



***R3 Response to the Financial Stability Board Consultative Report on Regulation,
Supervision and Oversight of Crypto-Asset Activities and Markets***
December 2022

R3 welcomes the Financial Stability Board's (FSB's) Consultative Report, "Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets." This is an important topic, and we support the overall approach that the FSB is taking.

Below we outline how we have approached many of the issues raised in the Consultative Report from R3's own perspective on digital assets. We would be delighted to discuss our perspective or any of the points raised in this consultation.

Introducing R3

R3 is an enterprise software company enabling digital transformation through our DLT and confidential computing platforms. Our applications and solutions are purpose-built for use in regulated financial industries and therefore have been designed to promote financial security and market integrity¹. Our global team of over 350 professionals in 14 countries is supported by over 2,000 technology, financial, and legal experts drawn from our global member base².

R3's DLT platform, Corda, is a scalable, permissioned peer-to-peer (P2P) DLT platform that enables the building of applications that foster and deliver digital trust between parties in regulated markets. While some regulated companies may start out using public blockchains, they soon realize they require capabilities native to a permissioned DLT platform like Corda, including privacy, security, scalability, and ease-of-integration with existing financial systems.

R3 provides services to shorten time-to-market, as well as support and guidance on implementation, integration, and developing ecosystems on our platforms to ensure that our customers derive the greatest value possible from our products. Moreover, our customers and partners have access to a network of leading systems integrators, cloud providers, technology firms, software vendors, corporates, and banks.

We also work closely with some of the world's largest commercial banks, financial market infrastructures (FMIs), and central banks to explore the utility of CBDC, asset-backed stablecoins, and other financial services products. The transparency and security enabled by Corda has driven its adoption among some of the world's most risk-sensitive institutions.

Moreover, R3 shares the priorities of our partners and developers. We focus on building technologies that ensure system security, appropriate risk mitigation, ownership traceability, and

¹ More information on Corda can be accessed here:

<https://www.corda.net/#:~:text=R3's%20Corda%20is%20a%20scalable,between%20parties%20in%20regulated%20markets.>

² More information on R3's work, portfolio, and customers can be accessed here: <https://www.r3.com/about/>



the ability to safeguard assets. It was these priorities that led SIX Swiss Exchange to choose Corda as the underlying DLT platform for its digital asset listing, trading, settlement, and custody service named SIX Digital Exchange (SDX)³, as well as Nasdaq's Digital Asset Suite⁴.

These priorities also led the Depository Trust & Clearing Corporation (DTCC), one of the world's more risk-sensitive institutions, to choose R3 as its partner to develop and launch its Project Ion platform. Project Ion, which recently entered production, leverages Corda to process an average of over 100,000 bilateral equity transactions per day, and almost 160,000 transactions on peak days⁵.

Corda has also served as the underlying platform for multiple wholesale and retail CBDC projects by the central banks of Canada, Hong Kong, Sweden, South Africa, Australia, Malaysia, France, Switzerland, and other institutions including the BIS.

Working with the FSB

R3 believes that the work of the FSB is essential to preserving financial stability and ensuring responsible use of crypto-assets globally. We have long recognized the value of engaging with a range of stakeholders to support their efforts in this space and look forward to further assisting the FSB as this important work progresses.

Overarching Comments

We welcome the FSB's timely publication of this consultation. 2022 has been a turbulent time for crypto-asset trading, with several high-profile collapses. Adequate, proportionate, and mature regulation is the key to moderating the excesses of this emerging market and R3 is encouraged by the significant investment towards a comprehensive regulatory approach from major jurisdictions. However, given the borderless nature of much crypto-asset trading, a common taxonomy is crucial to achieving the goal of a global regulatory model. Such a model must permit nation states the discretion they require to tailor policies in the best interests of their economies while also creating a global culture of accountable, prudent, and consumer friendly crypto-asset innovation. We believe the FSB has taken an important step forward in achieving that balance with this consultation.

We agree with and support the FSB's principle of "same activity, same risk, same regulation". We believe this is the most appropriate approach to ensure technology-neutral policies that fully leverage the potential for innovation.

³ Further information on SIX Digital Exchange is available here: <https://www.r3.com/blog/six-digital-exchange-goes-live-on-r3s-corda/>

⁴ More information Nasdaq's Digital Asset Suite built on Corda is available here: <https://www.corda.net/modal/nasdaq/>

⁵ A press release announcing the launch of DTCC's Project Ion can be accessed here: <https://www.dtcc.com/news/2022/august/22/project-ion>

We believe that regulations should be performance-based and technology-neutral, akin to the FSB’s “same activity, same risk, same regulation” principle. We support a risk-based approach to the supervision and regulation of crypto-assets that accounts for the varying magnitude and nature of consequences when considering risk mitigation. We also note that many regulators and central banks around the world agree that regulating a technology itself, rather than a technology’s use or the outcomes of its use, is a blunt instrument that may stifle innovation with little or no positive impact on risk.

