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Re: Consultative Document on Addressing the Regulatory, Supervisory and Oversight Challenges Raised by “Global Stablecoin” Arrangements

The Blockchain Association (the “Association”)¹ appreciates the opportunity to provide input on the consultative document issued by the Financial Stability Board (the “FSB”) “addressing the regulatory, supervisory, and oversight challenges raised by ‘global stablecoin’ arrangements” (the “Report”).² The Association welcomes the FSB Secretariat staff’s engagement with industry and recognizes the challenge of not only analyzing the array of fledgling stablecoin projects developing today but also crafting policy recommendations related to the financial stability risks they potentially raise.

In addition to the recommendations presented in this letter, the Association supports the separate recommendations being submitted by the Centre Consortium and cLabs, respectively. While this response to the Report focuses on decentralized permissionless stablecoin arrangements, we believe that a variety of distributed ledger-based stablecoin solutions could improve the usefulness and functionality of the financial system.

Section 1. Executive Summary

We have significant concerns about the Report’s treatment of permissionless decentralized stablecoin arrangements and systems more broadly. Substantively, our arguments in response to the Report, which are discussed in greater detail herein, include:

- 1. The FSB should not recommend that regulators consider prohibiting the use of permissionless decentralized systems.** We believe that the establishment of global financial infrastructure

¹ The Blockchain Association is a 501(c)(6) trade association based in the United States working to improve the public policy environment so that blockchain networks and cryptocurrencies can thrive.

² “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements” (Financial Stability Board, April 14, 2020), <https://www.fsb.org/2020/04/addressing-the-regulatory-supervisory-and-oversight-challenges-raised-by-global-stablecoin-arrangements-consultative-document/>.

based on permissionless decentralized systems would create a more accessible, equitable, and efficient financial system. Including this recommendation in the Report (1) would unnecessarily stifle potentially transformative innovations based on permissionless decentralized systems that could expand access to financial services and improve the efficiency of the system; and (2) presupposes that permissionless decentralized systems cannot be safely regulated. Instead, the FSB should consider an approach akin to the regulation of an existing systemically important global arrangement based on permissionless decentralized protocols: the internet.

- 2. To better capture potential financial stability risks, the FSB should adjust and clarify its definition of “global stablecoin” and the characteristics that differentiate “global stablecoin arrangements” from other arrangements.** As the Report acknowledges, like the internet, the technologies underlying stablecoins and stablecoin arrangements are “not limited in... geographic scope,”³ so a term other than “global stablecoin” may better distinguish coins and arrangements that could pose financial stability risks. We recommend the terms “systemic stablecoin” and “systemic stablecoin arrangements,” which we believe more effectively capture coins and arrangements that may create financial stability risks.⁴ In addition, regulators and market participants have a well-developed familiarity with the term “systemic” and its implications in the context of financial regulation. Moreover, we believe that the FSB should consider additional factors to distinguish global stablecoin arrangements from others, including (1) the distribution of stablecoins and availability of various stablecoin functions and services (such as issuance, reselling, redemption, etc.) through or in connection with a nonfinancial technology company with a large existing customer base; and (2) the “bundling” of stablecoin functions and services with nonfinancial products with large existing customer bases.
- 3. The FSB should recommend a principles-based, tailored, and technology-neutral regulatory approach to stablecoins that adheres to the “same business, same risks, same rules” principle in order to address arrangements’ unique characteristics, sizes, and complexities and to avoid creating a single compliance model.** The technological neutrality and “same business, same risks, same rules” principles should be implemented in practice, and therefore the Report should not mandate (or prohibit) the use of or give privilege to certain technologies. Stablecoin designs vary greatly, and many of the vulnerabilities and regulatory tools outlined in the Report are not applicable to all stablecoin arrangements. The FSB should recommend a regulatory approach that is principles-based and tailored in order to (1) address the risks associated with various arrangements while not disproportionately harming innovation, and (2) avoid entrenching any particular stablecoin arrangement as the only model able to comply with the FSB’s recommendations. Regulators should not pick winners and losers in new industries but rather create a framework to protect consumers, mitigate risks, and set a level playing field.

³ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 10.

⁴ For consistency, we continue using the terms “global stablecoins” and “global stablecoin arrangements” throughout this letter.

