REGULATING LIBRA & OTHER STABLECOINS

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Regulating Libra and other Stablecoins

- What could SCs deliver?
- Regulatory assessment
- Individual perspective: eg. where GSC refers to basket need to hedge against volatility (devel. countries)
- E.g. Libra as large-scale global basket could find appeal among multi-nationals

§ 1

What could SCs deliver?

- Stability matter of perspective and design
- Less so in developed, more so in developing countries
- Individual perspective: eg. where GSC refers to basket need to hedge against volatility (devel. countries)
- E.g. Libra as large-scale global basket could find appeal among multi-nationals

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- Cash-in, cash-out (+) if a consortium ensures acceptance
- Liquid currency for the unbanked? But:
    - illiquidity of scarcely traded currency
    - clients to pay the illiquidity bill

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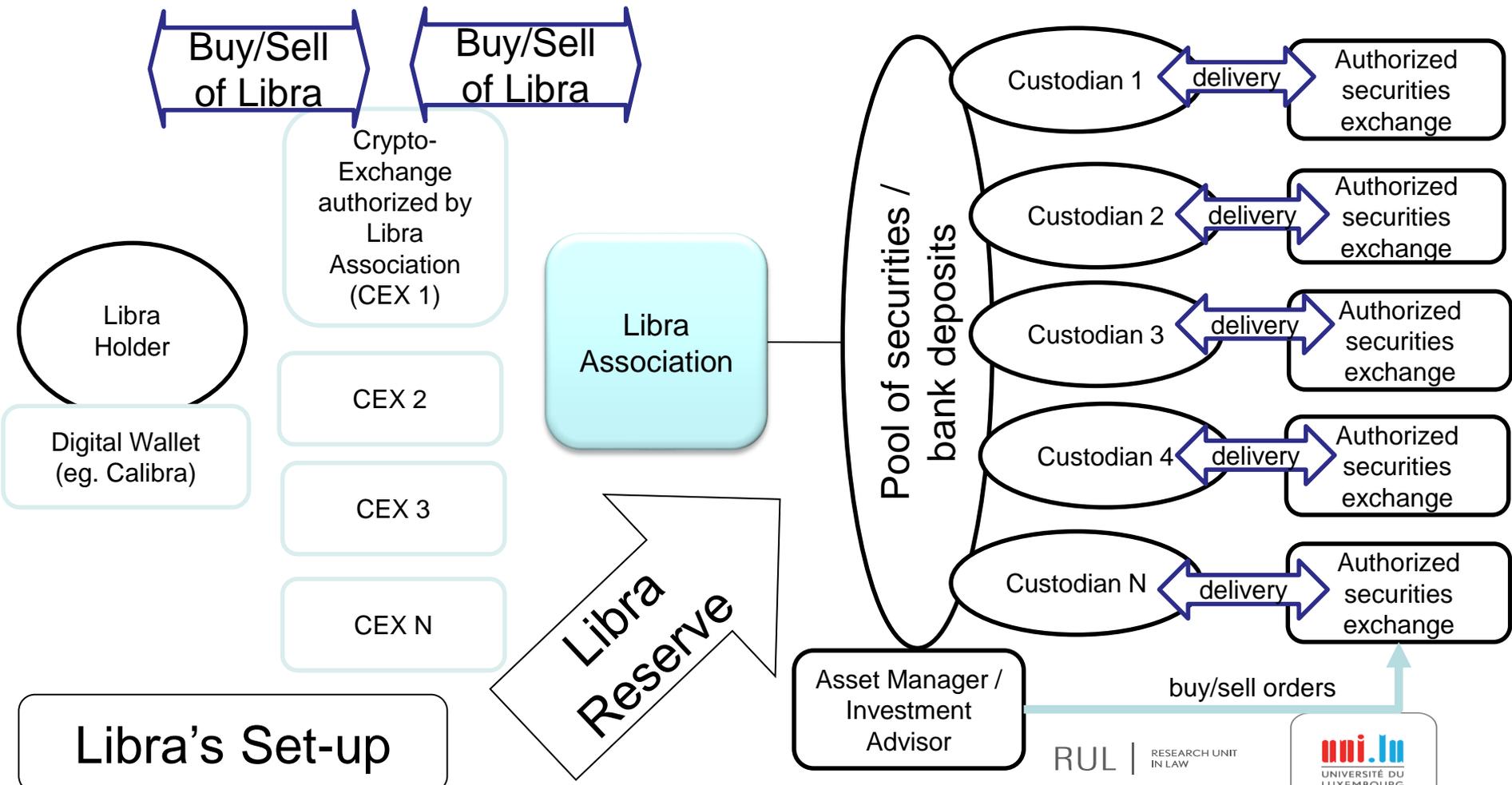
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- Remittances to exceed global development assistance
- Costs of remittances 5-15% of wired amount
- Uber: 800 million reasons for a GSC
- Who does save the costs?
- How will the money get back on the ground? (agents?)

