IOSCO's Roadmap for Crypto-Regulation: Fostering Fair, Resilient Markets and Responsible Innovation.

Keynote speech by Tuang Lee Lim, Chair of the IOSCO Fintech Task Force and Assistant Managing Director (Capital Markets), Monetary Authority of Singapore, at London Fintech Week, 11 July

Introduction

1. Good morning.

2. It's a real pleasure and honor to be here at Fintech Week London and to deliver one of the keynote speeches launching the conference.

3. I am doing so in my capacity as the Chair of the IOSCO Board's Fintech Task Force.

4. Last week, IOSCO published a Roadmap for Crypto-asset market regulation.[1] Today, I will take the opportunity to offer further insights into IOSCO's ambitious regulatory agenda for the crypto-asset sector over the next 12 to 24 months.

Background

5. Since the emergence of Bitcoin in 2008 and Ethereum in 2015, the crypto-asset sector has expanded well-beyond providing alternatives to digital payment.

6. It has branched out into a wide array of asset classes and use cases – that often are functionally seen as economic substitutes to traditional financial market products and services which are usually overseen by securities, banking or payment system regulators and central banks.

7. Critically, these innovative markets are global in their reach, operating on a cross-border basis and transcending traditional jurisdictional boundaries.

8. Global crypto-asset market capitalization has increased exponentially.

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[1] *Crypto-Asset Roadmap for 2022-2023*, IOSCO, July 2022 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD705.pdf

9. In 2021 alone, the market for cryptocurrencies hit a peak of just over $3 trillion in November, although this has receded very significantly to about $1 trillion in recent weeks.[2]

10. This illustrates two important points. First, that even at current numbers, the crypto-asset market is no longer in its infancy and cannot be ignored by either investors or regulators. Second, and more pertinently, there is still much volatility and opaqueness in crypto-asset markets, which calls for regulatory guardrails to be developed to ensure fairness and resilience.

Recent market developments

11. If we were to take a step back and ask ourselves what lies behind this exponential growth and dramatic shift in the market landscape, we would likely find that a major reason is the innovative application of advancements in technology.

12. The industry has come a long way since Bitcoin first emerged. For instance, to address issues of efficiency and transparency, the industry has experimented with and introduced new innovations, combining the use of distributed ledger technology or DLT with smart contracts to expand the variety of use cases beyond crypto-currency.

13. These technological advancements and innovations have allowed the development of Decentralized Finance, or DeFi, which has itself been another key catalyst for the recent market boom.

14. As highlighted by the March IOSCO DeFi report,[3] most of the activities in DeFi seek to replicate or clone traditional financial services.

15. In 2021, total value locked in DeFi transactions across blockchains grew to a peak of more than $250 billion from $19 billion just a year before.[4]

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[2] Howcroft, Elizabeth. *Cryptocurrency market value slumps under $1 trillion*. Article, Reuters, 14 June 2022, https://www.reuters.com/business/finance/cryptocurrency-market-value-slumps-under-1-trillion-2022-06-13/

[3] *IOSCO Decentralized Finance Report,* Report of the Board of IOSCO, March 2022 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD699.pdf

[4] Data from https://www.theblock.co

16. This explosive growth of Defi has also been fueled by the rise of Stablecoins.

17. Stablecoin market capitalization grew from near-to-nothing in early-2020 to over $150 billion by January 2022.[5]

18. While there are use cases in the area of payments, Stablecoins are typically used as the "cash of crypto", which includes the purportedly stable leg in a variety of DeFi transactions.

19. Stablecoins sit at the heart of DeFi market plumbing, playing the role that fiat currencies play in traditional financial markets for settlement purposes. In doing so, they provide a significant share of liquidity for the major DeFi protocols and allow asset holders to trade without moving any value 'off-chain'.

20. To the extent they are interoperable, Stablecoins are also used by crypto-asset investors as collateral to fund positions or to generate yield in the DeFi ecosystem through different lending arrangements across blockchain networks.

21. One of these, the Anchor protocol on the Terra platform, was offering returns of up to 20%. This proved unsustainable, but was very attractive while the music played on, drawing in capital from both retail and institutional investors alike.

