

31 July 2023

International Organization of Securities Commissions (IOSCO)
Oquendo 12
28006 Madrid
Spain

Submitted via email at cryptoassetsconsultation@iosco.org

**Public Comment on IOSCO's Consultation Report on Policy Recommendations for
Crypto and Digital Asset Markets**

Dear Madam or Sir,

The Cardano Foundation appreciates IOSCO's engagement with the digital asset and distributed ledger technology community, and welcomes the opportunity to provide inputs on the Consultation Report on Policy Recommendations for Crypto and Digital Asset Markets.

The Cardano Foundation is the independent, Swiss-based non-profit organisation responsible for stewarding the advancement of the public, permissionless blockchain platform Cardano. Our mission is to anchor the Cardano blockchain as a digital infrastructure for current and future financial and social systems. One of our aims is to explain and provide context to decentralisation risks for various stakeholders, while giving the Cardano community the tools and support necessary to leverage the Cardano infrastructure to solve real-world problems.

Our responses to the consultation questionnaire are enclosed with this letter. We would gladly address any follow-up questions or contribute to further discussions with IOSCO or any of its associated institutions.



Yours sincerely,

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Preliminary remarks

The Cardano Foundation is convinced that an adequate, risk- and outcome-based legal and regulatory framework is beneficial to the realisation of the potential of digital assets and blockchain technology. Appropriate rules, built on suitable principles, help foster innovation while reducing potential risks and unwanted social costs.

We appreciate the outcome-driven and principle-based approach followed in the Policy Recommendations for Crypto and Digital Asset Markets (hereinafter the “**Recommendations**”), as formulated in the Consultation Report (hereinafter the “**Report**”).

Preliminarily, we would like to highlight three key items which we believe provide the necessary foundation for answering the specific questions raised by the consultation:

- **Necessity for appropriate differentiation:** Sound, innovation-friendly and risk-adequate regulatory policy should duly consider material differences between blockchain infrastructures and their applications. Even if the currently predominant use of blockchain technology revolves around financial or finance-related activities, it should not be reduced to that. Use cases and their potential risks should be assessed with due care to avoid overreaching or inadequate regulation, which would ultimately hamper growth and innovation. It is crucial to differentiate between activities that concern the blockchain networks as an infrastructure versus activities that build and implement use cases and business models on said infrastructure. While the latter includes many business models that are financial in nature, the former is use-case agnostic, similar e.g. to cloud server offering. We believe that regulation should duly reflect this important distinction, and therefore appreciate the Report’s activities-based approach which explicitly recognizes the breadth of possible activities performed by crypto-asset service providers (“CASPs”).

However, we are of the view that a more granular and function-focused categorization would further improve clarity for both regulatory and market stakeholders. As a concrete example: It seems unclear pursuant to the Report and Recommendations whether a service provider trading carbon credits using a blockchain system would be considered as a CASP. If so, the Recommendations would go beyond the current legal framework for carbon credit trading in many jurisdictions.

- **Outcome-driven, principle- and risk-based approach:** Blockchain networks and what the Report defines as crypto-assets may cover a myriad of possible functions. Comprehensively anticipating all functions and use cases, let alone the respective associated risks, does not seem feasible. The fast-paced innovation in the blockchain space tends to make overly prescriptive rules quickly outdated. For these reasons, the Cardano Foundation believes that an appropriate legal framework should follow a functional- and outcome-driven approach, based on flexible principles, that mitigate immediate risks in a proportionate manner. We welcome that the Report reflects this approach and recommends it to regulators.
- **Perception of opportunities and risks:** Blockchain technology and its associated tokens are often seen solely through the lens of the risks associated with financial or finance-related activities. We fully acknowledge that these risks exist and support the principle of “same activity, same risk, same outcome” as expressed in the Report. Nevertheless, as previously mentioned, it is important to recognize that the opportunities of blockchain as an infrastructure technology go well beyond financial use cases.

Answers to the Questions

The below responses follow the Report’s structure and numbering. To avoid repetition, cross-references between responses are made. Omitted questions are indicated.