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§ 1.4. Disruptive Potential

- SCs as such do exist for several years
- Scale as 'game changer: e.g. Libra's link to Facebook
- Banks to loose out against BigTechs for lack of scale and data
- BigTech to develop TechFin-Ecosystems instead of FS

§ 2

Regulatory Assessment: Services

Libra's Set-up

Buy/Sell of Libra — Buy/Sell of Libra

Libra Holder

Digital Wallet (eg. Calibra)

Crypto-Exchange authorized by Libra Association (CEX 1)

CEX 2

CEX 3

CEX N

Libra Association

Libra Reserve

Pool of securities / bank deposits

Custodian 1 — delivery — Authorized securities exchange

Custodian 2 — delivery — Authorized securities exchange

Custodian 3 — delivery — Authorized securities exchange

Custodian 4 — delivery — Authorized securities exchange

Custodian N — delivery — Authorized securities exchange

Asset Manager / Investment Advisor — buy/sell orders

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§ 2.1. SC provider as payment system? – The example of Libra

- Libra applied for payment systems license in Switzerland (10/09)
- Swiss Finma (11/09/19):
    - PS for stablecoins (+) subject to certain conditions (eg. Libra holders do not participate in the pool, but pool functions as guarantee fund)
    - PS provider subject to additional requirements re Libra Reserve, risk man't etc.

$\Rightarrow$ Switzerland does not have a PSD2 framework

$\Rightarrow$ Applies CPMI/BIS Principles for Financial Market Infrastructure (PFMI)

$\Rightarrow$ Advantage: harmonized global approach

- **If GSC provider = Payment System => CEX, Wallet Providers?**
  - US: Money transmitter (US)
  - EU: Payment Service Provider <u>or</u> E-money institutions
  - Non-US/EU often: bank

- **And: bank or credit institution *if accepting deposits***
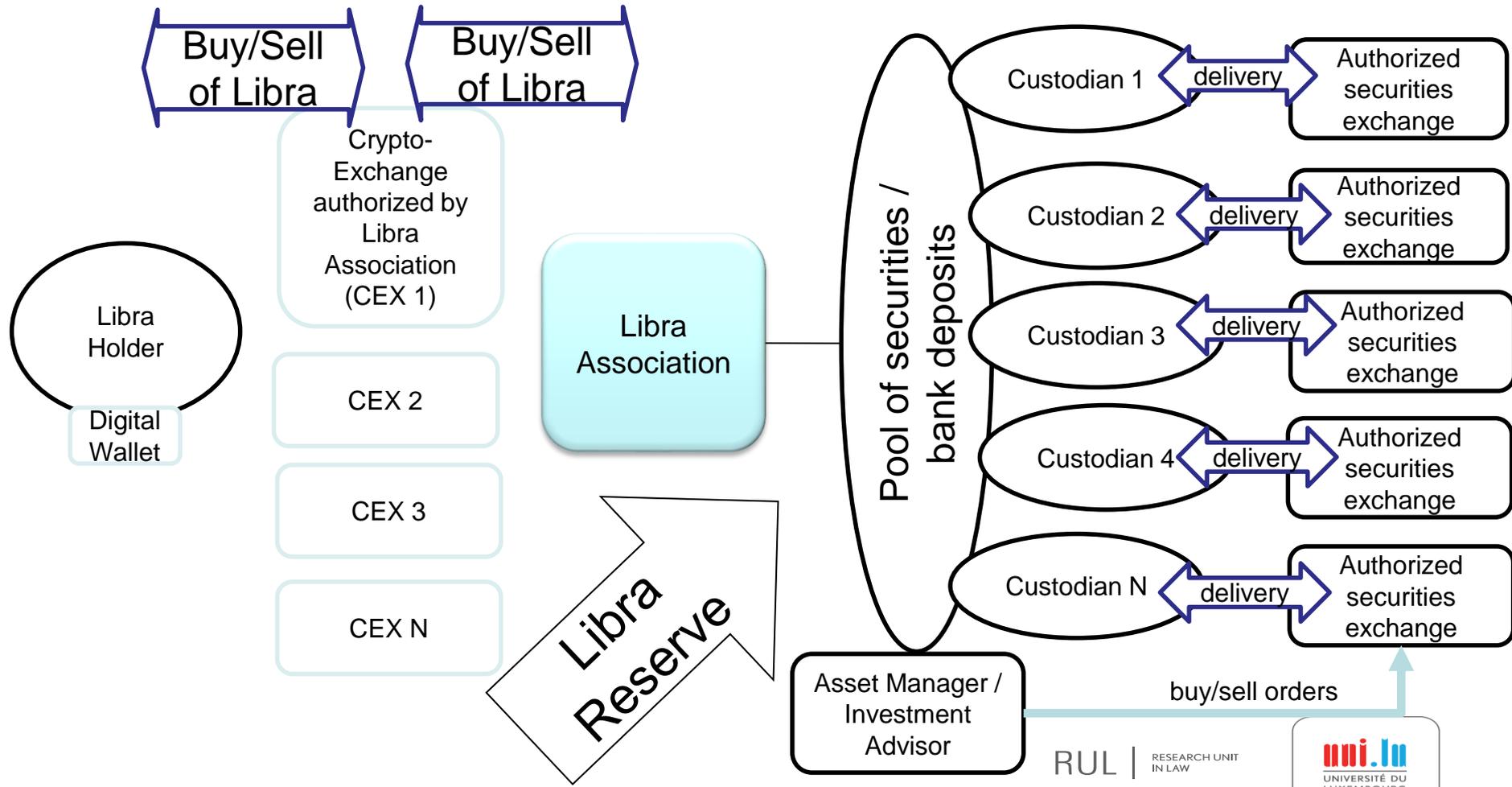
§ 2.2. Services: GSC as Collective Investment Schemes

