

September 20, 2023

Office of the Superintendent of Financial Institutions
255 Albert Street, 12th Floor
Ottawa, Ontario K1A 0H2

VIA EMAIL: Consultations@osfi-bsif.gc.ca

RE: Proposed Guidelines on the regulatory capital and liquidity treatment of crypto asset exposures (Banking and Insurance) “the Proposed Guidelines”

The Canadian Web3 Council (CW3) appreciates the opportunity to comment on the Office of the Superintendent of Financial Institutions’ (OSFI) consultation on the Proposed Guidelines.

The CW3 is a non-profit trade association founded by industry leaders to work constructively with policymakers and establish Canada as a leader in Web3 technology. The CW3 represents organizations that have made a critical impact on the development of Web3 technologies across the globe, and who are committed to responsibly building and innovating in Canada. Our membership is diverse, ranging from financial products and crypto trading platforms to investors, and open-source blockchain projects.

Executive Summary

We support OSFI’s goal¹ to provide clarity on the prudential treatment of crypto asset exposures to those banks and insurance companies supervised by OSFI (collectively “FIs”). Our submission focuses primarily on identifying those aspects of the Proposed Guideline relating to classification and prudential risk measurement, and the potential impact to participants in the crypto asset ecosystem. From an industry perspective, we find the guidelines in its present form to be overly conservative. We believe the prudential treatment should reflect the risk profile of the types of crypto assets, and the structures underlying a stablecoin arrangement. Restrictive prudential policies will especially inhibit the growth of regulated custodial services within Canada and benefit foreign custodians. Any prudential requirement that makes it even more difficult and costly to obtain the required insurance coverage to operate in Canada will further affect the growth of the crypto asset sector.

To support OSFI’s goals to promote clarity to stakeholders, we provide comments to simplify the classification method used for prudential risk measurement. As such, we provide our suggested

¹ Statement by Peter Routledge, Superintendent of Financial Institutions. The guidelines reflect recent changes to the recommendations of the Basel Committee on Banking Supervision for new banking standards for crypto asset exposures (Dec 2022)

drafting notes and other comments for your consideration in the attached Appendix 1 (the comments apply to both the Banking and Insurance Guidelines).

We set out below our key issues and recommendations, which are discussed in further detail under “Detailed Submission”.

Issues

We are pleased to see the creation of a Group 1b) category for stablecoins that meet certain conditions. However, the description for a Group 1b) classification is too broad and may lead FIs to bypass classification with potentially negative downstream effect on the crypto asset industry.

We have concerns that the Proposed Guidelines contain classifications that do not reflect the risk profiles of certain other crypto asset types. These concerns extend to the punitive impact of imposing a subjective blanket 2.5% infrastructure risk add-on for Group 1 crypto assets (for both banks and insurance companies), an Exposure Limit for Group 2b crypto assets, and a simplified method that requires a full deduction of crypto exposure from CET1 without corresponding relief from Operational RWA² (for banks). We believe the impact of the proposal on bank Operational RWA could disincentivize banks from offering crypto asset products and services, and from using technology solutions that address the frictions that exist in today’s financial and capital markets. The impact will be amplified for banks who provide crypto asset services such as safekeeping and administration of crypto assets on a segregated basis.

Aside from the additional capital needed to use/hold/custody crypto assets, we have two other concerns: i) With a blanket 2.5% Operational RWA (for banks), how will this affect capital reallocation particularly when a bank experiences an operational loss? Will the response be to cut credit or shrink assets? ii) The exposure limit, if correctly interpreted using the broad definition of exposure found in paragraph 5, could limit the capacity of banks to provide digital asset custodial services for clients. This constraint will have a significant downstream effect on crypto asset trading platforms who are required by the Canadian Securities Administrators (CSA) to hold clients’ crypto assets in segregated custodial accounts. The barriers to entry are already high, and any proposal that further limits the capacity of FIs to provide digital asset custody services in Canada can have the consequence of lessening investor protection.

The OSFI Guidelines are one of several frameworks currently in development and that have varying dependencies. We have concerns that the development of regulatory frameworks in isolation can create diverging and conflicting policies resulting in additional regulatory burden on market participants.

² The Operational RWA is one of three risk-weighted assets used to calculate a bank’s tier 1 capital ratio.

Recommendations

1. To simplify the classification process and to provide stakeholders with greater clarity for implementation, we provide comments and drafting notes for the Classification Conditions, found in Annex 1 of each of the Proposed Guidelines (e.g. the redemption risk test). The suggested edits could also promote more consistency in classifying crypto assets for prudential treatment³, and to improve comparability across FIs for supervisory monitoring. Moreover, whether a wallet provider is regulated or not is irrelevant to classification as currently required under Annex 1, and we recommend its removal as a condition. However the assessment of wallet providers could be relevant for credit risk valuation under Annex 2. [See Appendix 1]
2. FIs may lean towards the Simplified Method prescribed in Paragraph 9 of the Proposed Guideline in order to bypass the classification method. However, expediency comes at the cost of a higher capital requirement. We ask OSFI to consider using a more nuanced description for stablecoins that captures the intent of the conditions for Group 1b) crypto assets which can alleviate some of the effort to classify crypto assets. [REF: Proposed Guidelines, paragraphs 10 i) b) and 21⁴]. We propose the following description for a **Group 1b) crypto asset**:

“A digital payment token that is redeemable at, or exchangeable for, its peg value and fully reserved 1:1 with high quality and liquid referenced asset(s), and in the same currency as the referenced asset(s)”, and where the digital payment token issuer is a regulated entity.

To adopt a more forward looking approach, taxonomy can also be developed for domestically “significant crypto assets and arrangements” or “global stablecoin arrangements” (“GSC”) that require recognition as Financial Market Infrastructures. [See General Section - See paragraphs 1-3]

3. We urge policymakers to create a bespoke regulatory framework for stablecoins under the purview of a federal agency given the function of stablecoins in payments and

³ The classification of crypto assets should be the same for all FIs (bank and insurance).

⁴[Para 10 i) b) states: Group 1b): Crypto assets with effective stabilization mechanisms that meet the classification conditions. This includes stablecoins, which are crypto assets that aim to maintain a stable value relative to a specified asset, or a pool or basket of assets, as measured by the criteria in this document.

[Para 21 (banking guideline) states: Group 1b) crypto assets are crypto assets that are redeemable for a predefined amount of a referenced asset(s), or cash equal to the value of the reference asset(s). In addition, the crypto asset arrangement should include a sufficient pool of reserve assets [defined in Annex 1 as a pool of traditional assets] to ensure the redemption claims of crypto asset holders can be met. The Guideline allows for the crypto asset arrangement to be structured in a variety of different ways. The value of the reference asset(s) to which one unit of the crypto asset is designed to be redeemable is referred to as the “peg value”. [The Proposed Guideline, Annex 1, Para 1.4]. Similar wording is found under Para 20 (insurance guideline).

settlements. [See Areas of Continuous Review, paragraphs 17] We see stablecoins primarily as a payment technology. As such, regulating stablecoins under the Retail Payments Activities Act or similar framework is a more natural fit than under securities law or under a prudential regulator such as OSFI (particularly for non-bank issuers).

