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The Digital Regulator

The regulatory endorsement of global stablecoins (GSCs)

Abstract

International regulators reacted strongly to the announcement of the GSC project Libra in June 2019 by BigTech Facebook. The resultant debate on the merits and threats of GSCs created a fundamental regulatory uncertainty regarding the possibilities for GSCs to be issued in the first place, effectively putting such projects on hold. In July 2020, the Financial Stability Board (FSB), acting on behalf of the G20, concluded the public consultation on how to regulate GSCs. The joint consideration of the consultation paper and the comments received on it indicate a fundamental endorsement of GSCs by international regulators. The debate moves on to the implementation stage, wherein the manner of implementation of GSCs along with the application of the specific regulatory provisions need to be defined. As a consequence, GSC projects—including Libra—can resume full steam, and improved financial inclusion as well as cheaper and faster processing of (international) payments get closer. Overall, this fundamental endorsement of GSCs provides blockchain-based finance with a further boost.

The last few weeks have witnessed some other noteworthy developments in the area of digital regulation, such as the selection of Switzerland-based SEBA Bank AG by the Banque de France to help test wholesale Central Bank Digital Currency (CBDC) and the formal authorization granted to US banks by the Office of the Comptroller of the Currency (OCC) to offer custody services for cryptocurrencies.

GSCs: From fundamental concerns to fundamental endorsement

The announcement of project Libra by BigTech Facebook one year ago was followed by an intense and vital regulatory debate about the virtues and threats of GSCs. The debate has involved the most influential regulatory policy bodies globally, including the G7 and G20, the FSB, the Bank for International Settlements (BIS), the International Monetary Fund (IMF), the Financial Action Task Force (FATF), the International Organization of Securities Commissions (IOSCO), the European Central Bank (ECB), and many national authorities (for

example, those of France, Germany, England, and Switzerland). Despite a consensus around the legitimate nature of the problems GSCs set out to address (financial inclusion and cost and speed of international payments), the authorities emphasized the fundamental issues preventing the authorization of such projects in the first place. These items ranged from anti-money laundering (AML) and governance concerns to financial stability aspects and threats to national currencies of a geopolitical nature, thus generating a fundamental uncertainty around GSCs that halted related projects. The nature of the FSB consultative paper on the regulatory, supervisory, and oversight challenges arising from GSCs and the associated regulatory recommendations, as well as the tenor of the positions sent in by various stakeholders by the deadline (July 15, 2020), have clearly signalled the removal of the fundamental uncertainty and paved the way toward the implementation of GSC projects.

- ✓ *A fundamental uncertainty surrounds GSCs* – Facebook officially announced its GSC project Libra in June 2019, which aims to reduce the current cost and speed of international payment processing and improve financial inclusion (access). It plans to achieve these goals through the implementation of a permissioned blockchain solution and an end-user application, as well as the minting of cryptographic coins entirely backed by fiat reserves. International regulators recognized the validity of the problems that the project set out to solve, but immediately signalled that the approval process for Libra would be tortuous and long. They flagged the potential systemic importance of Libra, its (geo-political) threat to state currencies and monetary policies, along with the governance and AML issues. Facebook’s poor data privacy track record added to the regulatory concerns. The authorities rushed to emphasize “mass regulation before mass adoption,” and clarified their intention to hold GSC projects such as Libra against the highest prudential regulatory standards before considering its implementation. Libra chose to incorporate in Switzerland, the leading crypto-jurisdiction. The Swiss financial regulator FINMA stated its position on Libra in October 2019—the project’s launch would need a payment system license incremented by prudential regulatory requirements as well as an environment of effective international regulatory coordination. By the same token, FINMA complemented its initial coin offering (ICO) guidance with an appendix addressing smaller and non-

global stablecoin projects, subjecting these to regulatory pre-clearance. In October 2019, the G20 ruled that no authorization for GSCs would be given unless the challenges and risks posed by such projects were fully addressed. This decision halted de facto Libra and any other similar GSC projects. The G20 tasked the FSB to analyze the issues and develop a set of recommendations on how to authorize such projects.

