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The Digital Regulator

International regulators tackle the issues of stable coins and digital money

Abstract

Libra was a wake-up call for international regulators last summer. They realized that cryptocurrencies could rapidly become systemically relevant if they were to substitute national currencies to some extent. Analyses by the G7, Financial Stability Board (FSB) and the Bank for International Settlements (BIS) led to the introduction last October of a new category of token, the GSC, and to the formulation of strict authorization requirements. As a consequence, no such coin will be issued in the short term. The official sector has also been quite clear about the ineluctability of CBDCs and has initiated work to integrate CBDCs into a Distributed Ledger Technology (DLT) infrastructure.

Reportedly, China has positioned itself as a potential first CBDC mover. Depending on who starts the innovation process and on the degree of international influence of its currency, the current international monetary system based on the USD as a global payment currency could be challenged. Irrespective of conjectures, the intense regulatory focus has enhanced trust in digital and crypto finance.

The last few weeks has been rich of other noteworthy developments. Confirmation has been given in the US that the Bitcoin (BTC) and Ether (ETH) are not securities – and therefore fall outside the remit of securities law; that Liechtenstein has written history by becoming the first state to provide a comprehensive set of rules for a digital asset ecosystem; that China has unveiled plans to become a leading blockchain jurisdiction, and that Japan and Hong Kong have introduced guidelines for crypto fund managers.

Global Stable Coins are subject to new regulations

International regulators have introduced GSC as a new category and set strict authorization conditions for private initiatives, making the creation of a GSC such as Libra impossible for the time being.

- *On 13 October 2019, the FSB*[link1] *wrote to the G20 Finance Ministers and Central Bank Governors highlighting the regulatory challenges that the introduction of GSC would pose.* The GSC category is a new one, and highlights the potential of stable coin emerging from private initiatives to become systemically relevant by substituting domestic currencies to some extent. Such GSC would raise new challenges for financial stability, consumer and investor protection, data privacy and protection, financial integrity (including AML/CFT and KYC compliance), mitigation of tax evasion, fair competition and anti-trust policy, as well as market integrity. They would also raise the importance of sound and efficient governance, cyber security and operational risk management to previously unseen levels, and would question the appropriateness of the legal basis, in association with the private initiative.

✔ *On 17 October 2019, the BIS*[link1] *referred to the challenges highlighted by the FSB and concluded that no GSC project would be authorized unless the challenges and risks outlined were adequately addressed.* The BIS recalled that before being considered for authorization, the design of GSC provisions by the private sector would be expected to address a wide array of legal, regulatory and oversight challenges and risks, to adhere to the necessary standards and requirements, and to comply with the relevant laws and regulations of the various jurisdictions in which they are to operate. They would also need to incorporate sound governance and appropriate end-to-end risk management practices in order to address risks before they are implemented.

Further growth in public-sector resistance towards the GSC project Libra

✔ *In France as well as in Germany, high-ranked politicians think Libra should not happen. CBDCs are the way forward.* Germany's Finance Minister[link1] said that the launch of Facebook's digital currency Libra should be prevented because the creation of such a global currency is the responsibility of democratic states . The French Minister of the Economy and Finance noted that the Libra project would mean a private company controlling a common good and taking over tasks normally carried out by states[1]. This is unacceptable[link1] for both economic and political reasons. Further, a regulatory response would not be able to address the risks, because Libra is asking states to share their monetary sovereignty with private companies. The way forward is for the public sector to develop innovative national and cross-border payment methods which are faster and cheaper, and to consider the creation of CBDCs.

✔ *China does not believe in Libra and announces it will be the first to issue a CBDC.* China added that it believes Facebook's Libra is doomed to fail[link1] because it lacks political support. The Vice Chairman of the China International Economic Exchange Center predicts that China's central bank will be the first to issue a CBDC.

