

CRYPTO REGULATION



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A CDA implementation roadmap, towards similar outcomes in an evolving environment

In less than 18 months, IOSCO's recommended approach for crypto-assets markets for regulation and supervision, including Decentralized Finance (DeFi), have been delivered with unanimous support from the regulatory community. We published our two sets of Policy Recommendations on Crypto and Digital Asset (CDA) Markets and DeFi, along with an Umbrella Note in the final months of 2023.

By issuing these recommendations, we are helping securities regulators apply relevant existing IOSCO objectives, principles, standards, recommendations and good practices, which will promote greater consistency in the regulation and oversight of crypto-asset activities.

As we have delivered on our ambitious policy-focused Crypto-Asset Roadmap, we now turn our attention to helping jurisdictions globally – spanning the wide IOSCO membership – work to effectively implement these Recommendations into their local regulatory frameworks.

Some jurisdictions already have appropriate regulatory frameworks, and the task is about supervision and international cooperation. Some jurisdictions have bespoke regimes but need to assess whether those meet our recommendations. Some jurisdictions are in the process of building out their crypto regimes and can use our recommendations to finalise that.

We have developed a three-year Implementation Roadmap which will pave the way for a fully embedded approach to assessing implementation of our recommended approach through our Assessment Committee by 2027.

Our initial focus will be on the implementation of the CDA Recommendations so that the large crypto markets are better regulated.

In relation to the DeFi Recommendations, efforts will focus more on helping regulators to assess the new products that are emerging.

Our global membership enables us to promote ever more intensive cross border cooperation among regulators and this is an essential part of our approach to tackling the inherently global crypto market.

Will we achieve a sufficiently consistent global approach? Regulatory initiatives are either under way or at implementation stage in all G20 countries – the EU's own MICA of course came into force in June 2023, although will not apply until the end of 2024 – but the picture is blurrier where emerging markets are concerned.

As our members begin their journey towards policy development and implementation, we will likely to glean further insight into any impediments to effective and consistent implementation of our policy measures thanks to our planned stocktake exercise.

Jurisdictions may be taking different approaches in tackling crypto-asset markets – whether it be through the application of existing regimes or

the development of bespoke regimes. But our goal is to achieve sufficiently similar outcomes that investors are protected, and market integrity is preserved – irrespective of the regulatory approach adopted.

We have to achieve this at the same time as the crypto marketplace itself continues to evolve. In terms of emerging issues, while not new, the topic of tokenization remains an area of acute focus for regulatory authorities.

Another area of crypto-asset regulation that may necessitate a closer look is recovery and resolution. In traditional financial markets, there is the built-in expectation that entities will fail and there are regimes in place to manage this risk. Regulatory authorities need to have the right tools to wind down CASPs that get into difficulty. As has been exemplified on many occasions over the past couple years, CASPs do fail. CASPs will likely continue to fail, but how will regulatory authorities ensure that recovery and resolution takes place in an orderly manner and that investors are not held to ransom?

A third area that may become part of the debate would be a combination of crypto and Large Language A.I.

As regulators around the world increasingly get into authorisation and supervision engagements with crypto entities, we expect a rich feedback to us in IOSCO on the practical realities of protecting investors and maintaining market integrity in this fast-evolving space.

In addition, we remain conscious that while crypto is not a substantial financial stability risk today, it has a number of characteristics which mean that situation could change quite quickly. We will be coordinating closely with the Financial Stability Board (FSB) on these efforts.

i. <https://www.atlanticcouncil.org/programs/geoeconomics-center/cryptoregulationtracker/>



FRANÇOIS- LOUIS MICHAUD

Executive Director -
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Comply and converge: instilling sound practices in stablecoin issuance

The Markets in Crypto-assets Regulation (MiCAR) will apply to stablecoin issuance, in the form of asset-referenced tokens (ART) and electronic money tokens (EMT), from 30 June 2024.¹

In view of this fast-approaching application date, and the finalisation of the associated technical standards and guidelines,² the EBA is stepping up its actions to encourage industry and supervisors to sharpen focus on consistent and timely implementation.

As a starting point, in 2023, the EBA published a statement with 'guiding principles' to which issuers are encouraged to have regard until the application date.³ The principles are intended to facilitate early alignment with the MiCAR rules, for instance as regards the fair treatment of potential acquirers and holders of ARTs and EMTs, and for sound governance and effective risk management.

Additionally, the EBA consulted promptly on an extensive set of technical standards and guidelines to ensure industry has the best possible notice

of the likely additional requirements established by those mandates and can proactively anticipate and adjust compliance systems and controls.

