



Crypto assets

Developments, regulation, consequences

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22 September 2022

TECC The European
Compliance Conference

TECC online 2022

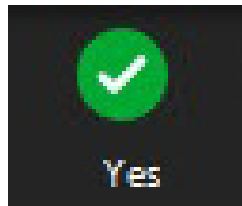
20 - 22 September 2022



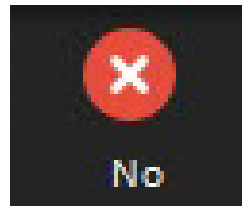
do your thing

A poll to warm up: are you active in some way in crypto space?

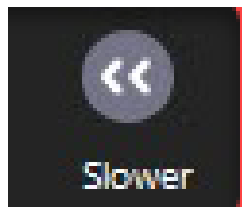
Go to “Reactions”, and select “Yes”, “No” or “Slower”.



Yes, I am investing / trading / lending / borrowing / coding / ...

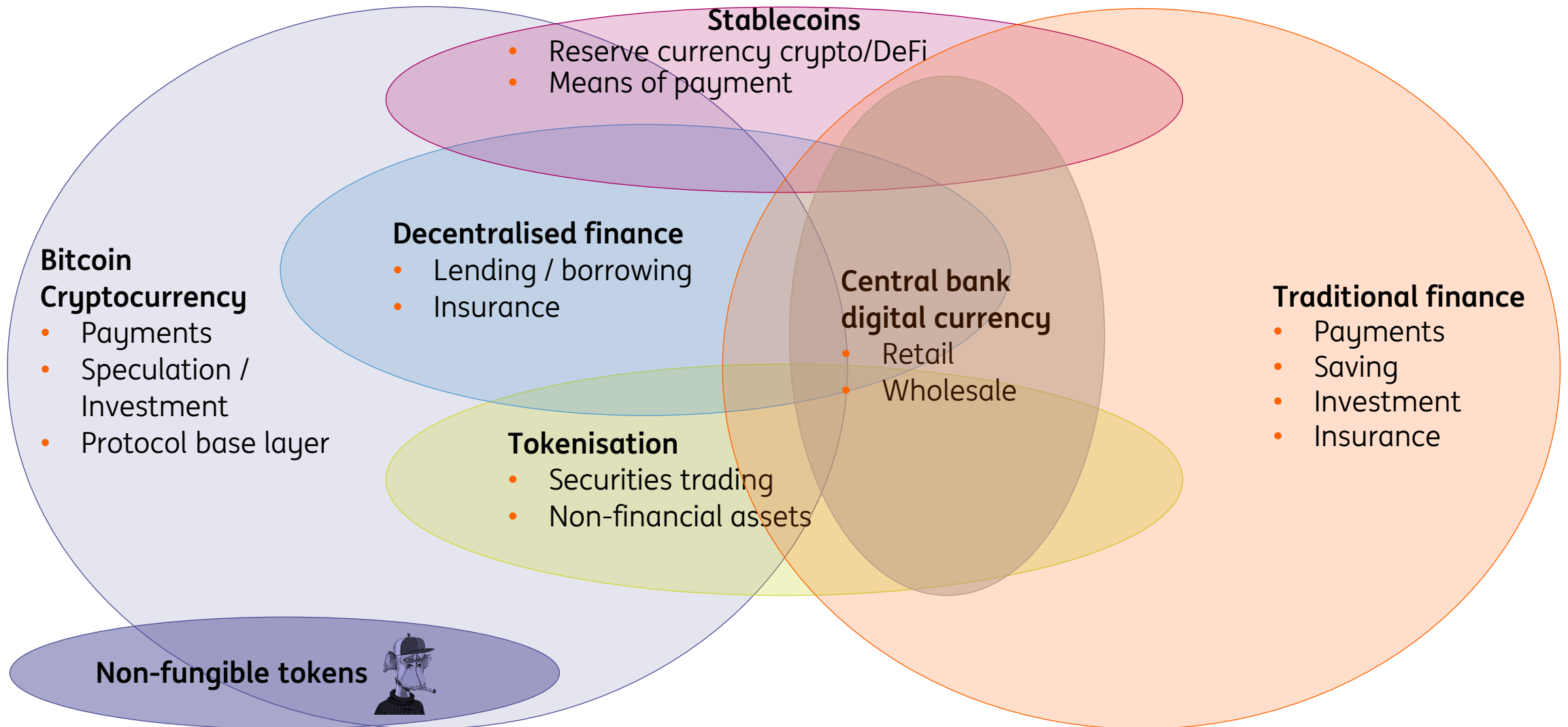


No! Not going anywhere near there

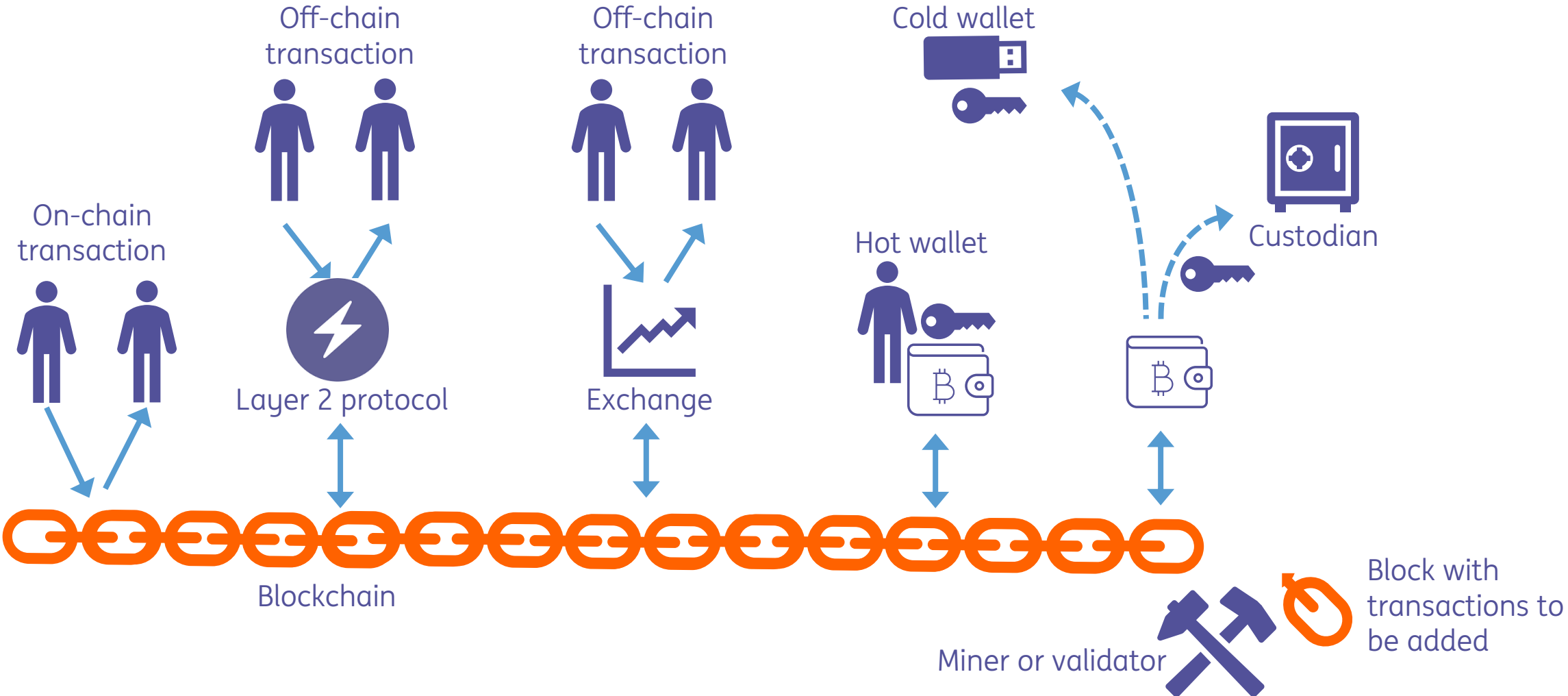


I might have taken a look once. Or I'm following what my kids are doing in crypto

