31 July 2023

SENT VIA EMAIL TO: cryptoassetsconsultation@iosco.org

To whom it may concern,

Re: IOSCO Consultation Report: Policy Recommendations for Crypto and Digital Asset Markets

About GBBC Digital Finance (GDF)

GDF is a not-for-profit industry body, the financial services vertical of the Global Blockchain Business Council (GBBC), that promotes the adoption of best practices for crypto and digital assets, and digital finance technologies, through the development of conduct standards, in a shared engagement forum with market participants, policymakers and regulators.

Established in 2018, GDF has convened a broad range of industry participants, with hundreds of firms and individuals across the global community - including some of the most influential digital asset and blockchain companies, financial institutions, and professional services firms supporting the industry.

The GDF Code of Conduct (the 'Code') is an industry-led initiative driving the creation of global best practices and sound governance policies for VASPs / CASPs. In addition, the GDF Global Cryptoasset Standards, which have just been released and were inspired by the Global FX Code, set principal-based best practices for financial institutions wishing to engage in crypto brokerage, custody, and settlement.

All GDF codes and standards are subject to multiple stages of member and community peer review, open public consultation, and regulatory purview, prior to public release.

The input to this response has been curated through a series of member discussions and roundtables, and GDF is grateful to its members who have taken part.

We have also included with this submission, our initial mapping of the IOSCO Summary Policy Recommendations for Crypto and Digital Asset Markets, May 2023 to the GDF Global Crypto Assets Standards.

As always, GDF remains at your disposal for any further questions or clarifications you may have, and we would welcome a meeting with you to further discuss these matters in more detail with our members.

Yours faithfully,

Lavan Thasarathakumar
Director of Government and Regulatory Affairs, Global Digital Finance

Response to the Consultation Report

Overall GDF is supportive of the recommendations made in the IOSCO Consultation Report. As such, the response to this consultation report looks more to the overarching considerations with a few examples that were highlighted over the course of member discussions.

GDF supports the Consultation's proposed adoption of a principles-based and outcomes-focused regulatory framework for cryptoassets. A principles-based approach provides the necessary flexibility to address the diverse nature of cryptoassets, which often differ significantly in terms of technology, utility, and potential risk profiles. By avoiding rigid rules and blanket regulations, the regulators can better respond to the dynamic and rapidly evolving crypto landscape.

A principles-based framework should focus on overarching principles that prioritise investor protection, market integrity, and fair practices. This approach allows regulators to keep up with the fast-paced nature of the crypto market while ensuring that regulatory oversight remains effective and up-to-date. It is crucial for regulators to collaborate with industry stakeholders and the wider community to develop these principles, ensuring that they strike a balance between innovation and risk mitigation.

GDF agrees with the recommendation across the consultation to identify cryptoassets that act as substitutes for regulated financial instruments and investigate situations where investors have replaced traditional financial activities with crypto asset activities. Based on an outcomes-based regulatory approach, identifying these substitutes can provide a direction for regulators on how to identify risks and how to mitigate them. The regulatory authority's focus on recognising these substitutes will enable more targeted and proportionate regulations, safeguarding investor interests and maintaining market integrity without stifling innovation.

GDF however, noted that a number of the recommendations are high-level, which is understandable and necessary when putting in place principles across multiple jurisdictions. However, as such it was difficult to ascertain the impact that certain recommendations will have in practice. Members also highlighted that where there are gaps in the detail, which is left up to different jurisdictions to fill in, it can lead to quite varying approaches, which at time could be counterproductive. Members highlighted the need for industry involvement in the discussion of these more technical matters and proposed setting up a model similar to the Virtual Asset Contact Group, which allows for public private partnerships to discuss technical solutions to regulatory objectives.

GDF also notes that IOSCO reiterate the need to take a tech neutral approach and therefore apply the same activity, same risk, same rules approach. While this is welcomed by members, it should be noted that there is often an implied calculation of risk. In reality, the calculation is same activity, same regulation and the risk is implied to be the same. This is often not the case with crypto and digital assets and more emphasis needs to be made on where the risk lies. The paper on the whole makes reference to risk and at times falls silent on many of the risk mitigation measures that are inherent in crypto and digital assets for example its immutability, the rigour of smart contract removing the risk of human error, traceability etc. and the resilience that comes with this. As such, GDF call for greater attention to be given to the risk proportion of this formula. On the flip side of this, crypto and digital assets bring novel risks that are not apparent in tradfi, for example market manipulation risk in maximum extractable value. Therefore, members noted that there is also merit in taking a technology specific approach in places.