Questions to Chapter 1 – Overarching Recommendation Addressed to All Regulators

Question 1: *Are there other activities and/or services in the crypto-asset markets which Recommendation 1 should cover? If so, please explain.*

We do not identify other activities and/or services at this stage. However, within the categories identified in Recommendation 1 (crypto-assets trading, other crypto-assets services, and the issuing, marketing and selling of crypto-assets), we highlight the importance of assessing each activity and their potential risks specifically, with the goal of avoiding overreaching or inadequate regulation that would ultimately hamper growth and innovation. In particular, it is crucial to distinguish between crypto-assets having unarguable financial purposes, which might realistically pose a risk for consumers and investors, and crypto-assets that do not have

any financial purpose or where such a purpose is clearly secondary to the crypto-asset's primary function (e.g., serving as an incentive mechanism for the security of a blockchain system). There are various promising use cases for the blockchain technology, some already deployed, and many still to be explored, including for instance in the area of supply chain, carbon credits, ESG, identity and privacy or Internet of Things (IoT). Depending on the case-specific use, crypto-assets' functions can vary greatly and can be far removed from what is presently deemed a financial application or a financial asset. Such use cases require an appropriate and proportionate regulatory approach that is most likely not based on financial market regulations.

Question 2: *Do respondents agree that regulators should take an outcomes-focused approach (which may include economic outcomes and structures) when they consider applying existing regulatory frameworks to, or adopting new frameworks for, crypto-asset markets?*

We strongly agree with that and welcome the approach of leveraging the existing framework and amending it where required to account for the unique features of crypto-assets and the risks they may involve, according to the principle "same activity, same risk, same regulatory outcome". An appropriate legal framework should be based on flexible principles which ensure risk mitigation in a proportionate manner. The regulatory approach should be communicated in a clear and consistent manner with the aim of ensuring legal certainty, particularly for market participants.

Questions to Chapter 2 – Recommendations on Governance and Disclosure of Conflicts

Question 3: *Does Chapter 2 adequately identify the potential conflicts of interest that may arise through a CASP's activities? What are other potential conflicts of interest which should be covered?*

We believe that the potential conflicts should be addressed on a principled basis.

Question 4: *Do respondents agree that conflicts of interest should be addressed, whether through mitigation, separation of activities in separate entities, or prohibition of conflicts? If not, please explain. Are there other ways to address conflicts of interest of CASPs that are not identified?*

We acknowledge that conflicts of interest can be a source of mistrust and deficiencies in the crypto industry, as they are in the traditional financial industry and other industries, and that addressing them would increase transparency and accountability vis-a-vis market participants. However, to ensure proportionality and adequately take into account the specific uses involving crypto-assets, self-regulatory initiatives should be preferred over direct legislative interventions, where this is conceivable under local rules. Concretely, CASPs should be encouraged to adhere to defined minimal disclosure, organisational and behavioural standards developed by self-regulatory organisations (SROs), which could be subject to governmental oversight.

Question 5: *Does Recommendation 3 sufficiently address the manner in which conflicts should be disclosed? If not, please explain.*

While we welcome initiatives aiming at increasing disclosure and transparency, new regulations should not translate into an excessive administrative burden that would not benefit market participants. Information subject to disclosure should be limited to what is reasonably required for an informed decision. Requiring disclosure of *all* the activities that CASPs operate at *all* times, including those that are not directly or indirectly materially relevant to the specific service offering, is excessive and will result in market participant confusion.

Questions to Chapter 3 – Recommendations on Order Handling and Trade Disclosures (Trading Intermediaries vs Market Operators)

Question 6: *What effect would Recommendations 4 and 5 have on CASPs operating as trading intermediaries? Are there other alternatives that would address the issue of assuring that market participants and clients are treated fairly?*

No comments at this stage.

