Charta | LESSON NOTES

Regulating Unbacked Crypto Assets

FRM Part II

1 A story: Veridia meets crypto

- Veridia: a made-up country whose people now buy crypto
- Brightmoor: a local crypto exchange that also lends
- Kestrel Bank: holds crypto, takes crypto firms' deposits
- Regulator: what are these assets, and who is at risk?
- Then: which rules apply, and how to design new ones

IN THE LESSON

- Imagine Veridia, a made up country whose people have started to buy crypto assets.
- Brightmoor is a local crypto exchange, a platform where people buy and sell these assets, and it has started to lend them as well.
- Kestrel Bank, a Veridian bank, holds some crypto on its own books and takes deposits from crypto firms such as Brightmoor.
- Veridia's financial regulator has two questions.
- First, what exactly are these assets, and who could be harmed by them?
- Then, which existing rules apply, and how should new rules be designed where the existing ones fall short?
- We will answer both, one step at a time, with Veridia as our running case.

2 What a crypto asset is

- A private digital asset
- Relies on cryptography and a distributed ledger
- Stores and transfers value with no central intermediary
- Not a central bank digital currency: an official liability
- Sorted by backing and by function

IN THE LESSON

- Start with a definition.
- A crypto asset is a private digital asset.
- Private means it is issued by someone other than a central bank or government.
- It relies on cryptography, the mathematics of codes, which lets an owner prove control with a secret key.
- It also relies on a distributed ledger or similar technology, a shared register of who owns what, copied across many computers and updated by agreed rules.
- Together these let people store and transfer value with no central intermediary, such as a bank, standing in the middle.
- A central bank digital currency is excluded, because it is an official liability of the central bank, not a private asset.
- Regulators then sort crypto assets in two ways, by their backing and by their function.

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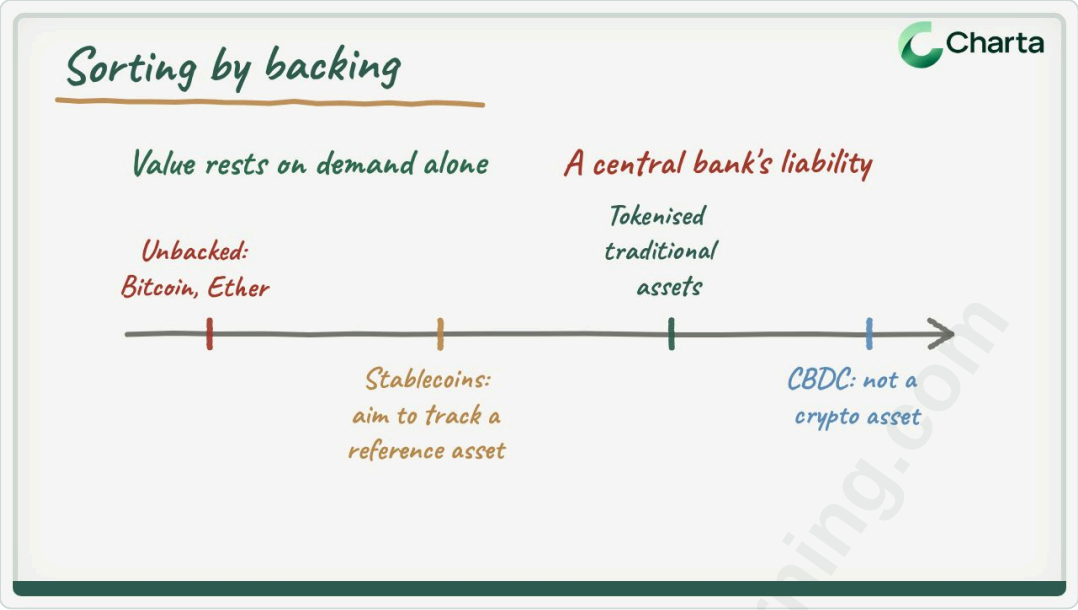
3 Sorting by backing



IN THE LESSON

- First, sorting by backing.
- Picture a line.
- At the left, value rests on demand alone; at the right sits a central bank's liability.
- At the far left are unbacked crypto assets, such as Bitcoin and Ether.
- They have no issuer liability, meaning nobody owes the holder anything, and no reference asset behind them.
- So their price rests only on supply, demand and sentiment.
- Next come stablecoins, which aim to hold a stable value against a reference asset, such as the dollar, usually by holding reserves.
- Further right are tokenised traditional assets, such as a bond or a deposit recorded as a token, which carry the claim of the asset they represent.
- At the far right is a central bank digital currency, which is not a crypto asset at all.