- Where SC holders participate in « pool of assets » (i..e bear risk of asset / risk management): CIS.

- Example of Libra (6/19):
  - No 'hard balance sheet' between Libra holder and Reserve
  - Language to indicate some participation
  - Holders seem to bear some of the risks relating to reserve management
  - ⇒ EU: UCITS under the UCITSD and MMF regulation

§ 3

<u>Regulatory Assessment: Coin Characteristics</u>

- Categorizing a stable coin?
- Money?
- Currency?
- Securities?
- Commodities?
- (Financial) Derivatives?
- Financial instrument?

Uncertainty remains
≈ ICOs

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- **US**: speculating on increase in value?
  - 'security' subject to Howey test? (+) if benefitting from others' work
  - 'proceeds' from the Libra reserve? (+)
  - 'functional' view (+): cross-currency stability as 'benefit'?
    [replaces currency hedges, and currency hedges would qualify as derivative)
  - isolated view (?)
- **EU**: 'financial instrument' (+), since link (as derivative) to financial instruments through participation in the Libra reserve (unless Libra Association group takes all risks with own balance sheet)

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§ 4

Regulatory Assessment: Reserve Management & Capital Requirements

§ 4.1. Reserve Management (Asset & Risk Management)

$\Rightarrow$ A GSC as cash equivalent requires many daily NAV calculations

$\Rightarrow$ GSC reserve concept does not work <u>if fragmented</u>, either due to regulation or due to factual reasons (infrastructure etc.)

- <u>AM/RM</u> of GSC reserve challenging
- MiFID/AIFMD/UCITSD firm if service to clients
- <u>Safekeeping to clients:</u> credit institutions, MiFID firms

$\Rightarrow$ And what about tech risk?

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- Main concern: Op Risk and financial currency risks
- *If GSC reserve diversifies* through currency baskets (eg. Libra): most currency risk in the IMF basked is likely to even out
- Substantial Op Risk to be covered by GSC provider

$\Rightarrow$ PSP, fund manager licenses do not come with <u>significant capital</u> requirements; MiFID investment firms => CRR

$\Rightarrow$ Capitalization of Tech Risk?
(GSC as Core of Financial Ecosystem?)

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- Money transmitter / PSP disclosures patchy at best
- Investment-style disclosures justified: portfolio of Libra reserve, exposures to single currencies, hedging costs, use of proceeds, cost and fee allocation, agent reimbursement etc.
- Ensured if Libra qualifies as MMF.