Digital assets taxonomy: an overview

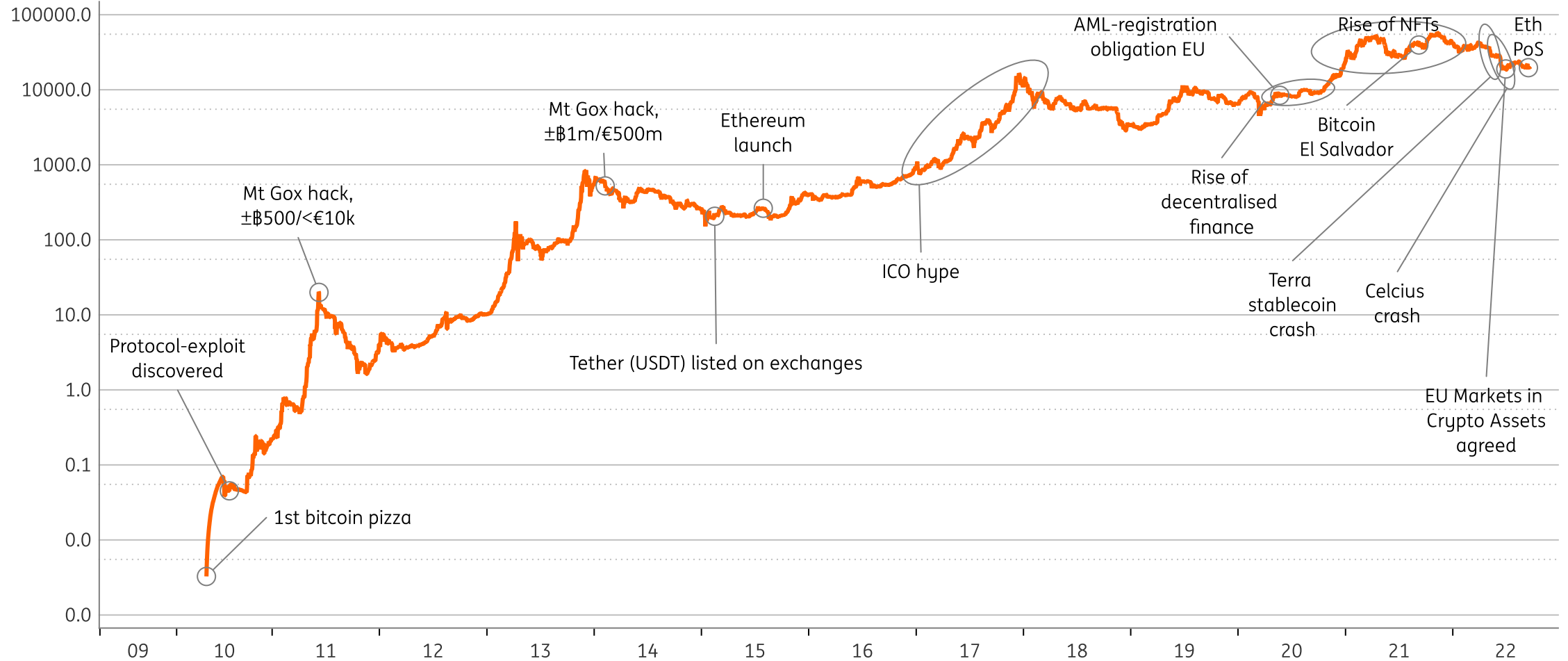


Crypto assets and blockchain: basic concepts



How did we get here? A brief crypto history

Bitcoin price (EUR, logarithmic scale)