4 Sorting by function

Token type	What it gives the holder	Rulebook it points to
Payment or exchange	A means of payment	Payments, anti-laundering
Utility	Access to a service	Consumer protection
Security or investment	Profit or ownership rights	Securities law

IN THE LESSON

- The second way to sort is by function, what a token does for the holder.
- A payment or exchange token is meant to be a means of payment, so it points towards payments rules and the rules against money laundering.
- A utility token gives access to a service, such as storage space or a seat in a game, so it points mainly towards consumer protection.
- A security or investment token carries profit or ownership rights, much like a share or a bond, so it points towards securities law, with its disclosure and investor protection.
- Notice the right hand column: the class is what tells a regulator which existing rulebook applies.

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5 Example 1: a label is not a class

Brightmoor's 'utility' BRM tokens: holders share 40% of its fee income

Label chosen by the issuer	'utility token'	**not decisive**
Fee income paid to holders	40% × $25m	**$10m a year**
Per token	$10m ÷ 50m tokens	**$0.20 a year**
Substance: a profit right	like a share	**security token**

Rulebook: securities law, with disclosure and investor protection

IN THE LESSON

- Brightmoor sells its own B R M tokens and calls them utility tokens, but holders share forty per cent of Brightmoor's fee income.
- Start with the label the issuer chose: utility token.
- That label is not decisive.
- Now look at what the holder gets.
- Brightmoor earns twenty five million dollars of fees a year, and forty per cent of that, ten million dollars a year, is paid to token holders.
- Spread over fifty million tokens, that is twenty cents per token a year.
- A right to a share of a business's profit is exactly what a share gives.
- So in substance this is a security or investment token, whatever it is called.
- The classic mistake is to accept the issuer's label.
- Regulators look at substance, and here substance points to securities law.

6 Example 2: backed and unbacked

$10,000 in a dollar stablecoin, $10,000 in Lumen (unbacked). Lumen falls 40%

Stablecoin, if it holds its peg	10,000 coins × $1	**$10,000**
Lumen: no issuer, no reserve	market price only	**no claim**
Lumen after a 40% fall	10,000 × (1 − 0.40)	**$6,000**
Loss, with nobody to claim from	10,000 − 6,000	**$4,000**

Unbacked: the price rests on supply, demand and sentiment

IN THE LESSON

- A Veridian saver has ten thousand dollars in a dollar stablecoin and ten thousand dollars in Lumen, a made up unbacked coin.
- Then Lumen falls forty per cent.
- Take the stablecoin first.
- If it holds its peg, its link to the dollar, ten thousand coins at one dollar each are still worth ten thousand dollars.
- Now Lumen.
- It has no issuer and no reserve, so there is nobody to claim from; all the saver has is the market price.
- After a forty per cent fall, ten thousand times one minus zero point four is six thousand dollars.
- The loss is ten thousand minus six thousand, four thousand dollars, and it simply stays with the saver.
- That is what unbacked means: the price rests on supply, demand and sentiment, and nothing else.

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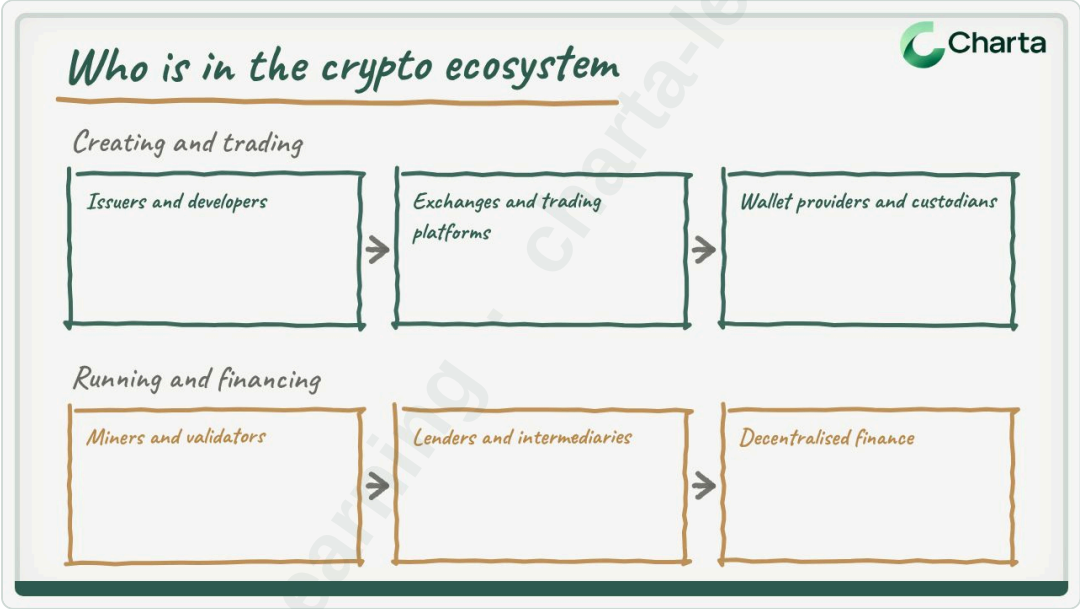
7 The exam point on classes