Section 2. Permissionless Decentralized Financial Infrastructure: Inclusion, Efficiency, and Innovation

The FSB should remove the Report’s conclusion that “fully permissionless ledgers... may not be suitable”⁵ and its recommendation that regulators consider “prohibiting fully decentralized systems.”⁶ It should do so because the language (1) presupposes that permissionless decentralized systems cannot be governed in a manner that facilitates effective regulation and supervision; (2) would unnecessarily stifle experimentation with permissionless distributed ledgers; and (3) would violate the technological neutrality and “same business, same risks, same rules” principles. Establishing decentralized permissionless financial infrastructure may make the financial system more inclusive and lower the cost of transferring value for the least privileged users of the system. As discussed in detail below, the establishment of such infrastructure could create a more accessible, equitable, and efficient financial system.

To begin with, it is critical to distinguish between permissionless distributed ledgers and the open-source applications that may run “on top of” them. Essentially, a distributed ledger is created by software that allows computers connected in a peer-to-peer network to reach agreement over the validity of shared data.⁷ A *permissionless* distributed ledger allows *any* connected computers running the software to participate in the validation process.

Permissionless distributed ledgers can store unique data sets, and some can be used to run computational processes. For example, data stored on a permissionless distributed ledger can reflect the current state of a running computation, creating “a shared world computing platform that can flexibly but securely run any application users want to code.”⁸ Like the permissionless distributed ledgers they use to operate, these applications themselves may be open-source and usable by anyone without permission.

In essence, permissionless distributed ledgers are public goods—global infrastructure that can be used without permission by anyone with an internet connection. They simply store the shared sets of data all computers participating in the networks agree are valid. Permissionless distributed ledgers act as “layer one” infrastructure and are discrete from and agnostic with respect to the “layer two” applications that run “on top of” them. While the potential uses of applications built “on top of” permissionless distributed ledgers are theoretically limited only by human imagination, one use is the creation of so-called “stablecoin arrangements.”

⁵ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 27-28.

⁶ *Ibid.*, 34.

⁷ Peter Van Valkenburgh, “What’s a Blockchain, Anyway?” (Coin Center, April 25, 2017), <https://www.coincenter.org/education/blockchain-101/whats-a-blockchain/>.

⁸ Vitalik Buterin, “Ethereum” (Coin Center, March 9, 2016), <https://www.coincenter.org/education/key-concepts/ethereum/>.

We agree with the Report’s claim that stablecoins “have the potential to bring efficiencies to payments (including cross-border payments) and to promote financial inclusion,”⁹ and we believe that permissionless decentralized stablecoin arrangements (and permissionless decentralized financial infrastructure more broadly) can play a part in realizing these potentialities.

Expanding the financial system’s inclusivity and lowering the cost of sending money for the least privileged users of the financial system are laudable policy goals, and the FSB should encourage experimentation with systems that may help achieve them. Gaining access to the most basic financial services can help reduce poverty and inequality by helping people invest in the future, moderate their consumption, and manage financial risks, and “although no conclusive evidence exists at this point, access to the formal financial system and appropriate credit can potentially facilitate investments in education and business opportunities that could, in the long term, boost economic growth and productivity.”¹⁰ According to the “Annual Economic Report 2020 of the Bank of International Settlements (“BIS”),

access to payment services has increased over time, yet is still far from universal... Low-income individuals, women and small businesses are still much more likely to lack access to formal payment services. Even in advanced economies, some groups lack access to bank accounts and the associated payment options; nearly half of Black and Hispanic US households are unbanked or underbanked. In the euro area, 10% of low-income households are unbanked.¹¹

In 2017, 1.7 billion people and 31 percent of adults worldwide did not have an account at a financial institution or through a mobile money provider.¹² In a World Bank survey conducted in 2017, 26 percent of adults without an account at a financial institution cited cost as an important barrier, 22 percent responded that financial institutions were too far away, 20 percent reported lacking the documentation needed to open an account at a financial institution, and 16 percent cited distrust in the financial system as an important reason for not having an account.¹³

In addition to individuals, lack of access to basic financial services afflicts businesses as well. For example, “in some emerging market and developing economies, fewer than half of firms have an account; lack of access to formal payment services, e.g. to pay suppliers and employees and to accept funds from customers, hinders firms’ access to other services such as credit.”¹⁴ Moreover, even for individuals with access to basic payment services, the BIS finds that

⁹ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 1.

¹⁰ Asli Demirguc-Kunt, Leora Klapper, and Dorothe Singer, “Financial Inclusion and Inclusive Growth: A Review of Recent Empirical Evidence” (The World Bank, April 2017), <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-8040>.

¹¹ “Annual Economic Report 2020” (Bank of International Settlements, June 2020), <http://www.bis.org/publ/arpdf/ar2020e.htm>, 72.