Crypto dream: no authorities or intermediaries needed

Traditional finance: trusted intermediaries and authorities, centralised setup



...while blockchain is “distributed”: all participants (can) have a copy of the ledger, and “code is law”



Crypto dreams meet reality... and it looks quite familiar

Crypto utopia: “code is law”

- Hyper-individualism, independence and freedom (e.g. from censorship)
- No trust, no intermediaries needed

BUT... Tech is a tool, no alternative market setup

- Decentralised software ≠ decentralised market”
- Removing govt/institutions ≠ removing centralisation
- Regulation sometimes needed to prevent monopolies

Governance

- Algorithm follows rules; but who determines rules?
- How to deal with unforeseen situations?

Users

- “Decentralised” and “open source” great for developers...
- ...but advantages are unclear for average user

Illustration: Terra crash Spring 2022

Technically different from GFC 2008...

...Economically very similar:

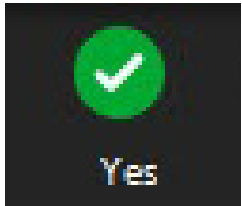
- Misguided belief in complex mathematics
 - Financial engineering (2008)
 - Tech engineering (crypto today)
- Excess leverage
- Correlations suddenly rising towards 1
- Outside regulatory perimeter
- Smart money vs (retail) bagholders

➤ **Don't discard the technology,
Instead use with care**

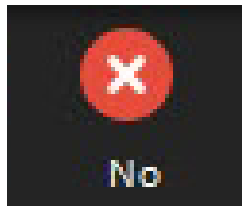
“We were seeing things that were 25 standard deviation moves, several days in a row”.
CFO GS, Aug '07

Poll: Within a year from now, the EU crypto regulatory framework has crystallised

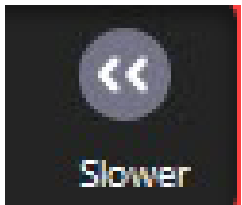
Go to “Reactions”, and select “Yes”, “No” or “Slower”.



Yes, from a regulatory/supervisory/compliance perspective, we'd be ready to engage in crypto next year



Really? The confusion only increases with each new regulatory initiative



Hmm... Things are moving in the right direction, but there's still a long way to go

Crypto assets regulatory goals: where are we?

Financial crime

Money laundering, tax evasion, sanctions, market manipulation...

- ✓ Civic law and criminal law apply (e.g. scams)
- ✓ EU framework: AMLD5
- TFR (Transfer of funds Regulation; [FATF travel rule](#))
 - Political agreement June '22, now technical details

Other

IFRS accounting, taxation

Investor protection

Suitability, information provision, transparency

Cyber security, privacy

- MiCAR
 - Political agreement June '22, now technical details
 - Still ±1,5-2yr to go until full application!

Monetary sovereignty

“Libra-trauma”. CBDC vs regulated stablecoin?

- Strict transaction caps in MiCAR for non-euro stablecoins

Sustainability

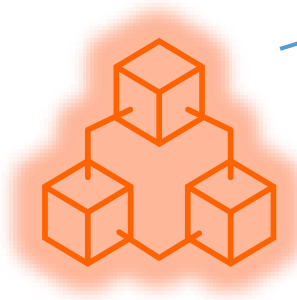
Electricity consumption of Proof-of-Work based crypto (bitcoin)

- Transparency requirements in MiCAR

Financial stability

Stablecoin bank run dynamics; contagion

- MiCAR collateral and redemption requirements
- Microprudential
- Basel Committee prudential exposure rules



EU regulatory framework MiCAR will need further development

Goals

Investor Protection
Suitability, information

Anti-crime
AML, tax, sanctions, manipulation

Financial Stability
Buffers

Instruments

Existing financial instrument
“if it looks like a duck, quacks like a duck...”