Question 7: *Do respondents believe that CASPs should be able to engage in both roles (i.e. as a market operator and trading intermediary) without limitation? If yes, please explain how the conflicts can be effectively mitigated.*

Like brokers in the traditional financial industry, CASPs should not in principle be prevented from acting both as market operators and as trading intermediaries. However, such activities should be disclosed and subject to local limitations (e.g. only operation of discretionary

markets) where the potential risks are similar to the one raised by the role of a traditional security brokers. Compliance with behavioural standards and the implementation of internal policies and procedures are adequate measures to mitigate conflicts of interest. Here too, self-regulatory initiatives should be preferred where possible over direct regulatory interventions.

Question 8: *Given many crypto-asset transactions occur “off-chain” how would respondents propose for CASPs to identify and disclose all pre- and post-trade “off-chain” transactions?*

Generally, the principles and restrictions applicable to on-chain transactions should extend to off-chain transactions. The respective volumes and internal rules should be disclosed. Naturally, this applies to CASPs only if they are involved in the relevant transaction categories.

Questions to Chapter 4 – Recommendations in Relation to Listing of Crypto-Assets and Certain Primary Market Activities

Question 9: *Will the proposed listing/delisting disclosures in Chapter 4 enable robust public disclosure about traded crypto-assets? Are there other mechanisms that respondents would suggest to assure sufficient public disclosure and avoid information asymmetry among market participants?*

New regulation requiring the disclosure of information about crypto-assets is welcomed but should consider the specificity of blockchain as an open and permissionless infrastructure. Accordingly, information about “ownership and control of the crypto asset”, “the issuer and its business” and “the issuer’s management team” may not always be relevant or obtainable for current and potential market participants. The Recommendations do not yet seem to give due consideration to such necessary differentiations.

Question 10: *Do respondents agree that there should be limitations, including prohibitions on CASPs listing and / or trading any crypto-assets in which they or their affiliates have a material interest? If not, please explain.*

Limitations can be justified in accordance with the principle “same activity, same risk, same outcome”. However, they should be narrowly tailored. A general prohibition for CASPs to trade any crypto-assets in which they might have a material interest seems excessive as such an interest may be unavoidable, e.g. for bootstrapping innovative projects. Disclosure

requirements as well as proportional limitations on trading should be sufficient to address the material market risks in such cases.

Questions to Chapter 5 – Recommendations to Address Abusive Behaviors

Question 11: *In addition to the types of offences identified in Chapter 5, are there*

c) other types of criminal or civil offences that should be specifically identified that are unique to crypto-asset markets, prevention of which would further limit market abuse behaviors and enhance integrity?

d) any novel offences, or behaviors, specific to crypto-assets that are not present in traditional financial markets?

We believe that the accountability of people making recommendations and predictions about crypto-assets, e.g. on social media or streaming platforms, should be increased. Arguably, such predictions and recommendations should qualify as investment advice. In practice they contribute significantly to the harm to retail market participants.

Question 12: *Do the market surveillance requirements adequately address the identified market abuse risks? What additional measures may be needed to supplement Recommendation 9 to address any risks specific to crypto-asset market activities? Please consider both on- and off-chain transactions.*

We generally welcome regulation addressing market abuse risks and increasing the general level of trust in crypto-assets. However, we would like to highlight the need for a proportionate approach that distinguishes between the different systems involving crypto-assets and the activities conducted on a blockchain.

Questions to Chapter 6 – Recommendation on Cross-Border Cooperation

Question 13: *Which measures, or combination of measures, would be the most effective in supporting cross-border cooperation amongst authorities? What other measures should be considered that can strengthen cross-border co-operation?*

No comments at this stage.

Questions to Chapter 7 – Recommendations on Custody of Client Monies and Assets

Question 14: *Do the Recommendations in Chapter 7 provide for adequate protection of customer crypto-assets held in custody by a CASP? If not, what other measures should be considered?*

We generally agree with the proposed approach and with the suggested strengthened disclosure around custody and the related arrangements. We emphasise the importance of taking into account the unique features and risks of crypto-assets, in particular in terms of operational and IT-security requirements differing from traditional custody activities.