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- Identity & AML, in particular re DCs; Libra ID = new official ID?

- Monetary regulators (central banks) to loose some influence over monetary policy; major concern in non-US countries; crisis management measures (capital controls? Global custodians: US control?)

- Data Protection

- Tax

- …

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§ 5

Crossborder Supervision

§ 4.1 – Need for Crossborder Harmonization

- Global cooperation in regulating Libra a 'must have' for cross-regional interoperability and global risk management (TBTF)
- Libra reserve concept does not work if fragmented, either due to regulation or due to factual reasons (infrastructure etc.)

- Recognition of foreign licenses across the globe limited to
  - financial derivatives
  - Globally SIFI Payments Systems under CPMI/BIS accord
- Equivalence-based substituted compliance only in EU

Regulatory frameworks that could apply to stablecoins
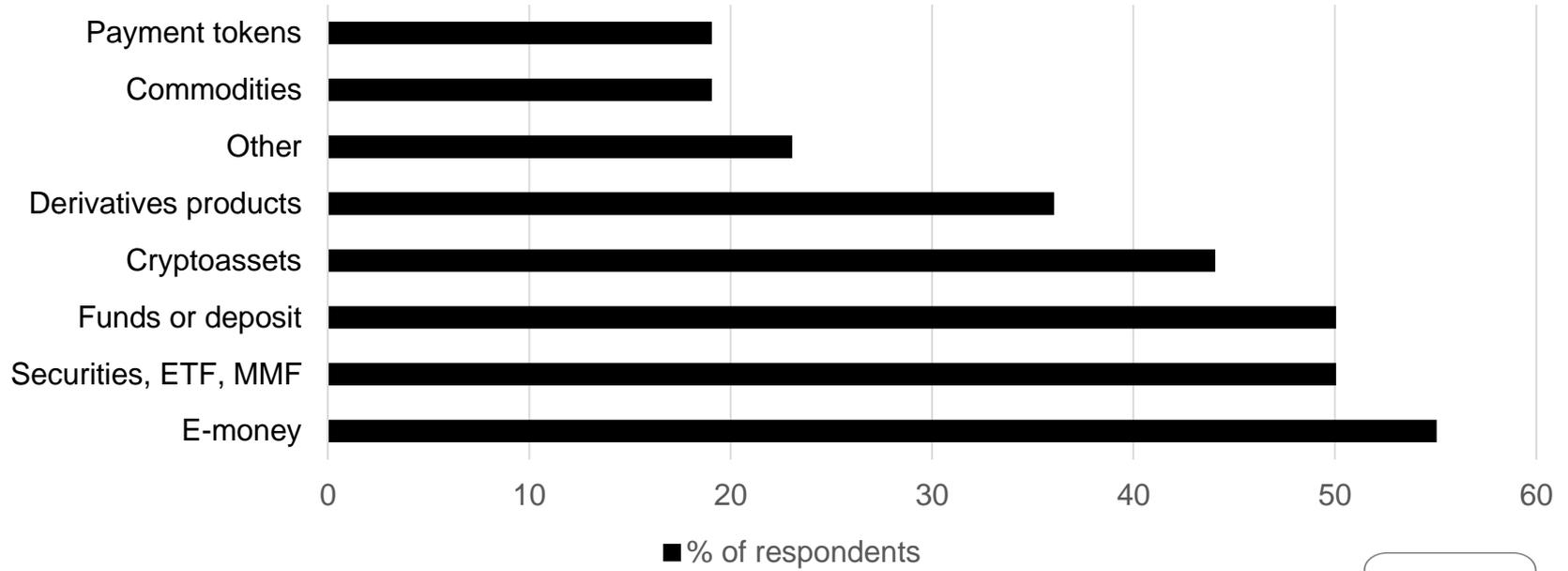
§ 6

Some results

- Libra's expected growth: towards «too large too fail» within seconds
- Licensing depends on interpreting vague documentation; Libra 'outsources' assessment to regulators; more than PS; Libra as MMF? Depends on Libra holders' position vis-a-vis Libra Reserve.
- New test case for global collaboration; fragmentation as barrier
- Libra: the unfair lady
  - EU/D: very restrictive approach likely for monetary policy reasons
  - US: less friendly reception ensured.
- Libra as door-opener for more successful clones by more welcome later movers? (Alibaba, Apple, Google & the likes)