For example, in situations where digital assets are merely digital versions of the represented assets, they should and have been regulated in the same way as the underlying asset as regards risk treatment. When considering new categories such as digitally native products, unique requirements may be evaluated because of untested risks to consumers, financial institutions, and impacts to financial and monetary stability.

We also agree with the FSB that national authorities should have the tools and authority necessary to effectively regulate crypto activities and markets, and that cross-border cooperation, coordination, and information sharing are essential given the inherent global nature of crypto-asset activities.

While the FSB can provide invaluable guidance to stakeholders it will ultimately be up to individual states to implement such recommendations with regard to its own overarching policy objectives and monetary policy. We further acknowledge the need for the FSB’s observations to be high-level, given its global remit. However, the crypto-asset market is developing at an extremely fast pace, and it is important that the FSB’s recommendations remain relevant and useful. We therefore recommend that the FSB remain in contact with organizations such as R3 and re-evaluate its recommendations at regular intervals.

It should also consider and integrate the work of other supra-national and international bodies in its recommendations, such as IOSCO’s plan to create minimum regulatory standards for virtual asset service providers (VASPs) to protect market integrity or the EU’s creation of crypto-asset service provider (CASP) categorization.

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 FSB’s proposals are sufficiently comprehensive and cover the primary crypto-asset activities that pose or potentially pose risks to financial stability. We consider the proposals an excellent foundation from which to build or augment a comprehensive regulatory model among the FSB’s membership. Naturally, significantly greater depth would be required when implementing a full regulatory model for crypto-assets, but the FSB correctly identifies these details as unique to the individual circumstances and policy outcomes pursued by those states.

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 certain activities, particularly those undertaken by Global Stablecoin (GSC) providers, should be subject to additional requirements. The FSB is correct to highlight the potential risks that GSCs pose if governed ineffectively, especially among emerging markets and developing economies (EMDEs). We view the potential for a GSC to establish a significant market share in domestic payments as a significant concern, specifically in relation to the monetary sovereignty of the nation in which it is operating.

Such an outcome is not undesirable in all circumstances, but regulators should consider the various risks of such an eventuality and what domestic market share for payments is tolerable, based on their own appetite and wider policy objectives. The FSB strikes the right balance in pointing out the various risks and how to mitigate them without mandating one approach over another.

3. Is the distinction between GSC and other types of crypto-assets sufficiently clear or should the FSB adopt a more granular categorization of crypto-assets (if so, please explain)?

- The FSB differentiate GSCs from other crypto-assets according to three criteria:
 - A GSC has a stabilization mechanism
 - Has usability as a means of payment/store of value
 - Has potential reach and adoption across multiple jurisdictions

Applying a more granular definition has the disadvantage of restricting the flexibility of the recommendations as crypto markets develop. The existing distinction is sufficiently clear and encompasses the features that would be necessary for a crypto-asset to be widely used, without being too specific that it might exclude other crypto-assets as they develop.

Therefore, we believe the distinction between GSC and other types of crypto-assets is sufficiently clear. As a GSC is a stablecoin that is widely adopted internationally, it has the potential to realize unique risks to global financial stability, and we believe the FSB has done an effective job conveying this in its Consultative Report.

We would argue that that crypto assets have the ability to reach and be adoption across multiple jurisdictions in much the same way GSC's do – however, we would agree that their potential impact on those jurisdictions would be much higher

In a previous response to the FSB, we discussed the significance of GSC to EMDEs and the knock-on effect this may have on their economic stability and monetary sovereignty. As the paper points out, advanced economies are likely to have a more mature regulatory environment and more robust enforcement, meaning that they are better equipped to remove a GSC from their jurisdiction if desired or ensure that it is unable to operate from the outset. In EMDE nations, we



believe that one of the major elements of what makes a GSC a GSC, is the potential public appeal of the coin to the user base. This is in accordance with the elements that the FSB outline in this paper. If this appeal is significant then it can reach the scale of use that could impact on the wider policy objectives of any Government, including monetary sovereignty and market stability.

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

Yes, the CA Recommendations and the GSC Recommendations would, in our view, address the relevant regulatory gaps and challenges that warrant a multinational response.