For supervisors, the EBA has established a new Crypto-asset Supervision Coordination Group (CSCG) to facilitate the exchange of very practical supervisory experience and supervisory actions. The CSCG is a specialist body to support knowledge exchange, help present a truly EU-aligned approach, and facilitate supervisory alignment in the application of MiCAR, including on authorisations and enforcement. The CSCG is expected to be very helpful until the EBA's new Crypto-asset Standing Committee becomes operational (Q1 2025).

As a further step to foster consistent application, in 2024, the EBA will develop a supervisory handbook for ARTs and EMTs guiding the EBA's and national authorities' supervisory practices for ARTs and EMTs. The supervisory handbook will provide guidance on the MiCAR application to support authorities in their day-to-day supervision activities. The goal is to facilitate ex ante convergence in supervisory practices and foster the consistent treatment and level playing field for ART and EMT issuers across the EU. It will facilitate the smooth transfer of supervisory responsibilities between national authorities and the EBA in the case of significant ARTs and EMTs thereby ensuring a continuum in supervisory approaches benefiting the supervisors and supervised issuer.

In 2024 the focus will shift to the sound implementation of the prudential framework for ART & EMT.

The EBA has also activated its 'Q&A Tool'⁴ to clarify questions on the practical application or implementation of legislation within the EBA's remit, including MiCAR and the AML/CFT framework, again with a view to promoting harmonised application.

Looking beyond the EU, the EBA is promoting discussions and dialogue on supervisory issues with third country authorities to prepare for the establishment of supervisory colleges for all significant ARTs and EMTs. The EBA continues to engage proactively in discussions for setting international standards (e.g. BCBS and FSB) to reduce the risks of forum shopping.

In light of the ongoing developments at international level, including implementation of the BCBS standards on banks' exposures to crypto-assets, the recently agreed CRR/CRD package includes a transitional prudential treatment for crypto assets taking into account the MiCAR requirements and specifying amongst others the capital treatment of EMTs and ARTs and disclosure requirements of exposures to crypto-assets and related activities. This is complemented with requirements on issuers set out in the EBA's draft RTSs on the liquidity requirements for the reserve of assets which are closely aligned with BCBS consultative document crypto standard amendments published in December 2023.⁵

Overall, the EBA will continue to foster sound collaboration and coordination between industry and supervisors and among supervisors with a view to ensuring the new framework for ART and EMT issuance is consistently and vigorously applied and I look forward to our discussions at EUROFI.

1. For information about the EBA's roles under MiCAR see: <https://www.eba.europa.eu/markets-crypto-assets>
2. All consultation papers are available from the EBA's website: <https://www.eba.europa.eu/regulation-and-policy/asset-referenced-and-e-money-tokens-micar>
3. https://www.eba.europa.eu/sites/default/files/document_library/Publications/Other%20publications/2023/Statement%20on%20%20preparatory%20steps%20towards%20application%20of%20MiCAR/1057527/Statement%20on%20timely%20preparatory%20steps%20towards%20the%20application%20of%20MiCAR%20to%20asset-referenced%20and%20e-money%20tokens.pdf
4. <https://www.eba.europa.eu/single-rule-book-qa>
5. <https://www.bis.org/bcbs/publ/d567.pdf>



CARLO COMPORTI

Commissioner - Commissione Nazionale per le Società e la Borsa (CONSOB)

Crypto Assets regulation: charting a course amidst complexity and innovation

The recent approval by the US SEC of spot bitcoin Exchange-Traded Funds (ETFs) confirms the trend of hybridization of crypto and traditional financial markets. This trend exacerbates the risks for investors (particularly retail ones) and for financial stability due to increasing interconnections between these markets. A consistent regulatory response cannot be further delayed.

IOSCO and the Financial Stability Board have recently adopted - under a remarkable tight timetable - standards and recommendations on crypto assets. Regulators and supervisors have now the responsibility to implement these measures in their national regimes through a sensible and globally convergent approach.

The EU has set the tone with the adoption of MiCAR (Markets in Crypto Assets Regulation) aimed at addressing market failures emerged in the inherently speculative crypto space. Guidelines and secondary rules will complement this framework, under the

leadership of ESMA and EBA. In parallel, market participants and regulators are called to ensure a smooth, timely and well-organized transition to MiCAR. Communications to retail investors should complement these actions to raise awareness of the intrinsic risks of crypto assets (due to their complexity, volatility and high exposure to losses) and of their distinctive features, compared to other regulated investment products.