¹² Asli Demirgüç-Kunt et al., “The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution” (Washington, D.C.: The World Bank, 2018), <https://globalfindex.worldbank.org/#GF-ReportChapters>.

¹³ Ibid.

¹⁴ “Annual Economic Report 2020,” 72.

payments across borders are not only typically slow and opaque, but also especially costly. Lower-value payments, such as remittances, are the prime example. Cash transfers are the most expensive, reflecting both handling costs and lack of competition wherever cash is the only option. Costs vary also with the number and type of firms involved. Most cross-border payments flow through a network of correspondent banks. Remittances transferred this way are the most expensive, at 10% of value, while those sent through money transfer operators (MTOs) are nearly half of the cost, at 6% of value. Regions with fewer channels through which to send remittances, such as Africa, face higher than average costs, making the poorest regions the hardest hit.¹⁵

Indeed, the least privileged users of the financial system often pay the highest fees. In 2019, global remittances—often used by migrant workers with low incomes¹⁶—reached \$714 billion,¹⁷ and the average cost was 6.75 percent of the amount sent.¹⁸ “The single most important factor leading to high remittance prices is a lack of transparency in the market,” according to the World Bank, but “underdeveloped financial infrastructure in some countries, limited competition, regulatory obstacles, lack of access to the banking sector by remittance senders and/or receivers, and difficulties for migrants to obtain the necessary identification documentation necessary to enter the financial mainstream” also play a role in the high costs of remittances.¹⁹

In light of these facts, we join the BIS in concluding that “there is scope to improve the quality of payment services in terms of convenience, transparency and speed. Despite greater demand for payments in real time (or very close to it), methods such as cross-border bank transfers often take days to clear and settle... Overall, the quality of payment services still falls short of evolving customer expectations.”²⁰

Permissionless decentralized systems may be best able to dramatically expand access to basic financial services and improve the efficiency of payments because they help ensure user-sovereignty, interoperability, longevity, fidelity, availability and durability, privacy, and political neutrality.²¹

¹⁵ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 75.

¹⁶ “About Remittance Prices Worldwide” (The World Bank), <https://remittanceprices.worldbank.org/en/about-remittance-prices-worldwide>.

¹⁷ Dennis Quinn, “Sharp Decline in Remittances Expected in 2020 amid COVID-19 Lockdowns in Top Sending Nations” (Pew Research Center, June 22, 2020), <https://www.pewresearch.org/fact-tank/2020/06/22/sharp-decline-in-remittances-expected-in-2020-amid-covid-19-lockdowns-in-top-sending-nations/>.

¹⁸ “Remittance Prices Worldwide” (Washington, D.C.: The World Bank, March 2020), https://remittanceprices.worldbank.org/sites/default/files/rpw_report_march_2020.pdf.

¹⁹ “About Remittance Prices Worldwide.”

²⁰ “Annual Economic Report 2020,” 75.

²¹ See: Peter Van Valkenburgh, “Open Matters: Why Permissionless Blockchains Are Essential to the Future of the Internet” (Washington, D.C.: Coin Center, December 14, 2016), <https://www.coincenter.org/app/uploads/2020/05/openmattersv1-1.pdf>, pages 41-47.

1. **User-sovereignty.** Individual users initiate transactions, and no intermediaries need to be relied upon to complete transactions.
2. **Interoperability.** A decentralized and permissionless system is hypothetically available for any individual's use, so no relationship needs to exist between individuals using the system. Stablecoins that aim to approximate the value of fiat currencies may enhance interoperability because the underlying asset is already familiar to economic actors and bears a relationship to the current economic structure.
3. **Longevity.** By decentralizing the storage of data across a network of unrelated participants, decentralized permissionless systems ensure that information is never lost. In the context of financial infrastructure, balances a user has left untouched for years or even decades would still be available for use.
4. **Fidelity.** Data stored on a distributed ledger cannot be altered without the consensus agreement of the system's users. In other words, digital representations of value (potentially a stablecoin) cannot be altered after they are added to the ledger, and transactions that flout the "rules" of a network (e.g., a double spending prohibition) are not added.
5. **Availability and durability.** Decentralized permissionless systems ensure that a single entity cannot block a transaction indefinitely. Moreover, because a decentralized permissionless system's operations are distributed, the technical failure of any particular participant would not affect the system's functionality.
6. **Privacy.** Permissionless decentralized systems may be designed to incorporate various levels of privacy (from pseudonymous to fully anonymous), but since they may be used by anyone, they inherently lack an identification requirement for use.
7. **Political neutrality.** Because decentralized permissionless systems create an open and global market for participation in maintaining the system, the network ensures that it will never be vulnerable to attempts by one government, organization, or institution to censor or stop particular transactions or freeze particular balances.²²