Without a Canadian regulatory framework for stablecoins, non-bank Canadian stablecoin issuers would not be able to receive “regulated” status⁵ on their own. Under the Proposed Guidelines, stablecoin issuers are required to be regulated and subject to prudential requirements. We believe non-bank issuers may also be disadvantaged compared to their global counterparts operating in jurisdictions with licensing regimes such as MiCA in the European Union and the Payment Services Act Singapore. We urge policymakers to make this a priority.

4. The Proposed Guidelines allow for a simplified approach for capital and liquidity treatment for crypto assets but no relief for operational risk. [REF: Proposed Guideline, paragraphs 8, 9, 71] We believe the Simplified Method, as currently constructed, to be punitive given that banks would still have to account for crypto asset exposures under operational risk RWA while simultaneously taking a full deduction against CET1. We recommend a carveout for Operational Risk RWA under the Simplified Method. We provide additional comments for your consideration. [See Impact and Implementation Considerations, paragraph 13]
5. We have concerns that a mandatory add-on of 2.5% for infrastructure risk for Group 1 crypto assets could have idiosyncratic outcomes with the potential to negatively impact crypto asset service providers (particularly bank custodians, see paragraph 7 below). An automatic fixed 2.5% add-on for infrastructure risk for Group 1 Crypto Assets is also inconsistent with Basel’s recommendation⁶ [REF: Proposed Guideline, P32]. Arguably the blanket add-on is both subjective and duplicative, and it takes the focus away from interoperability risk discussed below. We recommend reverting to the Basel approach that empowers supervisors to levy this “charge” based on any observed weakness in the infrastructure of Group 1 crypto assets (for both banks and insurance companies). [See Capital Requirements for Crypto Asset Categories, paragraphs 9-11].

⁵ To qualify for a more favourable treatment under Group 1b), OSFI’s Proposed Guideline “stablecoin issuers must be regulated and supervised and subject to prudential capital and liquidity requirements”. We believe a properly structured stablecoin arrangement can achieve the same regulatory objective without the need for an issuer to be subject to prudential requirements.

⁶ According to BIS rationale, The technological infrastructure that underlies all crypto assets, such as the DLT, is still relatively new and may pose various additional risks even in cases where the crypto assets comply with the Group 1 classification conditions. Therefore, authorities must have the power to apply an add-on to the capital requirement for exposures to Group 1 crypto assets. [SCO60.53] The add-on for infrastructure risk described above will initially be set as zero but will be increased by authorities based on any observed weakness in the infrastructure used by Group 1 crypto assets.

We believe the Digital Innovation Sandbox can be used to study distributed ledger technology (DLT) and blockchain infrastructure with the specific goal of identifying those crypto assets that meet the Group 1b) requirements. This would also permit OSFI to observe interoperability risk and determine whether an add-on is warranted.

6. We submit that **Group 1a) crypto assets** should also include “a digital payment token that is redeemable at its peg value, and fully reserved 1:1 **with traditional cash or cash equivalents** and in the same currency as the fiat equivalent, and where the issuer of the digital payment token is a regulated entity”.

In addition, certain **Group 2b) crypto assets** can be further subdivided for prudential treatment as market evidence shows that not all crypto assets are equal (as determined by market capitalization and liquidity). For example, we submit that Bitcoin (“BTC”) and Ether (“ETH”) exhibit qualities of High Quality Liquid Assets. We support the initiative by OSFI and BIS to study and consider such metrics. [See Categories of Crypto Assets, paragraphs 5-8]

7. Custody is central to investor protection and yet, the guideline as presently constructed is punitive towards banks providing custodial services. We have concerns that the mandatory 2.5% infrastructure risk add-on and the Group 2 exposure limit (as currently interpreted) will restrict the ability of banks to provide digital asset custodial services⁷. We seek clarification on how the infrastructure risk add-on and the Group 2 exposure limit will apply to crypto assets under custody (“CAUC”) given the broad definition of “exposure” in paragraph 5 of the Proposed Guideline. Canadian crypto asset platforms are required by the CSA to use a qualified custodian to hold clients’ crypto assets in segregated custodial accounts. We submit any exposure limit using tier 1 capital will restrict the capacity of crypto asset custody services in Canada and force Canadian platforms to use foreign custodians. This could introduce additional risks to Canadian consumers, investors and service providers.

The concerns expressed in paragraphs 4 and 5 above regarding the infrastructure risk add-on (and also as it relates to the Simplified Approach) apply equally to the CAUC balances. We believe that a mandatory levy will make it more costly for Canadian custodians to invest in and upgrade their existing infrastructure to meet the needs of a modern capital and financial markets.

Given the downstream impact to the crypto asset ecosystem in Canada, we recommend OSFI reconsider applying an Operational RWA only where warranted, providing an explicit carve out for off-balance sheet exposure of CAUC from the exposure limit, and providing relief from Operational RWA for any bank custodian that has deducted all its crypto asset

⁷ We have yet to see any proposals regarding capital requirements for non-bank custodians supervised by OSFI.

exposures from CET1 under the Simplified Approach. [See Implementation Considerations paragraph 15].

8. We understand that the BIS/OSFI plan to study blockchain and stablecoins with the possible result of adding a basis risk test and other metrics. We ask that BIS/OSFI publish the results along with any recommendations for stakeholder input, if the BIS recommends the inclusion of such a test as a condition for Group 1b)) crypto assets. [See Areas of Continuous Review paragraph 21].
9. We urge policymakers and Heads of Agencies⁸ to collaborate and to apply a holistic and principled approach to setting a regulatory framework for crypto assets. We understand the desire to bring participants into the regulatory perimeter. However, we believe more coordination amongst federal and provincial agencies (in particular) can help to reduce the regulatory burden on regulators and market participants (especially small, medium enterprises⁹).

We encourage policymakers, regulators and others to adopt a forward-looking, strategic approach to establish a clear and bespoke regulatory framework for crypto assets. We emphasize the importance for Canada to **adopt a global view** and taxonomy when tailoring a regulatory framework for crypto assets given the global reach of crypto assets. Furthermore, we encourage the Heads of Regulatory Agencies¹⁰ to resist path dependency, and to take a holistic, principles-based approach when setting policy for prudential regulation, consumer and/or investor protection. Alignment on “purpose” can allow Canadian innovators with global operations to be more competitive and run more efficient and compliant global operations.

