ECSDA RESPONSE TO THE FINANCIAL STABILITY BOARD CONSULTATION: *ADDRESSING THE REGULATORY, SUPERVISORY AND OVERSIGHT CHALLENGES RAISED BY "GLOBAL STABLECOIN" ARRANGEMENTS*

Introductory remarks

ECSDA welcomes **FSB´s on-going efforts to further enhance market stability and market integrity** by, among others, addressing the regulatory, supervisory and oversight related challenges raised by global stablecoin arrangements. We also acknowledge **FSB´s valuable work within the DLT discussion.** As operators of Central Securities Depositories (CSDs), we have a long experience in supporting markets and implementing safeguard mechanisms for these markets.

We favour the approach undertaken by the FSB, especially referring to already existing international standards to deal with global stablecoins (GSC). From our point of view, it is time to **raise the crypto-asset ecosystem to the same level of regulation as the rest of the financial system**. **"Same business, same risks, same rules" should apply as a general principle.**

CSDs are primarily looking at GSC as a potential means of settling one of the 'legs' of the transactions in securities or digital- assets. We would, therefore, ask regulators not to look at the arrangements in isolation, but as part of the ecosystem in which this new segment will be integrated. **Due to the interdependence of different actors and segments of financial markets, regulators should also pay attention to financial stability risks related to GSC.** Lessons learned from the previous financial turmoil should be kept in mind: the technology changes should not lead to the creation of a less regulated financial segment that may lead to global systemic consequences. The regulation of the actors using the technology should always be technology-neutral, and the technology should be no justification for different treatment.

Given that the application of the technology in financial markets is still in an early stage, we would ideally **favour a close global alignment of regulators** when addressing the vulnerabilities of the various activities of GSC arrangements. Therefore, we welcome the opportunity to comment on the FSB´s Consultative document.

I. KEY MESSAGES

1. Financial stability has to be ensured at all times

We agree with the consultation risks to financial stability which were mentioned. However, we would add:

A. The need for attention to the value and stability of a fiat currency (or even multiple fiat currencies) and how the respective central bank(s) in charge might be affected (e.g. by inflation), and the need for attention to the value and stability of the securities backing GSCs and the risks linked to those.

B. GSCs need to evidence the existence and amount/value of reserves they maintain at all times, both reliably and continuously. For this purpose, specific trusted third parties responsible for the 'notary' functions should be used.
There should be mechanisms preventing custodian insolvency impacts, including ensuring the use of dedicated trusted third parties. Maximum protection, which may be desirable in

the case of GSC, would be ensured by having reserves in the form of cash held in central banks and reserves in the form of securities held in CSDs.

2. We would encourage further global and regional cooperation and clarification of GSC arrangements

A. **Clear classification of crypto-currencies and (global) stablecoins is necessary.**
Digital payment assets (payment tokens) or 'digital money' in general, have different subcategories, depending on the features we specify below. The risks (including related to the probability of the issuer insolvency) related to the backed assets ('reserves' or 'collateral') will be a crucial factor for investors, and hence should be taken into account by regulators.

B. It would also be useful to clarify the **distinction between stablecoins and securities-tokens.**

C. Due to their insolvency remoteness and their proven resilience as systemic FMIs, **the safety and resilience of a global stablecoin arrangement can be enhanced by having existing CSDs taking roles in the arrangements**. For that reason, there may be no need to duplicate the PFMI requirements applicable to these institutions in a framework dedicated to stablecoins.

D. We see the need for the **detailing of the future FSB recommendations at the national or regional level in the near future**.

II. COMMENTS IN DETAIL

1. Do you agree with the analysis of the characteristics of stablecoins that distinguish them from other crypto-assets?

Yes, in general, we agree with the proposed distinction, but we would like to highlight the need to increased focus on the issuer of any token in order to assess the associated risks. From our point of view, digital payment assets (payment tokens) or 'digital money' in general, have different subcategories, depending upon certain features such as the openness of the network and governance structure used (public or private ledger, permissioned or permissionless), the backing or the reserve (no backing or backing by assets) and the issuer. This could result in the following classification (illustrative):

a) Crypto-currencies: native tokens which have no issuer, usually running on a public/permissionless ledger; example: Bitcoin.
b) Stablecoins: issued by a private non-financial company, backed by asset(s), on a private or public ledger; example: Libra.
c) Digital bank money: issued by a financial institution with a banking license, additional backing with assets is optional, usually on a private/permissioned ledger; example: JP Morgan Coin.
d) Central Bank Digital Currency: issued by a central bank.

This categorization is important, as the issuers are regulated and overseen in different ways. They also have different experiences and roles within the financial systems. Therefore, the issuer-dimension has to be more prominently considered regarding the respective vulnerabilities of (global) stablecoins.