22. We have seen the dominos beginning to fall on this front as some of these institutions begin to face liquidity, or even solvency issues as seen in the current market turmoil.

Why should we care?

23. So why should IOSCO, regulators and the official sector care about all this?

24. Well, as mentioned earlier, about two-thirds of the market capitalization of cryptocurrencies has been wiped out since its recent peak.

25. The price of Bitcoin has fallen more than 70 per cent.

5 *Global Financial Stability Report*, International Monetary Fund, April 2022.

26. While this has thankfully not quite resulted in contagion to traditional financial markets, the recent turmoil in the crypto-asset market has resulted in significant losses and harm, especially to the retail investor.

27. In addition, we should not ignore that these recent market events were preceded by many smaller incidences of losses, such as the hack of Ronin Bridge and the Beanstalk governance exploit.

28. And that is not to mention rug pulls, such as the Squid Game token, which has no linkage to its Netflix namesake by the way.

29. All these occurrences, big and small, cast a shadow over the fairness and resilience of cyrpto-asset markets.

30. They also raise considerable concerns about the viability of *'not-so-stable'* Stablecoins in fulfilling their core role at the heart of the crypto-ecosystem plumbing.

31. This brings me to the title of my speech today, of how there is a need for regulation to foster fair, resilient markets and responsible innovation.

32. The DeFi market and its participants – like other segments of the wider crypto ecosystem – have to date operated either outside the scope of existing regulatory frameworks or are not compliant with applicable regulations.

The roadmap towards sound crypto-asset regulation

33. In the minds of IOSCO and its members, other standard-setting bodies – and the central banking community – a critical inflexion point has now been reached in international regulatory agenda.

34. Crypto assets have been an IOSCO priority since 2017, and a lot of good risk-based analytical work has been undertaken through IOSCO's former Fintech Network and Policy Committees.

35. While there was a certainly a time for regulators to monitor market developments, exchange regulatory intelligence and their jurisdictions' experiences, the time has now come for more decisive action.

36. IOSCO and its members are collectively resolved to develop common standards to the various sectors of the crypto-asset ecosystem.

37. This is the reason the IOSCO Board agreed to establish a Board-level Fintech Task Force that we refer to as the **FTF** in March 2022.

38. While the FTF will monitor and review activities and market developments related to broader Fintech trends and innovations in line with its wider mandate – its core, immediate task is to prioritize policy-focused work on crypto-asset markets and activities.

39. The priorities of the FTF were reflected in its roadmap for crypto-asset regulation, which was published on Thursday last week (7 July).

40. The initial program of work includes two workstreams, one looking at (i) Crypto and Digital Assets (CDA) and the other at (ii) DeFi.

41. Both workstreams will primarily focus on analyzing and responding to market integrity and investor protection concerns within the crypto-asset space.

42. The CDA workstream has two phases: First, it will look at issues on fair and orderly trading, transparent markets, suitability, and market manipulation. It will then investigate matters relating to safekeeping, custody and financial soundness in phase two.

43. The DeFi workstream will build on its previous work, which culminated in the IOSCO DeFi report released in March. It will continue to explore and highlight the links between DeFi, Stablecoins, and crypto-asset trading, lending and borrowing platforms, as well as interactions of DeFi with broader financial markets.

44. The intention for both workstreams is to develop and consult on recommendations and guidance by end-2023.

45. The FTF will ensure this objective is achieved in a coherent and coordinated cross-sectoral manner in response to the risks, both crystallized and emerging, across the crypto ecosystem.

The key regulatory challenges

46. This agenda is not however without its own challenges for traditional market regulators.

47. IOSCO's globally accepted standards are generally designed to apply to an intermediated financial activity with respect to an identified financial instrument.

48. In this sense, the standards generally assume, implicitly at least, the existence of the proverbial 'middleman' – be that a bank, a broker, a payment service provider, an infrastructure and so on.