⁸ The Heads of Regulatory Agencies Committee comprises members who are heads or senior representatives of key federal and provincial agencies with regulatory and prudential responsibility for different elements of the financial system. It includes the Bank of Canada, the provincial securities regulators from each of Ontario, Quebec, Alberta and B.C., OSFI and the Department of Finance Canada

⁹ We submit that legal complexity creates a burden for SMEs and will have a negative impact on productivity similar to the paperwork burden. See *The Impact of Regulatory Compliance Costs on Business Performance*, a study by Innovation, Science and Economic Development Canada on Paperwork Burden Reduction. [Link Here](#)

¹⁰ The Heads of Regulatory Agencies Committee comprises members who are heads or senior representatives of key federal and provincial agencies with regulatory and prudential responsibility for different elements of the financial system. It includes the Bank of Canada, the provincial securities regulators from each of Ontario, Quebec, Alberta and B.C., OSFI and the Department of Finance Canada.

Detailed Submission

We understand the objectives of the Proposed Guideline are to provide clarity to stakeholders, to put measures in place that measure risk and for FIs to have sufficient capital available against those risks. Well capitalized FIs are important for the stability of Canada's financial system. Canada's banking sector is traditionally resilient as noted by achieving the highest possible grade for consistency with Basel's net funding ratio¹¹. From an industry perspective, access to financial services (particularly regulated custodial services and insurance coverage) remains a key concern as these are requirements to operate a compliant business.

Our submission focuses primarily on enhancing those aspects of the Proposed Guideline relating to risk classification and measurement and noting the potential impact to participants in the crypto asset ecosystem.

General

1. The scope of the Proposed Guideline covers only private digital assets dependent on cryptography and DLT and other similar technologies, whereas central bank digital currencies (CDBC) and other centrally administered traditional assets that use electronic registers and databases are beyond its scope. Even still, this casts a wide net of varying types of crypto assets that require classification, monitoring and risk assessment.

The drafting notes which accompany this submission in the attached Appendix 1 include a description for the type of stablecoin (a digital payment token) that meets the conditions contemplated by BIS/OSFI for Group 1b) classification¹². This description should be interpreted as an example that captures more precisely the type of crypto asset that is contemplated under the current proposal for Group 1b) classification rather than an endorsement of the conditions.

2. We believe there is value in establishing and promoting a common taxonomy that can be used across industries to classify the different types of crypto assets (and service providers). We encourage Canadian Heads of Regulatory Agencies and their global counterparts to work with industry towards the aspirational goal of harmonisation starting with developing an industry-wide taxonomy for crypto assets. This effort can lead to a

¹¹ BIS Financial Assessment Program Basel (Canada). Core Principles of Effective Banking Supervision - Detailed Assessment of Observance [Link Here](#)

¹² The current proposed classification reads: "Crypto assets that aim to maintain a stable value relative to a specified asset, or a pool or basket of assets, as measured by the criteria in this document." FIs may choose to bypass classification of Group 1b) crypto assets. A more nuanced description provides clarity. This can result in a more consistent treatment for crypto assets that have the appropriate risk profile. This is especially important since capital allocations affect business decisions.

simpler and more consistent classification process and prudential treatment of crypto assets in the banking sector globally.

We believe the lack of a common taxonomy (either domestically or globally) for the different types of crypto assets can lead FIs to bypass classification and regulators to adopt a one size fits all approach to setting prudential limits. For example, OSFI uses “wallet provider” in the context of an intermediary (e.g. a crypto trading platform) whereas the CSA uses the term to refer to providers of wallet technology. A taxonomy that provides clear and consistent descriptions that more accurately reflect the nuances of the various types of crypto assets and service providers can result in a simpler classification framework, better risk measurement and capital allocation decisions, and enhance comparability amongst FIs.

3. To be more forward-looking, we submit that a common taxonomy should include a separate category for “domestically significant digital payment tokens” and/or “global stablecoin arrangements” (“GSC”). This would allow OSFI’s prudential framework to set specific criteria for, and to tailor the capital requirements for the recognition of such arrangements as Financial Market Infrastructure¹³. This will be particularly important as more and more G20 jurisdictions introduce stablecoins. [See section Categories of Crypto Assets, paragraphs 8].
4. We note OSFI’s digital roadmap provides for a digital innovation sandbox¹⁴. We are supportive of a sandbox initiative that is transparent, and that can be evaluated against specific project objectives using measurable criteria, and is results oriented.

Categories of Crypto Assets

5. We are pleased to see the expansion of Group 1 to include stablecoins that meet certain conditions. However, we are concerned that OSFI may have taken a very narrow view of certain other crypto assets in a manner that is inconsistent with other regulatory bodies, including securities regulators who treat these crypto assets as commodities, not securities.

The highest risk classification is given to Group 2b crypto assets which includes all tokenized traditional assets, stablecoins, unbacked crypto-assets that do not meet the

¹³ For example, the Singapore Monetary Authorities introduced legislation to bring “systemic” stablecoin arrangements (i.e., stablecoins which are deemed significant enough such that disruptions to the arrangements could disrupt or affect public confidence in Singapore’s financial system) within the scope of the Payment Services Act’s designated payment system framework. [Link Here to August 24, 2023 article by Latham & Watkins LLP](#)

¹⁴ Considerable research has been conducted on the success and challenges of regulatory sandboxes to support fintech innovation including the World [Bank](#), the [BIS](#) and [CGAP](#). Sandboxes can be useful tools if properly designed, implemented and monitored.

conditions of the other groups or pass the hedging recognition criteria. This has the effect of including “unbacked” crypto assets such as Bitcoin (“BTC”) and Ether (“ETH”) as these assets do not have an underlying traditional asset from which to derive a risk profile. However, the value of these crypto assets comes from the value of the protocol they carry - evidenced by its usage or potential usage. It is our belief certain unbacked crypto assets such as BTC and ETH meet the conditions of a liquid market and should be treated differently than other types of unbacked crypto assets.¹⁵ It has been acknowledged by the Ontario Securities Commission (OSC)¹⁶ and other regulatory organizations¹⁷ that certain crypto assets, such as Bitcoin and Ether, have real volume and real trading on registered exchanges.

In addition, we encourage OSFI to review the Proposed Guideline if unlevel playing fields arise following other jurisdictions' implementation of the Basel standard and as other regulatory bodies finalize their regulation of crypto assets. For example, given the lack of a universally agreed legal or regulatory definition of stablecoin¹⁸ different jurisdictions may include certain crypto assets that are excluded from the OSFI guideline.