- Unbacked: no issuer liability, no reference asset
- Stablecoins: aim at a stable value against a reference
- Function: payment, utility, or security and investment
- Trap: accepting the issuer's label; look at substance
- Exam point: the class decides which rulebook applies

IN THE LESSON

- Here is what to carry forward from this first part.
- Unbacked crypto assets have no issuer liability and no reference asset.
- Stablecoins aim to hold a stable value against a reference asset, though they may fail to.
- By function, tokens are payment or exchange tokens, utility tokens, or security or investment tokens.
- The trap is to accept the label an issuer chooses, as Brightmoor hoped its regulator would.
- Regulators look at substance: what rights does the holder really get?
- And here is the exam point.
- The class decides which existing rulebook applies, whether payments rules, consumer protection or securities law.
- That is why classification is the first thing a regulator does with any new token.

8 Who is in the crypto ecosystem



IN THE LESSON

- Now the second question: who could be harmed, and by whom?
- The crypto ecosystem has several kinds of participant, and each creates its own risks.
- The first row is about creating and trading.
- Issuers and developers create tokens and the software behind them.
- Exchanges and trading platforms match buyers and sellers.
- Wallet providers and custodians hold the secret keys that control the assets.
- The second row is about running and financing the system.
- Miners and validators are the computers that check transactions and add them to the ledger.
- Lenders and intermediaries take in crypto and lend it out.
- And decentralised finance offers lending and trading through self executing code, with no firm in the middle.
- We take their risks in turn.

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9 Risks and measures: issuers to validators

Participant	Risk it creates	Measure aimed at it
Issuers, developers	Misleading buyers	Disclosure, fraud rules
Exchanges, platforms	Conflicts, manipulation	Licensing, surveillance
Exchanges, platforms	Commingling client assets	Separation, segregation
Wallets, custodians	Key theft or loss	Custody standards
Miners, validators	Energy use, concentration	Monitoring, energy disclosure

IN THE LESSON

- Match each participant to its risk and to a measure aimed at that risk.
- Issuers and developers can mislead buyers about what a token is or does, so disclosure and fraud rules matter.
- Exchanges and trading platforms often do several jobs at once, so they create conflicts of interest and room for manipulation of prices, which licensing and market surveillance address.
- Exchanges also risk commingling, the mixing of client assets with the firm's own, which separation of functions and segregation of client assets address.
- Wallet providers and custodians face theft or loss of the keys, and a lost key means lost assets, so custody standards apply.
- Miners and validators raise energy use and the risk that control of the ledger is concentrated in a few hands, so regulators monitor them, and disclosure of energy use is one possible measure.

10 Example 3: commingling at Brightmoor

Brightmoor holds $500m of client crypto and lends $200m of it to its own trading arm

Client assets owed	deposited by clients	**$500m**
Lent to its own trading arm	no client consent	**$200m**
Trading arm loses 60%	60% × 200	**$120m**
Assets left for clients	500 − 120	**$380m**
Shortfall per client dollar	120 ÷ 500	**24%**

Segregation and separation of functions keep the $500m intact

IN THE LESSON

- Brightmoor holds five hundred million dollars of client crypto, and it quietly lends two hundred million of it to its own trading arm.
- Clients are owed the full five hundred million, but the lending is done with no client consent.
- The trading arm then loses sixty per cent of what it borrowed, which is one hundred and twenty million dollars.
- So the assets left for clients are five hundred minus one hundred and twenty, three hundred and eighty million.
- The shortfall is one hundred and twenty divided by five hundred, twenty four per cent of every client dollar.
- This pattern echoes the collapse of the F T X exchange in twenty twenty two, where client assets were used by an affiliated trading firm.
- Segregation and separation of functions would have kept the five hundred million intact.