Finally, stablecoin is a means of payment and should, therefore, be distinguished from securities and security-tokens.

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***

From our point of view, the described stabilization mechanisms are sufficient.

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?***

We agree with the different activities highlighted in the document.

We note that CSDs are providing services for the assets. As experts in this domain, their role concerning the securities-tokens or the assets backing stablecoins should be clear as well. From the technology-neutral perspective, Principles for Financial Market infrastructures should apply – leaving the due care of securities in different forms to the compliant FMIs.

Providing custody/trust services for reserve assets:
The consultative document highlights that the different functions and activities of a stablecoin arrangement could be provided by a single entity[1] and that the entity issuing the stablecoin may hold the reserve assets[2]. In our view, the possibility of having one legal entity performing all tasks could present significant risks, both in terms of financial stability and in terms of consumer protection.

It would be appropriate for the FSB to assess which functions and activities should be performed by specific legal entities, ring-fenced from the risk of bankruptcy of other key legal entities involved in the arrangement. The activity of 'custody/trust services for reserves assets' must, in our view, be one of those. Indeed, the insolvency remoteness of the entity charged with the custody of the backed assets ('reserve' or 'collateral') will be a crucial factor for investors, and to ensure trust in the arrangement. This requirement would be in line with the principle 'same activity, same risks, same rules'.

To maximize trust in the arrangement, the provider of custody/trust services for reserve assets should be regulated and of the highest creditworthiness possible. For that reason, when the reserves of a global or systemically important stablecoin is composed of securities, we believe there is merit for these assets to be safekept in CSDs, which are low-risk entities subject to appropriate legislation/regulation and proven safe places, including in times of crisis and market turmoil.

As a generic comment, we would suggest changing the term 'reserve' by 'collateral'. This term would be more appropriate based on the mechanisms currently employed and the different types of assets which can potentially back the stablecoins (cash, securities and other). Stablecoins are essentially asset-backed crypto-assets.

[1] "[…] a stablecoin arrangement is generally understood as an arrangement comprised of different, interrelated functions and activities that can be provided by one or several entities." (FSB consultative document – Page 14)
[2] "The entity or entities issuing the stablecoin or other entities may hold the reserve assets." (FSB consultative document – Page 15)

4. What criteria or characteristics differentiate GSC arrangements from other stablecoin arrangements?

Drawing a distinction between 'stablecoins' and 'global stablecoins' might fail to fully address the risks of financial stability, monetary policy transmission and monetary sovereignty that these types of assets may represent. From an economic and functional perspective, stablecoins and global stablecoins seem to be identical. For example, a stablecoin operating across only two large jurisdictions with different currencies can represent significant risks, while it would not be considered 'global'.

A distinction between 'Global Systemically Important', 'Domestic Systemically Important' and 'non-systemically important' stablecoins could address that problem. The minimal legislative requirements could apply to all stablecoins, while some specific additional requirements may apply to those considered to have a systemic or global nature. Global standard-setting bodies may be tasked to determine the systemic importance (similar designation as G-SIFIs and local SIFIs). The metrics used to determine systemic importance could be based on the total value of stablecoins in circulation, the number of currencies involved (coin itself and/or reserve pool), the number of countries it is used in, whether G-SIFIs or FMIs use the coin (wholesale versus retail use), transaction value, etc.

Although we do not intend to propose an exhaustive list of characteristics, please find the following suggestions that you may find appropriate:

Categorisation of stablecoins/global stablecoins may make a distinction between the following factors: 1) Number of currencies (coin itself and/or reserve pool) 2) Number of participants (reach) 3) Volume(s) of coins(s) issued.

Authorisation and supervision of companies issuing (global) stablecoins: To address the corresponding risks, the issuer and/or system operator should be authorized and supervised companies. A strong rulebook should be required including clear and transparent rules for the management of the reserve (e.g. fiat-money and highest quality securities, no cross-currency risk etc.).

Additional requirements for the custody of the reserves should include:

- Assets of the reserve should be kept at a central bank (cash) or with regulated/supervised institutions (CSD or custodian); The insolvency remoteness of the backed assets ('reserve') will also be a crucial factor for investors.
- Assets of the reserve should be highly liquid, with a limited market and credit risk.
- Prudent risk parameters should be applied for the reserve: e.g. the composition of the reserve (cash vs. securities), concentration risks, the definition of volume caps per currency, ratios of asset classes amongst each other. If reserves are in the form of cash, then ideally, they should be held with central banks; if cash reserves are held with commercial banks, additional risks need to be considered and addressed.
  To address specific risks of stablecoins and global stablecoins a temporary limitation on the geographical spread through underlying regional networks might be helpful.