6. We also note that the classification conditions for stablecoins require assets with minimal market and credit risk and that are capable of being liquidated quickly with minimal adverse price effect (high quality liquid assets (HQLA) of the Liquidity Adequacy Requirements)¹⁹. The risk profile of crypto assets vary by asset and by market. The IMF has noted that crypto prices are moving more in sync with stocks.²⁰ The fundamental characteristics of HQLA²¹ could apply to such Group 2b crypto assets as BTC and ETH. As

¹⁵ Finance UK set out thoughts on regulating unbacked crypto assets in their December 2022 paper [the future regulation of unbacked Cryptoassets in the UK](#)

¹⁶ The OSC found in their reasons and decisions in the Matter of 3iQ Corp. and the Bitcoin Fund# that not only are there regulated trading platforms and there can be reliable price discovery, there is also an OTC market that facilitates larger transactions. See [Matter of 3iQ and the Bitcoin Fund](#)

¹⁷ Other regulatory organizations have also commented on the price discovery including a recent US court decision with [Greyscale](#). The CSA also commented on this in their recent staff notice [CSA Staff Notice 81-336](#).

¹⁸ The [FSB](#) highlights this lack of universally agreed upon definition

¹⁹ See OSFI [Liquidity Adequacy Requirements](#)

²⁰ A number of studies and commentary about the movement of crypto prices in relation to the traditional financial markets. Like many alternative asset classes, there can be times where they are highly correlated and other times that they act more like one would expect from an alternative asset class. The IMF noted that crypto prices are moving more in sync with stocks, which raise different risks than if they are less correlated. [IMF link](#).

²¹ The [fundamental characteristics](#) of HQLA include: low risk, ease and certainty of valuation, low correlation with risky assets, and listed on a developed and recognised exchange. The market-related characteristics include active and sizable market, low volatility and flight to quality: historically, the market has shown tendencies to move into these types of assets in a systemic crisis.

this holds true, we believe that similar standards should be applied to crypto assets as they are to traditional financial instruments.

7. The regulatory environment for crypto assets is changing quickly and the prudential framework should also be forward looking. For example, IOSCO has recently closed its consultation on “Policy Recommendations for Crypto and Digital Asset Markets”²² with the aim to put final policy recommendations by the end of 2023. As the crypto asset market matures, both with growing interest by institutional investors and different offerings such as Bitcoin ETFs²³, and becomes more regulated there should be greater volume and price discovery which can change the risk characterizations of certain crypto assets.²⁴
8. We note that central bank digital currencies (“CBDC”) are not included in the scope of the Proposed Guideline. We ask that this be revisited as the risk profile of the CBDCs will differ from those currently in Group 1 and Group 2. This is of particular importance as 19 of the G20 countries are now in the advanced stage of CBDC development.²⁵

Capital Requirements for Crypto Asset Categories

The Proposed Guideline will be an important component of the Canadian prudential regulatory framework. A financial institution’s **risk appetite and risk capacity** can impact the range of products and services offered by Canadian financial institutions (“FIs”).

In general, we do not believe that **a blanket infrastructure add-on** is good policy regardless of the types of entities undertaking the infrastructure project (e.g., traditional FIs or non-bank Fintech companies). Given the significant investment required to upgrade current legacy systems to make them interoperable with blockchain rails, we believe this approach can disincentivize an FI from adopting technology solutions that reduce frictions that are present in today’s financial

²² For example IOSCO has recently closed its consultation on “Policy Recommendations for Crypto and Digital Asset Markets”# with the aim to put final policy recommendations by the end of 2023.. See IOSCO [Policy Recommendation for Crypto and Digital Asset Markets](#)

²³ The US moved closer to its first Bitcoin ETF as a result of [a recent court decision](#).

²⁴ The IMF set out the elements of effective policies for crypto assets. See IMF Policy Paper [See IMF February 2023 policy paper](#)

²⁵ [Link to CBDC Tracker](#) . In addition, 11 countries have fully launched a digital currency. China’s pilot, which currently reaches 260 million people, is being tested in over 200 scenarios, some of which include public transit, stimulus payments and e-commerce. The European Central Bank is on track to begin its pilot for the digital euro. Over 20 other countries will take steps towards piloting their CBDCs in 2023. Australia, Thailand and Russia intend to continue pilot testing. India and Brazil plan to launch in 2024.

markets²⁶. It also does not support the adoption of crypto asset products and services that have many benefits and use cases outside of finance²⁷.

Any prudential requirement that makes it **even more difficult** and costly for the crypto asset sector to obtain the required insurance coverage (e.g. Financial Institutions Bond, Directors and Officers insurance) to operate in Canada will further affect the growth of the crypto asset sector. Moreover, the impact of this outcome on good governance should not be underestimated.

9. We submit that applying an **automatic** fixed 2.5% add-on for infrastructure risk for Group 1 Crypto Assets is inconsistent with Basel’s recommendation for supervisors to have the discretion to add-on based on “observed weakness in the infrastructure” that underlies the stablecoin arrangement²⁸ [REF: Proposed Guideline, P32]. Furthermore, for banks leaning towards the Simplified Method, the requirement to take a full deduction for crypto exposure from CET1 without accompanying relief for operational risk is punitive. This impact will be felt by all banks who have crypto asset exposure, especially bank custodians, given the higher weighting for Operational RWA.
10. OSFI’s rationale for the add-on is to capture the “newness” of distributed ledger technology “DLT” and that “it may pose various additional risks even in cases where the crypto assets meet the classification conditions of Group 1”. We submit that a blanket add-on is subjective, duplicative and unnecessary given the following:
 - a. Infrastructure risk is operational in nature. FIs are already required to account for operational risk separately.
 - b. There are requirements to account for crypto assets under OSFI’s credit risk management framework (for banking book positions).²⁹
 - c. The add-on does not appear to recognize that stablecoin issuers (who meet the Group 1b) classification) are expected to i) be regulated, ii) be subject to prudential and liquidity requirements and iii) have appropriate governance and risk management frameworks in place (which includes operational risk assessment

²⁶ See *The Seven Defining Opportunities in “On-Chain” FX*, by Alex McDougal, President and CEO of StableCorp. “The age-old challenge with new technology lies with ensuring a conducive and consistent regulatory environment exists to enable mainstream adoption.

²⁷ See CW3 submission to federal budget consultation [Link Here](#)

²⁸ According to BIS rationale, The technological infrastructure that underlies all crypto assets, such as the DLT, is still relatively new and may pose various additional risks even in cases where the crypto assets comply with the Group 1 classification conditions. Therefore, authorities must have the power to apply an add-on to the capital requirement for exposures to Group 1 crypto assets. [SCO60.53] The add-on for infrastructure risk described above will initially be set as zero but will be increased by authorities based on any observed weakness in the infrastructure used by Group 1 crypto assets.