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AFTER BITCOIN & LIBRA: TOWARDS CBDCS
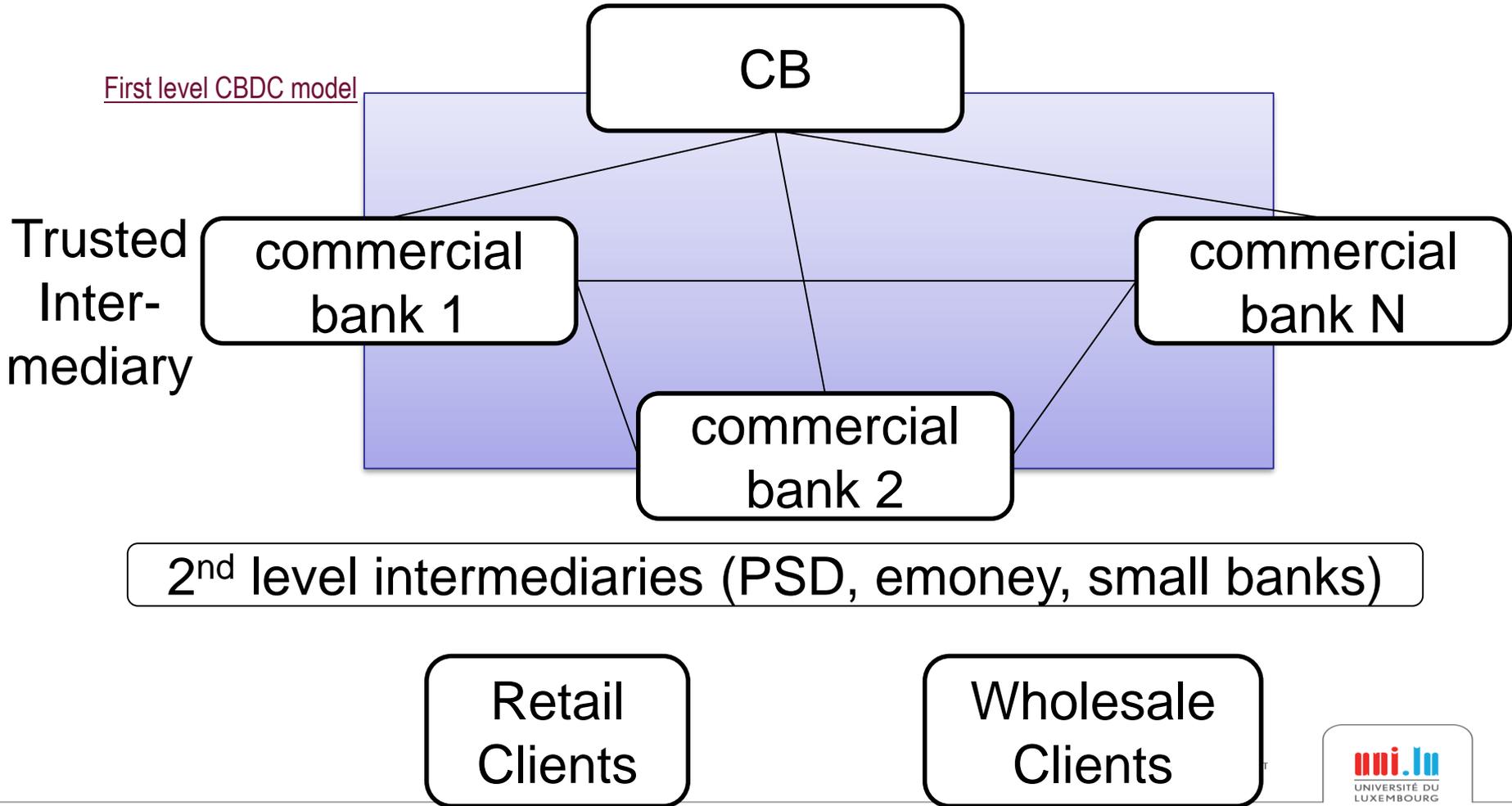
Based on *Didenko/Zetzsche/Buckley/Arner*, After Bitcoin & Libra, *forthcoming*

