

## Addressing the regulatory, supervisory and oversight challenges raised by “global stablecoin” arrangements FSB Consultation response

XReg consulting is a specialist advisory firm founded by former regulators, with expertise in formulating public policy and developing regulation for virtual assets and virtual asset service providers. We welcome the work of the FSB in this innovative and developing area. An area with a lack of regulatory certainty for operators and more importantly a lack of protection for users, which would be provided by sound and proportionate regulation.

### **1 DO YOU AGREE WITH THE ANALYSIS OF THE CHARACTERISTICS OF STABLECOINS THAT DISTINGUISH THEM FROM OTHER CRYPTO-ASSETS?**

While we largely agree with the analysis of the characteristics of stablecoins that distinguish them from other crypto-assets, the FSB should further explore the existence of hybrid assets which have characteristics of both stablecoins and crypto-assets, as well as the more traditional assets such as securities. Although the paper acknowledges more decentralised models it seems that the focus is on centralised stablecoins, particularly those which are asset backed.

To date, the main industry activity focuses on these types of models, however there are many initiatives which are seeking to achieve price stability relative to other assets, in a decentralised and algorithmic way.

### **2 ARE THERE STABILISATION MECHANISMS OTHER THAN THE ONES DESCRIBED, INCLUDING EMERGING ONES, THAT MAY HAVE IMPLICATIONS ON THE ANALYSIS OF RISKS AND VULNERABILITIES? PLEASE DESCRIBE AND PROVIDE FURTHER INFORMATION ABOUT SUCH MECHANISMS.**

No stabilisation mechanisms other than those described, however, the report could further distinguish between risks and vulnerabilities of stablecoins backed by fiat currencies, those stabilised with crypto-assets, and those which use algorithmic stabilisation mechanisms as the risks involved in each vary and it would be useful to further break down the different stabilisation mechanisms. This would allow a more focussed approach towards the very different risks which these stabilisation mechanisms present.

### **3 DOES THE FSB PROPERLY IDENTIFY THE FUNCTIONS AND ACTIVITIES OF A STABLECOIN ARRANGEMENT? DOES THE APPROACH TAKEN APPROPRIATELY DEAL WITH THE VARIOUS DEGREES OF DECENTRALISATION OF STABLECOIN ARRANGEMENTS?**

Yes, however, there is an increase in decentralised stablecoins, mainly due to the increasing popularity of Decentralised Finance (DeFi), which will need to be identified in the near future. The



consultation highlights the varying degree of decentralisation of governance, stressing that authorities should ensure one or more governance bodies are subject to appropriate oversight. This however may not be possible when a GSC is truly decentralised and relies on an automated stabilisation mechanism with little to no influence from a centralised third party. Where this is the case, the supervisory oversight should be focused on those entities which interact with the GSC and act as a Virtual Asset Service Provider (VASP) in line with the FATF definitions and terminology.

#### **4 WHAT CRITERIA OR CHARACTERISTICS DIFFERENTIATE GSC ARRANGEMENTS FROM OTHER STABLECOIN ARRANGEMENTS?**

As identified in the paper, a stablecoin with large reach and adoption across multiple jurisdictions could be characterised as a GSC. We agree with this analysis, however, would stress that most crypto-assets have cross border reach, and the widespread adoption of such assets would be the main determining factor of whether a stablecoin should be considered a GSC. However, there are significant challenges in determining in what instances a stablecoin should be considered a GSC and subject to the recommendations set out in section 5 of the report. As such, we believe it would be wise to apply recommendations to ALL stablecoins.

#### **5 DO YOU AGREE WITH THE ANALYSIS OF POTENTIAL RISKS TO FINANCIAL STABILITY ARISING FROM GSC ARRANGEMENTS? WHAT OTHER RELEVANT RISKS SHOULD REGULATORS CONSIDER?**

We agree with the analysis presented.

