is encouraged, alongside flexibility given to domestic authorities.

Binance agrees with the inherent flexibility and proportionality within the recommendations for national regulators to assess financial stability issues but within a clear framework set by global standards setting bodies to ensure consistency and harmonisation at the global level.

<u>Crypto-assets and markets (CA Recommendations)</u>

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?

The Recommendations in Annex I of CA cover almost all existing crypto activities and risks. However, given the diversity of crypto-assets and given they can be fairly complex instruments, Model Risk should be added as an additional risk.

Currently there are no widely used models in the crypto-asset market for modelling the value of crypto assets, for example, through building monte-carlo simulations. This, in turn, complicates the procedure for assessing (a) the fair value of crypto derivative financial instruments; and (b) market and counterparty risks.

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

The classification of the activities and the sub-categories with the identified key risks are both extensive and comprehensive.

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?

Please see our comments on financial stability, and related challenges, covered under our answer to Question 5.

In response to recommendation 2, in general, Binance supports the principle "same activities, same risks, same regulation". However, as indicated by the FSB stock-take survey (Annex III to CA Recommendations), crypto, in some cases, presents different risks to traditional finance.

The crypto industry is yet to reach a comparable level of market capitalization to be subject to global traditional financial services standards. Proportionality is therefore paramount, which is clearly embedded across global standards in traditional financial services. See for instance the "Core Principles for effective banking supervision" which provide a comprehensive standard for establishing a sound foundation for the regulation, supervision, governance and risk management of the banking sector.

In response to recommendation 9, relating to certain crypto-asset service providers who may undertake a variety of services, we agree that these service providers should be subject to appropriate regulation, supervision and oversight. However, the practical disaggregation and separation of certain functions legally similar to traditional financial services may require a different approach to segregation of risks in practice.

The structure of the services and activities offered by crypto-asset trading platforms (which may include the facilitation of transactions, settlement and clearing, non-custodial and custodial wallet provisioning, asset management or lending/borrowing) may depend on their legal structure, or the legislative environment in which they operate. As stated in Annex I, the key risk related to Function 2: Wallets and custody and to such activities as provisioning of custodial/non-custodial (hosted/unhosted) wallets are operational risks (please refer to Annex I[1]) and therefore, legal segregation of these functions will not result in more robust and effective supervision.

Instead, we propose that alternative mechanisms which have already been introduced and

[1] (1) Operational risks: cyber security risks leading to unavailability or unauthorised outflow of customers' crypto-assets; This includes technical vulnerabilities including wallet software design and cyber security measures, and operational vulnerabilities such as loss or mismanagement of private keys. Misconduct risk from, e.g., loss of funds due to negligence, fraud/theft, poor administration, inadequate record keeping, or co-mingling of assets.

applied by key crypto industry participants should be implemented in a legal framework to mitigate operational risks (for example, self-insurance funds similar to the Binance SAFU fund). Where custodians may be considered to have conflicts of interests with e.g. crypto exchanges such conflicts can be effectively managed by appropriate asset segregation, supported by internal systems and controls and external audit.

It is conceivable that crypto exchange businesses may need to be segregated from lending and deposit-taking businesses, for example, in the future. However, due to the inherent characteristics of crypto exchange businesses, as compared with traditional lending and deposit-taking businesses, it may be necessary to regulate them on a more bespoke basis. Notwithstanding this, the lending, deposit-taking and related activities are more likely to be subject to regulatory standards equivalent to those applied to traditional firms. Irrespective of the degree of legal segregation of activities, crypto-assets firms should have robust governance, effective risk procedures and adequate internal control mechanisms proportionate to the nature, scale and complexity of the risks inherent in the business model and the firm's activities.

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?

Binance fully supports recommendations 5, 6 and 7 (Risk Management, Data Management and Disclosure) that state that authorities should understand the different risk-profiles of crypto-assets issuers and service providers and require them, as appropriate, to establish a risk management framework that is proportionate to their risk, size, complexity and systemic importance, and to the financial stability risk that may be posed by the activity or market in which they are participating.