Regulators need to ensure that the journey to MiCAR is smooth, orderly, and expeditious. This goal requires the prompt designation of national authorities and their empowerment with adequate resources and effective powers. Nowadays, global crypto groups operate across multiple EU Member States, navigating diverse national laws and setups. In this context there is a need to avoid that such legacy may hamper the safeguards provided by the new regime, creating uncertainty and limiting protection for investors during the transition to MiCAR. Supervisory convergence from the inception of the journey to MiCAR is a top priority for ESMA and for national authorities.

Many risks stemming from crypto markets depend on the same fragilities observed in traditional capital markets, others are new and deep-rooted in the underpinning technology. While traditional financial risks can be addressed through conventional tools, novel dynamics call for a fresh, innovative approach. Regulators are requested to adopt a holistic and open-minded approach to comprehend these dynamics and address both existing and emerging vulnerabilities, respecting the principle “same activity, same risks, same regulation”.

Supervisory convergence from the inception of the journey to MiCAR is a top priority.

Blockchain introduces new technological and governance risks, such as the trilemma, which encompasses scalability and security issues. Governance challenges surface during protocol changes or when engaging with Decentralized Autonomous Organizations (DAOs). Moreover, a safe cross-ledger interoperability remains a significant hurdle that is far from being achieved and difficult to be modelled in or prompted by regulation. These areas warrant further exploration in preparation for the future MiCAR review and beyond.

Market surveillance is another critical challenge. In public permissionless blockchains, financial incentives and game theory interlace with technology. The domains of finance and technology have merged, becoming inextricably intertwined. The state of a distributed ledger relies on consensus mechanisms, with consensus being achieved through the financial incentives embodied in crypto assets. As a result, the efficiency of price formation mechanisms and market integrity are fundamental for the good functioning of the entire ecosystem. However, achieving proper pricing in highly speculative crypto markets, where shared standards are lacking, is complex. Data-driven and proactive approaches are essential for detecting emerging abusive behaviours and tracing beneficial owners behind multiple wallets.

As the regulatory landscape navigates the complexities of crypto assets, ESMA and national authorities are committed to establishing a fair regulated environment, actively working to prevent and mitigate both longstanding and newfound vulnerabilities.



SASHA MILLS

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Balancing stablecoin risks and opportunities for UK retail payments

Innovation in money and payments driven by the private sector initiatives has been fast paced in recent years with the digital assets emerging as instruments of payments. Given the volatility of unbacked cryptoassets, stablecoins emerged to facilitate trading and other transactions in the cryptoasset world. One key feature of stablecoins is that they are issued and transacted on blockchains which offer novel features such as programmability, leading to potentially faster and cheaper payments. Therefore, they may rapidly become attractive to consumers and at scale.

These opportunities come with specific risks. Stablecoins are susceptible to 'de-pegging' which can cause losses for investors, pose contagion risks, undermine confidence in money and payments and pose a threat to financial stability.

International principles such as the FSB's High-Level Recommendations for Global Stablecoins and CPMI-IOSCO's Guidance on Stablecoin Arrangements were developed to mitigate stablecoin risks and we welcomed and contributed to their development. Multiple jurisdictions also developed detailed regulatory regimes based on these

principles, such as the EU's Markets in Crypto-Asset Regulation.

In the UK, one of the Bank of England's (the Bank's) core objectives is to preserve the financial stability, which can be defined as protecting essential services which people and businesses rely on. An essential element of this is ensuring public confidence in money and payments is underpinned by our remit to regulate systemic payment systems and supervise financial market infrastructures.

Against this backdrop the Bank's Discussion Paper on a 'Regulatory Regime for Systemic Payment Systems Using Stablecoins and Related Service Providers' (DP) was published in November last year, accompanied by other UK regulators' proposals i.e. the Financial Conduct Authority's discussion paper on non-systemic stablecoins, and the Prudential Regulatory Authority's Dear CEO letter for deposit takers who look to innovate in the payments space.

The proposals aim to give regulatory clarity, providing a holistic picture for stablecoins in the UK and illustrate the options available to firms and associated regulatory requirements.

Aligned with our objective to maintain financial stability and the FSB's recommendations, our DP focuses on stablecoins used in *systemic payment systems*, i.e., those with the potential to scale up and become widely used as a trusted form of sterling-based retail payments. The Bank already regulates operators of systemic payment systems and service providers that provide essential services to these payment systems once these have been recognised by HM Treasury (HMT). Last year's legislative changes expanded this to operators of systemic payment systems that transfer 'digital settlement assets' (DSAs). The Bank will also be able to regulate service providers to these, as well as DSA service providers that are systemic, subject to HMT recognition.