Turning to the FSB's recommendations, as a threshold matter, we recommend that the FSB clarify its use of terms referring to permissionless and/or decentralized elements of a stablecoin arrangement and identify which elements may raise particular regulatory concerns. As noted in the Report, stablecoin arrangements may display varying levels of decentralization depending on which "aspects" of the arrangement employ decentralized permissionless systems.²³ However, the Report states throughout that "fully permissionless ledgers,"²⁴ "permissionless or anonymous networks,"²⁵ and "fully decentralized systems"²⁶ raise particular regulatory concerns. We do not clearly understand to

²² *Bullets one through seven: "Open Matters: Why Permissionless Blockchains Are Essential to the Future of the Internet."*

²³ "Addressing the Regulatory, Supervisory and Oversight Challenges Raised by 'Global Stablecoin' Arrangements," 25 and 28.

²⁴ *Ibid.*, 27-28.

²⁵ *Ibid.*, 29.

²⁶ *Ibid.*, 34.

which elements of a stablecoin arrangement based upon permissionless and decentralized protocols these terms refer.

The Report’s recommendation that regulators consider “prohibiting fully decentralized systems” presupposes that decentralized systems cannot be governed in a manner that facilitates effective regulation and supervision, which is inaccurate. On the contrary, decentralized stablecoin systems support some of the principles and values central to financial regulation, such as transparency and security. Rather than proposing to prohibit fully decentralized systems, which would be disproportionate and harmful to competition and innovation, the FSB should recognize that these novel systems have only been implemented on a small scale and have the potential to expand financial inclusion, promote efficiency, and catalyze innovation all while adequately protecting consumers.

Relatedly, preemptively recommending that regulators consider prohibiting the use of “fully decentralized systems” will stifle the ongoing experimentation with distributed ledgers that could bring to fruition a more accessible and efficient financial system. Permissionless distributed ledgers do not themselves create risks because, as discussed, they act as public goods that can be used by anyone for (hypothetically) any purpose. The ledger can be used by criminals or other bad actors or create systemic financial risks, but this is true of any public good, including existing financial systems and infrastructure. In this regard, permissionless distributed ledgers resemble the protocols that underlie perhaps the most systemically important global infrastructure currently in use: the internet and the permissionless protocols that run it—the Transfer Control Protocol and the Internet Protocol (together, “TCP/IP”). And while it is prudent to bring thoughtful regulation to bear on the use of such a public good, it does not make sense to prohibit its development.

Permissionless distributed ledgers and the internet share several of the qualities that have made the internet one of the greatest catalysts of knowledge creation, innovation, and economic development in history. Like permissionless distributed ledgers, the internet is ultimately a neutral, universally accessible platform. Anyone with a connection can develop applications “on top of” TCP/IP, the protocols that essentially make the internet possible as a network of networks.

No permission is necessary for anyone to develop applications on the internet, and therefore innovation is decentralized and placed in the hands of creative individuals anywhere in the world. TCP/IP is the logistical infrastructure “on top of” which sits internet applications like the World Wide Web and email. In short, the underlying protocols of the internet (TCP/IP) are completely discrete from and agnostic with respect to the applications that use it to function. And while the open and permissionless nature of the internet allows malicious actors to use it for illicit purposes, we believe that the permissionless nature of the internet has been a net positive for society because of the innumerable innovations it has facilitated.

To balance protecting the economic potential of permissionless innovation on the internet with the need to prevent illegal activity, TCP/IP is not formally regulated,²⁷ but many governments regulate the *applications* built on top of the permissionless, decentralized protocols that serve as the internet’s

²⁷Jason Oxman, “The FCC and the Unregulation of the Internet” (Office of Plans and Policy Federal Communications Commission, July 1999), https://transition.fcc.gov/Bureaus/OPP/working_papers/oppwp31.pdf, 5-6.

foundation. The FSB should recommend such a regulatory approach to permissionless distributed ledgers in order to allow permissionless innovation to continue while mitigating unwanted activity.