Properly and consistently implemented, these recommendations can help regulators fulfil their obligations by enabling the industry to operate in a regulatory framework that accurately reflects the risks and benefits that the sector presents.

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.

There does not appear to be any differentiation in the recommendations between types of intermediaries or service providers. There is merit in having a clearer distinction in the recommendations and how they apply to specific ‘low-risk’ intermediaries and service providers, in addition to ensuring proportionality based on the risk within specific activities.

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 provides a general description of recent developments in crypto markets and seeks to identify vulnerabilities in stablecoins and stablecoin arrangements. However, it does not account in sufficient detail for differences in their respective performance. The assessment of existing stablecoins should be further substantiated and the language used to describe its results made consistent.

Distinctions should be made between: (1) stablecoins backed by fiat assets, held in custody; (2) stablecoins backed by reserves in unrelated crypto assets (i.e. ‘exogenous’ collateral); and (3) stablecoins commonly referred to as ‘algorithmic stablecoins’ that maintain a stable value via protocols that provide for an increase or decrease of the supply of backing crypto assets, which are ‘endogenous‘ to the stablecoin arrangement.

As shown in graphs 1 and 3, stablecoins backed by fiat assets, which include most of the stablecoins in the market and the largest three stablecoins, performed differently to each other during the period of the analysis. With one exception, deviations from peg were very limited in size. Furthermore, most of those deviations, including most of the sizable deviations, were into positive territory, meaning the market value was above $1. However, the report does not appropriately recognise that de-pegging was the ‘exception to the rule’. This is noteworthy in particular in a period of “broader market fears around crypto assets, liquidations of leverage positions and uncertainty over the stability of stablecoins following UST’s collapse”.

Furthermore, the report does not discuss in sufficient detail possible factors behind deviations from the peg, in particular negative deviations. Reserves, disclosures and redemption policies are singled out as likely factors, but the report glosses over their explanatory power.

As far as non-fiat backed stablecoins are concerned, the collapse of UST exposed the “difficulty of designing a robust stabilization mechanism based on algorithms” and where the stablecoins are backed by endogenous collateral. However, it does not seem appropriate to extrapolate this conclusion to all stablecoins backed by crypto assets. Graph 1 provides information on DAI, which is overcollateralised and the collateral is exogenous to its arrangement. According to the data presented in the report, DAI experienced limited deviations from the peg and those deviations were mostly positive. It is worth noting that the peg was maintained despite sharp drops in the value of unbacked crypto assets.

Turning to the assessment of the features of existing stablecoins and the extent to which they meet the FSB High-Level Recommendations, we would like to highlight an inconsistency in the text and the way the results of the assessment are presented.

At one point, the report states:

> *"The analysis found that the existing stablecoin arrangements analysed would not meet the FSB's High-level Recommendations."*

Further down, it states

> *"This analysis indicates that most existing stablecoin arrangements do not meet the FSB's High-level Recommendations."*

As such it is unclear what the FSB's overall view is. Irrespective of this, we would welcome any detail about the analysis that would justify the conclusion.

At Binance we support BUSD, which is a Binance branded stablecoin issued by Paxos Trust Company. We would like to take the opportunity to set out its features, so as to inform your analysis.

- Paxos is the US custodian and issuer of BUSD and is directly regulated by the New York State Department of Financial Services as a trust company.
- Both BUSD stablecoin and reserves are subject to strict regulatory oversight by the New York State Department of Financial Services.
- BUSD is 100% backed by reserves held in either or both (i) fiat cash in dedicated omnibus accounts at insured U.S. banks; and/or (ii) U.S. Treasury bills. (You can find monthly self-reports of portfolio composition and attestation reports here: https://paxos.com/busd-transparency/).
- All assets are held in bankruptcy remote accounts. In the event of insolvency, New York banking law protects customer assets.
- A US audit firm independently attests to the matching supply of BUSD tokens and underlying U.S. dollars on a monthly basis and these audits are published by Paxos.
- Paxos treats BUSD as USD on its platform. You can then withdraw your funds as USD at par directly from the issuer Paxos' platform in a timely manner.

