

**EXECUTIVE  
BOARD  
MEETING**

SM/23/4

Correction 2

February 14, 2023

To: Members of the Executive Board

From: The Secretary

Subject: **Elements of Effective Policies for Crypto Assets**

Board Action: The attached corrections to SM/23/4 (1/5/23) have been provided by the staff:

**Evident Ambiguity** **Page 23 (para. 48, lines 4–6, “International work to establish...”, and footnote 46)**

**Factual Errors Not Affecting the Presentation of Staff’s Analysis or Views** **Pages 23 (para. 48, line 4, “and there is an absence of cross-sectoral standards”) and 29**

Questions: Mr. Ismail, MCM (ext. 35331)



responsible authorities clearly designated, and coordination mechanisms among them well defined.<sup>45</sup>

**48. Where global standards exist and can be mapped onto crypto assets, authorities should implement these standards into domestic regulation.** Currently, global standards have focused on either sectors (banking), issues (financial integrity), or specific products (global stablecoins) ~~and there is an absence of cross-sectoral standards.~~ [International work to establish comprehensive recommendations for crypto assets is being taken forward by the Financial Stability Board \(FSB\) and international standard setting bodies \(SSBs\).](#)<sup>46</sup> Annex 2 provides a snapshot of the progress on the development of standards. Where standards exist—for example, the FATF standards on AML/CFT, and the International Organization of Securities Commissions’ (IOSCO) guidance on exchanges—these should be implemented. Standards should encompass both the safety of the underlying assets as well as the network that facilitates the transfer of the assets. Guidance may be drawn from CPMI and IOSCO’s Principles for Financial Market Infrastructures (PFMI) to address issues related to transfer, governance, and risk management of the infrastructure and networks, or those related to the safe settlement of assets.

### Box 3. The Rationale for Comprehensive Regulations

**Comprehensive regulations are preferred to blanket bans.** Comprehensive regulations should address the specific features of crypto assets that generate externalities, such as those that enable high degrees of anonymity (which could facilitate illicit transactions) or lead to environmental burden (for example, when proof-of-work consensus mechanisms are used). Additionally, regulation, as it relates to consumer protection, is needed to address internalities—cases where consumers do not fully take into account the costs of using or holding crypto assets (e.g., volatility in value, possible losses due to cyber-attacks).<sup>1</sup> Issuing warnings and increasing the availability of information can also be helpful, but it might not be sufficient to address externalities and internalities. Moreover, it can provide legitimacy to the market, facilitating closer links with wider financial services that could generate systemic risks without adequately addressing them.

**Blanket bans that make all crypto asset activities (e.g., trading and mining) illegal may stifle innovation and drive illicit activities underground.** The crypto ecosystem is undergoing rapid change. There is much uncertainty about the extent to which this change will ultimately materialize as productive innovation. Allowing the system to develop (with proper regulation) will allow policy makers to learn about these potential benefits and better mitigate risks (including financial integrity risks), while bans may inadvertently increase the risk exposure.

**Bans can be costly to enforce and increase the incentives for circumvention** due to the inherent borderless nature of crypto assets, resulting in potentially heightened financial integrity risks, and can also create inefficiencies. A decision to ban should be informed by an assessment of money laundering and terrorist financing (ML/TF) risks, and other considerations, such as large capital outflows and other public policy aims. Regulations imply that certain forms of crypto assets will still be available in the legal marketplace, and thus the degree of substitutability of illegal versus legal assets is likely to be much larger relative to blanket bans of crypto assets. When substitute assets are not widely available in legal markets, users may be more motivated to access illegal markets and willing to pay higher prices for these assets, due to the stronger incentives to obtain them. A higher willingness to pay for illegal assets increases the profits to those providing such assets, thus raising the incentives for circumvention. Higher incentives for circumvention imply higher enforcement costs. Moreover, as incentives to circumvent bans are stronger, private sector actors devote more resources to circumvention—an activity that does not produce any socially valuable good or service—and therefore efficiency is negatively affected.

<sup>45</sup> Depending on the domestic legal framework, the type of regulation involved, and the nature of the “product” (such as unbacked tokens or stablecoins), the relevant authorities could include banking regulators, payment system regulators, securities regulators, financial intelligence center authorities, or tax authorities.

<sup>46</sup> [In October 2022, the FSB published a proposed framework for the international regulation of crypto-asset activities. Further, the BCBS, CPMI and IOSCO, and FATF have provided guidance on the application of existing and new standards to crypto-assets.](#)

#### Box 4. Potential Implementation Challenges (concluded)

- **Legal challenges:** A critical challenge when adopting legal reforms is maintaining a level of flexibility to allow for the rapidly evolving technology in the crypto ecosystems, while still providing sufficient legal certainty.
- **Challenges with novelty:** Some requirements may be difficult to implement. For instance, the so-called Travel Rule<sup>1</sup> in the FATF Standards on AML/CFT raises implementation challenges that require greater technological knowhow and collaboration to be overcome.

**Authorities should implement the necessary elements in a pragmatic manner, taking into account jurisdictional contexts and idiosyncratic constraints.** Authorities face various constraints and need to explore a “constrained best solution.” In most instances, the constrained best solution is likely to be *bespoke* national frameworks that are guided by global standards and best practices, supplemented by a mix of targeted restrictions where global standards have not been completed and supervisory capacity is lacking. Public communication and other soft measures can help supplement and fill outstanding gaps.

**Authorities that are faced with rapid uptake of crypto assets may prioritize select elements.** The nine elements work together to create a holistic framework, but some may be more important than others depending on the rate of adoption. A starting point is establishing legal certainty within both private and public law. Following legal clarification, comprehensive and consistent regulations are preferable, but under specific circumstances, targeted restrictions may be considered as an alternative (as discussed in Box 3).

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<sup>1</sup> FATF’s Travel Rule requires crypto asset service providers and other financial institutions to share relevant originator and beneficiary information alongside virtual asset transactions, therefore helping to prevent criminal and terrorist misuse.

**62. Authorities should also collaborate on data collection and analysis to improve monitoring capacities.** Consistent and reliable data are important for monitoring and enforcement. The fragmented approach to categorizing crypto assets can inhibit the reliability and availability of data. The FSB and other standard setters are well placed to develop common global taxonomies. At present, the reporting of crypto asset data is largely limited to voluntary reporting or reporting under AML/CFT frameworks. Gaps in reporting exist, including off-chain transaction data from the entities that perform critical functions, such as crypto asset service providers. Some authorities are beginning to work with blockchain analytics firms to better understand the flow of funds through a crypto asset value chain, and where significant limitations exist (for example, off-chain data collection and the use of virtual private networks).<sup>55</sup> Finally, data collection should be made more consistent across borders, and collected data should be shared among relevant home and host authorities.

**63. To support consistent recording in macroeconomic statistics across economies, there is a need to develop a data collection framework.** Work is ongoing on the development of a statistical methodology on the recording of crypto assets in macroeconomic statistics, in the context of the ongoing update of international statistical standards.<sup>56</sup> Also, the new G20 Data Gaps Initiative,

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<sup>55</sup> In addition, some organizations are exploring concepts of embedded supervision (i.e., supotech) that enable authorities to directly interact with distributed networks. This will improve access to data and allow authorities to monitor compliance in real time by viewing blockchain transaction data.

<sup>56</sup> See [Guidance Note F.18 on The Recording of Crypto Assets in Macroeconomic Statistics](#).