“Classic” cryptocurrency

- White paper
- Sustainability information

Stablecoins (100% backed)

“Asset-referenced token”

- ± mutual fund-like
- Cap at €200m daily vol

“E-money token” ±bank
Immediately redeemable;
claim on issuer, at par

- ECB/NCB veto possible

Truly decentralised coins

Non-EU based coins

Truly decentralised protocols

Self-hosted wallets

NFTs

DeFi
Lending, borrowing

Non-EU based CASPs

Services providers

CASPs (MiCAR, AMLD5, TFR)

- Duty of care, KYC, trade transparency, AML, ...

Policymaker perspective on consensus mechanisms

asdfasdf

How to reach consensus on the state of the world?

Decentralised

Centralised

Characteristics

- Examples
- Code vulnerability
- Scalability
- Censorship resistance

Acceptability

- Electricity use
- Sustainability
- AML/CFT/Sanctions

Proof of Work



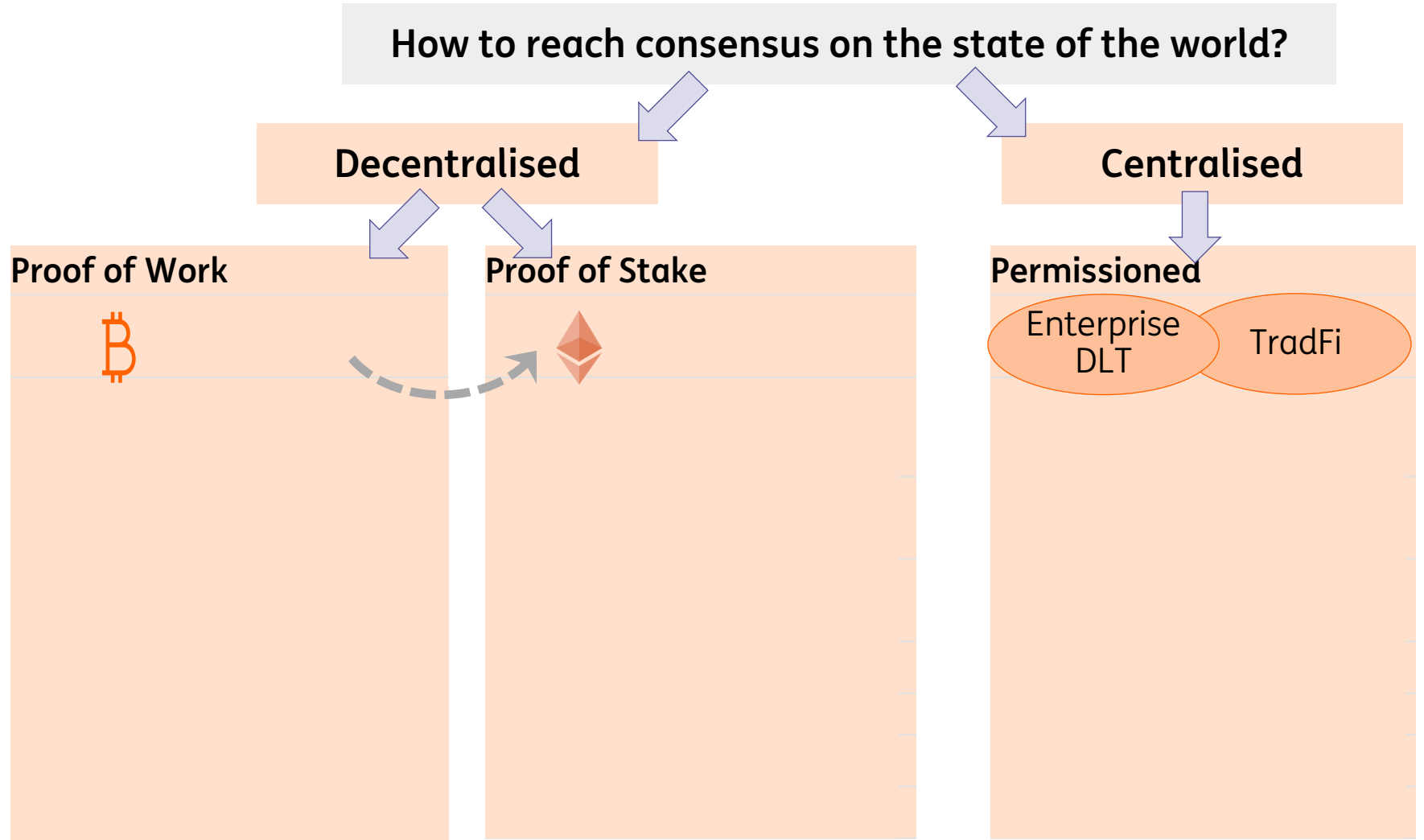
Proof of Stake



Permissioned

Enterprise DLT

TradFi



MiCAR impact for banks & other financial institutions

Doing business with CASPs

- Easier when MiCAR-regulated (rather than just AMLD5)

Classic cryptocurrencies

- Prudential exposure? BCBS -> CRR – substantial capital requirements; 1250%RW; exposure constraint 1%
- Broad liability, also for vague “operational incidents” (MiCAR article 67(8))
- On 1-2yr horizon, much will depend on (prudential) supervisor disposition towards crypto

