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At a cross-roads: the path towards responsible innovation in the crypto-asset ecosystem

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Keynote speech by Klaas Knot, Chair, Financial Stability Board[1]

Thank you for inviting me to speak today. I am sorry that I cannot be there with you in person. But nevertheless, I am grateful for the chance to speak about a topic that is not for the faint-hearted: crypto-assets.

As some of you who've invested in Bitcoin know, the price curve has gone through some steep inclines and quick descents the past couple of years. And it is not just the price of Bitcoin that resembles a rollercoaster. The crypto-ecosystem itself also continues to evolve rapidly and in different directions. It is not just some retail investors that are 'dipping their toes' into crypto. Large institutional parties continue to show serious interest in crypto-assets and its underlying technologies.

In its role as 'guardian' of global financial stability, the FSB has been closely monitoring crypto-asset markets since 2018. While we have been working hard to address crypto's potentially systemic implications, we do recognize the possible benefits of this innovation. In our opinion, effective regulation should create the right conditions for innovation to unfold in a responsible manner. Being technology neutral forms a guiding principle of the FSB's recommendations.

In recent years we have for example seen the potential benefits of distributed ledger technology. We have also seen that these benefits will not be realized without the comprehensive regulation of financial activities built on top of this technology.

For the FSB, supporting effective regulation of crypto-assets has so far meant addressing the risks related to it. Since 2018 we have repeatedly expressed concern about the risks associated with crypto's fast evolving nature and its growing interconnectedness with traditional finance. As

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1 The views expressed in these remarks are those of the speaker in his role as FSB Chair and do not necessarily reflect those of the FSB or its members.

an example, some of crypto's inherent financial vulnerabilities became painfully apparent during the crypto-winter of 2022 and 2023. Think only of the spectacular rise and fall of FTX.

The authorities represented at the FSB have taken important steps to effectively regulate crypto-related activities – either through the introduction of new rules or through the enhanced enforcement of existing rules and regulations.

In recent years we have also seen that those national initiatives were not always fully aligned with each other. Therefore, the FSB published a Global Regulatory Framework last year, aimed at supporting the consistency and comprehensiveness of regulatory approaches to crypto-asset activities. But the job is not done yet. 'Crypto' is at a cross-roads, and if society wants to stay on the path towards responsible innovation, we cannot be complacent.

Let me highlight two interesting market developments.

First of all, the emergence of so-called 'multifunction crypto-asset intermediaries', or MCIs. This has shown that crypto may not be as decentralized as some claim it to be. These entities combine economic functions in a manner that is not commonly seen in traditional finance. We also find that most MCIs lack proper governance. As a result, the functioning of MCIs may actually amplify financial vulnerabilities.[2]

MCIs can also form nodes that link the crypto-ecosystem with the broader economy and investors. This means that, at a certain scale, their failure could have serious implications for the wider financial system. A key policy lesson we thus learned is that, if needed, these entities should be able to be wound down in an orderly manner: *memento mori*, or in this case, remember that you may fail.

Next to MCIs, we have seen revived interest in the stablecoin market, following earlier crypto-market turmoil. Some of this interest has come from BigTechs and traditional financial institutions. These institutions could leverage large existing customer bases and rapidly issue a more widely used stablecoin. The potentially significant systemic implications of such a stablecoin means that they require careful regulation and oversight. After all, these coins have proved to not always be that 'stable'.

It is thus essential that we keep opting for fitting regulation. At the same time, let me be clear: opting for regulation is not a stamp of approval. Investing in crypto remains a risky and volatile business, illustrating that our work is not done yet. In the meantime, I'd like to therefore also stress: *memento perdere* – remember that you may lose.

The FSB's regulatory framework forms a global baseline. However, on top of this baseline, individual jurisdictions can implement additional measures should national circumstances require them to do so. For example, we observed that the financial stability risks presented by crypto-assets may already be heightened in some EMDEs. These jurisdictions often have weaker domestic currencies or large underbanked populations.

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[2] See FSB, The Financial Stability Implications of Multifunction Crypto-asset Intermediaries, November 2023.

I do recognize that not all EMDEs are the same. As we can see right here in Asia, there can be a wide variety of EMDEs in a single region, and advanced economies could also be in the mix. There is however one common risk for EMDEs: residents might come to primarily rely on off-shore providers of crypto-services. This dynamic may require us to place greater emphasis on effective cross-border regulatory cooperation. Without such coordination and cooperation, crypto service-providers may find it easier to evade local requirements. In this context, the FSB is doing further work to practically address the cross-border regulatory challenges of stablecoins for EMDEs.

Also central in our framework is the principle of 'same activity, same risk, same regulation'. This principle means that effective regulation should fit the financial stability risks that crypto-asset-activities pose. Flashy marketing terms might muddy the waters for regulators. This makes it all the more important to find the actual underlying economic functions and risks.

Publishing a framework is only part of the job. The most important next step is making sure that our recommendations are consistently implemented across the globe. Because, without globally consistent implementation, certain crypto-service providers may continue to evade regulation.

The FSB aims to deliver effective and consistent implementation of its regulatory framework by working closely with other standard-setting bodies, such as IOSCO, the IMF, and FATF. Because crypto-asset activities are inherently cross-border, specific attention will go to promoting implementation beyond the FSB's membership. We will do this through our own channels, including our regional consultative groups. But we will also closely work on this with the IMF – given it's near global membership.

As implementation is ongoing, we are committed to learning new lessons and to keep responding to new developments in the crypto-ecosystem. The sector is moving fast, so there is no room for complacency.

Before moving to a conclusion, I would like to touch upon one of these developments: tokenization. Creating a digital representation of an asset and placing it on a distributed ledger could bring benefits to the financial system. This includes efficiency gains and potentially increased liquidity of certain assets. Of course, there may also be risks for financial stability. For example, tokenization could increase the linkages between the crypto-ecosystem and traditional finance. The FSB is assessing the financial stability implications of tokenization, although our work is still in the early stages. And we are not the only standard setter considering this topic.

To conclude, the crypto ecosystem is at a major cross-roads. We cannot presume that this innovation, and potentially more decentralization, will bring significant benefits to the global financial system. What I do know is that the full benefits of digital innovation stemming from crypto-assets can only be realized if there is durable trust in the sector. For this, we need to keep on working on a strong and consistent regulatory system, to safeguard financial stability.

Let me stop here.