We uphold the expectation of 'same risk, same regulatory outcome' set forth publicly by the FPC in 2019. This means that to the extent that systemic payment systems using stablecoins and service providers pose similar risks as traditional payment systems and existing forms of privately issued money, the Bank's existing approach to those should apply equally and they should be subject to equally robust standards.

The DP's requirements on stablecoin issuers, therefore, aim to ensure that stablecoins used in systemic payment systems always maintain their value, can be used for payments with confidence,

and that coinholders can redeem their funds at full value at all times. Guaranteeing that systemic payment stablecoins meet equivalent standards to those expected of commercial bank money though without the backstop that is usually available in a banking context is a priority for us. Currently, the backstops available for banks such as the Financial Services Compensation Regime are not available for stablecoins, which necessitate the requirements on backing assets to be stricter to ensure consumer protections are equivalent to those in existing systems.

To deliver on this, the Bank proposes to require issuers to fully back stablecoins in issuance with unremunerated deposits at the Bank of England. Moreover, the proposed regime seeks to be flexible over how stablecoin payment chains are structured and which functions are performed.

Going forward, the Bank plans to consult on policy proposals and enforceable rules after considering input from the industry on our DP. We look forward to working with stakeholders to maximise the opportunities engendered by stablecoins and enable safe navigation of this nascent industry.

On the international front, we look forward to engaging with other jurisdictions to promote regulatory and supervisory coordination, and to continue international work to further understand the risks, identify any gaps in our principles, and seek ways to address them.



MARCO SANTORI

Chief Legal Officer - Kraken
Digital Asset Exchange

Navigating MiCA: a closer look at implementations across the EU

The European Union's fintech regulatory landscape is undergoing a transformative shift with the implementation of the Markets in Crypto-Assets (MiCA) Regulation. Scheduled to take effect this December for the majority of the crypto-asset market, MiCA introduces a critical juncture for existing registered firms as well as for the new entrants. The nuances of MiCA's transitional arrangements, the differing regulatory interpretations across EU Member States, as well as the missing piece of ESA's final round of consultations underscore the importance of the need for a more explicitly convergent approach by the authorities. The final piece of the puzzle will be how MiCA fits with the crypto frameworks globally.

Transition periods

MiCA, set to be applied from December this year, allows Member States the discretion to introduce a transition period for existing registered firms to move to this new framework. While the maximum transition period enshrined in MiCA stands at 18 months, ESMA recommends a 12-month transition. Thus far, we have seen divergent approaches from Member States. Some

have remained faithful to the 18 months agreed by the co-legislators, some are following the 12 months suggested by ESMA, and others have decided to scrap transitional periods altogether.

The divergences have the potential to create uncertainty and confusion for both the consumers and the practitioners across the EU. For example, consumers may not pick up legal nuances between jurisdictions and therefore be unsure whether they already benefit from the protections that MiCA will bring. Even for the practitioners, the specific regulatory requirements of each Member State during the transition period remain unclear. This may cater to regulatory arbitrage and negatively impact the competition.

Whitepaper regulatory interpretations

Unlike in traditional finance, MiCA does not put the liability of producing a whitepaper solely on the issuers. Instead, the preparer of whitepapers can also be offerors of crypto assets, or trading platforms. This can create confusion among the practitioners around who should be the first mover and which party should assume the burden of ensuring that all the information in a whitepaper is correct. In the scenario where a number of offerors decide to draft their own whitepaper for the same asset, consumers may receive different levels of information in different versions of whitepapers. This risk is exacerbated where the information in the whitepaper relies on estimates or assessments, for example on sustainability metrics.

The transitional arrangements and regulatory interpretations call for more convergence.

While MiCA resolutely puts the whitepaper obligation on newly issued tokens, there are several ongoing industry debates related to tokens already trading pre-MiCA. For example, whether some of the most popular tokens that hold a significant share of the crypto market today will require a whitepaper for trading. This will become even more relevant after December 2027 when this requirement is fully in force regardless of whether they started trading pre- or post-MiCA.

Pending Level 2 and 3

The European Supervisory Authorities (ESAs) are still finalising the Regulatory and Technical Standards (RTS) and

Guidelines mandated by MiCA. MiCA contains an unprecedented number of these empowerments which means that a significant portion of the final text will be rolled out close to the go-live date and will require a quick, nimble implementation by the broader crypto industry.

For example, the crucial, yet pending, definition of whether crypto is a financial instrument has potential to significantly impact the industry. This is because firms that are providing services in crypto assets that are deemed as financial instruments will need to change their strategic direction and licensing plans towards MiFID. Given that this clarification comes late in the process and closer to the implementation date, it could create disruptions within the market, and impact client trading experiences.