Paxos is a US-based blockchain infrastructure platform and it is regulated in New York and Singapore. It is our assessment that it meets the highest of regulatory standards available and satisfies the FSB's High-Level Recommendations.

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

Binance welcomes efforts to promote consistency in the regulation and supervision of stablecoins and are broadly supportive of the objectives that underlie the proposed changes to the recommendations. Our comments below focus on areas that could be improved and, in most cases, concern a specific recommendation or proposed amendment.

Regarding the scope, Binance supports proposals to apply the recommendations to stablecoins that have genuine potential to become GSC, and to other stablecoins in a proportionate and consistent manner. This should contribute to ensuring regulatory consistency, to create a level playing field as well as to foster trust in the sector as a whole. This is all the more important given the broad definition of GSC, the interplay between both sets of recommendations, and the risk of inconsistent application (Question 15).

Binance considers that well designed fiat stablecoins, backed by high quality reserves, appropriately audited and regulated, provide the highest level of confidence and assurance in a capital efficient manner. However, authorities should refrain from prohibiting decentralised stablecoin arrangements out of principle. As mentioned in our answer to Question 11, in some cases, stablecoins backed by crypto assets that rely on smart contracts for their operation have proven to be stable. Where crypto-backed stablecoins are not widely used for payments or as a store of value, where there are limited risks to the financial stability, where they have credible stabilisation mechanisms and comprehensive disclosures, a *de facto* ban would seem unwarranted. This comment is particularly relevant for recommendation 4, but it is also relevant to recommendations 2 and 9 as well as to Annex 3, on the elements to determine a global stablecoin. What is more, the FSB should reflect on the appropriate regulatory treatment of crypto-backed stablecoins, possibly in the context of ongoing discussions on the regulation and supervision of DeFi.

Recommendation 2 states: *"Where a GSC arrangement relies on trading platforms or other intermediaries to perform <u>critical functions</u>, including some or all of its stabilisation function, authorities should require that those intermediaries fall within the regulatory, supervisory and oversight perimeter wherever possible."*

The concept of 'critical functions' is not defined in the report. It would be useful to clarify whether this is aligned with the concept of 'core functions', set out in footnote 1, or if a narrower definition, with a focus on stabilisation, is intended in this case. We would argue the latter option is more appropriate. Previous work by the FSB on recovery and resolution included guidance on the identification of critical functions which assisted industry and authorities in meeting the FSB requirements and further clarity would assist in this regard.

Concerning recommendation 4, we are supportive of the requirement for GSC to have clear governance arrangements to ensure the conditions for the application of regulatory requirements. This requires a clear allocation of functions and, as appropriate, a mechanism for the resolution of conflicts of interests. However, it is less obvious in what circumstances this objective would require the setting up of a 'governance body', in particular in cases where 'critical functions' are clearly divided between different regulated entities, as per recommendation 2.

The responsibilities of the governance body of the stablecoin arrangement should also be clarified and defined consistently across the report. In recommendation 4, it states the governance body should disclose 'how governance and accountability is allocated and how potential conflicts of interest are addressed among different entities within the GSC arrangement and in different jurisdictions, as well as clarify the limits of accountability and legal liability in any one jurisdiction'. In the glossary, it states the governance body should establish and monitor 'rules governing the stablecoin arrangement which would cover, among other issues, the types of entities that could be involved in the arrangement, the protocol for validating transactions, and the manner in which the stablecoin is "stabilised".'

The setting up of a ‘governance body’ should become a ‘requirement’ that authorities could jointly agree on only in cases where direct lines of responsibility and accountability for all functions are not deemed to be ensured otherwise. Consistent with this, the definition of ‘function’ in the glossary should be amended, so as to recognise the ‘governance’ function may be redundant when lines of responsibility are clear.