- Purely private CCs do not work (or face resistance to ensure they do not work)
- Purely public CCs?
  - Disintermediate the banking sector?
  - State / CBs not better at managing millions / billions of retail accounts and their woes
  - CBs could employ private sector for operations, but: liability?
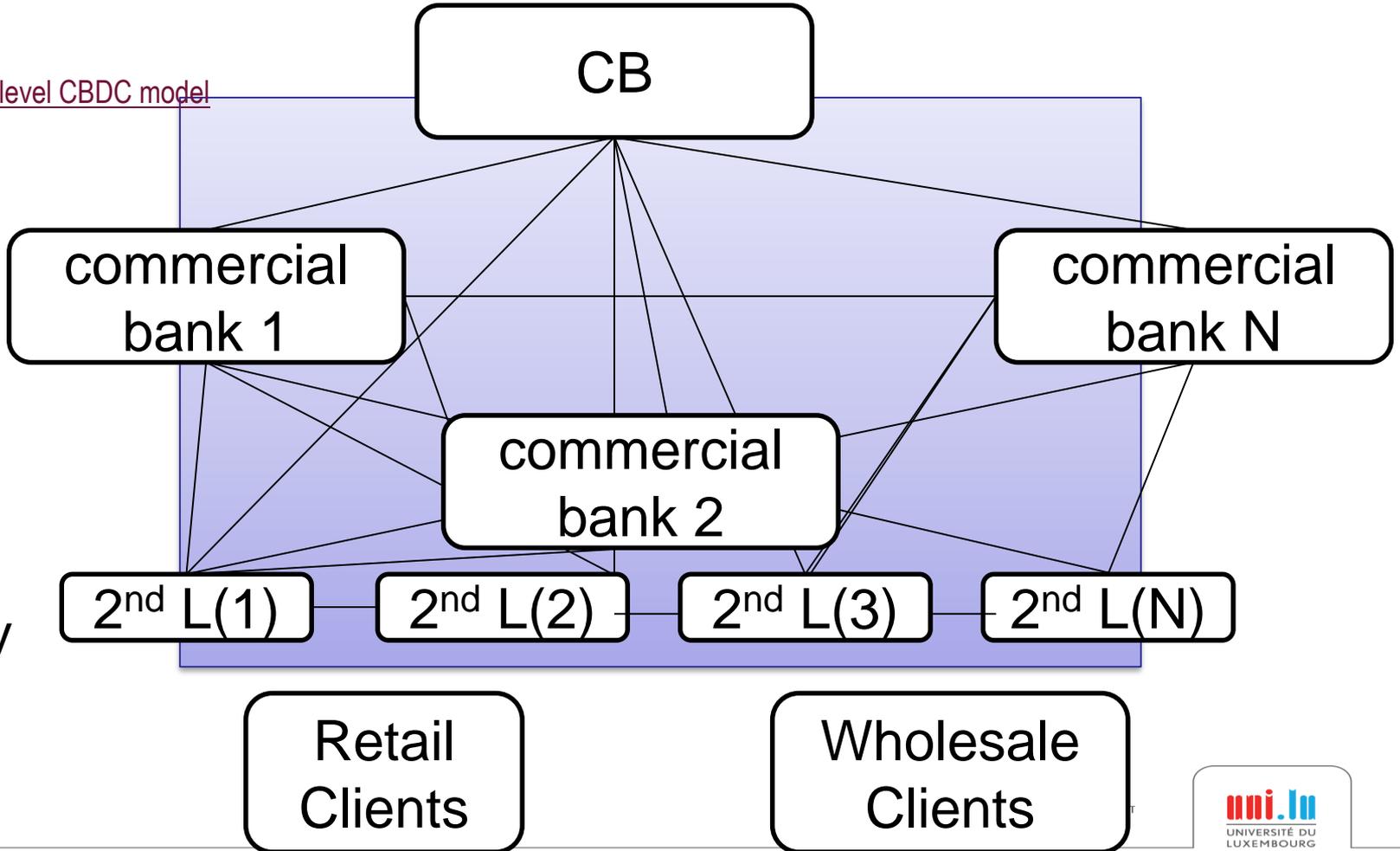 - $\Rightarrow$ Purely public CCs do not work either

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Where do we stand?

- Purely private CCs do not work (or face resistance to ensure they do not work)
- Purely public CCs do not work either

$\Rightarrow$ Cooperation necessary

$\Rightarrow$ How much public and how much private?

