Annex 1: GFMA Proposed Approach for the Classification and Understanding of Digital Assets

Initial Proposed Approach for the Classification and Understanding of Digital Assets[487]

The Global Financial Markets Association (GFMA) developed the following approach to classification of digital-assets to support our response to the Basel Committee on Banking Supervision (BCBS) discussion paper on **'Designing a Prudential Treatment for Crypto-Assets'**[488] **and** FSBs recent consultation on the **"Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets".** The approach reflects the principle that the treatment of digital-assets should be underpinned by clear methodology for identifying different types of digital-assets' risk which will allow for tailored regulatory treatment, as appropriate.

We believe this provides an initial basis for a taxonomy and it is key that there is close engagement between the industry and the regulatory community on this topic. We therefore recommend a joint industry-regulatory task force is formed to urgently develop a global taxonomy as a priority in 2023.

Approach to classification and understanding of digital assets

Broadly, digital assets may serve a variety of economic functions, such as an agent for payments[489], a vehicle for investment or trading[490], or a utility to access other goods or services[491]. Within those functions, when those assets have the characteristics of existing regulated instruments, a specific regulatory framework may apply. However, given the features of digital-assets, other key attributes beyond economic function, may need to be taken into consideration by regulators in order to classify those assets and determine what regulations should apply, if any (similar to how frameworks such as those that are leveraged for classifying a security/financial instrument function today).

For this initial taxonomy proposal[492] we focused on defining features of digital-assets such as:

- **Issuer** (e.g., central bank)
- **Mechanism or structure underlying the asset value** (e.g., pegged to or in reference to an underlying asset or access to a network product or service)
- **Rights conferred** (e.g., entitlement to cash flows, redemption rights, voting)
- **Nature of the claim** (e.g., claim on an issuer or claim on an underlying asset)

---

487 As discussed in our Note to the Reader, we believe that 'digital-assets' is a much more appropriate term when discussing DLT based assets in the general sense. However, we would reiterate our initial point that a global taxonomy is urgently needed. We would note that when we discuss digital assets that this does also include fiat deposit accounts where the transfer of ownership is accomplished via blockchain or DLT.

488 GFMA Response to BCBS Discussion Paper on the Prudential Treatment for Crypto-Assets.

489 Payment tokens may also be referred to as exchange tokens in some jurisdictions. Key uses may include, the crypto-asset being held and transferred primarily for the purposes of buying or selling other assets or being used as a store of value.

490 Security/ Investment/Financial instrument tokens provide entitlement to proceeds or a right to vote and could also meet the characteristics or definition of a financial instrument or equivalent regulatory classification.

491 Crypto-assets used as a means of accessing a DLT platform and/or a medium of exchange for the provision of goods and services provided on the DLT platform, and does not have value or application, outside of the DLT platform on which it was issued (Note that the crypto -asset may be used as a means for data and database management, data recordation, or other bookkeeping or recordkeeping activity. As these do not constitute financial instruments, they are intentionally excluded here.)

492 This approach has not been formally endorsed by all GFMA members and is intended as a basis for discussion.

There are additional features that should be assessed against each type of digital-asset to help differentiate and evaluate the risk, including types of users/holders (e.g., retail versus wholesale), **systemic importance,** and if an **asset is linked to a real or off-chain asset,** who or what **type of entity has Custody of that asset,** if any.

Other features that we recommend be considered for a future global taxonomy is the type of network upon which the digital asset exists. There are various configurations of DLTs, each with varying levels of privacy, governance and control. These are set out below:

- **Private-permissioned (e.g., R3 Corda):** Private-permissioned networks are characterized by a centralized authority that can control **access to the network** (private) and **actors that can perform actions on the network** (permissioned). Private networks enable a comparable model to existing infrastructure used by capital markets today, with control over all network layers, and their defining characteristics mean existing legal, regulatory and institutional risk management frameworks (operational risk and cyber resilience frameworks) can be applied.

- **Public-permissioned (e.g., Corda Network):** Public-permissioned networks are characterized by allowing **public access to the network** and a centralized authority to control **actors that can perform actions on the network** (permissioned). Though public-permissioned distributed networks mark a step away from the tight central control of private networks, they also operate as closed networks with centralization retained over key network attributes. Therefore, like private networks, the same legal, regulatory, and institutional risk-management frameworks also provide a sufficient basis to govern these networks, including differentiated considerations around cybersecurity and impacts on operational resilience, and KYC/AML/CFT compliance.

- **Public-permissionless (e.g., Ethereum):** Public-permissionless networks allow unrestricted access to the network and allow anyone to perform actions on the network by default. These publicly available distributed ledger networks have defining characteristics, such as decentralization, pseudonymity, and large-scale user bases, that are different to private-permissioned and public-permissioned networks.

Further to this distinction, digital assets can be subdivided into characteristic types:

- **Fungible:** interchangeable and divisible – like securities, cash, or commodities
- **Non-Fungible:** unique and indivisible – like real estate, fine art, and other nonfinancial assets
- **Digital Only or Real World:** accessed via a centralized bridge that relies on a service provider

Both of these distinctions should also be part of the 'type' that digital assets can belong to in a global taxonomy. Many digital assets have functions and features spanning more than one of the categories or may not even be contemplated at this time [493]

These types of digital assets may have characteristics that enable their use for more than one purpose (means of payment or investment) at any single point in the lifecycle of the asset or have characteristics that change during the course of their lifecycle. Further consideration should be given to these types of assets as well as when and how the rules should apply to them. The GFMA would encourage an approach that is agile and remains robust, providing the market clarity while also allowing innovation as market structures develop, uses evolve, and technology changes, or new assets are created.