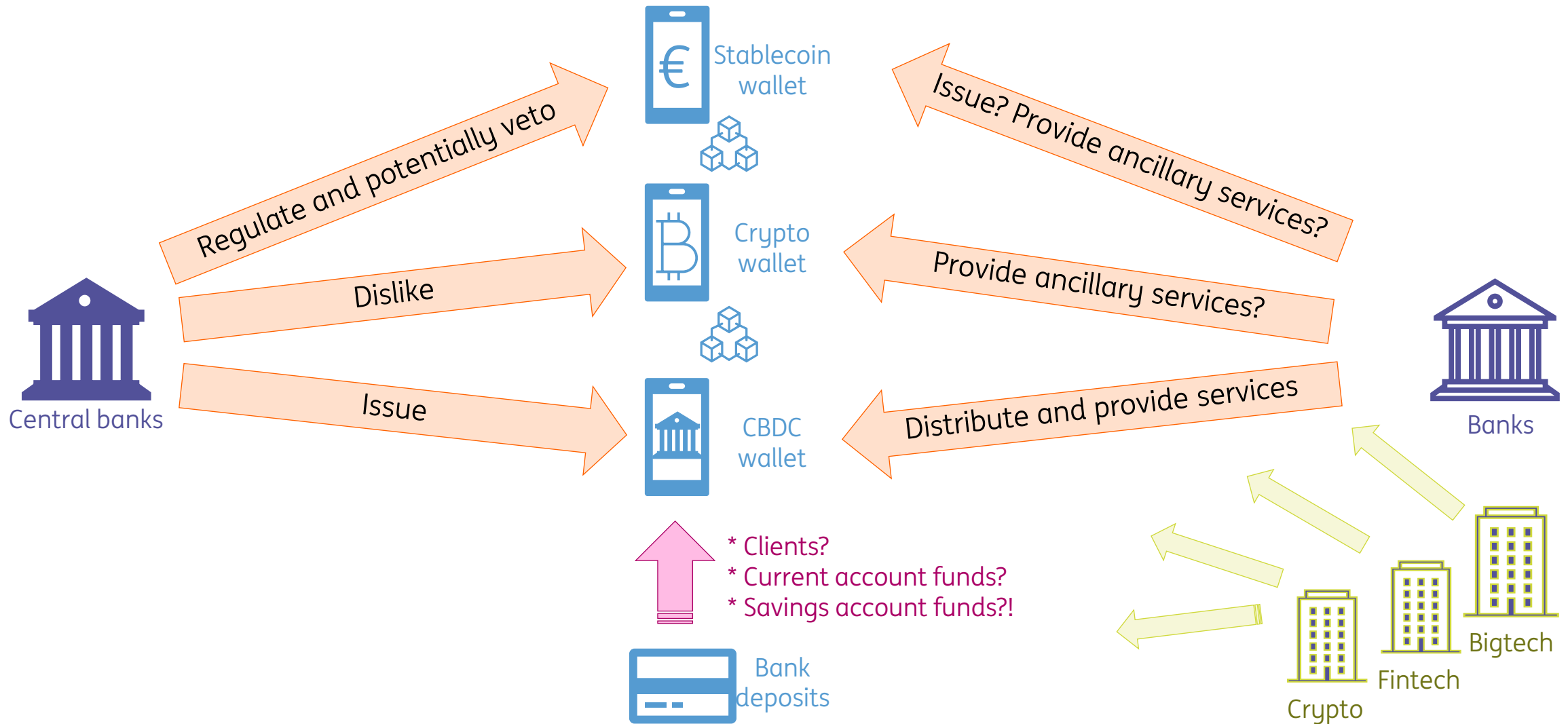
Stablecoins

- Policymakers “traumatised” by Facebook Libra. Digital euro pushed as alternative
- Daily volume limit – “ART”-stablecoin dead on arrival?
- Strong veto powers for ECB/NCB is Sword of Damocles above any stablecoin

Other

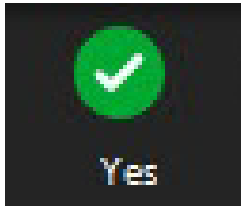
- MiCAR not in force until 2024 at earliest...
- MiCAR has already changed conversation with supervisors.
- Sustainability / ESG. Bitcoin vs Ethereum and others?

Digital currencies, banks and central banks

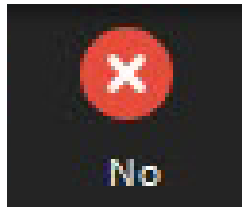


Poll: Will crypto and TradFi will converge over time?

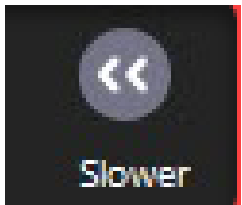
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Yes, helped by regulation, business models will converge and competition will intensify



No, crypto and traditional finance will remain separate spheres. Regulation, supervision and culture are too far apart



We may see some selected and specific links, but it will take years

Crypto, stablecoin, CBDC: this is not the future; this is today

Why worry about all this?
The crypto hype will pass.
DeFi is only about leveraged speculation.
CBDC development will take years!

Sure... but have another look...

- Large retailers gaining bitcoin payment experience
- One-stop CBDC solutions (Nigeria, Eastern Caribbean);