11 Risks and measures: lenders, DeFi, links

Participant	Risk it creates	Measure aimed at it
Lenders, intermediaries	Runs and leverage	Prudential rules
Decentralised finance	No obvious accountable party	Target access points
Links to banks, funds	Risk into the wider system	Exposure limits, capital

IN THE LESSON

- Three more participants.
- Lenders and intermediaries take in crypto that customers can ask for at any time, and lend it out for longer, often with borrowed money.
- So they create run risk and leverage risk, which call for prudential rules, meaning rules on capital, liquidity and leverage like those for banks.
- Decentralised finance has no obvious accountable party, no firm to license or supervise, so regulators target its access points instead.
- Finally, links to banks and funds carry risk out of crypto and into the wider financial system, when a bank holds crypto or relies on deposits from crypto firms.
- Exposure limits and capital requirements for banks address that, as we will see with the Basel Committee's standard.

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12 Example 4: a run on Brightmoor Lend

Brightmoor Lend: $300m deposits payable on demand, $20m equity, $60m kept liquid

Lent out	300 + 20 − 60	**$260m**
Withdrawals in a price crash	30% × 300	**$90m**
Liquid assets fall short by	90 − 60	**$30m**
Leverage: assets ÷ equity	320 ÷ 20	**16 times**
Loss that wipes out equity	20 ÷ 320	**6.25% of assets**

Prudential rules: capital, liquidity and limits on leverage

IN THE LESSON

- Brightmoor Lend takes three hundred million dollars of deposits that customers can withdraw on demand, has twenty million of equity, its owners' own money, and keeps sixty million liquid.
- The amount lent out is the three hundred of deposits plus the twenty of equity, minus the sixty kept liquid, which is two hundred and sixty million.
- Now crypto prices crash, and customers withdraw thirty per cent of deposits, ninety million dollars.
- Liquid assets fall short by ninety minus sixty, thirty million, so Brightmoor Lend cannot pay everyone from cash and must sell assets or freeze withdrawals.
- Worse, leverage, total assets divided by equity, is three hundred and twenty over twenty, sixteen times.
- A loss of only twenty over three hundred and twenty, six point two five per cent of assets, wipes out the equity.
- That is why lenders need prudential rules: capital, liquidity and limits on leverage.

13 Decentralised finance: who is accountable?

- DeFi: lending and trading run by self-executing code
- No obvious firm to license or supervise
- Front ends: the websites and apps users reach it through
- Governance: those who vote on changes to the code
- On and off ramps: where ordinary money enters and leaves

IN THE LESSON

- Decentralised finance, often shortened to De Fi, is lending and trading run by self executing code on a ledger.
- No firm is obviously in charge, so there is nobody to license or supervise in the usual way.
- Regulators therefore aim at the points where people reach it.
- Front ends are the websites and apps through which most users get in, and someone builds and runs them.
- Governance is the group that votes on changes to the code, often holders of a governance token, and they may be identifiable.
- On and off ramps are the places where ordinary money enters and leaves crypto, usually exchanges and payment firms, and those can be licensed and checked for money laundering.

14 Example 5: crypto stress reaches Kestrel Bank

Kestrel: deposits $50bn, of which $4bn from crypto firms; liquid assets $6bn

Crypto firms' share of deposits	4 ÷ 50	**8%**
Crypto firms pull 75%	75% × 4	**$3bn**
Share of liquid assets used	3 ÷ 6	**50%**

A crypto run becomes a bank funding problem

IN THE LESSON

- Kestrel Bank has fifty billion dollars of deposits, of which four billion come from crypto firms, and it holds six billion of liquid assets.
- First, the crypto firms' share of deposits is four divided by fifty, eight per cent.
- Now a crypto crash hits those firms, as in Brightmoor's case, and they withdraw seventy five per cent of their deposits to meet their own customers, three billion dollars.
- That uses three divided by six, half of Kestrel's liquid assets, in one go.
- This is how links to banks carry crypto risk into the wider financial system, and why supervisors watch concentrated deposits from crypto firms.
- So a run that started in crypto has become a bank funding problem.

