Position Paper: Reassessing the Regulatory Approach to Permissionless Blockchains

Introduction

The Basel Committee on Banking Supervision's Consultative Document on Cryptoasset Standard Amendments[1] exhibits a notably cautious stance on permissionless blockchains, emphasising perceived risks over potential benefits. The European Crypto Initiative (EUCI) argues that the Committee's approach is overly conservative, potentially stifling innovation and overlooking the robust security measures and benefits that permissionless blockchains like Ethereum offer. We propose a reassessment based on evidence-based risks and technological advancements that will support the integration of public blockchains into the financial ecosystem.

Misrepresentation of Risks and Benefits

Evidence-Based Risk Analysis

The Consultative Document outlines concerns regarding permissionless blockchains, particularly related to networks' reliance on third parties to carry out basic operations without sufficiently evidencing these risks with real-world occurrences or comparative analysis with existing financial systems. Therefore, EUCI feels it necessary to stress that contrary to the assertion of their unmitigated risks, permissionless blockchains have demonstrated increasing resilience and security. This trend is particularly notable since Ethereum's transition to a Proof-of-Stake consensus mechanism, which reduced dependency on third-party validators.

AML/CFT Risks Overstated

Furthermore, we find it crucial to note that the perception that permissionless blockchains inherently increase Anti-Money Laundering (AML) and Countering the Financing of

[1] Available here: https://www.bis.org/bcbs/publ/d567.html.

Terrorism (CFT) risks is questioned by empirical evidence. Studies, such as those previously conducted by Elliptic and Chainalysis, show that the proportion of crypto transactions linked to illicit activities is significantly lower than that of those in the traditional banking sector.[2] Furthermore, the inherent transparency of public blockchains facilitates tracking and tracing transactions, enhancing rather than diminishing AML/CFT efforts. This technical characteristic, combined with the soon-to-be applicable EU regulatory framework based on the Transfer of Funds Regulation and the Anti-Money Laundering Regulation, further suggests that the mentioned AML/CFT risk is greatly exaggerated as compliant solutions are currently being implemented.

Technological Advancements and Security

Resilience of Public Blockchains

Permissionless blockchains, especially Ethereum, have so far shown exceptional resilience to cyber-attacks and operational risks[3], with the decentralised nature of these platforms distributing risk and preventing single points of failure.

Conclusion and Recommendations

While likely rooted in a desire to protect financial stability, the Basel Committee on Banking Supervision's cautious stance towards permissionless blockchains risks sidelining a transformative technological evolution. A balanced approach that recognises the unique benefits and advances in security and resilience offered by permissionless blockchains is necessary. We recommend:

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[2] See, for example, Chainalysis' 2024 *Crypto Crime Trends*, available here: https://www.chainalysis.com/blog/2024-crypto-crime-report-introduction/ and Elliptic's 2023 *Report on Preventing Financial Crime in Cryptoassets*, available here: https://www.elliptic.co/hubfs/Typologies%202023/Elliptic_Typologies_2023_Report.pdf.

[3] See, for example, *Blockchain as a Cyber Defense: Opportunities, Applications, and Challenges*, available for download here: https://www.researchgate.net/publication/357102811_Blockchain_as_a_Cyber_Defense_Opportunities_Applications_and_Challenges, and *Ethereum's Peer-to-Peer Network Monitoring and Sybil Attack Prevention*, available here: https://inria.hal.science/hal-03777454/document.

1. Conducting a comprehensive, evidence-based and case-specific analysis of the risks and benefits associated with permissionless blockchains.
2. Recognising and incorporating technological advancements in blockchain security and consensus mechanisms.

EUCI believes that by adopting a more nuanced and forward-looking regulatory approach, the Basel Committee can foster an environment that leverages the full potential of permissionless blockchains for the future of finance.