While we have used the term 'digital-asset,' as the overarching category to group together a number of instruments, not all the categories (and associated uses and attributes) should be treated as instruments for which

---

493 As the crypto-asset market evolves and the understanding of uses matures, additional uses beyond those identified as payment, investment, or utility may need to be addressed or identified.

a new financial regulatory framework is necessary or appropriate. A robust regulatory framework (including customer/investor protection safeguards) may already exist for the instruments or activity represented by the 'digital-asset.'

We would reiterate that the proposal below is intended to be an initial starting point for a classification of digital assets. It is designed to help regulators evaluate which types of regulations should apply to which type of assets. We note however that as these assets evolve and potentially new ones are created, this classification may need to be updated over time. We would still encourage that a global taxonomy be developed. This global taxonomy should be comprehensive, but also have the ability to be reviewed and adapt with time and new innovations.

Types of Digital Assets[494],[495]

Value-Stable Digital Assets

1. **Tokenized Commercial Bank Money[496]**
   - Digital tokens reflecting a deposit ownership claim reflected on DLT for a fixed amount of fiat money denominated in a single currency by the token-holder against the token issuing bank or other similarly highly regulated depository institution. It may or may not pay interest.

2. **Financial Market Infrastructure (FMI) Tokens (e.g., USC)**
   - Digital tokens representing a claim on an FMI for a fixed amount of fiat money denominated in a single currency by the token-holder, fully collateralized by reserves held at a central bank or deposits held at a commercial bank. It may or may not pay interest.

3. **Wholesale Central Bank Digital Currencies (wCBDC[497], none launched)**
   - Specialized, limited purpose digital tokens representing a claim on a central bank for a fixed amount of fiat money denominated in a single currency, designed for specific use by wholesale market participants who have central bank account access. It may or may not pay interest.

4. **Stablecoins (e.g., USDC):** Tokens designed to minimize price fluctuations relative or in reference to other asset(s) which are not issued by a central bank, FMI, bank, credit institution or highly-regulated depository institution. May represent a claim on the issuing entity, if any, and/or the underlying assets. There are two types of stablecoins.

---

494 GFMA also notes that the term 'coin' and 'token' are synonymously leveraged below and are not intending to insinuate differences between the two terms.

495 Some of those instruments may meet the 'e-money' criteria in those jurisdictions where that regulatory classification exists and be classified as such for regulatory purposes.

496 Note: Deposits recorded via DLT may not be considered true digital assets as they do not create a new asset class with separate intrinsic value from the fiat currency they represent. However, we have included this to be responsive to varying definitions of digital asset under consideration, and to comprehensively articulate when the use of distributed ledger technology would not require new regulatory treatment, but would be governed by an existing regulatory framework.

497 CBDC can rely on non-DLT/blockchain technology, this taxonomy is intending to capture only those leveraging DLT/blockchain technology.

- Asset Linked Digital-Asset: value may be fixed or variable and in reference to individual structures or include a combination of:
  - Fiat currency linked (e.g., Tether, Paxos, USDC)
  - Other real asset linked (e.g., Sendgold)
  - Digital asset linked (e.g., Maker)
- Algorithmic Digital-Asset: Typically, not linked to any underlying assets and each token can be pegged to a price level or a unit maintained through buying, selling or exchange among assets or some other pre-determined mechanism. To meet the standard defined here, an algorithmic digital asset must be pegged to assets that are highly liquid and hold intrinsic value

DLT-based Securities[498]

- **Tokenized Security (e.g., UBS AG's digital bond dual listed on Swiss SIX and SDX):** Token that represents on DLT infrastructure underlying securities/financial instruments issued on a different platform (e.g., a traditional CSD, registrar, etc.), where such representation itself satisfies the definition of a security/financial instrument under local law.
- **Security Token (e.g., World Bank's "Blockchain Bond"):** Token issued solely on DLT infrastructure that satisfies the applicable regulatory definition of a security or financial instrument under local law

Cryptocurrencies

- Digital representations of value with no redemption rights against a central party and may function within the community (enabled through peer-to-peer networks) of its users as a medium of exchange, unit of account or store of value, without having legal tender status. They may also act as an incentive mechanism and/or facilitate functions performed on the network they are created in; their value is driven by market supply/demand therein.

Settlement Token

- Representation on DLT or blockchain infrastructure of underlying traditional securities/financial instruments issued on a different platform (e.g., a traditional CSD, registrar, etc.) where such representation itself does not satisfy the definition of a security or financial instrument under local law and is used solely to transfer or record ownership or perform other mid/back-office functions (e.g., collateral transfer, recording of ownership)

Utility Token

- A means of accessing a DLT or blockchain platform and/or a medium of exchange which participants on that platform may use for the provision of goods and services provided on that platform (e.g. loyalty rewards programs/systems, gift card rewards, credit points that are only usable within the DLT or blockchain platform, memory and network server space, and other utilities- based value); or
- Tokens that are not native to the underlying network but are used for accessing applications that are built on top of another DLT or blockchain infrastructure platform (dApp)

Other Crypto-Assets (not structured as value-stable crypto-assets)

- Representation on DLT or blockchain infrastructure of ownership in tangible or intangible underlying assets or of certain rights in those assets (such as interest, e.g., loans), which are not securities or financial instruments (e.g., real estate, art, intellectual property rights, precious metals, grains, or non-fungible assets that only exist in digital form on a DLT network); they may represent a claim on the issuing entity or the underlying assets.

---

498 This category encompasses different regulated instruments from a legal perspective, which may attract different regulatory treatment amongst themselves and across jurisdictions.