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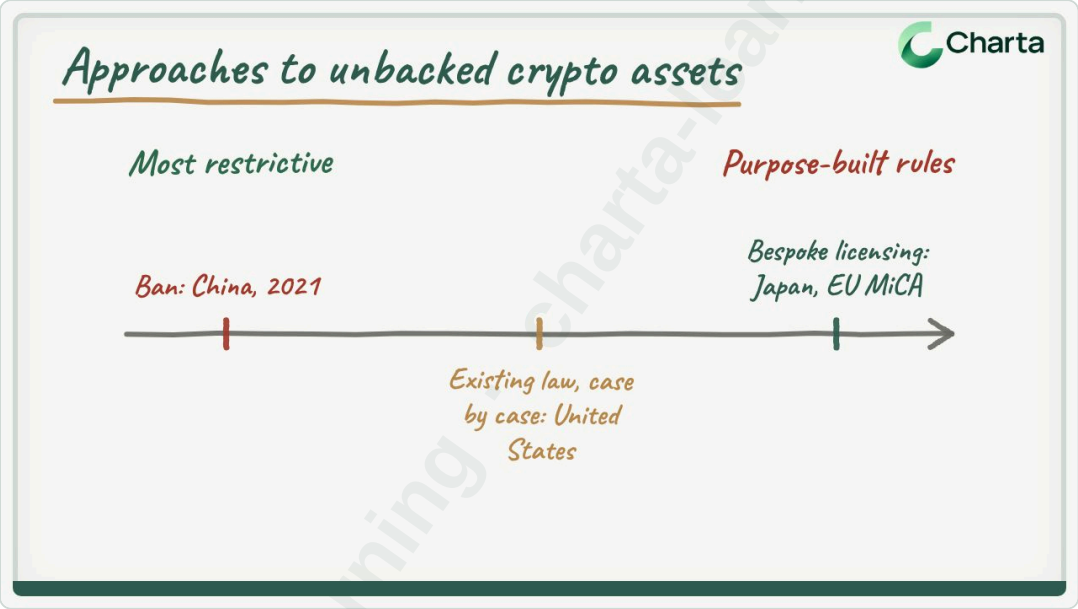
15 Matching risk, participant and measure

- Issuers mislead: disclosure and fraud rules
- Exchanges conflict, commingle: licensing, segregation
- Custodians lose keys: custody standards
- Lenders run: prudential rules. DeFi: access points
- Exam point: match each risk to its source and a measure

IN THE LESSON

- Here is the second part in one place.
- Issuers can mislead buyers, so the answer is disclosure and fraud rules.
- Exchanges create conflicts and commingle client assets, so the answer is licensing, separation of functions and segregation.
- Custodians can lose keys, so they need custody standards.
- Lenders can suffer runs and carry leverage, so they need prudential rules, and decentralised finance is reached through its access points.
- And here is the exam point.
- Match each risk to the participant that creates it, and to a measure aimed at that risk.
- A measure that misses the source, such as a capital rule for a fraud problem, does little.

16 Approaches to unbacked crypto assets



IN THE LESSON

- Now the third part: how do countries regulate unbacked crypto assets?
- Their approaches lie along a line, from the most restrictive at the left to purpose built rules at the right.
- At the far left is a ban.
- Some countries prohibit the activity, as China did in twenty twenty one.
- In the middle is applying existing law case by case.
- The United States largely does this, asking whether a given asset or activity falls under its securities law or its commodities law.
- At the right are bespoke licensing regimes, built for crypto.
- Japan requires crypto exchanges to register, and the European Union has its Markets in Crypto Assets Regulation, known as MiCA.

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17 The approaches compared

- Ban: simple, but activity may move offshore or underground
- Existing law: securities and commodities rules, case by case
- Case by case: flexible, but uncertain for firms
- Bespoke: Japan registers exchanges; the EU has MiCA
- Bespoke: clear licences and duties, but slow to build

IN THE LESSON

- Each approach has a cost.
- A ban is simple to state, but activity can move offshore or underground, where the regulator sees even less.
- Applying existing law means fitting crypto into securities and commodities rules one case at a time.
- That is flexible, because no new law is needed, but it leaves firms uncertain which rules apply until a regulator or a court decides.
- A bespoke regime, such as Japan's registration of exchanges or the European Union's MiCA, gives clear licences and clear duties.
- Its cost is that it is slow to build, and it may lag behind a market that changes quickly.
- Veridia, like most countries, must choose among these, and may mix them.

18 The Basel Committee's standard for banks

- Basel Committee: prudential standard, December 2022
- Prudential: how much capital a bank must hold
- Classification conditions sort each asset into a group
- Group 1: treated like its traditional counterpart
- Group 2: much higher charges, unbacked crypto included

IN THE LESSON

- Banks are a special case, because a bank that loses heavily on crypto puts depositors and the wider system at risk.
- In December twenty twenty two, the Basel Committee, the body that sets global standards for bank supervision, issued a prudential standard for banks' crypto exposures.
- Prudential rules set how much capital a bank must hold, capital being the owners' money that absorbs losses.
- Under the standard, classification conditions sort each crypto asset into a group.
- Group one receives treatment equivalent to its traditional counterpart, the ordinary asset it resembles.
- Group two, which includes unbacked crypto assets, gets much higher charges.