Preemptively limiting or prohibiting the use of permissionless distributed ledgers will stifle the ongoing permissionless innovation that may eventually bring to market revolutionary solutions to improve the efficiency and accessibility of the financial system. Permissionless distributed ledgers are a new technology, and it remains to be seen whether they can, in practice, achieve the many transformational innovations that proponents claim they will. Yet the past is prologue. “Throwing the baby out with the bathwater” in instances of permissionless innovation could be especially costly: TCP/IP were first created in 1972.²⁸ *Fifteen years later* the World Wide Web was invented,²⁹ and *thirty-three years later* media streaming over the internet was introduced.³⁰ The first distributed ledger began operating just over eleven years ago.³¹

Section 3. Characterizing Stablecoin Arrangements and Identifying Potential Risks

We believe that the FSB has the opportunity to more accurately categorize the functions of a stablecoin arrangement, differentiate between stablecoin arrangements that incorporate differing levels of decentralization, and identify the distinguishing traits of *global* stablecoin arrangements. By doing so, the FSB will be better able to identify the risks associated with various stablecoin arrangements and create a more effective and flexible regulatory framework.

We believe that the FSB has the opportunity to identify the functions and activities of a stablecoin arrangement beyond those included in the Report.³² In order to craft regulatory recommendations that respond to a given stablecoin arrangement’s potential risks, the functions and activities of a stablecoin arrangement should be clearly identified so that their practical implementation in various stablecoin arrangements can be better understood. Broadly, stablecoin arrangements may involve the following functions and activities, not necessarily provided by related entities (as the FSB accurately notes³³):

- Peg determination;
- Participation in governance;
- Stabilization mechanism;
- Issuance;
- Redemption;
- Distribution;

²⁸ Marco Iansiti and Karim R. Lakhani, “The Truth About Blockchain,” *Harvard Business Review*, January 1, 2017, <https://hbr.org/2017/01/the-truth-about-blockchain>.

²⁹ “Where the Web Was Born” (CERN), <https://home.cern/science/computing/where-web-was-born>.

³⁰ Amy Lamare, “How Streaming Started: YouTube, Netflix, and Hulu’s Quick Ascent” (Thinknum, July 31, 2018), <https://media.thinknum.com/articles/a-brief-history-of-video-streaming-by-the-numbers/>.

³¹ Iansiti and Lakhani, “The Truth About Blockchain.”

³² “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 8.

³³ *Ibid.*, 9.

- Management of reserve assets;
- Custody over reserve assets;
- Transfer;
- Control over user activities;
- Storing;
- Data management; and
- Exchanging, trading, and market making.

As discussed in more detail in the next section, clearly distinguishing stablecoin arrangements that incorporate decentralized and permissionless systems at *both* the ledger and protocol layers from arrangements that incorporate such systems solely at the ledger layer allows for a more accurate analysis of the risks associated with the various functions and activities of potentially global stablecoin arrangements. For example, some stablecoin arrangements are based on permissionless infrastructures and independent protocols at both the ledger and application layers. In other words, most or all of the functions and activities of these stablecoin arrangements are not performed by centralized parties. On the other hand, some stablecoin arrangements employ a permissionless distributed ledger to track transactions (ledger layer), but the other functions and activities of these arrangements are performed by an identifiable, centralized party or parties.

The FSB defines “global stablecoin” as “a stablecoin with a potential reach and adoption across multiple jurisdictions and the potential to achieve substantial volume.”³⁴ However, we believe that the term “systemic stablecoin” (and by extension, “systemic stablecoin arrangement”) would more accurately identify arrangements that could create financial stability risks.³⁵ “As with many financial services that utilize the internet, the technological infrastructure underlying stablecoin arrangements is not limited in its geographic scope,”³⁶ according to the Report, and the same is true of stablecoins themselves. Consequently, any stablecoin technically has “potential reach and adoption across multiple jurisdictions,” the first prong of the FSB’s definition. We believe that focusing the definition on the potential for *systemic importance* would better capture arrangements that could pose systemic risks. Moreover, using the term “systemic” may clarify the FSB’s regulatory intent given that market participants and regulators alike are very familiar with the term and its meanings in the context of international financial regulation. Finally, we note that the meaning of “potential reach and adoption across multiple jurisdictions” could be interpreted in multiple ways, and our interpretation may not match the FSB’s intent. Should this be the case, we request that the FSB further elaborate on its definition of global stablecoin.

Beyond global stablecoins, we recommend that the FSB consider additional factors to distinguish *global* stablecoin arrangements from others. In its proposed characteristics differentiating *global* stablecoin arrangements, the FSB focuses on

³⁴ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 4.

³⁵ For consistency, we continue using the terms “global stablecoins” and “global stablecoin arrangements” throughout this letter.

³⁶ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 10.