- Crypto services providers moving towards payment and banking services?

Transaction services

- Facilitating DC payments for clients
- Programmability, IoT, automated payments, pay-per-use, track-and-trace, fee collection, ...

Crypto protocols: promising global, always-on, seamless, instant base layer

- Tokenised trading
- Tokenised everything?

Finance

- Crypto/DeFi issuance (DCM/ECM)
- On-chain syndication

Investment use cases

- Investment, trading

Operational use cases

- Global cash management using stablecoins and CBDC
- Custody and conversion of DC holdings

Digital assets, regulation and “TradFi”

Context

- *Convergence of crypto, fintech, neobank, bank, bigtech*
- Common theme: disintermediation
- Funding (and lending?)
- Client and data (Open Banking)
- Engaging with new generation



Classic cryptocurrencies and CASPs

- Regulation removes obstacles
- Prudential exposure rules?
- Custodial liability?



Central bank digital currency

- Long term impact (function creep)
- Governance
- Retail vs wholesale approach?
- Costs



Stablecoins

- Banking license required: plus for banks?
- Ring-fencing? Separate legal entity?
- Sword of Damocles: ECB/NCB veto
- Stablecoin direct competitor to CBDC?



Decentralised Finance

- Use cases to be developed
- Not covered in MiCAR
- Protocol issues and entity liability



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