19 The Basel groups

Group	What it covers	Treatment
1a	Tokenised traditional assets	As the asset it represents
1b	Stablecoins meeting the conditions	In line with reference assets
2a	Unbacked or failed, hedgeable	Market risk, limited netting
2b	All other Group 2	1250% risk weight

IN THE LESSON

- Here are the groups in more detail.
- Group one a covers tokenised traditional assets, such as a tokenised bond, and they are treated as the asset they represent.
- Group one b covers stablecoins that meet the classification conditions, for example on the quality of their reserves and their redemption, and they are treated in line with their reference assets.
- Group two a covers unbacked crypto assets and failing stablecoins that meet extra criteria for hedging, such as having liquid, traded markets.
- They get a modified market risk treatment that allows limited netting of positions.
- Group two b is all other group two exposures.
- It carries a risk weight of one thousand two hundred and fifty per cent.
- That last figure needs a closer look.

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20 The Group 2b capital charge

Capital = exposure × 1250% × 8%
1250% × 8% = 100%, so capital = exposure

Exposure	Group 2b crypto held
Risk weight	Group 2b weight: 1250%
Minimum ratio	Minimum capital ratio: 8%
Capital	Equals the exposure

IN THE LESSON

- A risk weight scales an exposure into risk weighted assets, and the bank must hold capital of at least the minimum ratio, eight per cent, of those assets.
- So the capital is the exposure, times one thousand two hundred and fifty per cent, times eight per cent.
- Now multiply the two percentages.
- Twelve point five times zero point zero eight is exactly one, or one hundred per cent.
- So the capital charge equals the exposure.
- The exposure is what the bank holds in group two b crypto, in dollars.
- The risk weight is the group two b weight.
- The minimum ratio is the eight per cent capital ratio.
- And the capital comes out equal to the exposure, a dollar of capital for every dollar held.

21 Example 6: Kestrel's Bitcoin

Kestrel holds $30m of Bitcoin, a Group 2b exposure. Minimum capital ratio 8%

Risk-weighted assets	30 × 1250%	**$375m**
Capital required	375 × 8%	**$30m**
Shortcut	1250% × 8% = 100%	**= the exposure**

IN THE LESSON

- Kestrel Bank holds thirty million dollars of Bitcoin, which falls in group two b, and its minimum capital ratio is eight per cent.
- First, the risk weighted assets are thirty times one thousand two hundred and fifty per cent, three hundred and seventy five million dollars.
- Then the capital required is three hundred and seventy five times eight per cent, thirty million dollars.
- The shortcut gives the same answer at once.
- One thousand two hundred and fifty per cent times eight per cent is one hundred per cent, so the capital equals the exposure.
- In effect, Kestrel must fund its whole Bitcoin holding with its own capital, so that it could lose every dollar without touching depositors' money.

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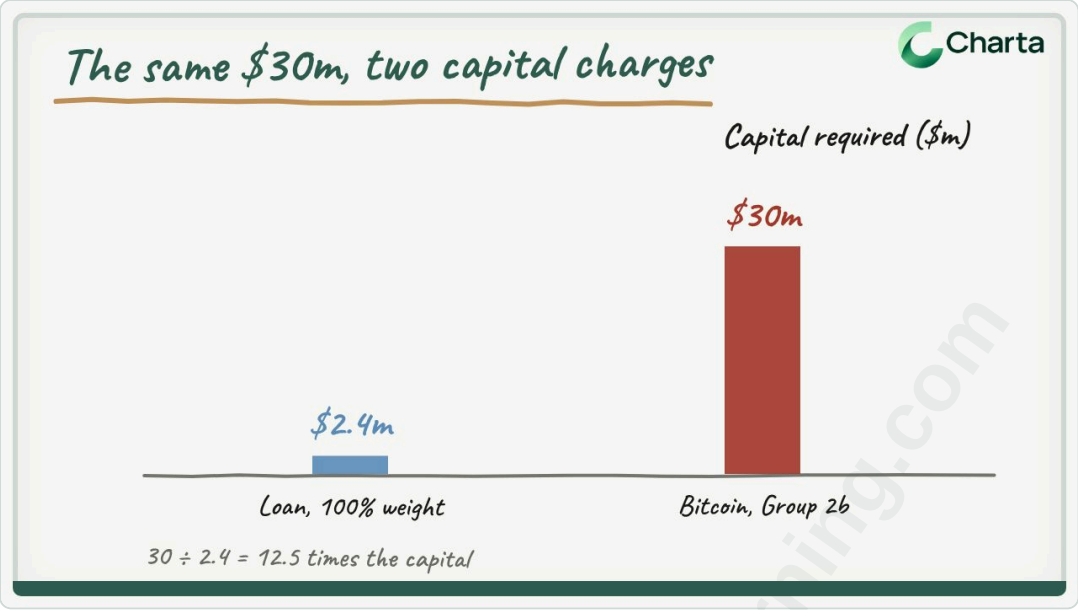
22 The same $30m, two capital charges



IN THE LESSON

- Here is how punitive that is.
- The heights are the capital each holding needs, from zero.
- The first bar is a thirty million dollar loan to a company with a risk weight of one hundred per cent.
- Its capital is thirty times one hundred per cent times eight per cent, two point four million dollars.
- The second bar is Kestrel's thirty million of Bitcoin in group two b, which needs thirty million.
- That is the Basel Committee's intent: banks may hold unbacked crypto, but only if their owners bear every dollar of the risk.
- So thirty divided by two point four is twelve point five: the Bitcoin needs twelve and a half times the capital of the same amount lent to a company.