²⁹ See Annex 4 Bank Risk Management paragraphs 4.4

under Annex 1 Classification Condition 3). Moreover, regulators in some jurisdictions are seeking additional capital requirements for issuers of Global Stablecoin Arrangements³⁰. Under these circumstances, an add-on is duplicative and unnecessary in our view.

11. We recommend a more nuanced and focused approach to risk assessment. For example: a single stablecoin (e.g. USDC) can be deployed on multiple blockchain networks, and it is possible for each network to have a different infrastructure risk profile. A stablecoin's risk profile can also be influenced by its legal structure and stabilization mechanism. The add-on should only apply in cases where a risk is identified. There may also be interoperability risks between the stablecoin and an FI's existing technology infrastructure. Under such scenarios, the infrastructure add-on should only apply to the specific network(s) rather than to apply the 2.5% RWA to all USDC. We ask OSFI to recalibrate the requirement to reflect Basel's proposal and to apply the add-on **only where it is warranted**.
12. Liquidity Risk Requirements and High Quality Liquid Assets (HQLA). Conceptually, we believe that a "digital payment token that is redeemable at its peg value, and fully reserved 1:1 **with traditional cash or cash equivalents** and in the same currency as the fiat equivalent, and where the issuer of the digital payment token is a regulated entity" should receive similar capital treatment as Group 1a crypto assets.

[REF: Proposed Guideline (for banks) P73, P74, and P78] speak to the treatment of high-quality liquid assets (HQLA) and Tokenized Claims on a bank. The Proposed Guideline allows for Group 1a Crypto assets that are tokenized versions of HQLA (e.g. a tokenized deposit receipt) if both the underlying assets in their traditional form and the tokenized form of the assets satisfy the characteristics of HQLA in the Liquidity Coverage Ratio. In contrast, the Proposed Guideline states that Group 1b) crypto assets should not be considered HQLA. We query the rationale for the inconsistency and ask OSFI to reconsider broadening Group 1a crypto assets to include the type of digital payment token described above.

Impact and Implementation Considerations

13. Regulatory Treatment Options [REF Proposed Guidelines, P6] The Proposed Guidelines allow FIs with "limited crypto asset exposures, or FIs wishing to streamline or bypass classification determination to use a simplified approach". We ask OSFI to clarify what is meant by "limited crypto asset exposures".

³⁰ The FSB (Oct 13, 2020 Regulation, Supervision and Oversight of Global Stablecoin Arrangements) views GSCs as "a widely adopted stablecoin with a potential reach and use across multiple jurisdictions (a so-called "global stablecoin" or GSC) could become systemically important in and across one or many jurisdictions, including as a means of making payments".

For banks leaning towards using the simplified approach to “bypass the classification determination”, taking a full deduction from CET1 without relief for operational RWA can have the impact of limiting crypto asset product offerings given the punitive effect on capital for Group 2b exposures - **expediency comes with a cost**. We offer a simpler description to more quickly identify the types of crypto assets that can fit the Group 1b) conditions. However, we acknowledge that the simplified method may be useful in situations where banks do not have sufficient data to apply the “look through” approach. As the industry matures, the focus should be to improve data reporting and collection rather than use the option to “bypass classification treatment”.

We encourage OSFI and FIs to work with the crypto industry to make the necessary preparations for implementation (e.g., review the data points needed to apply the LTA). This type of collaboration would be suitable for the Sandbox (e.g. studying the underlying blockchain infrastructure for a specific crypto asset type). Projects operating under the Sandbox would receive an exemption from the infrastructure add-on while the solutions are being tested.

However, if OSFI still decides to retain the simplified approach in its current state, we recommend that OSFI do a post-implementation review to determine how many FI's use the simplified method (including the reasons) and to share this information with industry. This can pave the way for collaborative efforts to address any operational challenges, for example through improved data reporting.

14. Categorization of Crypto Assets [REF: Proposed Guidelines P12]. The guidelines state that FIs are responsible for assessing whether the crypto assets are compliant with the classification conditions set out in Annex 1. This process makes sense if the FI issues/creates/uses a crypto asset. FIs are to fully document this assessment and to make it available to OSFI upon request. The Guidelines also state that OSFI may override the FIs' classification decision if OSFI does not agree with the assessment. There is no requirement for OSFI to provide a No Objection letter.

However, non-bank entities (or decentralized entities) can also create or issue a crypto asset. Under these circumstances, we believe there is value in establishing a process to use an industry-wide framework to classify the different types of crypto assets. This exercise can bring about efficiencies and lead to more consistent classification results, with clear guidance to stakeholders preparing for implementation.

The framework would also outline the criteria for determining when a crypto asset infrastructure or arrangement becomes domestically significant as well as systemically important globally (i.e., a Global Stablecoin Arrangement “GSC”). Regulators in certain jurisdictions are seeking higher capital requirements for GSCs. In the context of an FI holding a global stablecoin, this provides additional layers of protection that should be recognized by OSFI.

We understand that Basel plans to study the use of a basis risk test. We ask that the results of such a study be made the subject of future industry consultation should Basel recommend the inclusion of such a test as a condition for Group 1b) classification of crypto assets.

15. We ask OSFI to clarify whether the infrastructure risk add-on for Group 1 crypto asset exposures and the proposed Group 2 total exposure limit applies to FI's who offer custodial services to crypto asset providers.

Under CSA Staff Notice 21-332, crypto trading platforms are **required** to hold client assets with a qualified custodian in accounts/wallets for the benefit of clients and that are segregated from firm assets, and in the case of cash, in a trust account. Specifically, crypto assets under custody held in segregated client accounts (without rehypothecation) do not give rise to "off-balance sheet exposures"³¹, only operational risk. Under this approach, CAUC are held off the balance sheet of Canadian custodians³². Custodians who adopt this practice should not be subject to the Group 2 exposure limit. Applying the Group 2 exposure limit to CAUC will potentially limit the number of qualified Canadian custodians.

An overwhelming majority of Canadian CTPs currently use foreign custodians. The proposed guideline as currently interpreted will create an even higher barrier to entry for crypto asset custodians in Canada, and will impede innovation. We have concerns that these two provisions will make it costly to provide regulated custodial services here in Canada. This will force Canadian crypto asset providers to use foreign crypto asset custodians which can introduce additional risks to Canadian consumers, investors and service providers.

16. Some fiat-backed stablecoins have, as part of the pool of its reserve assets, a digital deposit receipt issued by a regulated financial institution³³ along with other highly liquid

³¹ CSA SN 21-332 requires a CTP to hold assets of a Canadian client separate and apart from its own property, (b) in trust for the benefit of the client, (c) in the case of cash, in a designated trust account or in an account designated for the benefit of clients with a Canadian custodian or Canadian financial institution. CSA SN 81-336 describes the requirements for a public crypto asset investment fund. Assets of an investment fund held by a custodian or sub-custodian are required to be segregated under Part 6 of NI 81-102. Segregation of crypto assets means visible on the blockchain.