- The overall size of a given stablecoin arrangement, as measured by the number of users, number of jurisdictions, value of stablecoins in circulation, size of reserve assets, market share, etc.; and
- An arrangement's links to the traditional financial system, such as redemptions linked to sovereign currencies or interconnectedness with financial institutions.

While we agree with the above characteristics, what distinguishes *global* arrangements from other stablecoin arrangements is not only their potential size and links to the current financial system, but also the

- Involvement of nonfinancial companies with large existing user bases in the creation and operation of stablecoin arrangements, as well as their provision of services related to the arrangement, as their involvement could significantly accelerate the pace in which stablecoin arrangements become of global systemic importance; and
- Concentration of functions and activities of a stablecoin arrangement within one centralized structure addressed to and accessible in many jurisdictions, as such concentration would focus risks within one entity.

We agree in principle with the Financial Action Task Force's ("FATF") analysis that

some proposed so-called stablecoins have been sponsored by large technology, telecommunications or financial firms and seem to have the potential for rapid scaling and mass-adoption. By contrast, so-called stablecoins which already exist have not been widely adopted so far. These proposed so-called stablecoins aspire to quickly reach widespread global adoption, by offering global payment arrangements that are purported to be faster, cheaper and more inclusive than present arrangements; and *by leveraging the capital and customer-base of their backers through their integration into pre-existing communication platforms* (emphasis added).³⁷

In line with the above, the following additional factors should be considered as differentiating *global* stablecoin arrangements from other stablecoin arrangements:

- The distribution of stablecoins and availability of various stablecoin functions and services (such as issuance, reselling, redemption, etc.) through or in connection with a non-financial technology company with a large existing customer base; and
- The "bundling" of stablecoin functions and services with nonfinancial products with large existing customer bases.

Section 4. A Principles-Based, Flexible, and Tech-Neutral Regulatory Approach to Stablecoins

We appreciate the Financial Stability Board's goal of mitigating the potential risks associated with GSCs while supporting responsible innovation. We also fully support the focus on technological

³⁷ "FATF Report to the G20 Finance Ministers and Central Bank Governors on So-called Stablecoins" (The Financial Action Task Force, June 2020), <http://www.fatf-gafi.org/media/fatf/documents/recommendations/Virtual-Assets-FATF-Report-G20-So-Called-Stablecoins.pdf>.

neutrality when crafting recommendations for the regulation of global stablecoin arrangements,³⁸ as well as adhering to the “same business, same risks, same rules” principle.³⁹ With respect to the above fundamental principles, we would like to make the following general comments on the FSB’s proposed recommendations:

- **Regulations must remain technology neutral, especially in the context of decentralized and permissionless stablecoin arrangements.** The technological neutrality principle should not only function as a general guideline for policymakers but also be implemented in practice. While many stablecoin arrangements are currently centralized or partially decentralized (often not technologically, but functionally, e.g. via applying multi-stakeholder governance or operational structures), many projects are focused on building open, public, and transparent permissionless decentralized stablecoin arrangements. These arrangements should be covered by a global stablecoin regulatory framework, but the framework should remain technology neutral and not mandate (or prohibit) the use of or give privilege to certain technologies or arrangement models.
- **Regulations should be principles-based and tailored to address the unique characteristics, size, and complexity of a given stablecoin arrangement.** Stablecoin designs vary greatly, and many of the vulnerabilities and regulatory tools outlined in the Report are not appropriate for all stablecoin arrangements. The regulatory approach should be modular and tailored in order to address the risks associated with various arrangements while not disproportionately harming innovation or entrenching any particular arrangement model. We believe that such an approach aligns with the “same business, same risks, same rules” principle.

Overall, we agree with the Report’s finding that “financial stability risks from the current use of stablecoins are currently contained.”⁴⁰ Stablecoin arrangements have been in existence for a few years, and despite significant growth over the past months,⁴¹ they remain niche financial products used in specific markets, primarily crypto-asset markets.⁴² Their growth has been largely organic, and the arrangements usually fall under specific national regulatory regimes, such as e-money legislation or AML/CFT regulation.

Moreover, given that the Report states that its recommendations could also be relevant for “other crypto assets that could pose risks similar to some of those posed by [global stablecoins]

³⁸ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 25, 27.

³⁹ Ibid., 1-2.

⁴⁰ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 11.

⁴¹ Zack Voell, “Stablecoin Supply Breaks \$10B as Traders Demand Dollars Over Bitcoin” (CoinDesk, May 12, 2020), <https://www.coindesk.com/stablecoin-supply-breaks-10b-as-traders-demand-dollars-over-bitcoin>.