Second level CBDC model

CB

Trusted Inter-mediary
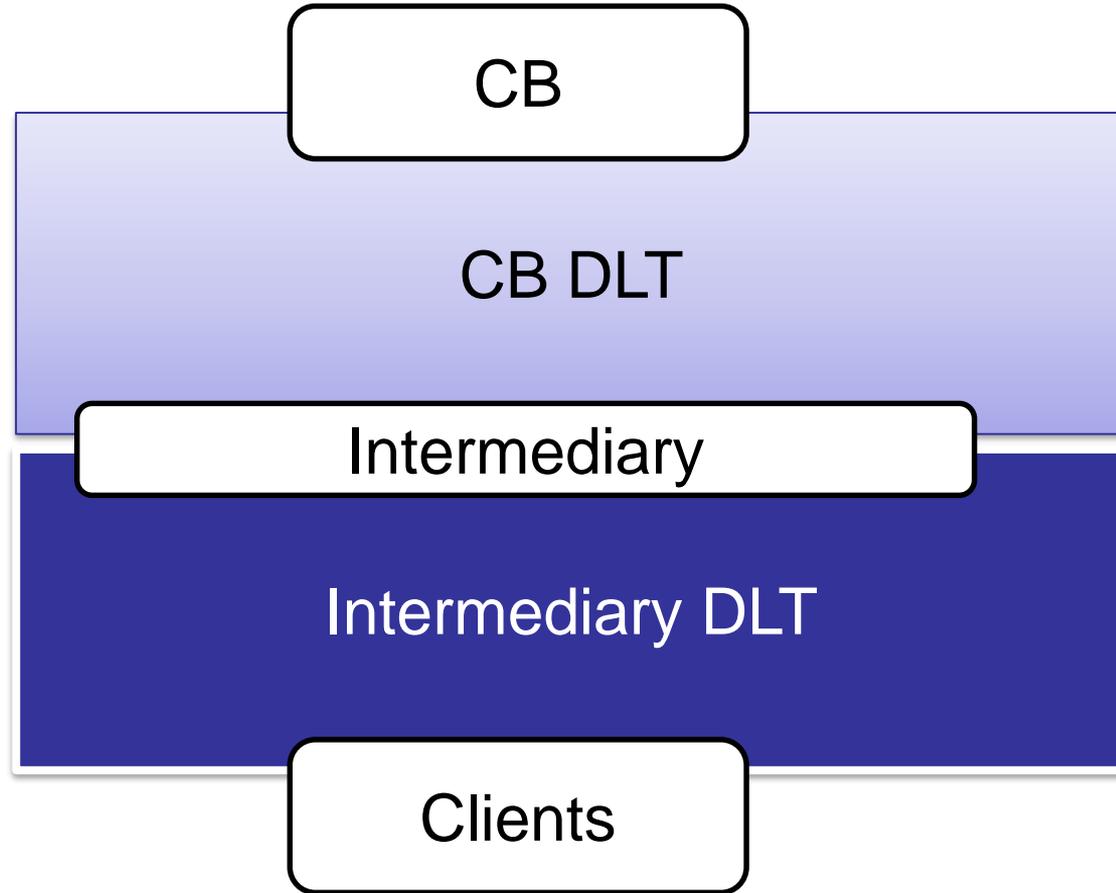
commercial bank 1

commercial bank N

2nd Lvl Inter-mediary

commercial bank 2

2nd L(1) 2nd L(2) 2nd L(3) 2nd L(N)

Retail Clients

Wholesale Clients

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Two layer CBDC model

CB

CB DLT

Intermediary

Intermediary DLT

Clients

<u>Con</u>

- Purely private CCs do not work (or face resistance to ensure they do not work)

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<u>Conclusion & Thesis</u>

- Stablecoins have given the CBDC thinking new motivation

- Intermediary with CB access likely to persist due to liability shielding, investment and technology guidance through competition

- CBs to replace intermediary vis-a-vis client handling only where intermediary level dysfunctional (e.g. DCs, antitrust)

- Intermediaries with CB access likely to increase by numbers and include all licensed financial intermediaries with account functions; CBs to ensure operational efficiency through tokenization? Possible.

- Rents from CB access to sink. CBs need to deal with more intermediaries.

- Main Issue of two-layer-CBDC systems: ensure interoperability; SEPA for CBDCs?

