



**2022**

*25<sup>th</sup> Annual Japan - U.S. Symposium  
on Building the Financial System of  
the 21<sup>st</sup> Century*





# **The Future of Crypto Assets— Regulation, Cross-Border Issues and Role of Traditional Financial Institutions**



## Core Issues

- Principles for regulating crypto
  - Financial stability
  - Investor protection
  - Promoting innovation
  - Ensuring liquidity
  - Risk management
  - Usable liquidation regime
  - Clear jurisdictions
  - Full backing for stablecoins
- What needs to be regulated?
  - Disclosure!
  - Crypto assets? Probably not – buyer beware
  - Stablecoins? Definitely – contagion concerns, resemblance to unregulated MMFs
  - Exchanges (but maybe not DeFi)



## FTX Failure

- Causes of FTX failure and investor losses
  - Lack of custodianship
    - Commingling + risk-taking = disaster
  - Bad corporate governance and internal controls
  - Lack of uniform regulation
    - Offshore exchanges skirt jurisdictional regulations
  - “Yield farming” as Ponzi scheme?
- Regulation can be effective
  - Japan FTX looks fine, while US and Bahamas units tanked
  - Bad actors thrive in unregulated spaces
  - Robust regulation may incentivize quality entrants and competition and deter investors from using less regulated entities

## Regulating Crypto

- Regulating crypto exchanges
  - Key functions for capital markets
    - Exchange (matching orders)
    - Broker/market making
    - Payment/settlement
    - Lending
    - Custodianship
  - In traditional finance, separate entities and segregated assets
  - In crypto world, “exchanges” blur all the lines - nomenclature matters
- Can we adapt the existing regulatory toolkit to crypto?
  - Principles of segregation, KYC/AML may be sufficient in digital as in traditional if applied uniformly
  - Challenge in US of regulatory fragmentation
  - Crypto founders often from tech, not financial background



## Regulating Crypto

- JFSA as global first mover
  - User protection: crypto asset exchange service providers (CESPS) must meet rules re segregation of users' assets, reporting, market integrity
  - AML/CFT: Implementing FATF recommendations, CESP's must monitor and report suspicious activities
  - Financial stability: stablecoin issuers set to be licensed as banks, fund transfer service providers, or trust companies
- Challenges to custodian model in crypto
  - BIS capital framework: 1250% risk weighting for crypto assets
  - U.S. banks barred from crypto custodianship by SEC accounting rules
  - Should regulators seek to increase connections with the formal financial system instead of seeking to isolate crypto?

## Politics of Crypto

- Rise of crypto reflects mistrust of govt, big banks
  - Allure of “trustless” transactions ruled by algorithms
  - Reality is that much crypto is stored and traded on exchanges
    - Regulation is needed, but users seek to avoid
  - What do governments owe crypto investors?
    - Investor protection is about process, not about bailing out risky investments
    - Distinguish between unaware retail and institutional who should know better?
- Prospects for U.S. crypto legislation
  - Grounds for optimism
    - Bills currently in preparation are bipartisan
    - FTX and other failures raise urgency
    - But many crypto exchanges, issuers, and investors will continue to resist
  - First step likely to be stablecoins, seen as unregulated MMFs and main potential conduit for contagion to trad finance



# **The War in Ukraine, Financial Sanctions, and Consequences for International Finance**





## Effects of War

- Disruption
  - Challenge to international order, including global financial system
  - Massive humanitarian disaster and physical/economic damage
  - Knock-on economic effects– energy prices, supply chain, food insecurity
  - Debt implications for emerging market countries
    - Exacerbates already challenging environment of global inflation, monetary tightening, post-pandemic supply disruptions
    - Requires cooperation of creditors – G7, Paris Club, China
- Future implications
  - Does this make Chinese attack on Taiwan more or less likely?
  - MNCs and FIs must prepare for new contingencies
    - What effects on capital investments and risk premiums?



## Sanctions

- Unprecedented range and strictness of sanctions
  - G7 appears unified in its response
    - Or is this just U.S. pushing its own agenda?
  - Import bans – but energy not fully covered
  - Export controls – especially tech and military use
  - Freezing of Russian USD reserves
  - Finance – removal of central bank and others from SWIFT and USD system
  - Targets – designated entities, countries, individuals (oligarchs)
- Leakages in sanctions regime
  - No global coordination via UN Security Council
  - Active circumvention by Iran, North Korea, China, etc.
  - Global South – willingness to trade with Russia
  - Can these be addressed by U.S., Japan, UK, Europe sanctions on companies that violate?
  - Will we resort to secondary sanctions to reduce leakages?



## Sanction Effects

- What do sanctions accomplish?
  - Goals: degrading war capability, punishment, deterrence of future aggression, alternative to military response, symbolism
  - Effects: have degraded ability to wage war, but not determination or Putin's political position
  - History: don't expect regime change, but can hurt future growth
  - Oil price cap: Will it work as planned? Will it affect Russian war effort?
- Japan in sensitive position
  - Energy prices, curtailed access to supply
  - How to manage China relations, changing NE Asia geopolitics?
  - Challenge of keeping solidarity with U.S. and Europe



## Unintended Consequences of Sanctions

- Short-term consequences
  - Burdens on MNCs – geographical and logistical shifts, regulatory compliance
  - Developing countries dealing with higher food and energy inflation
  - Seizing of individual assets a slippery slope
  - SWIFT cut off - future challenge to USD as a reserve currency?
  - Crypto as a tool to by-pass sanctions
- Long-term consequences
  - Shifting patterns of trade and finance
  - Efforts to insure against future sanctions
    - Stepped-up Chinese efforts to decouple
    - Will this accelerate creation of non-USD alternative financial system?



## Long-Term Consequences for Japan, U.S., Europe

- New world order?
  - Will this make use of economic sanctions more common?
  - How to plan for counter-actions by China or others?
  - Possibility of deglobalization (or perhaps reregionalization) – friendshoring, industrial policy, reduced financial openness
- Effects on energy transition
  - Increased urgency for energy transition to preserve security
  - But inflation and fiscal consolidation reduce capacity to invest – may slow transition
  - Can governments speed the transition with carbon tax, feed-in tariffs, incentives for conservation?
- Are sanctions politically sustainable?
  - Popular frustration with inflation, food & energy volatility, aid to Ukraine
  - Cracks in the façade? European energy woes, new U.S. Congress



# UPCOMING EVENTS

## 2023

### Europe - U.S. Symposium

*May 10-12, in-person*

*Frankfurt, Germany*

---

To receive an invitation to other PIFS Symposia,  
or to recommend your colleagues for participation, please contact:

**Whitney Vasey**

[wvasey@pifsinternational.org](mailto:wvasey@pifsinternational.org) | 857-242-6072

[www.pifsinternational.org](http://www.pifsinternational.org)