- *The Libra project is meeting with resistance in the UK and the US alike.* The Bank of England (BoE) expanded on the conditions [link1]laid down by international regulators and said that the Facebook-led Libra cryptocurrency project would need to grant access to the BoE for the purpose of monitoring payment chain information. The US Congress[link1], for its part, is considering (by means of a bill) urging Facebook and its partners not to launch Libra – and even asking them to halt all development entirely – until regulatory questions about the project and its governance can be resolved.

International regulators have started analysing the integration of CBDCs into a DLT infrastructure and now recognize the inevitability of CBDCs

- *On 8 October 2019, the BIS announced the signature of an agreement with the Swiss National Bank (SNB) to create a BIS Innovation Hub Centre in Switzerland*[link1]. The Hub will initially conduct research on (i) the integration of CBDCs into a DLT infrastructure to facilitate the settlement of tokenized assets between financial institutions, and (ii) the requirements needed for central banks to effectively track and monitor fast-paced electronic markets.

- *On 15 October 2019, the BIS noted that the digitalization*[link1] *of means of payment is inevitable.* The BIS is observing increased sophistication of internet technologies, demand for continuously available payment services, the emergence of big techs and major retailers as players on the payments market, the mushrooming of new projects for tokens designed to serve as means of settlement using blockchain technology, as well as the emergence of electronic payment instruments and systems. It concludes that new forms of digital payment methods will emerge.

Other noteworthy developments

BTC and ETH are not classed as securities in the US; securities law does not apply

- The US Commodity Futures Trading Commission (CFTC) has said that Ether, like Bitcoin, is a commodity[link1], not a security . The US Securities and Exchange Commission (SEC) has made it clear that Bitcoin is not a security[link1].

Liechtenstein passed the Blockchain Act, making the state the first to provide a comprehensive legal framework for digital assets

- Liechtenstein has passed the Blockchain Act[link1], which includes, in particular, the "Token Container Model" and aligns token transfers with civil law. Liechtenstein has become the first nation worldwide to provide a comprehensive set of rules for an ecosystem of digital assets and to establish legal certainty into the area. The Act will come into force on 1 Jan 2020.

The financial authorities in Japan and Hong Kong are introducing guidelines for crypto fund managers; more predictability will foster this industry segment

- The Japanese Financial Services Authority has issued draft guidelines[link1] for funds investing in crypto. The guidelines emphasize volatility and liquidity risks and highlight the composition of such products. The Hong Kong Securities and Futures Commission announced the issue of a pro forma set of terms and conditions for virtual asset fund managers. The document [link1]lists eight general principles for all virtual asset fund managers, including minimum liquid capital requirements.

China embraces blockchain technology, news that has moved the market

- China's President[link1] has emphasized the importance of blockchain technology. The Chinese government intends to accelerate the development of blockchain technology and industrial innovation, and actively promote the development of blockchain and social-economic integration. The Congress passed a cryptography law[link1] that will encourage research and development on commercial cryptography technologies as well as nationwide educational efforts .

Conclusion

The last 4-5 weeks have witnessed a strong regulatory focus on stable coins and, in particular, the introduction of the GSC category and related authorization conditions. These developments have made the creation of a private-sector GSC such as Libra impossible for the time being.

According to BIS statements, there is a clear belief that CBDCs are inevitable. China claims that it will soon issue the first CBDC. The BIS has initiated analysis of their integration into a DLT infrastructure in partnership with the Swiss National Bank. On balance, these developments have helped to enhance collective trust in digital and crypto finance.

Other noteworthy developments include the confirmation by US regulators that BTC and ETH are not securities in the US (this sets these cryptocurrencies outside the scope of securities law), the passing of the Blockchain Act in Liechtenstein (making Liechtenstein the first state to provide a comprehensive DLT legal framework), the introduction of guidelines for crypto fund managers in Japan and Hong Kong (creating further legal certainty). Finally, China has officially embraced blockchain technology, a development that has reverberated through the global crypto economy.

[1] See the Digital Investor - Enter Project Libra

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