

IOSCO Consultation Report - Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms

Overview

The WFE welcomes this timely IOSCO report into the current issues and risks that have been identified with the trading of crypto-assets on trading platforms (CTPs) as well as the identification of the differing regulatory approaches by national jurisdictions. It also welcomes the guidance and toolkits in addressing these issues.

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructure providers, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~21%).

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to raise capital and manage financial risk. We seek outcomes that maximise financial stability, consumer confidence and economic growth.

We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

Response to IOSCO's Report

It is clear from the report that a fragmented approach has developed across regulatory jurisdictions in the regulation of CPTs, with key differences between the emerging sets of rules that are being proposed and implemented by individual national authorities. This, in itself, evidences the fact that regulators have not yet settled on a unified approach on how to regulate CTPs in their financial markets. Further, the current jurisdiction-based and patchwork approach is not consistent with a key aim and objective of IOSCO, and other international standards setting bodies (ISSBs), as well as those of the WFE: namely that of achieving greater harmonisation of the regulatory environment to benefit trade flows and market competition. Therefore, we support IOSCO's proposals to (i) highlight the key considerations that national regulators should consider, and (ii) to provide toolkits that they could use, when regulating CTPs. This would promote a more coherent and co-ordinated approach towards CTP regulation to the benefit of investors and other market participants alike.

It is also important for the industry and standard setters to look towards a regulatory environment in which technological innovation can not only thrive and prosper but also do so in a safe and efficient manner, which serves the consumer and supports stable markets and economic growth. The WFE strongly supports the enabling of innovation to flourish and grow within the sector it represents and to the benefit of the wider financial services environment. Innovative technology is beneficial to competition-based growth which, in turn, encourages a vibrant, healthy market. Those ingredients are core to the good functioning of market infrastructure.

However, innovation which has the potential to present systemic risk or is allowed to operate in an unchecked or unregulated manner is detrimental to financial markets and investor interests. The use of inappropriate forms of a 'light-touch' approach to regulation would be a wilful rejection of the lessons which have been learned and applied over many years to more established financial services. These experiences have generated rules and procedures which are aimed at ensuring the future protection of the global economy and to enforce the implementation of good governance practices. Not only is consistency in the application of regulation an important component in approaching the supervision of CTPs but so too is ensuring a level-playing field. Balanced competition must not be unfairly tilted by

the burdens of that regulation falling unevenly against established market infrastructure, when they have, and are required, to invest time and resources to deliver that high-level compliance.

Establishing a co-ordinated, widely understood and applied approach to the regulation of the CTPs, via the use of the IOSCO Principles and key considerations outlined in this report, will likely benefit national regulators, consumers and the industry alike, as much needed certainty and clarity is introduced to the market place. The current lack of certainty in regulatory coherence risks affecting investor confidence and could slow down the growth of a developing facet of the financial services industry. It could also be said that investors and consumers who engage with platforms without being aware of the lack of an established regulatory approach, and who suffer the consequences of such a lack of protection, may withdraw from investing or supporting the use of such technology again – even if such protection and regulation were applied in the future. In fact, they may retreat from investing more generally, with serious social consequences related to a lack of long-term savings and retirement provision.

It is therefore important to introduce appropriate and internationally co-ordinated regulation to the use of CTPs speedily to avoid unintentionally impeding the technology whilst at an early stage and to ensure the longer-term trust and protection of consumers.

The consideration and use of the IOSCO Principles by national regulators will help to enable the future growth and security that is needed for the safe and effective operation of this emerging technology in the global economy. As a result, the WFE welcomes the application of the IOSCO Principles as guidance to CTP regulation as outlined in the report, and encourages policymakers and regulators to implement the threshold standards that are applied to established market infrastructures¹ as soon as possible, before the disparities in national regulatory approaches become embedded within financial operating processes and in the markets. Failure to tackle this clear example of international market fragmentation would increase the potential for the type of negative consequences previously witnessed – increased costs, inefficient markets and barriers to trade. It is rare that such an opportunity is formed for the ISSBs to guide the regulatory approach to a particular set of financial activities and their service providers and one that should not be overlooked or avoided. This is further reason why the WFE supports IOSCO's work in this space and would encourage IOSCO to go further in considering the use of globally agreed definitions for 'financial assets', in the context of crypto-assets, for regulators and industry to employ.