³² This practice may not be the case for entities who are required to adopt Staff Accounting Bulletin 121 (issued by the SEC) regarding *Accounting for Obligations to Safeguard Crypto-Assets an Entity Holds for its Platform Users*. We believe the argument still holds under that scenario, where a U.S. custodian is required to hold CAUC in segregated accounts for the benefit of clients.

³³ See Stablecorp's QCAD arrangement. As noted on their website, "QCAD is entirely fiat-backed and The Forge technology ensures that there is always 1 QCAD for every fiat dollar held as reserves. We have more recently partnered with a federally regulated, A-rated financial institution (VersaBank), to leverage The Forge suite in tokenizing a Deposit Receipt that represents an actual deposit within the bank. This asset, known as VCAD, represents a new standard for tokenized, regulated bank products and is a global first "Digital Deposit Receipt"."

assets. We seek clarification as to whether a digital deposit receipt issued by a Canadian FI is covered by deposit insurance.

Areas of Continuous Review

17. We ask OSFI to prioritise collaboration with Heads of Regulatory Agencies to establish a distinct regulatory framework for both stablecoins³⁴ and blockchain³⁵ that is fit for purpose and that includes participants who are non-bank issuers and distributors. We urge policymakers and federal and provincial Heads of Agencies to take a holistic and principled approach to the framework. Without a supportive regulatory framework, Canadian stablecoin issuers would lag global counterparts operating in countries that have already enacted (or drafted) specific Stablecoin legislation (e.g. MiCA in the EU, Singapore, U.S.A. etc).³⁶
18. We believe that it would be extremely beneficial for Canadian Heads of Agencies to work with their global counterparts to promote industry-wide classification for **types of crypto assets** (i.e., stablecoins) that are eligible for Group 1b) classification.
19. Moreover, we believe an ongoing review of market data will support further subdividing of the Group 2 crypto asset classification categories into large market capitalization, highly liquid crypto assets versus more obscure and smaller, less liquid counterparts. This would also help to ensure consistent application globally and help level the playing field for Canadian innovators.
20. If OSFI decides to retain the blanket infrastructure risk add-on, we ask OSFI to prioritise the “study” of the technology infrastructure that underlies crypto assets prior to the implementation date to ensure the evidence supports the policy. [REF Proposed Guidelines, P32 (bank) and P28 (insurance)]
21. The Basel Committee on Banking Supervision “BIS” has agreed on a set of issues that will be subject to specific monitoring and review. We ask OSFI to remain vested in the BIS

³⁴ The Bank of Canada continues to study [digital currencies and fintech](#).

³⁵ The Standing Committee for Innovation and Technology - *Blockchain Technology: Cryptocurrencies and Beyond* recommends a national strategy on blockchain (p.34) [Link here](#)

³⁶ The June 2023 Report of The Standing Committee for Innovation and Technology - [Blockchain Technology: Cryptocurrencies and Beyond](#). The Committee was generally satisfied with the state of the current regulatory approach of cryptocurrencies in Canada, in the context of investor protection. “Nonetheless, regulatory improvements can, and should, be made to ensure that Canada continues to be a leader in cryptocurrencies, and the blockchain industry more broadly. To that end, the Committee believes that a national strategy, similar to those already in place for other key sectors, is required to clarify the government approach to regulation and demonstrate Canada’s commitment to the industry.

project³⁷ that would allow Group 1b) crypto assets received as collateral to be recognised as eligible collateral for regulatory capital requirements.

Conclusion

Canada's global reputation for safety and soundness³⁸ is admirable. At the same time, we believe the Proposed Guidelines as currently constructed will impose additional barriers to provide crypto asset services in Canada and restrict the growth of the sector. We encourage OSFI to adopt a simple and more nuanced approach to classification of crypto assets for prudential treatment that permits FIs and supervisors to better monitor and manage risk without compromising on safety and soundness. Moreover, we ask OSFI to reconsider the proposed prudential requirements given the potential downstream impact to both the crypto asset ecosystem in Canada and the protection of investors' crypto assets.

CW3 and its members support open dialogue with standard setters and regulators to help shape the regulatory framework(s) for crypto assets. To foster a collaborative relationship, we welcome the opportunity to provide additional context to our submission and to answer any questions you may have.

Yours truly,

The Canadian Web3 Council

³⁷ Section 4 of BIS Prudential Treatment of Crypto Assets. Group 1b) crypto assets received as collateral: Under the final standard, Group 1b) crypto assets that a bank receives as collateral are not permitted to be recognised as eligible collateral for the purposes of calculating regulatory capital requirements. The Committee intends to continue to monitor this treatment and assess whether any Group 1b) crypto assets have the required characteristics to receive recognition as collateral for capital requirements purposes.

³⁸ According to the CDIC Canada's financial system is one of the safest and strongest in the world [Link Here](#) Six domestic banks make up 94% of the total banking system in Canada.

Canadian Web3 Council (CW3) Members

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Round3
CAPITAL

 **NDAX**

Appendix 1

To simplify the classification method and to provide additional clarity for Group 1b) Crypto Asset Classification Conditions found in Annex 1, we submit the following for OSFI's consideration [see text in blue font below]. **These comments apply to both the Banking and Insurance Guidelines.**

[Annex 1: Classification Condition 1]

[1.1] The crypto asset is either i) a tokenized traditional asset; or ii) has a stabilization mechanism that is effective at all times in linking its value to a traditional asset or a pool of traditional assets (i.e., stablecoins).

We propose replacing ii) with the following detailed description:

“is a digital payment token that is redeemable at, or exchangeable for, its peg value and fully reserved 1:1 with high quality and liquid referenced asset(s), and in the same currency (currencies) as the referenced asset(s), and where the issuer of the digital payment token is a regulated entity.”

1.4 Crypto assets that have a stabilization mechanism will only meet classification condition 1 if they satisfy all of the following expectations:

i) The crypto asset is designed to be redeemable for a predefined amount of a reference asset or assets (1 USD, 1 oz gold) OR cash equal to the current market value of the reference asset(s) (e.g. USD value of 1 oz gold). The value of the reference asset(s) to which one unit of the crypto-asset is designed to be redeemable is referred to as the “peg value”.

Given the Guideline contemplates stablecoins referenced to gold in the above section, this implies that gold (a commodity) is sufficiently high quality and liquid. We submit that BTC and ETH also exhibit qualities of a liquid asset and ask OSFI to study these crypto asset types for future consideration as Group 1 crypto assets.

ii) The stabilization mechanism is designed to minimize fluctuations in the market value of the crypto assets relative to the peg value. In order to satisfy the “effective at all times” condition, banks should have a monitoring framework verifying that the stabilization mechanism is functioning as intended).