#### **6 DO YOU AGREE WITH THE ANALYSIS OF THE VULNERABILITIES ARISING FROM VARIOUS STABLECOIN FUNCTIONS AND ACTIVITIES (SEE ANNEX 2)? WHAT, IF ANY, AMENDMENTS OR ALTERATIONS WOULD YOU PROPOSE?**

We suggest expanding on annex 2 and analysing the vulnerabilities more specifically from the stabilisation mechanism point of view, including the different vulnerabilities presented by each. There is also a further vulnerability which is that of the reliance of oracles.

Oracle functions are relied upon by smart contracts when there is a need to obtain data externally, for example, when obtaining price feeds. Oracle functions are relied on by stablecoins which have some form of algorithmic stabilisation mechanism and/or smart contracts to help stabilise the price. There have been a number of abuses of these Oracle functions, particularly when a smart contract relies on a single Oracle. Should the Oracle be manipulated, should it malfunction, or for whatever reason fail to provide an accurate data feed, the stabilisation mechanism will not function as intended and the reserves would be put at risk.



**7 DO YOU HAVE COMMENTS ON THE POTENTIAL REGULATORY AUTHORITIES AND TOOLS AND INTERNATIONAL STANDARDS APPLICABLE TO GSC ACTIVITIES PRESENTED IN ANNEX 2?**

None

**8 DO YOU AGREE WITH THE CHARACTERISATION OF CROSS-BORDER ISSUES ARISING FROM GSC ARRANGEMENTS?**

Yes

**9 ARE THE PROPOSED RECOMMENDATIONS APPROPRIATE AND PROPORTIONATE WITH THE RISKS? DO THEY PROMOTE FINANCIAL STABILITY, MARKET INTEGRITY, AND CONSUMER PROTECTION WITHOUT OVERLY CONSTRAINING BENEFICIAL FINANCIAL AND TECHNOLOGICAL INNOVATION?**

9.1 Are domestic regulatory, supervisory and oversight issues appropriately identified?

9.2 Are cross-border regulatory, supervisory and oversight issues appropriately identified?

9.3 Do the recommendations adequately anticipate and address potential developments and future innovation in this sector?

Yes, although care should be taken to ensure as harmonistic an approach as possible is taken between regulatory authorities involved in order to reduce regulatory arbitrage.

**10 DO YOU THINK THAT THE RECOMMENDATIONS WOULD BE APPROPRIATE FOR STABLECOINS PREDOMINATELY USED FOR WHOLESALE PURPOSES AND OTHER TYPES OF CRYPTO-ASSETS?**

Yes, the recommendations are broad in nature and can be tailored to the particular asset in question. As such we believe that the recommendations are suitable for a broader range of assets, including other crypto-assets.

**11 ARE THERE ADDITIONAL RECOMMENDATIONS THAT SHOULD BE INCLUDED OR RECOMMENDATIONS THAT SHOULD BE REMOVED?**

We would suggest including a recommendation for independent audit of the stablecoin arrangement, this is most relevant for a fiat-backed stablecoin which is centralised in nature. The assets held to support the stabilisation mechanism should be independently audited to ensure that they are protected. For stablecoins which rely on smart contracts and/or algorithmic stabilisation mechanisms, the independent audit could be focused on the smart contracts and whether the stabilisation mechanism is coded appropriately and assuring that there are no significant vulnerabilities.

**12 ARE THERE COST-BENEFIT CONSIDERATIONS THAT CAN AND SHOULD BE ADDRESSED AT THIS STAGE?**

Establishing such regulatory regimes will be burdensome and costly. Although we believe that the sound and safe development of the crypto-assets would be beneficial, currently there are very few crypto-assets which are widely adopted. Should these regulatory regimes be implemented too soon, the cost of implementation could outweigh the potential benefits. We would suggest that a comprehensive risk assessment is undertaken by the FSB as well as by individual jurisdictions in order to be able to formulate an appropriate response.