- ✓ *The fundamental uncertainty leaves room for implementation* – On April 14, 2020, the FSB issued a consultation ^{link1}paper on “Addressing the regulatory, supervisory and oversight challenges raised by ‘global stablecoin’ arrangements.” The consultation ended on July 15, 2020, and around 50 responses ^{link1}were handed in. The FSB describes how GSCs differ from other crypto-assets and other stablecoins, and analyzes the risks that GSCs raise. It identifies issues that regulators, supervisors, and oversight authorities need to address, including cross-border challenges. It proposes a set of recommendations to address the challenges. The consultative paper and the responses received during the consultation period indicate that international regulators have largely welcomed GSCs. This state of affairs eliminates the possibility of a fundamental ban on such coins and resolves the uncertainty that had surrounded GSC projects. It moves the debate and the work to the implementation level. The nature of the recommendations suggests that it will take a long time to translate the regulatory recommendations into actionable points. This work shall ideally be carried out in connection with the approval process of specific projects. The responses also reveal that, in the final version of the paper, the stakeholders have expressed interest that the FSB distinguish less sharply between GSCs and other stablecoins (as a non-GSC may well develop into a GSC over time), refine the risk analysis of stablecoins, recognize the peculiarities that currently characterize the crypto market infrastructure, and ensure pragmatism in dealing with international differences characterizing the applicable legal framework.

Overall, the culmination of the consultation and the fundamental endorsement by industry and regulators of the innovative GSCs open the possibility for GSC projects to be implemented in coordination with relevant international regulators in the future. In this context, it is reasonable to expect several GSC projects to enter the implementation phase during the second half of 2020 and see light before the end of

2021. The materialization of this ideal scenario would benefit the entire cryptofinance and blockchain industry, incentivizing innovation and applications, and further progressing the broader and mainstream acceptance of cryptofinance.

Other noteworthy developments

Banque de France ^{link1}(BdF) acknowledges the excellence of crypto nation Switzerland by selecting SEBA Bank AG to test wholesale CBDC.

- ✓ SEBA Bank AG is among the eight candidates selected by the BdF to test the integration of a CBDC for interbank settlements. The pilot projects will also attempt to establish how CBDCs can be distributed and used for cross-border payments.

The US Office ^{link1}of the Comptroller of the Currency (OCC) authorizes banks to offer cryptocurrency custody services. This decision is expected to benefit the development and adoption of cryptofinance in the US.

- ✓ The pivotal decision was taken after recognizing that providing cryptocurrency custody services, including holding unique cryptographic keys associated with cryptocurrency, is just a modern technological form of traditional bank activities related to custody services.

The BIS ^{link1}innovation hub expands operations. Cryptofinance is bound to benefit from this work.

- ✓ The BIS hub adds new centres in Toronto, London, Frankfurt, Paris, and Stockholm to the existing centres in Switzerland, Singapore, and Hong Kong, and agrees on a strategic partnership with the Federal Reserve Bank of New York. This expansion positively impacts cryptofinance because the hub focuses on CBDCs and stablecoins, as well as on the tokenized securities environment.

By investing ^{link1} over USD 48.2 billion in blockchain by 2025, South Korea lines up to become a leading blockchain nation.

- ✓ The planned investment of over USD 48.2 billion in blockchain and other Industry 4.0 technologies by 2025 is expected to promote digitization in the form of big data, networks, and artificial intelligence, preliminarily in the logistics sector. The creation of over 567,000 jobs is expected.

China ^{link1} confirms its aspiration to lead blockchain-based applications globally by making Beijing a blockchain innovation hub by 2022.

- ✓ China plans to transform Beijing into a hub for blockchain innovation over the next two years. To achieve that goal, it has produced a development plan that assigns a role integral to blockchain technology in concrete projects. The plan also contemplates supporting the research and development of blockchains and encouraging adoption.

Conclusion

Summer 2020 is likely to be remembered in the digital regulatory space by what the conclusion of the consultation period on the FSB paper “Addressing the regulatory, supervisory and oversight challenges raised by ‘global stablecoin’ arrangements” really signified—the end of the fundamental uncertainty surrounding the possibilities for GSC projects. These projects can now resume full steam toward implementation mode—a phase which should be ideally carried out in active cooperation with the relevant regulatory authorities. On a more holistic note, the resolution of the fundamental uncertainty that has surrounded GSC projects is bound to further boost crypto finance adoption globally over time.

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