A key point to consider in relation to a stablecoin arrangement will be the design of the liability framework for participants. Absolute clarity on the contractual relationships in the system between the different service providers and the nature of the rights associated with the stablecoin, including whom these can be exercised against and who can enforce those rights, will be crucial.

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 mentioned risks to financial stability. However, we would add that the value and stability of a fiat currency (or even multiple fiat currencies) and the respective central bank(s) in charge might be impacted (e.g. by inflation), and the need for attention to the value and stability of the securities backing GSCs and the risks linked to those.

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 agree with the mentioned vulnerabilities. Possible additional vulnerabilities to be noted are:

- programming of the smart contracts, and
- the question of liability within permissionless DLT networks.

Further GSCs need to prove the existence, the amount and value of reserves they undertake at all times, reliably and continuously. For this purpose, specific trusted third parties with notary functions should be used.

7. ***Do you have comments on the potential regulatory authorities and tools and international standards applicable to GSC activities presented in Annex 2?***

Through their roles and responsibilities, some entities involved in stablecoin arrangements can be assimilated to FMIs. Therefore, we agree that it would be relevant to apply the appropriate PFMIs, and we support the ongoing analysis made by CPMI-IOSCO in that regard.
Considering the importance of segregating critical activities among different specialised legal entities, it may not always be necessary to duplicate in a dedicated stablecoin arrangement framework some principles which are currently followed by existing FMIs. In order to avoid further fragmentation, we encourage FSB and CPMI-IOSCO to consider the appropriateness of using the existing PFMIs and the FMIs attached to them.
For example, this may be the case for principle 11 that addresses CSD activity. In their current state, CSDs can support and handle specific roles for global stablecoin arrangements, ensuring the safety and the continuity of the services offered by their insolvency remoteness and their proven resilience as systemic FMIs.

8. ***Do you agree with the characterisation of cross-border issues arising from GSC arrangements?***

From our point of view, the characterisation of cross-border issues is satisfactory.

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?***
   a. **Are domestic regulatory, supervisory and oversight issues properly identified?**
   b. **Are cross-border regulatory, supervisory and oversight issues properly identified?**
   c. **Do the recommendations adequately anticipate and address future developments and innovation in this sector?**

We agree with the recommendations in general. However, as different jurisdictions at different levels are already working on future legal frameworks, we see the need for a potential revision of those or their further detailing and adjustment based on the results of the legislative processes.

10. Do you think that the recommendations would be appropriate for stablecoins predominately used for wholesale purposes and other types of crypto-assets?

Wholesale stablecoins

Although the risks posed by wholesale stablecoins are different than those of retail stablecoins, notably in terms of consumer protection, they could still be a source of financial stability and systemic risks. For that reason, we believe it may indeed be relevant to apply similar recommendations. A difference is that wholesale users should have a more professional background in the subject and should, therefore, need less protection than retail users. As stablecoins for wholesale purposes are 'injected' into already existing legal structures (e.g. banking/FMI rules), we would suggest only minor necessary adjustments on how to include stablecoins.

Other types of crypto-assets (to be taken into account in the context beyond the present consultation)

Similar recommendations and clarifications would be appropriate for all crypto-assets which may induce systemic risks, such as security tokens. PFMIs should be followed by entities involved in the provision of key functions and activities related to the servicing of those crypto-assets. The principles to be applied will depend on the type of crypto-asset serviced, and the roles performed by those entities. PFMI should also apply to institutions servicing security tokens.

11. Are there additional recommendations that should be included or recommendations that should be removed?

We agree with the list of recommendations and believe that no recommendations should be removed.

We would recommend adding a recommendation that regulators should ensure that any issuer of a GSC is qualified and suitable to operate such a scheme. This could be established via mandatory management skills, which would ultimately result in trust in the GSC and could enhance the stability of operations.

12. Are there cost-benefit considerations that can and should be addressed at this stage?

It would be advisable to allow for innovation in the wholesale area, which is more contained/secure/regulated, than for stablecoins with a global reach predominantly targeting the retail sector. When companies can test their use-cases and obtain experience, this will enhance efficiency gains for the system in general (such as machine-to-machine payment and other industry 4.0 benefits).

We would also be supportive of further standardization, such as using ISO standards to ensure machine readability.

Should you have any further questions or want to engage in dialogue on the consultation, the Association and its members will certainly make themselves available.

About ECSDA

ECSDA represents 41 national and international central securities depositories (CSDs) across 36 European countries. The association provides a forum for European CSDs to exchange views and take forward projects of mutual interest. It aims to promote a constructive dialogue between the CSD community, European public authorities and other stakeholders aiming at contributing to an efficient and risk-averse infrastructure for European financial markets