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The Digital Regulator

# **COVID-19 pandemic places digital payment regulation at centre stage**

During the coronavirus (COVID-19) pandemic, the literature on digital regulations has focused on digital payment solutions, particularly, Global Stablecoins (GSCs) and Central Bank Digital Currencies (CBDCs). It is reasonable to expect that the pandemic will lead to improved regulatory certainty, which would enable the speedy market entry of digital payment solutions.

## **Introduction**

The advantages of contactless payments and digital banking solutions (web- or mobile phone-based) have emerged quite prominently in the current lockdown (characterised by limited mobility, social distancing, and contactless relationships). Yet, the fundamental opportunities for the development of GSC (i.e. inefficient cross-border payments and inclusion) and CBDC (i.e. de-materialisation of cash) have been recognised long before the pandemic. The renewed regulatory focus on digital payment solutions, due to the current pandemic, reminds us that such solutions depend on regulatory (or legal) certainty to see the light of day.

Reviewing the past 4-5 weeks, we also highlight the development of industry standards by trade associations, for security token offerings (STOs) as well as for digital assets custody; recent initiatives by the Chinese authorities to develop blockchain standards and solutions; the creation of a digital sandbox zone in Portugal; and the pivotal role of the implementation of legal frameworks in influencing success in the blockchain industry (as seen in Switzerland and Malta).

## **Regulatory certainty, a prerequisite for digital payment solutions**

The pandemic and the subsequent lockdown has highlighted the advantages of contactless payments and digital banking solutions.

In the wake of the COVID-19 epidemic, international regulators, such as the Financial Stability Board (FSB<sup>link1</sup>), the Basel Committee on Banking Supervision (BCBS<sup>link1</sup>), and the European Central Bank (ECB<sup>link1</sup>), have focused on discussing private sector's GSC and (retail) CBDC. A few central banks have followed suit<sup>1</sup>. Amid these developments, the Swiss FINMA<sup>link1</sup> announced that the Libra association filed an application for a payment system licence.

The correlation between these discussions and COVID-19 is however a weak one. CBDC and GSC cannot stop a pandemic just like paper money did not cause it. The efforts towards regulation of digital payment solutions had begun well before the pandemic was declared, based on secular trends like de-materialisation of money and the realisation of inefficient cross-border payments. The regulatory focus brought on by the pandemic reminds us that digital payment solutions, fundamentally ready and waiting from a technological perspective, depend on regulatory certainty to see the light of day.

✓ *The pandemic has highlighted the case for digital payment solutions* – Measures to contain COVID-19 have required people to avoid contact with paper money and coins, to maintain social distance and to limit movements. Reportedly, cash and ATM usage in the UK<sup>link1</sup> dropped by 50% in a few days, and Germany<sup>link1</sup> witnessed a surge in contactless payments. Other countries<sup>link1</sup> such as Indonesia, India and Russia urged their citizens to steer away from cash. These incidents can be safely generalised to the entire world. The pandemic has thus vividly shown the value of technologies in allowing the society to bank at arm's length by means of contactless payments and digital banking solutions. The fundamental opportunities for developing these solutions have however been highlighted well before the pandemic – as CBDC was introduced as a result of the secular trend of de-materialisation of money, while GSC was developed due to inefficient cross-border payments and insufficient inclusion. GSC and CBDC are poised to provide financial services in a more efficient way, promote financial inclusion, diversify the payments market, and enhance cooperation amongst regulators.

✓ *Regulatory certainty is necessary to enable digital payment solutions* – GSC systems will see the light of day when regulators provide solutions for the challenges such systems raise. GSC systems heighten the regulatory challenge to mitigate the risk of financial instability that the malfunctioning of such a system would cause. The hurdles are pre-eminently with regard to governance Stabilisation mechanisms, redemption arrangements and reserve management raise market, liquidity, and credit risks. The infrastructure supporting GSC systems also involves operational and privacy risks. The functioning of a GSC system presents legal issues on the rights of redemption and the related processes. Finally, the supervision of a GSC system raises the challenge of effective cross-border regulatory cooperation and dialogue. The providers of GSC systems need regulatory certainty to bring the products to the market. The Swiss regulator FINMA is once again paving the way in creating such certainty by engaging with the Libra association in a license application process. The challenges around the introduction of CBDC are with regard to economic policy. CBDCs may affect the execution of monetary policy and exacerbate the risk of a bank run (e.g. in a crisis, economic agents can easily convert the balances they hold with commercial banks into CBDCs). The Swiss National Bank participates in a BIS<sup>link1</sup>-led group created to assess the case for and address the challenges put forth by CBDC.