Looking more specifically at conflicts of interest. Our members have found that the potential conflict of interests that require particular regulatory attention are risks connected to:

- Vertical integration: as was exemplified by FTX. If a CASP is involved in multiple aspects of the crypto ecosystem, such as operating an exchange, providing trading services, and issuing tokens, there is a risk of favouring its own products or services over others. This can create a biased market and disadvantage traders and investors.

- Role of intermediaries in deposit holding: many crypto traders and investors rely on intermediaries, such as custodians and exchanges, to hold their assets securely. This introduces potential conflicts of interest where intermediaries may be tempted to use clients' deposits for their own benefit, leading to liquidity issues or loss of funds in extreme cases. It is essential to consider the dual role of some CASPs as both market operators and trading intermediaries. Such a position can create conflicts of interest as the CASP may prioritise their role as a market operator over serving the best interests of their clients.

- Role of brokers in crypto: In crypto, brokers may not have the same level of possession and control over assets as they do in traditional finance. This raises concerns about the ability of brokers to effectively manage client assets and execute trades without conflicts arising due to the unique nature of crypto assets.

In addressing conflicts of interest in the crypto industry, disclosure plays a crucial role. CASPs should be required to disclose any potential conflicts to their clients to promote transparency in a proportionate manner. Disclosure requirements in crypto should reflect practices in traditional finance to ensure consistency and investor protection across both sectors.

While some conflicts of interest may be managed through stringent controls and transparency, some systemic conflicts are too risky and cannot be prevented by disclosures. In those cases, a prohibition on some practices may be necessary to protect investors and maintain market integrity.

Another example that members highlighted was disclosure requirements.

In order for Crypto Asset Service Providers (CASPs) to identify and disclose all pre- and post-trade "off-chain" transactions it is crucial to enhance transparency and mitigate risks by introducing proportionate disclosure requirements. Given that many crypto-asset transactions occur off-chain, the following steps can be considered:

- Implementing Robust Transaction Reporting: CASPs should be required to implement robust transaction reporting mechanisms for all their on-chain and off-chain transactions. This reporting could include detailed information about the parties involved, transaction amounts, timestamps, and any relevant identifiers. Such reporting can be mandated for both Over-The-Counter (OTC) trades and trades occurring on centralised exchanges.

- Establishing a Regulatory Framework for Off-Chain Transactions: Regulatory authorities should develop a clear framework that outlines the obligations of CASPs in reporting off-chain transactions. This framework should be aligned with existing regulations in other financial markets (e.g., MiFID and APA in the UK and EU) to ensure an appropriate level of transparency and diligence.

- Information Sharing and Processing Responsibilities: CASPs should cooperate with relevant regulatory authorities to facilitate proportionate oversight and market surveillance. This could involve cooperating with regulatory bodies to ensure access to transaction data and any necessary clarifications.

- Enhancing Security and Privacy Measures: While promoting transparency, it is equally important to safeguard sensitive customer data and ensure compliance with data protection regulations. CASPs must adopt strong security measures to protect customer information during the reporting process.

- Encouraging Collaboration and Industry Standards: Industry stakeholders, including CASPs, regulators, and trade associations, should collaborate to establish industry-wide standards for off-chain transaction reporting. Standardisation would streamline reporting processes, making it easier for CASPs to comply with regulatory requirements.

- Proportionate obligations: regulatory requirements for CASP responsibilities should reflect a same-risk-same-regulation model in which CASPs are not overburdened with disproportionate requirements for data privacy and data disclosure. A sensible balance between transparency, mitigation of risks and functionality of the services must be achieved to ensure further growth in the market.

A differentiation between retail and wholesale participants is important in determining the extent of limitations and prohibitions placed on CASPs. Retail customers may require stronger safeguards, given their potentially limited knowledge and risk tolerance, whereas wholesale participants, such as institutional investors, may have more expertise and risk management capabilities.

Moreover, the principle of proportionality should be applied in implementing the limitations. Applying the principle of proportionality is crucial in tailoring regulatory requirements to the size and nature of CASPs and their operations. Larger CASPs with a significant impact on the market should adhere to more stringent limitations, while smaller CASPs may have relatively lighter requirements to encourage market participation.

Regulations should emphasise clear and comprehensive disclosure requirements for CASPs regarding any material interests they or their affiliates have in listed crypto-assets. This disclosure would enable customers to make informed decisions and understand any potential conflicts of interest that may arise.

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