49. Yet, the crypto-ecosystem's key selling point is its 'peer-to-peer' nature – blockchain data, smart contract code, and digital protocols underpinned by machine learning algorithms – with the professed ability to disintermediate these traditional financial market actors.

50. The decentralized characteristics of these markets certainly hamper regulators' ability to monitor and oversee them to ensure they function fairly and efficiently. This is given that our frameworks typically impose requirements on intermediaries that are centrally-governed legal entities.

51. Yet despite claims of decentralization, our DeFi report and earlier IOSCO work on Stablecoins and crypto asset trading platforms put a serious question mark over the true level of decentralization occurring within this sector.

52. The March DeFi report concludes that decentralization is developing on a continuum in which central actors often retain control – for example, through the distribution of "governance tokens" that do not necessarily distribute control of the enterprise – and through the important role played by centralized platforms as the 'on-ramp' to participation.

53. In this respect, the risks observed through our work to date are in fact our 'bread and butter' risks linked to conflicts of interest, information asymmetries between principals and agents, market manipulation, fraud and other concerns that affect the integrity of market functioning.

54. Accordingly, we should generally stand guided by the principle of *"same risk, same regulatory outcome"*.

55. Investors in these markets – particularly retail investors – deserve the same safeguards as those for traditional financial gatekeepers – the banks, the brokers, the exchanges – to ensure strong consumer protection and basic rules of the road for the operation of these markets.

56. What we will therefore set out to do in the first instance in developing an outcomes-focused, principles-based approach is to functionally map the infrastructure, the participants and the activities across the ecosystem. We will begin by applying IOSCO's existing rules to identified risks.

57. Nonetheless, we acknowledge that our established IOSCO policy framework may not fully cover all dimensions of risks and activities related to crypto-assets.

58. Idiosyncratic challenges linked to the technology and the more decentralized and disintermediated nature of the crypto-ecosystem may conceivably require targeted adjustments to our rules and/or supplementing our guidance to account for these peculiarities.

International cooperation

59. Now finally a quick word on international cooperation.

60. As part of its mandate, the FTF is also charged with coordinating IOSCO's engagement with the Financial Stability Board (FSB) and other international bodies on Fintech and crypto-related matters.

61. Systemic risk concerns will be considered part of the FTF's work and ultimately channeled into the FSB's financial stability agenda through close and continuous engagement with relevant FSB workstreams.

Conclusion

62. As noted at the outset, the crypto-asset ecosystem is no longer in its infancy.

63. It has clearly reached a new development phase where its scale is raising the need for better investor protection and market integrity oversight, and for guardrails to be put in place to foster fair and resilient markets.

64. This should not be the task of the regulators only, but rather, a joint effort with the industry, to restore credibility to the crypto-asset ecosystem and bring it into alignment with accepted global standards.

65. Otherwise, the stark alternative would be to force the hand of the official sector to intervene more forcefully to stem the growing tide of investor harm.

66. The clear ambition of IOSCO and its members over the next 12 to 24 months is to step-up to that challenge through the FTF, by laying down a basic framework of principles and recommendations to address risks across the crypto-asset ecosystem and to apply them globally.

67. We encourage crypto market participants to rise to that challenge as well, to offer your undeniable expertise to the task, drop your aversion to regulation and engage with standard-setters.

68. Without basic regulatory safeguards and access to better auditable data, the market will fall short of its 'peer-to-peer' promise to investors.

69. We need to help ensure that the general public is protected from the increased risks of harm and fraud that they are exposed to currently.

70. Together we can do this in a proportionate, outcome-focused manner that supports the crypto-asset ecosystem and harnesses the full benefits of innovation and technology responsibly.

71. In closing, I would like to reiterate my thanks and appreciation to the organizers for this opportunity. After meeting a few people this morning, I am aware that governments, regulators and industry players are aligned in our desire for consistent, robust global standards for crypto-assets.

72. I also hope you can join my colleague Abigail Ng and our two workstream leads Richard Fox, FCA, and Valerie Szczepanik, SEC, later today at 1.30pm. They will discuss the Task Force's work in greater detail, including how we, alongside the industry, can work together to realize the vision that I have outlined.

73. Thank you.