UK Finance response to FSB consultation on a proposed framework for international regulation of cryptoassets activities

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About UK Finance

UK Finance is the collective voice for the banking and finance industry in the United Kingdom. Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers, and facilitate innovation.

Introduction

UK Finance welcomes the opportunity to respond to the Financial Stability Board (FSB) consultation on the international regulation of cryptoassets activities. UK Finance views this consultation as an important opportunity to help improve future frameworks for regulating digital currencies and assets, including global stablecoins and wider cryptoassets. Despite recent market volatility, the use of cryptoassets (including stablecoins and tokenised forms of traditional financial instruments) is likely to continue to increase over time. A fundamental value of regulatory clarity is that this will ultimately and importantly enhance and protect the experience of consumers, and ensure they are adequately informed on the rules (and potential risks) around cryptoasset activities.

We have not answered the individual questions in the consultation but are providing a general response on behalf of our members.

UK Finance response

UK Finance members believe in the value of an economy that is global in terms of its reach and participants. Members recognise the value of different forms of money and a widening asset base: this will support consumers, businesses and financial institutions and ensures a long-term innovative and thriving financial services ecosystem.

Recent developments in crypto markets illustrate the need for comprehensive regulatory frameworks for crypto firms and activities, and we believe that the FSB is well-placed to coordinate an internationally consistent approach to crypto regulation. It was helpful to see the updated recommendations regarding oversight of global stablecoins, which built on your 2020 report. It is also clear that some of the main recommendations in the report, for example around risk management, separation of activities, and governance, have proved to be timely given some of the shocks in the crypto ecosystem during later 2022.

Our comments below are broken into sub-sections. For all of them we suggest that the FSB should continue to focus on (i) international alignment and also (ii) working to ensure high levels of understanding of critical distinctions between different types of cryptoassets as novel and rapidly developing services/products wherever possible.

1. **The need for a level playing field and consistent regulation**

UK Finance is supportive of the FSB's work in this space. We believe that regulated financial institutions with deep experience in financial markets could and should play a beneficial role in crypto markets through improved risk management and greater transparency. These firms may also be well-placed to leverage the potential benefits of distributed ledger technology (DLT) in capital markets and payments. Regulators should work to allow regulated financial institutions to play on a level playing field with currently unregulated or underregulated institutions.

It is welcome that the consultation addresses the key risk of regulatory fragmentation. The crypto ecosystem addressed by the consultation is international by nature, and consistent regulation for cryptoassets is vital for financial stability and market players. While we appreciate the challenges of designing principles for international regulation, we support the FSB aim to ensure a level-playing field across jurisdictions and thereby reduce the risks of cross-border regulatory arbitrage.

2. **Consistent terminology / taxonomy**

The report also touches on the issue of taxonomy and globally consistent terminology. We recognise that this is a challenging topic, however, a consistent taxonomy and terminology could bring great benefits. In line with the principles-based approach of the FSB, it could aim to be broad rather than deep, at least initially. This might be another area that the FSB could seek to work with international standards bodies on. While differences will no doubt exist between the precise rulesets in different jurisdictions, a consistent terminology might assist regulators and market participants, and help to minimise the risk of fragmentation. Such a taxonomy might also, for example, differentiate between cryptoassets issued by regulated versus non-regulated entities.

3. **Same activity, same risk, same regulatory outcome**

We support an approach based on the principle of 'same activity, same risk, same regulatory outcome', which is also the approach that the UK authorities are proposing to follow. Our members are supportive of technology-neutral regulatory frameworks that enables competition and innovation, while ensuring a level playing field.

Certain cryptoasset activities may fall under existing regulatory frameworks, although it may be necessary to expand or clarify the regulatory perimeter to ensure they are subject to appropriate oversight. Equally, however, the existing rulesets may not always be best suited to the novel risks posed by cryptoassets, and more specialist rule setting may be required. Overall, rules/standards should be proportionate to the risks and dynamic to respond to evolving circumstances. A flexible risk-based approach is key when regulating new technologies. As technology develops, so will the risks associated with it. It is essential for regulation to remain flexible and for authorities to continuously assess risk as technology evolves. A flexible risk-based approach will also support innovation and harness the benefits of technological progress.

Any regulatory framework should make a clear distinction between different types of cryptoassets and business models. There are crucial distinctions to be drawn between cryptocurrencies, digital and tokenised assets, and different forms of digital money. For example, tokenised bank deposits are different from stablecoins, and therefore they should be treated like their non-tokenised equivalents, i.e. like standard commercial bank deposits. As a matter of scope, tokenised bank deposits, whether issued on public or permissioned blockchains, are different from GSCs and CAs and any stablecoin regulation should recognise the difference between these instruments. Deposits are one side of a banking balance sheet and are not cash collateralised. They are an intrinsic part of a bank's risk-taking activities and subject to extensive prudential capital and liquidity requirements in light of that fact, which allows for fractional reserve banking and therefore different from the full-reserve asset backing requirements proposed for GSCs. Tokenised deposits are the same as deposits recorded in a traditional bank database, the difference being they are recorded in an external database (permissioned or permissionless blockchain). Legally, tokenised deposits retail the same status as existing deposits. It is important that stablecoins regulation acknowledges the distinction between these separate instruments.

There are also different types of blockchain and DLT use cases. Furthermore, several members made the point that banks should not be subjected to additional capital, licensing or prudential requirements for use of DLT as robust regulatory requirements for banks already exist and this would not be in line with the principle of technology-neutrality. Regulatory frameworks should recognise these distinctions and regulate distinct types of cryptoasset activities based on their specific risks.

4. International regulatory cooperation and coordination

Another consideration for future work for the FSB might be around enhancements to coordination and information sharing between jurisdictions and supervisory authorities. The crypto ecosystem is truly global in nature (due in large part to the nature of the technology), and it is far easier for these businesses to expand or relocate in order to better serve their customer base than is the case for some traditional financial services firms.

In due course, the FSB might also consider collating information relating to expected threats in this area, such as national jurisdictions not implementing the principles proposed. This would help to provide regulators and the market with a holistic overview of where the regulatory gaps may be. International standardisation around information reporting might also be another avenue to explore.

5. Looking forward to other/new risk-management approaches

The principles outlined did not include as much detail on areas such as decentralised autonomous organisations (DAO) or non-fungible tokens (NFTs). These areas are intrinsically more varied and complex and perhaps harder to categorise for the purposes of rule-setting, but a principles-based approach for some aspects could nevertheless be helpful in the future. These areas have the potential to be highly impactful in the future and thinking about them early is valuable.

Finally, we note that more time is needed to see how different (and novel) approaches to supervision and rule-setting may work in the cryptoasset ecosystem, and how these might interact with the FSB principles. We note that the EU work to explore embedded supervision may have some merits and could utilise features of this new technology that might assist regulatory activities, such as transparency and enhanced/richer data. In addition, we note that in the UK a member of the Bank of England Financial Policy Committee has suggested that the role of voluntary industry-led standards setting should be explored further[1]. It is not yet clear whether this would be

[1] https://www.bankofengland.co.uk/speech/2022/october/carolyn-wilkins-speech-at-ucl-centre-for-blockchain-technologies

appropriate or sufficient but may be worth exploring as helpful while regulatory or legislative frameworks are being developed.