In addition, the guidance should clarify that a stablecoin can lose its peg temporarily due to externalities. Under these circumstances, this condition is met as long as the stablecoin issuer tops up the collateral within a reasonable period of time and continues to honor the peg value at all times.

1.4 Crypto assets that have a stabilization mechanism will only meet classification condition 1 if they satisfy all of the following expectations:

The inclusion of such factors in the Guideline can lead to more consistent results.

iii) The Stabilization mechanism enables risk management similar to the risk management of traditional assets, **based on sufficient data or experience**. For newly established crypto assets, there may be insufficient data and/or practical experience to perform a detailed assessment of the stabilization mechanism. Evidence should be provided to satisfy supervisors of the effectiveness of the stabilization mechanism, including the composition, valuation and frequency of valuation of reserve assets and the quality of available data.

The guidance does not indicate the parameters for determining what is “sufficient data or experience”. To provide a clearer path to attain classification status, innovators will desire more clarity as to whether a project will meet the requirements.

To support innovation, we recommend that newly established crypto assets be permitted to operate within the OSFI innovation sandbox. While in the sandbox, the stablecoin would be given a Group 1b) Test Classification. This would allow stakeholders and regulators to set the specific parameters and the time period to evaluate data/experience with the objective of meeting the data and experience condition for Group 1b) within an agreed upon period in a controlled setting.

iv) There exists sufficient information that banks use to verify the ownership rights of the reserve assets upon which the stable value of crypto assets is dependent. In the case of underlying physical assets, banks should verify that these assets are stored and managed appropriately. This monitoring framework should function regardless of the crypto asset issuer. Banks may use the assessment of independent third parties for the purposes of **verification of ownership rights only if they are satisfied that the assessments are reliable**

In the case of the underlying physical assets, banks should verify that these assets are stored and managed appropriately. The monitoring framework should function regardless of the crypto asset issuer.

Obtaining a legal opinion to satisfy the condition above will be difficult. As an alternative to providing a legal opinion on legal ownership rights, this condition could be satisfied if all of the following are met:

- the reserve assets are held in a bankruptcy remote structure that assigns the rights to the holders of the stablecoin,
- the structure’s assets are subjected to a periodic attestation report by an independent accountant. The report would cover whether the reserve assets are

1.4 Crypto assets that have a stabilization mechanism will only meet classification condition 1 if they satisfy all of the following expectations:

held in a segregated custodial account of the structure, for the benefit of stablecoin holders, and that are unencumbered, separate and apart from other accounts of the company including general corporate funds,

- such reports are posted publicly, and
- the crypto asset passes the redemption risk test, set out below.

Additional comments:

- While structures are commonly used in investment funds, this is not an endorsement of regulating stablecoin issuers under a securities framework. There are other frameworks that can achieve the same regulatory objectives.
- We also recommend that a blanket exemption for the types of legal structures that satisfy this condition will be made available. This would alleviate the regulatory burden for issuers and regulators alike.

v) The crypto asset passes the redemption risk test, set out below **and** the issuer is supervised and regulated by a supervisor. ~~that applies prudential capital and liquidity requirements to the issuer.~~

We understand the objective of this requirement. However, we believe that requiring both of conditions iv) and v) **AND** subjecting the issuer to prudential capital and liquidity requirements to be unnecessary. The current proposal favors bank incumbents. We recommend removing prudential capital and liquidity requirements from condition 1.4 v) given that other regulatory frameworks can achieve consumer protection objectives.

We emphasize the need for a regulatory framework for stablecoins in Canada under the purview of a federal agency given the function of stablecoins in payments, remittances and settlements. Without it, non-bank issuers will be disadvantaged relative to bank issuers and Canada will lag its global counterparts (e.g. EU and Singapore) to the detriment of Canadian innovators.

1.5 Redemption risk test. The objective of this test is “to ensure that the reserve assets are sufficient to enable the crypto assets to be redeemable at all times for the peg value, including during times of extreme stress”.

To pass this test, the FI should ensure that the crypto asset arrangement meets the following conditions.

- “Value and composition of reserve assets. The value of the reserve assets (net all

1.4 Crypto assets that have a stabilization mechanism will only meet classification condition 1 if they satisfy all of the following expectations:

non-crypto asset claims on these assets) should at all times, including during periods of extreme stress, equal or exceed the aggregate peg value of **all outstanding crypto assets**³⁹. If the reserve assets expose the holder to risk in addition to the risks arising from the reference assets, the value of the reserve assets should sufficiently overcollateralize the redemption rights of all outstanding crypto assets. The level of overcollateralization should be sufficient to ensure that even after stressed losses are incurred on the reserve assets, their value exceeds the aggregate value of the peg of all outstanding crypto assets.”

The test uses “all outstanding crypto assets” but does not provide a calculation. We draw your attention to the calculation of the amount of stablecoins in circulation used by stablecoin issuers (e.g. USDC) for your drafting consideration.

1. Calculation of the amount of stablecoins in circulation =
 - a. Total supply of the [stablecoin] on approved blockchains
 - b. Less tokens allowed by not issued on said approved blockchains
 - c. Less Access denied Tokens as reported on said approved blockchains

Providing additional clarity will achieve a consistent method of calculation.

2. In the event that the aggregate fair value of the reference assets falls below the aggregate peg value of all outstanding crypto assets (the “gap”), or if the stablecoin loses its peg, the test can be satisfied if
 - a. the issuer places additional collateral in the reserve pool **within an acceptable timeframe** to address the gap, and
 - b. the issuer continues to honor the redemption of the stablecoin (for cash or in-kind) at its peg value.

Practically, reserve assets are generally traditional assets held off chain and do not have 24x7 settlement cycles.

³⁹ **Guidance may be needed to explain this concept.** Re Circle’s Proof of Reserves states: EUROCC In Circulation is defined as the total EUROCC supply on EUROCC Approved Blockchains at the Report Dates (48,149,956 and 47,917,232 respectively) **less (i) Tokens Allowed But Not Issued as reported on EUROCC Approved Blockchains (zero at the Report Dates) and (ii) Access Denied Tokens as reported on EUROCC Approved Blockchains (zero at the Report Dates)**

1.4 Crypto assets that have a stabilization mechanism will only meet classification condition 1 if they satisfy all of the following expectations:

ii) Asset quality criteria for reserve assets. For crypto assets that are pegged to one or more currencies, the reserve assets should be comprised of assets with minimal market and credit risk. The assets shall be capable of being liquidated rapidly with minimal adverse price effect. For example these assets may be defined as Level 1 HQLA as stipulated in LAR. Further, the reserve assets must be denominated in the same currency or currencies in the same ratios as the currencies used for the peg value. A de minimis portion of the reserve assets may be held in a currency other than the currencies used for the peg value, provided that the holding of such currency is necessary for the operation of the crypto asset arrangement and all currency mismatch risk between the reserve assets and peg value has been appropriately hedged.