23 Example 7: two classic mistakes

Same $30m of Bitcoin. Two common wrong answers, and the right one

Wrong: only the 8%	30 × 8%	**$2.4m**
Wrong: stop at the risk weight	30 × 1250%	**$375m**
Right: weight, then ratio	30 × 1250% × 8%	**$30m**

$375m is risk-weighted assets, not capital

IN THE LESSON

- Same thirty million dollars of Bitcoin.
- There are two common wrong answers.
- The first applies only the eight per cent, as if the asset had an ordinary weight of one hundred per cent.
- That gives thirty times eight per cent, two point four million, far too little.
- The second stops at the risk weight: thirty times one thousand two hundred and fifty per cent, three hundred and seventy five million.
- The right answer applies the weight, then the ratio: thirty times one thousand two hundred and fifty per cent times eight per cent, thirty million, equal to the exposure.
- So remember, three hundred and seventy five million is risk weighted assets, not capital; it is twelve and a half times the holding itself.

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24 Example 8: the Group 2 exposure limit

Kestrel's Tier 1 capital is $2,000m; its Group 2 crypto exposure is $30m

Exposure ÷ Tier 1	30 ÷ 2,000	**1.5%**
Ceiling: within 2%	2% × 2,000	**$40m**
Generally below 1%	1% × 2,000	**$20m**
Cut to reach 1%	30 − 20	**$10m**

IN THE LESSON

- Kestrel's tier one capital, the highest quality capital and mainly shareholders' equity, is two thousand million dollars, and its group two crypto exposure is thirty million.
- The standard limits group two holdings against tier one capital.
- First, thirty divided by two thousand is one point five per cent of tier one.
- The standard says group two exposures should stay within two per cent of tier one, which here is forty million, so Kestrel is inside that ceiling.
- But they should generally be below one per cent, which is twenty million, and Kestrel is above that.
- To come down to one per cent, Kestrel would cut its holding by thirty minus twenty, ten million dollars.

25 The exam point on approaches and Basel

- Ban, existing law case by case, or bespoke licensing
- Basel Group 1: like its traditional counterpart
- Group 2b: 1250% × 8% = 100%, capital = exposure
- Group 2: within 2% of Tier 1, generally below 1%
- Exam point: Group 2 is deliberately punitive

IN THE LESSON

- Here is the third part in one place.
- Countries ban crypto activity, apply existing law case by case, or build bespoke licensing regimes.
- For banks, the Basel Committee's standard treats group one assets like their traditional counterparts.
- Group two b carries a weight of one thousand two hundred and fifty per cent, and with the eight per cent ratio that is one hundred per cent, so the capital equals the exposure.
- Group two exposures should stay within two per cent of tier one capital, and generally below one per cent.
- And here is the exam point.
- Group two is deliberately punitive: the standard does not forbid banks to hold unbacked crypto, but it makes doing so expensive.

26 The Bali Fintech Agenda

- Issued by the IMF and the World Bank, October 2018
- Twelve elements to guide countries on fintech
- High level: not binding rules, and not a ban
- Used as a design framework for crypto rules

IN THE LESSON

- The last part is about designing rules.
- The Bali Fintech Agenda was issued by the I M F and the World Bank in October twenty eighteen.
- It sets out twelve elements to guide countries as fintech, meaning new technology in financial services, changes their financial systems.
- It is high level.
- It does not lay down binding rules, and it is not a ban on anything.
- Instead, it lists the questions a country should work through.
- The I M F's work on regulating crypto uses it as a design framework, a checklist for what crypto regulation should achieve.
- So when Veridia designs its own crypto rules, the agenda tells it what to consider, not what to write.