As drawn out in the report, there is a risk of "regulatory arbitrage" associated with regulatory authorities operating different supervisory approaches, as they create confusion over the application and protection of rights of investors. This is especially the case where a CTP located in one jurisdiction provides cross-border access to participants in a jurisdiction where different rules apply or where trading via a CTP is not permitted. The WFE welcomes the cross-border information sharing that IOSCO advocates in the report in addressing this issue and further highlights it as an example of the need to ensure ISSBs co-ordinate and take the lead on implementing the global regulatory approach to crypto-assets.

While recognising the uniqueness of each national market, the WFE supports clear macro guidance on the global regulatory approach to ensure a more harmonised and 'enabled' future market place for the cross-border trading of crypto-assets – something which is inherent in this global technology. The WFE also welcomes the key considerations and toolkits which have been outlined in the report in supporting this objective.

Specific Commentary

As IOSCO's report highlights, there are worrying concerns in a host of core issues – transparency of operations, price discovery mechanisms, clearing and settlement, safekeeping of participants' assets, identification and management of conflicts of interests. Guidance from the IOSCO Principles are a helpful addition in addressing these issues.

Notably, whilst the report discusses "alternative" or "tailored regulatory approaches" for CTPs, it will be important to ensure that the regulatory approach is fair, balanced and effective, and in line with those rules applied to established market infrastructure. As previously stated, the WFE supports the growth of innovation and believes the right balance must be found that does not unnecessarily or inappropriately burden growing and innovative organisations. However, many predict large increases in the growth of the crypto-asset market and the volumes traded through CTPs. Such

¹ The WFE supports the guidance provided by IOSCO Principle 38 in relation to clearing and settlement by CTPs and to the wider application of PFMI – recognising that it is under the review of CPMI-IOSCO.

volumes may be comparatively small, when compared to other markets, but stability in the market economy relies on the integrity of the whole ecosystem and it will be important for IOSCO and other ISSBs to keep the application of regulation to CTPs under review.

Many of the additional, or atypical, services performed by these new technologies require greater monitoring and supervision as they operate in spaces, and with providers, which and who have not been tested in the same manner as those operating in established markets. This does not necessarily mean additional regulation must be applied but basic threshold requirements must be adhered to by such providers and continued cooperation with regulators should be ensured to avoid serious issues building within the market that may affect wider financial stability. For example, and as reviewed in the report, a CTP which has the ability to continuously trade over 24 hours needs to demonstrate to the supervisory authorities how it would still provide effective market surveillance systems.

Transparency associated with price discovery is the lynchpin of the trust and value associated with market infrastructures. Whilst the report believes that it may be “premature to determine the appropriate level of transparency at this point in time”, due to the early stage of development of the crypto-asset market, the WFE supports IOSCO’s use of the term Crypto-Asset Trading Platform instead of ‘crypto exchange’ as price discovery is one of the clear examples of the gap between what ‘true’, established exchanges do (in terms of regulated practices brought to the market place) established exchanges and what CTPs do. Indulging the use of the term ‘crypto exchange’ creates the possibility of misleading investors into thinking that all such platforms are regulated or that all CTPs meet the regulatory standards of the world’s leading securities and derivatives exchanges.

In reviewing the ‘on-boarding’ process, it was noted in the report how the current lack of controls around some CTPs may allow participants, particularly retail investors, to trade when it may be unsuitable for them and create investor harm. This is an example of the lack of investor protection that has been subject to much scrutiny in financial services and market infrastructure operations in recent years, in order to reduce that risk. Failing to address these risks in the manner IOSCO recommends, if not more stringently, would be a backwards step.

As the report notes, IOSCO has deliberately avoids an analysis of the criteria that is used by regulatory authorities to determine whether a crypto-asset falls within its remit. The decision of whether a crypto-asset falls under securities law is one that is bound by national autonomy and accompanying relevant legislation (e.g. MiFID). However, the WFE would suggest that an additional area of focus that would be welcome from IOSCO, concerns the promotion of an international agreement on what constitutes a ‘financial asset’, in the context of crypto-assets, in the first instance – creating an overarching global definition for regulators and industry to operate under.

Conclusion

The WFE supports the intentions and application of IOSCO key considerations and toolkits in the regulation of CPTs. The WFE also recommends continued coordination and cooperation between ISSBs, as well as national authorities, to ensure a safe and efficient set of international regulatory standards that benefits the long-term trading of crypto-assets across geographical borders. These standards must be implemented appropriately and efficiently to ensure the protection of its users, engender trust in the technology and for the stability of the wider financial ecosystem.