Question 15:

(a) Should the Recommendations in Chapter 7 address the manner in which the customer crypto- assets should be held?

We believe that the Recommendations should focus, as they currently do, on a set of outcome-oriented minimal standards that CASPs should comply with. More detailed prescriptions can rapidly become outdated and hinder technological advancement and innovation.

(b) How should the Recommendations in Chapter 7 address, in the context of custody of customer crypto-assets, new technological and other developments regarding safeguarding of customer crypto-assets?

As stated in the previous answer, regulation should not hinder new technological developments. As long as innovation does not increase the generally accepted level of risk of loss of customers' crypto-assets, it should be welcomed. For this reason, the focus should remain on the desired regulatory outcome rather than on the choice of the means to achieve it.

(c) What safeguards should a CASP put in place to ensure that they maintain accurate books and records of clients' crypto-asset held in custody at all times, including information held both on and off-chain?

No comments at this stage.

(d) Should the Recommendations in Chapter 7 include a requirement for CASPs to have procedures in place for fair and reliable valuation of crypto-assets held in custody? If so, please explain why.

We believe that existing regulation, notably in the accounting space, already addresses this aspect, and where there are still gaps the relevant standard organisations are already working on closing them. Therefore, in our view, there is no need for additional recommendations on crypto-assets valuation procedures.

Question 16: *Should the Recommendations address particular safeguards that a CASP should put in place? If so, please provide examples.*

No comments at this stage.

Questions to Chapter 8 – Recommendation to Address Operational and Technological Risks

Question 17: *Are there additional or unique technology/cyber/operational risks related to crypto-assets and the use of DLT which CASPs should take into account? If so, please explain.*

Market participants using blockchain-based services more generally should be able to procure suitable information and data on the blockchain network in question, thus enabling informed decision-making. In our experience, one of the key challenges in this regard is the availability of qualitative and reliable data. While data is generally available on-chain, reliable access and aggregation of the data poses a challenge. A certain expectation gap seems to exist between many regulators, trusted verifiers such as auditors, and the technical community. Current data feeds and explorers for information on blockchains often focus on technical information offering little to no context. This makes it difficult for non-technical users to understand and ultimately trust the data. We therefore see great potential in fostering access to reliable and more easily understood blockchain data. Regulators could support the building of such solutions by making the quality of data tooling a factor in regulatory assessments for crypto-asset use by market participants. Finally, education focusing on the functioning of the blockchain networks and the related risks should be encouraged.

Question 18: *Are there particular ways that CASPs should evaluate these risks and communicate these risks to retail investors? If so, please explain.*

No comments at this stage.

Questions to Chapter 9 – Recommendation for Retail Distribution

Question 19: *What other point of sale / distribution safeguards should be adopted when services are offered to retail investors?*

Recommendation 18 does not sufficiently distinguish between the numerous categories of CASPs and does not take into consideration that not every use case involving crypto-assets relates to the financial industry. We believe a more granular approach is required to achieve suitable proportionality.

Question 20: *Should regulators take steps to restrict advertisements and endorsements promoting crypto-assets? If so, what limitations should be considered?*

Reference is made to our Answer to Question 11.

Questions to Chapter – Box Text on Stablecoins Additional issues

Question 21: *Are there additional features of stablecoins which should be considered under Chapter 10? If so, please explain.*

We believe that, barring the unlikely introduction of CBDCs on any given blockchain network, stablecoins will continue to play an important role in bridging the gap between the blockchain ecosystems and the traditional financial industry. To fulfil their promises, stablecoins have to be implemented on principles of good governance, professional conduct, prudent risk management, and appropriate solvency. Overall, and subject to the comments made under the previous questions, we are of the view that the Recommendations duly reflect these notions.

Question 22: *IOSCO also welcomes views from stakeholders on potential additional issues for consideration.*

Generally, we believe that the specifics of stablecoins should be given due consideration, as their structure and functions vary widely. To preserve future innovation, the applicable regime

should remain open to regulating such tokens differently than unbacked crypto-assets, subject to adequate proof by project backers.

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