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Readings on FinTech

Future of Data-Driven Finance
www.ssrn.com/abstract=3359399

FT4FI Roadmap
www.ssrn.com/abstract=3245287

Distributed Ledgers / Blockchain
www.ssrn.com/abstract=3018214

TechFin / Data-driven Finance
www.ssrn.com/abstract=2959925

Corporate Technologies (AI etc.)
www.ssrn.com/abstract=3392321

Rise of Tech Risk
www.ssrn.com/abstract=3478640

eID / KYC Utilities
www.ssrn.com/abstract=3224115

Regulatory Sandboxes
www.ssrn.com/abstract=3018534

Regulating Libra
www.ssrn.com/abstract =3414401

ICO Gold Rush
www.ssrn.com/abstract=3072298

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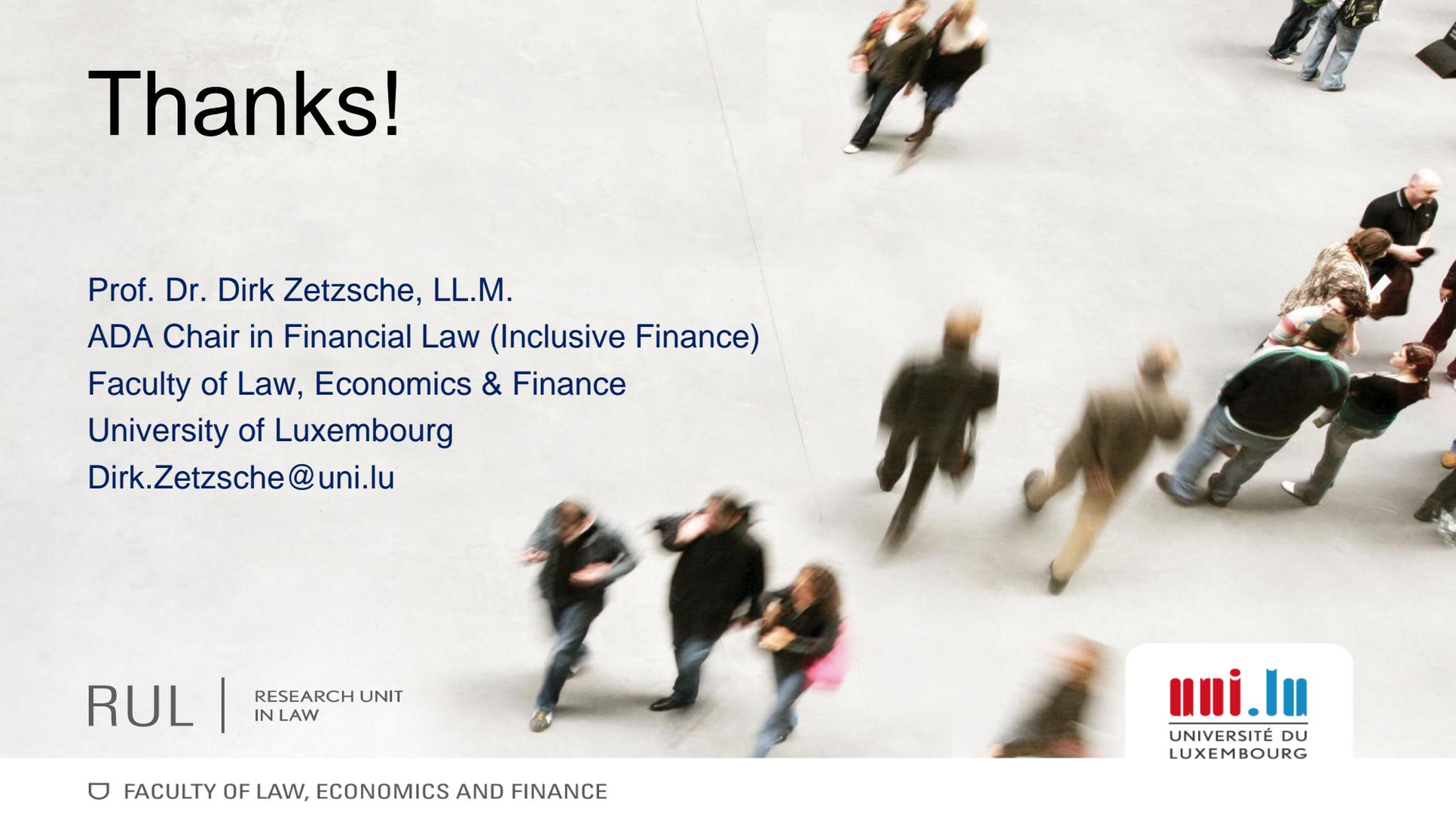
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Thanks!

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