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27 The elements a crypto regulator leans on

Element	What it asks	Crypto risk it answers
Monitor developments	Understand before acting	Regulating blind
Adapt regulation	Proportionate rules, supervision	Rules too heavy or too light
Financial integrity	AML and CFT rules	Money laundering
Modernise legal frameworks	Clear ownership, insolvency	Who owns coins in a failure
Monetary, financial stability	Protect the domestic system	Monetary substitution

IN THE LESSON

- Five elements matter most for crypto.
- Monitor developments closely, to understand the market before acting, rather than regulating blind.
- Adapt the regulatory framework and supervisory practices, in proportion to the risk, neither too heavy nor too light.
- Safeguard financial integrity through anti money laundering and counter terrorist financing rules, often shortened to A M L and C F T, which answer the use of crypto for laundering.
- Modernise legal frameworks so that ownership and insolvency treatment are clear, which answers the question of who owns the coins when a platform fails.
- And ensure the stability of domestic monetary and financial systems, which answers monetary substitution, the risk that crypto displaces the local currency in payments and savings.

28 Cooperation, and the other elements

- International cooperation: crypto crosses borders
- Without it, firms pick the laxest place: regulatory arbitrage
- Other elements: competition and financial inclusion
- Also: data infrastructure and collective surveillance
- And: embrace fintech's promise, enable new technologies

IN THE LESSON

- A sixth element matters just as much.
- Encourage international cooperation, because crypto assets cross borders with a few clicks.
- Without cooperation, firms move to the country with the laxest rules and serve everyone else from there.
- That is regulatory arbitrage.
- The remaining elements are broader.
- They cover competition and financial inclusion, so that new firms can enter and more people can reach financial services.
- They cover data infrastructure, and collective surveillance of the international monetary and financial system.
- And the first two elements ask countries to embrace the promise of fintech and enable new technologies.
- Counting up: six so far, eight with competition and inclusion, ten with data and surveillance, and twelve with the first two.

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29 Example 9: Veridia applies the agenda

Veridia: crypto's share of retail payments rises from 4% to 12%; most platforms are offshore

First, size the market	survey platforms and flows	**Monitor**
Payments share	12% ÷ 4%	**3 times**
Risk: monetary substitution	crypto displaces the currency	**Stability**
Laundering via offshore sites	funds cross borders	**Integrity**
Platforms based abroad	regulatory arbitrage	**Cooperation**

IN THE LESSON

- Veridia's regulator sees crypto's share of retail payments rise from four per cent to twelve per cent, and most platforms are based offshore.
- It links each risk to an element.
- First, it sizes the market by surveying platforms and flows: that is monitoring.
- Next, the payments share is twelve divided by four, three times what it was.
- That points to monetary substitution, crypto displacing the Veridian currency, so the element is stability.
- Laundering through offshore sites, where funds cross borders unchecked, calls for financial integrity.
- And platforms based abroad invite regulatory arbitrage, so Veridia needs international cooperation.
- Notice that no element tells Veridia to ban crypto; the agenda guides the design and leaves the choice to Veridia.

30 Mistakes to avoid

- Accepting the issuer's label instead of the substance
- Counting a CBDC as a crypto asset
- Matching a risk to the wrong measure
- Stopping at the 1250% weight: apply the 8% too
- Treating the Bali Fintech Agenda as binding rules or a ban

IN THE LESSON

- Before the quiz, here are the mistakes to avoid across the whole topic.
- Do not accept the label an issuer chooses; classify a token by its substance.
- Do not count a central bank digital currency as a crypto asset, because it is an official liability.
- Do not match a risk to the wrong measure: custody standards answer key loss, prudential rules answer runs and leverage.
- Do not stop at the risk weight.
- For group two b, apply the eight per cent ratio too, and the capital equals the exposure.
- And do not treat the Bali Fintech Agenda as binding rules or as a ban.
- It is a high level framework for designing rules.

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31 Try three quick questions

1. A bank holds $50m of Group 2b crypto. Capital required?
   Answer: $50m: 50 × 1250% × 8%, equal to the exposure.
2. A 'utility' token's holders share the issuer's profits. Class?
   Answer: Security or investment token: substance beats the label.
3. Which Bali Fintech Agenda element answers money laundering?
   Answer: Safeguard financial integrity: AML and CFT rules.

IN THE LESSON

- Try three quick questions, then listen to the answers.
- Question one.
- A bank holds fifty million dollars of group two b crypto.
- What capital must it hold?
- Fifty times one thousand two hundred and fifty per cent times eight per cent is fifty million dollars, equal to the exposure.
- Question two.
- A token is called a utility token, but its holders share the issuer's profits.
- What class is it?
- A security or investment token, because substance beats the label.
- Question three.
- Which element of the Bali Fintech Agenda answers money laundering through crypto?
- Safeguarding financial integrity, through anti money laundering and counter terrorist financing rules.

Summary notes for the Charta whiteboard lesson. Figures are from the lesson's made-up examples.

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