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

We commend the FSB for its work to cover a wide range of risks but note that there are several potential risks to financial stability that remain unaddressed or mentioned only in passing, including cybersecurity, AML, CFT and consumer protection – however the FSB may assert that such wider issues are beyond its remit. Further critical considerations for the long-term sustainability and risk mitigation with crypto assets is their associated environmental impact, including the significant differences found in permissionless and permissioned blockchains, such as R3's Corda. Further, settlement timing and finality also play a role in risk management of such assets and are worthy of consideration. R3 would be pleased to share its wider views on these topics as they relate to digital assets and the FSB role should it find this of interest.

Crypto-assets and markets (CA Recommendations)

6. Does the report accurately characterize the functions and activities within the cryptoecosystem that pose or may pose financial stability risk? What, if any, functions, or activities are missing or should be assessed differently?

Table 1: Essential functions and activities in the crypto-asset ecosystem

Functions	Activities
Creation, issuance, distribution, redemption and underlying infrastructure	1. Creating, issuing, and redeeming crypto-assets, distribution, underwriting, placement, market-making, marketing and sales
	2. Operating infrastructure and validating transactions
Wallets and custody	3. Provision of custodial (hosted) wallet and custody services
	4. Provision of non-custodial (unhosted) wallets
Transfer and transactions	5. Payment for/of goods, services, gifts and remittances.
	6. Exchange between crypto-assets or against fiat currencies, clearing and settlement
Investment, leverage and risk management	7. Use as collateral to borrow/purchase other crypto-assets
	8. Trading/borrowing/lending of crypto-assets
	9. Insurance
	10. Direct/outright exposures to crypto-assets
	11. Synthetic/derivative exposures to crypto-assets

We encourage the FSB to further analyze developments and risks related to decentralized finance (DeFi). We believe there may be additional policy work required to address the unique properties of DeFi.

Whilst regulating DeFi is certainly an important consideration going forward, we recognize the complexity of this issue. We encourage the FSB to avoid deferring decisions on guidance and best practice and instead begin to actively engage with this relevant, and growing, sector in finance.

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

We agree with the FSB’s analysis of activity patterns and the associated potential risks. In particular, we agree with the FSB’s characterization of the past year’s crypto-asset market turbulence and the clear pattern that crypto-asset markets and traditional markets are increasingly correlated. Indeed, crypto-assets are subject to the same economic laws and, in many cases, the same associated potential risks as traditional assets. In the same vein, we would encourage the FSB to consider the growing interconnectedness between crypto-asset markets and traditional financial markets. The Bank of England’s Jon Cunliffe argued recently that regulators “should not wait” for crypto-assets to have the ability to destabilize the wider financial market before regulating it.

The FSB will be aware that such interconnectivity provides opportunities to reduce risk through improved settlement times and traceability in a number of settings. It is for this reason that regulation is critical to realizing the benefits of this technology rather than the risks. Clear guide rails around how such technology and products are to be used – in keeping with an FSB member state’s wider policy objectives – provides an environment in which to realize the

potential of this technology while preserving market integrity and consumer protection. Any delay in providing such clarity will only perpetuate the high profile collapses we have seen in 2022. In short, a failure to regulate and guide the implementation of crypto-based products within current markets is a major contributor to the high-profile failures we have seen in 2022 and continued failure to act will perpetuate such failures into the future.

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

Yes, the regulatory, supervisory, and oversight issues and challenges as related to financial stability have been identified accurately.

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?

Given recent developments in crypto-markets, R3 strongly supports the following observations from the FSB:

“Authorities should expect crypto-asset issuers and service providers to be directed by a management which is qualified and of good repute, allocates adequate resources to risk management and other control functions (i.e., compliance and internal audit), and ensures that these functions can exercise their mandates with independence.”

Recent market events have demonstrated the importance of the risk-management practices of crypto-asset issuers and service providers. The FSB rightly points out the importance of effective management practices and corporate compliance measures.

Like regulators across the world, R3 has examined the circumstances that led to high profile market failures in the crypto space over the last year. While a failure of corporate controls has clearly been at the heart of such incidents, the seemingly laissez-faire approach to compliance, professional standards and fiduciary responsibilities displayed by corporate officers has also been cause for concern. There are well publicized examples of senior officials operating within failed organizations that have been accused of acting in a reckless and irresponsible manner in both corporate governance and as custodians of customer funds.

Such alleged irresponsibility – while not completely without precedent – has been reduced significantly within traditional financial services setting, mostly through lessons hard learned. It is for this reason that some of the reported behaviors within crypto assets firms have been described as an affront to the legal, financial, and accounting professions in almost any other setting.



While each crypto provider will govern their business differently, with many demonstrating significant integrity and robust safeguards, the need for regulatory action is nonetheless clear.