In conclusion, the economic situation that brought about the GSC and CBDC systems was noted long before the COVID-19 pandemic. It, however, amplified the advantages and use cases of digital payment solutions, and reminded policy makers to address the regulatory hurdles that hinder such solutions from entering the market. It is reasonable to expect that the renewed focus of regulators on digital payment solutions triggered by this pandemic will enable such products to reach the market faster.

## Other noteworthy developments

*The FSB<sup>link1</sup> issued ten consultative recommendations to advance GSC regulation.*

- ✓ The recommendations, addressed to national authorities, call upon them to embrace functional and risk-based regulations; ensure effective cooperation, comprehensive risk management, and governance frameworks; and grant legal clarity and transparent disclosure. The FSB declared that the implementation of these recommendations would be a pre-condition for authorising any GSC system to operate.

*Trade associations provide industry standards for STOs and Digital Assets Custody.*

- ✓ The Japan Security Token Offering Association (JSTOA<sup>link1</sup>) published self-regulatory guidelines covering the digitisation of transfer rights and the management of client assets. This self-regulation enhances regulatory clarity and favours STOs.
- ✓ The Capital Markets and Technology Association (CMTA<sup>link1</sup>) released Digital Assets Custody Standard with the aim to bridge the gap between traditional asset custody (which is well standardised) and digital asset custody.

*China takes steps to develop blockchain standards and solutions.*

- ✓ The Chinese<sup>link1</sup> government put together a technical committee devoted to the development of standards for blockchain and distributed ledger technology, and also launched<sup>link1</sup> its national blockchain platform to encourage enterprises and individuals to innovate and accelerate the development and use of blockchain technology.

*Portugal creates a digital sandbox zone.*

- ✓ The creation of the “Technological Free Zone” in Portugal<sup>link1</sup> is part of the country’s digital transition action plan. It stands out from the existing sandboxes in that it goes beyond existing approaches in terms of scope and depth.

*FINMA reported investigation into 60 ICOs during 2019, opening enforcement proceedings against three companies.*

- ✓ In 2019, FINMA<sup>link1</sup> carried out investigations into approximately 60 Initial Coin Offerings (ICOs), identifying a breach of the Anti-Money Laundering Act (AMLA) in more than ten ICOs and opening enforcement proceedings against three companies. Switzerland thus demonstrates that its success as a ‘cryptonation’ is owed to an efficient implementation of the legal framework.

*Delays in implementing the legal framework led to departure of several blockchain firms from Malta.*

- ✓ Malta<sup>link1</sup> has failed to license any business even after more than 15 months since the passing of the blockchain legal framework. As a consequence, this led to the departure of a number of companies from the ‘blockchain island’. Thus, Malta has set an example that delayed implementation of the legal framework can complicate the development of a ‘blockchain island’.

## Conclusion

The review of the digital regulation literature during the pandemic has revealed a clear focus on digital payment solutions such as GSC and CBDC. While the focus is understandable, given the circumstances of lock-down and social distancing, the opportunity for digital payment solutions pre-dates the COVID-19 pandemic. Yet, the renewed attention to these topics may bring forward the legal (regulatory) certainty required for the practical solutions to see light.

We have highlighted initiatives by trade associations to standardise STO processes and Digital Assets Custody. We also looked at the different fates witnessed in ‘cryptonation’ Switzerland and ‘blockchain island’ Malta, attributable to the attitudes of commercial banks towards cryptofinance legal frameworks.

<sup>1</sup> These include the Dutch (DNB) and Chinese central banks as well as regulatory authorities in the United States.

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