Way forward

To ensure market consistency and consumer protections, it is vital for authorities to promote convergent regulatory approaches and to commit to a smooth transition. This process will include harmonising the transition period lengths to the extent possible and providing clarity on which regulatory requirements will be applicable during the transition period.

We suggest that the National Competent Authorities and ESMA collaborate closely to help the industry navigate the path towards compliance by among others ESMA issuing guidance addressing the possible multiplicity of whitepapers per asset. Overall, such an approach limits opportunities for regulatory arbitrage and increases consumer protection.

The impending Technical Standards and Guidelines, including on definitions of crypto as a financial instrument, should ensure that MiCA is not hollowed out and that crypto assets do not end up almost accidentally in traditional finance frameworks as this would miss the whole point of putting the EU at a competitive forefront with MiCA.



ARNAUD MISSET

Chief Digital Officer - CACEIS

Digital assets challenge for traditionnal players

When dealing with crypto and digital assets, we have to be clear exactly what we're talking about because it covers such a wide range of asset types from cryptocurrencies such as BTC and ETH, to NFTs, utility tokens, securities tokens, stable coins, and the upcoming CBDCs. Secure custody is the core business of an asset servicing company like CACEIS, and our one-stop shop approach means we have to be in a position to cover our clients' needs across all the aforementioned digital and crypto assets. Having said that, it is essential to closely analyse potential IT, operations and control functions issues (i.e. legal, compliance & risk) as these new asset types are a source of both opportunities and threats.

The industry is aligned on the benefits of digital assets and blockchain technology which bring major efficiency gains for settlement times, reporting and reduction of complexity across the value chain. On the IT side, it is common knowledge that a private key management system is essential to security, whatever the underlying digital asset. However, on the Operational side it is a different story, and discussing risk and compliance issues is key. This is where regulation is necessary to clarify methods of operation. The regulatory environment is nevertheless

a complex framework of rules and although securities tokens fall nicely under MiFiD and the traditional way of working, assets like utility tokens, cryptocurrencies, NFTs and stable coins operate under a new set of rules that are currently fragmented across Europe. The industry hopes that MiCa will set out a common rule book across Europe. We now know that tokenized financial instruments and the rest of the digital assets family won't have to comply with the same set of rules, so let's look at both frameworks.

Tokenised financial instruments are commonly viewed as a part of the potential future for the financial industry. For many years, successful trials have been run and have not revealed any particular regulatory or operational issues. These instruments could see a major take-off in the industry if the following two challenges are resolved:

- The first challenge is managing the cash side of a transaction in the form of a token. This is essential if we are to benefit from one of the most valuable features of traditional finance - the Delivery versus Payment process. CBDCs do provide a solution here but currently lack any official regulatory status and there are no plans to implement one any earlier than the two or three years. Questions are also raised around the use of stable coins, their reliability and the quality of the issuer.
- The second challenge is setting up a secondary market for tokens, as the OTC market on its own is definitely insufficient. The DLT Pilot Regime was intended to provide a boost in this area but to date has not performed as expected. In addition to this, support by the industry's custodians is also essential in the wide-spread adoption of tokens as investors need providers with token safekeeping capabilities.

Other newer digital asset classes such as cryptocurrencies, utility tokens and NFTs, are still perceived as higher risk assets especially from a compliance and reputational point of view. MiCa will definitely help align industry thinking and underscore the importance of acquiring robust and adequate IT systems along with the in-house capabilities and expertise needed to comply with regulators' expectations. This is mainly things like AML/KYC and the newly-introduced concept of KYT - Know Your Transactions.

Clearly, traditional and digital assets will have to co-exist for quite a time. This will bring additional challenges for players

along the value chain, as investors will expect processes, communication and reporting to be harmonised. Technical discussions around Blockchain have probably been too abstract, with investors only interested in the potential cost savings but less willing to adopt new standards. We shouldn't forget that the European market already operates with a high standard of efficiency, and the investor won't accept being exposed to the additional complexity of private key management, smart contracts and interoperability between the various protocols. Industry stakeholders involved with these new assets will need to strike a balance between the investment required for new systems, specialist IT teams and legacy system interfaces, and the expected commercial gains and increase in client satisfaction.

**For custodians, having
to deal with digital
assets is highly complex
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In conclusion, for custodians, having to deal with digital assets is highly complex and yet unavoidable. With the current patchwork of unharmonised regulations, new regulation soon coming into force, the need for large IT investments, the size of the operational workforce required, and industry-wide education still to be delivered, we are facing major hurdles. But isn't that what makes business life so interesting...?