Furthermore, a governance body for GSC should, as a rule, focus on functions and activities that are directly relevant for the stabilisation and, possibly, redemption of the GSC stablecoin. Extending its responsibilities to establishing and monitoring the rules of the protocol for validating transactions would be unjustified and seemingly incompatible with the minting of stablecoins available in permissionless or permissioned blockchains controlled by other entities. It would also be disproportionate and unnecessary to require the governance body to establish and monitor rules for the provision of functions and activities relating to the broader stablecoin arrangement when such entities will be regulated and supervised by regulators as part of the wider crypto recommendations. This would also avoid duplication with FSB recommendations on Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets (Questions 6-10).

Recommendation 5 states that: “Authorities should ensure that GSC arrangements put appropriate AML/CFT measures in place consistent with FATF Standards, including requirements to comply with the FATF ‘travel rule’, with specific consideration if the GSC arrangements allow peer-to-peer transactions by unhosted wallets.”

It is not evident how an issuer, offeror, custodian of stablecoins or any other intermediary performing a core function in the stablecoin arrangement, broadly defined, would have the power to allow (or disallow) peer-to-peer transactions by unhosted wallets, given that, by definition, these do not involve any intermediaries. This limitation is recognised by the FATF in its guidance: “P2P transactions are not explicitly subject to AML/CFT controls under the FATF Standards. This is because the Standards generally place obligations on intermediaries, rather than on individuals themselves.” In light of this, the recommendation should be fully aligned with the content and the language of FATF standards and the travel rule, including its provisions on unhosted wallets.

In respect to recommendation 8, Binance supports the objective of increasing transparency around the reserves and redemption requirements. Transparency helps to foster trust and ultimately contributes to stability. We acknowledge disclosures would need to be adapted to the operating framework under which the issuer is operating (e.g. e-money issuer, credit institution or other). This said, to ensure a level playing, any adaptation should be clearly justified and avoid duplication and hence confusion, whilst ensuring it can adapt to changes introduced through new technology or innovation.

Recommendation 9 states that: “Authorities should consider limitations to the reserve that would exclude speculative and volatile assets as well as assets where there is insufficient historical evidence and data of quality and liquidity, as is likely to be the case for crypto-assets”. In line with our comments on question 11, it would be justified to distinguish between stablecoins backed by crypto assets that are endogenous to the arrangement and those backed by crypto assets that are exogenous to the arrangement. In the latter case, the reserve requirements should not only take into account the volatility in historical perspective, but also the level of collateralisation and the mechanism of liquidation.

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?

The cross-border nature of stablecoins makes it important that authorities cooperate and coordinate so as to avoid an unnecessary supervisory burden on companies. It would be important for cooperation agreements to provide an appropriate framework for sharing of data, thus contributing to addressing issues raised in recommendation 6.

Binance is strongly supportive of international standard setters enhancing cross-border cooperation and information sharing arrangements across regulatory authorities for GSCs and also crypto-asset activities. While some general international standards regarding cross-border coordination are currently available they lack the granularity to be of practical use. The litmus test should be for these arrangements to avoid gaps, duplication of requests and conflicts which is not easy given the complexity of GSCs.

For other forms of crypto-asset activities based on their relative size, complexity and interconnectedness these may be more country and micro specific, requiring less coordination of the activity globally relative to a macro network such as a GSC. However, consistent and coordinated cross-border supervision of large crypto-asset service providers, where the service provider may operate across multiple jurisdictions globally could still be mutually beneficial if done proportionately and effectively. It may be helpful to consider whether the “Key design considerations for cooperation and information sharing arrangements” adequately covers the coordination of cross-border supervision of global crypto-asset service providers, the interplay with the “governance body” of the GSC, and who, amongst the regulatory community, would ultimately lead on such matters globally.

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?

Yes.

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 criteria are excessively broad, which would create uncertainty for firms and increase the risk of divergence in the implementation of the recommendations across jurisdictions. Binance supports a clearer focus on the use of stablecoins in payments and as a store of value, their use in more than one jurisdiction and the interconnectedness with the wider financial system. If the existing list of criteria is maintained, the criteria mentioned above could be identified as primary criteria, with the others being deemed secondary criteria for the assessment underpinning a decision on the classification.