[We have no comments](#)

iii) Management of reserve assets The governance arrangements relating to the management of reserve assets should be comprehensive and transparent. They must ensure that

- The reserve assets are managed and invested with an explicit legally enforceable objective of ensuring that all crypto assets can be redeemed promptly at the peg value, including under periods of extreme stress
- a robust operational risk and resilience framework exists to ensure the availability and safe custody of the reserve assets
- A mandate that describes the types of assets that may be included in the reserved should be publicly disclosed and kept up to date,
- The composition and value of the reserve assets are publicly disclosed on a regular basis. The value should be disclosed at least daily and the composition should be disclosed at least weekly
- The reserve assets are subject to independent external audit at least annually to confirm they match the disclosed reserves and are consistent with the mandate

[For greater clarity we recommend adding the following words to the last bullet - the addition reflects our interpretation of the condition:](#)

The reserve assets are subject to independent external audit at least annually to confirm they match the disclosed reserves and [that the composition of the reserve assets is consistent with the mandate.](#)

[Additional comment: Generally speaking, independent auditors do not provide audit opinions on compliance with investment mandates. Such matters are better addressed through internal governance and oversight structures.](#)

Classification condition Two Expectations

1.7 All rights, obligations and interests arising from the crypto asset arrangement are clearly defined and legally enforceable in all the jurisdictions where the asset is issued and redeemed. In addition, the applicable legal framework(s) ensure(s) settlement finality. Banks are required to conduct a legal review of the crypto asset arrangements to ensure this condition is met, and make the review available to their lead supervisors upon request.

1.8 To meet classification 2, the following expectations should be met.

i) At all times the crypto asset arrangements should provide a robust legal claim against the issuer and/or underlying reserve assets and should ensure full redeemability, i.e. the ability to exchange crypto assets for amounts of pre-defined assets such as cash, bonds, commodities, equities or other traditional assets) at all times and at their peg value. In order for a crypto asset arrangement to be considered as having full redeemability, it should allow for the redemption to be completed within 5 calendar days of the redemption request at all times.

We ask OSFI to clarify the requirement “settlement finality” to mean economic finality rather than legal finality. FIs can use Pillar 3 disclosure requirements to disclose any residual legal risks.

For greater clarity, we ask OSFI to incorporate the following guidance **as one example** of how the condition can be met:

This requirement can be satisfied by reviewing the constitution documents of the reserve pool

- that describe the legal structure of the special purpose vehicle that holds the reserve assets, and
- The contractual terms that describe settlement finality.

ii) At all times the crypto asset arrangements are properly documented. For crypto assets with stabilization mechanisms, crypto asset arrangements should clearly

- Define which parties have the right to redeem
- The obligation of the redeemer to fulfill the arrangement
- The timeframes for the redemption to take place
- The traditional assets in the exchange
- How the redemption value is determined
- These arrangements should also be valid where the parties involved may not be located in the same jurisdictions where the crypto asset is issued and redeemed.

Classification condition Two Expectations

- At all times, settlement finality in crypto asset arrangements should be properly documented such that it is clear when key financial risks are transferred from one party to another, including the point at which transactions are irrevocable.
- The documentation described in this paragraph should be publicly disclosed by the crypto asset issuer. If the offering of the crypto asset to the public has been approved by the relevant regulator on the basis of this public disclosure, this condition will be considered fulfilled. Otherwise, an independent legal opinion would be needed to confirm this condition has been met.

[We have no comments for this section of the Guideline.](#)

Classification condition Three Expectations

[1.9] The functions of the crypto assets and the network on which it operates including the distributed ledger or similar technology on which it is based, are designed and operated to sufficiently mitigate and manage any material risks. [\[See suggested addition below\]](#)

[1.10] To meet classification condition 3, the following expectations must be met:

i) The functions of the crypto asset, such as issuance, validation, redemption and transfer of the crypto assets, and the network on which it runs, do not pose any material risks that could impair the transferability, settlement finality or, where applicable, redeemability of the crypto asset. To this end, **entities performing activities associated with these functions should follow robust risk governance and risk control policies and practices to address risks** including, but not limited to: credit, market and liquidity risks; operational risk (including outsourcing, fraud, and cyber risk) and risk of loss of data; various non-financial risks, such as data integrity; operational resilience (i.e. operational reliability and capacity); third-party risk management; and Anti-Money Laundering/Counter Terrorist Financing.

ii) All key elements of **the network** should be well-defined such that all transactions and participants are traceable. Key elements include: (i) the operational structure (i.e. whether there is one or multiple entities that perform core function(s) of the network); (ii) degree of access (i.e. whether the network is restricted or unrestricted); (iii) technical roles of the nodes (including whether there is a differential role and responsibility among nodes); and (iv) the validation and consensus mechanism of the network (i.e. whether validation of a transaction is conducted with single or multiple entities).

**Classification condition Three
Expectations**

We interpret this guidance to apply to the main blockchain network as well as the application Layer. Given the decentralized nature of certain blockchain networks, we offer the following addition to the lead in paragraph:

“For permissionless blockchains, the documented protocols, enforcement of the protocols (e.g. slashing) and monitoring public channels for evidence of security incidents, provide satisfactory evidence to meet this condition.”

**Classification condition Four
Expectations**

[P1.11] **Entities** that execute redemptions, transfers, storage or settlement finality of the crypto asset or manage or invest reserve assets

- **Must be regulated and supervised or subject to appropriate risk management standards** and
- **have in place and disclose a comprehensive governance framework**

For stablecoins, we recommend the Guidance clarify that this requirement applies only to the participants in the stablecoin arrangement, this requirement does not apply to the underlying network (Layer 1). Moreover, we believe the condition should not favour permissioned over permissionless blockchains.

[P1.12] The **entities** subject to this condition include

- Operators of the transfer and settlement systems for the crypto assets
- Wallet providers
- Administrators of the stabilization mechanism
- Custodians of the reserve assets

NOTE: Node validators may be subject to appropriate risk management standards as an alternative to being regulated and supervised

We submit the guidance should include decentralized blockchain networks, which operate according to network protocols and consensus mechanisms. Otherwise, stablecoins on permissionless blockchains will not meet condition 4.

We believe that the credit risk of the wallet provider is not a relevant condition to qualify a stablecoin for Group 1b) status. We believe there should be a separate category for wallet providers (i.e. an intermediary) under Credit Risk [i.e. as part of Annex 2]. Note, the CSA uses

**Classification condition Four
Expectations**

wallet provider to mean the provider of wallet technology. Common taxonomy is needed.