Setting and applying the highest standards of corporate controls is an obvious and vital next step, as envisaged by the FSB. However, and as the FSB identifies, higher standards of professional behavior and integrity of corporate leaders must also be established. R3 does not believe that the professional integrity, expertise, and standards of probity should differ between those of senior bank officials and senior officials of crypto providers.

R3 therefore suggests that the FSB considers professional standards for senior officers running crypto providers. This could be an analogue of the UK's Senior Managers and Certification Regime (SM&CR) administered by the Financial Conduct Authority, with slight modifications to account for crypto-based products. In recommending such qualifications across multiple jurisdictions, the FSB can reduce any gap in understanding of senior professionals, create clear accountability among that leadership and begin to transform and mature the industry's governance as a whole.

While such requirements may apply a cost pressure to those engaging in innovation in the sector, we believe this to be minimal, and is likely to pail in comparison to the benefits created by creating a more robust, reliable and regulatable crypto asset market

Indeed, a similar proposal to create direct, personal accountability within the crypto environment is a feature of the European Union's Markets in Crypto-Assets regulation, which may provide a useful foundation for any future recommendations from the FSB in this area.

However, in the specific case of distributed finance or DeFi – the task of assigning accountability and ensuring adequate corporate controls becomes difficult. The FSB, alongside the industry, will need to consider carefully how controls can be applied to such networks if necessary. Further industry collaboration on this specific point is strongly recommended.

On the matter of applying prudential and market conduct regulatory tools, this make sense in general terms, but the applicability will depend on the specific circumstances these tools are called upon to address. We encourage the FSB to clarify what they mean by "technological risks". Thus far, high profile collapses of crypto based products have been a result of the management and design of those products, rather than any limitation or flaw in the technology itself. We emphasize that focusing on the technology rather than actual risks posed by how the technology is deployed may result in regulations that penalize these technologies rather than simply mitigating the risk. As we have already alluded to, distributed ledger technology has the potential to significantly reduce market risks as well as exacerbate them, depending on how it is used and, critically, how it is regulated.

One example is how DLT can provide regulators direct access to networks in operation. R3's Corda, for example, can provide a regulatory node to national competent authorities. This not only removes the risk of transposition errors in transaction reporting and delays in accessing data

in more traditional settings, but it also provides complete transparency and live information to regulators looking to understanding emerging, fast-moving products in more detail.

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.

Within the context of this consultation, we argue that it is adequate to leave the recommendations undifferentiated. A broad-brush approach reduces the risk of regulatory arbitrage and ensures that national regulators consider the full range of risks posed by different types of intermediaries or service providers in the context of their own jurisdictions and market conditions. At the national level, authorities may wish to implement these recommendations on a more differentiated basis, as they see fit.

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 generally provides an accurate analysis of recent market developments and existing stablecoins.

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

We believe that the FSB strikes the right balance between establishing high level principles and best practices, interspersed with examples and specificity when needed. Every stakeholder will seek to emphasize one area over another based on their own interest but R3 commends the FSB for writing authoritatively on a broad ranging and complex subject that will benefit mature and maturing jurisdictions alike.

13. Do you have comments on the key design considerations for cross-border cooperation and information sharing arrangements presented in Annex 1? Should Annex 1 be specific to GSCs, or could it be also applicable to crypto-asset activities other than GSCs?

The key design considerations presented in Annex 2 are sufficient to provide an effective system for cross-border cooperation and information sharing. We encourage the FSB to consider extending these concepts to other crypto-asset activities. Whilst GSCs are currently most likely to have cross-border financial stability implications, other crypto-assets may develop to have similar implications. The FSB could consider future use cases and include them within the ambit of its recommendations by extending the applicability to other crypto-asset activities.

We encourage the FSB to explore the application of these key design considerations for cross-border cooperation to other crypto-assets.

14. Does the proposed template for common disclosure of reserve assets in Annex 2 identify the relevant information that needs to be disclosed to users and stakeholders?

The list is appropriate. However, the FSB may wish to consider that, in addition to the amount of Government bonds held in reserve, entities should disclose which Governments issued the bonds as this could have bearing on the overall risk profile of any investment.

15. Do you have comments on the elements that could be used to determine whether a stablecoin qualifies as a GSC presented in Annex 3?

R3 believes that the criteria set out in Annex 3 provides a useful set of features that could be tested to determine if a stablecoin reaches the threshold of a GSC. Consideration should be given to shortening this list if possible, accounting for any overlap in the categorization.

Further, we also believe that this list falls short of providing the clarity required for a coordinated approach to GSCs. While the categories put forward are sensible, they have little impact without guidance on the thresholds that must be met to qualify a product as a GSC.

In that respect, the FSB has made progress in defining the categories of discussion for a debate that must nonetheless still take place among industry and FSB members.