⁴² Michel Rauchs, Apolline Blandin, Kristina Klein, Dr. Gina Pieters, Martino Recanatini, and Bryan Zhang, “2nd Annual Global Cryptoasset Benchmarking Study” (Cambridge Centre for Alternative Finance, 2018), https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2019-09-cca-f-2nd-global-cryptoasset-benchmarking.pdf.

because of comparable international reach, scale and use,⁴³ we believe that the FSB should emphasize the appropriateness of a tailored regulatory approach to crypto assets that responds to the size and complexity of a given asset or arrangement.

Relative to other entities and industries of global systemic importance, crypto assets and the distributed ledger industry are miniscule in size. For example, the smallest FSB-designated global systemically important bank (G-SIB) by total assets is State Street, which has \$245 billion of total assets, controls over \$3.1 trillion of assets under management, and is the custodian of \$34.4 trillion of assets.⁴⁴ The thirty financial institutions designated as G-SIBs in 2019 have total assets of over \$54 trillion.⁴⁵ In comparison, by market capitalization, the largest crypto asset is bitcoin, which has a capitalization of \$173 billion.⁴⁶ The five largest stablecoins currently in circulation (all of which reference the U.S. dollar) have a *combined* market capitalization of \$10.45 billion, while the U.S. money supply is over \$18.4 trillion.⁴⁷ The largest stablecoin based on decentralized and permissionless systems at both the ledger and protocol layers also references the USD and has a market capitalization of \$187 million,⁴⁸ 0.07 percent of State Street's total assets ($\approx 1/1400$). In aggregate, the total market capitalization of the top 100 crypto assets in circulation is just over \$275 billion,⁴⁹ 0.51 percent of the G-SIBs' aggregate total assets ($\approx 1/200$).

In addition, the relatively small scale of the crypto and blockchain industry extends to criminal activity using cryptocurrencies. For example, according to the Financial Action Task Force ("FATF"), "the value of virtual assets involved in most ML/TF cases detected to date has been relatively small so far compared to cases using more traditional financial services and products, although there needs to be ongoing monitoring for any potential changes."⁵⁰ Moreover, the FATF finds that among "the types of offences involving virtual assets... narcotics-related and fraud offences (e.g. investment scams and swindling, blackmail, and extortion) are the most prevalent."⁵¹ We note that these activities have

⁴³ "Addressing the Regulatory, Supervisory and Oversight Challenges Raised by 'Global Stablecoin' Arrangements," 25.

⁴⁴ "Annual Report to Shareholders 2019" (State Street Corporation, 2020), <http://investors.statestreet.com/Cache/IRCache/ba5477b3-d7d1-e8d2-98ff-22b8bc670197.pdf>, 4.

⁴⁵ "Bank Capital Analysis" (Kansas City, MO: Federal Reserve Bank of Kansas City, December 31, 2020), https://www.kansascityfed.org/~media/files/publicat/banking/bca/5-6-2020-release/bank%20capital%20analysis_december%2031%202019.pdf.

⁴⁶ "Bitcoin (BTC) Price, Charts, Market Cap, and Other Metrics," (CoinMarketCap, accessed July 8, 2020), <https://coinmarketcap.com/currencies/bitcoin/>.

⁴⁷ Board of Governors of the Federal Reserve System, "M2 Money Stock" (FRED, Federal Reserve Bank of St. Louis, accessed July 8, 2020), <https://fred.stlouisfed.org/series/M2>.

⁴⁸ "Dai (DAI) Price, Charts, Market Cap, and Other Metrics" (CoinMarketCap, accessed July 8, 2020), <https://coinmarketcap.com/currencies/multi-collateral-dai/>.

⁴⁹ "Top 100 Cryptocurrencies by Market Capitalization" (CoinMarketCap, accessed July 8, 2020), <https://coinmarketcap.com>.

⁵⁰ "12 Month Review of the Revised FATF Standards on Virtual Assets and Virtual Asset Service Providers" (The Financial Action Task Force, June 2020), <http://www.fatf-gafi.org/media/fatf/documents/recommendations/12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf>

⁵¹ *Ibid.*

occurred since before the advent of cryptocurrencies in 2009, and no inherent trait or characteristic of digital assets precipitates them.

* * *

Examining the functions of a stablecoin arrangement in relation to a given arrangement's level of decentralization reveals the unique risks that different arrangements may create. Indeed, fully decentralized systems' noncustodial (no counterparty risk) and peer-to-peer (no central risk of failure) nature avoids many of the risks and vulnerabilities listed Annex 2 of the Report⁵² and fulfills several regulatory and supervisory goals. For example, the issuance, distribution, and custody of assets is solely user-driven and user-based in arrangements that incorporate decentralized permissionless elements at both the ledger and protocol layers. Moreover, such arrangements do not usually involve reserve management (users are in sole control of their assets) or have a redemption mechanism. Finally, because the protocols of these arrangements are open source, operational risks are mitigated by the full transparency and auditability of the system.

Given that not all vulnerabilities are present in all stablecoin arrangements, any future regulation of stablecoin arrangements should be modular and flexible in order to address the specific risks a given arrangement may create. Such a modular approach would allow for the effective regulation of risks without unnecessarily restricting the activities of arrangements that do not create certain risks.

In addition, ensuring that stablecoin and crypto-asset regulations remain technology-neutral, modular, and flexible would prevent not only privileging certain technologies or arrangement models but also the rapid obsolescence of the regulations themselves. Given that the structures of global stablecoin arrangements will develop over time, involve the activities of multiple (potentially unrelated) actors, and likely incorporate unique (and potentially yet-to-be invented) technologies, overly prescriptive recommendations may unintentionally entrench a particular arrangement as the only model conducive to effective regulatory oversight. Finally, because experimentation with stablecoin arrangement models remains active, a technology-neutral and modular approach would allow the FSB's recommendations to better "address potential developments and future innovation in this sector."⁵³

Considering the varied characteristics of stablecoin arrangements, and thus the risks they may present, we would like to make the following comments on certain regulatory authorities and tools presented in the report:

- *"Power to wind down or resolve a GSC arrangement"*⁵⁴

Please further elaborate on the use of this tool in the context of decentralized arrangements.

⁵² "Addressing the Regulatory, Supervisory and Oversight Challenges Raised by 'Global Stablecoin' Arrangements," 34.

⁵³ *Ibid.*, iv.

⁵⁴ *Ibid.*, 34.

- *“Cybersecurity and other operational resiliency safeguards”⁵⁵*

We agree with the need for such safeguards. In the case of stablecoin arrangements based on public and open-source software, these safeguards should take the form of industry standards in consultation with regulatory authorities.

- *“AML/CFT and sanctions controls”⁵⁶*

We note that the developments at FATF and the amendment of the FATF Recommendations in response to crypto-assets already provide an appropriate basis for AML/CFT compliance in the case of global stablecoin arrangements.

- *“Certain own funds/liquidity requirements; Requirements on disclosure of the composition of the assets; Disclosure of investment policies; Segregation requirements/rights for reserve assets”⁵⁷*

We note that these types of requirements primarily apply to custodial GSC arrangements. In the case of those which use noncustodial designs, where users remain solely responsible for their own assets, these requirements should not apply.

- *“Requirements on payments finality; Settlement finality requirements”⁵⁸*

Any requirements on payments or settlement finality should take into account the specific nature of blockchains and other decentralized systems in which the technological and economic concept of finality is different than in incumbent financial systems. Simply because a transaction is immutable does not mean that subsequent transactions cannot remedy a mistake or make a party whole.

- *“Allocation of legal responsibility for unauthorised transactions”⁵⁹*

Some stablecoin arrangements use public and permissionless blockchains as their value transfer and settlement layers. In such cases, they should not be responsible for unauthorized transactions as individual users, not the protocol, will ultimately control and direct their own assets. Individual users are responsible for the security of their own passwords or private keys.

* * *

⁵⁵ “Addressing the Regulatory, Supervisory and Oversight Challenges Raised by ‘Global Stablecoin’ Arrangements,” 34-36; 39.

⁵⁶ Ibid., 34-39.

⁵⁷ Ibid., 35.


⁵⁸ Ibid., 38.

⁵⁹ Ibid., 39.

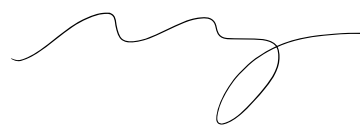
The Blockchain Association sincerely thanks the FSB for the opportunity to provide our feedback to the consultative document addressing the oversight and financial stability risks potentially raised by global stablecoin arrangements. In addition, the Association welcomes the FSB Secretariat's ongoing and open-minded engagement with industry.

We believe that the recommendations presented in this letter would strengthen the Report and align with the FSB's mission to strengthen financial systems and promote the stability of international financial markets. Our hope is that the FSB seriously considers these recommendations and does not unintentionally stymie innovation and progress towards a more accessible, equitable, and efficient financial system.

Sincerely,



Kristin Smith



Miller Whitehouse-Levine