



Financial Services Management

Global Stablecoin Standards

Cite

Financial Stability Board (FSB), Consultative Document, Addressing the Regulatory, Supervisory and Oversight Challenges Raised by “Global Stablecoin” Arrangements

Recommended Distribution:

Digital Finance, Payment Services, Retail Finance, Custody, Policy, Legal, Government Relations

Websites:

<https://www.fsb.org/wp-content/uploads/P140420-1.pdf>

Impact Assessment

- Global regulators have concluded that cross-border stablecoins such as Libra require comprehensive regulation. However, still-vague principles leave considerable room for product introduction and large variances in applicable rules.
- Slowed GSC innovation will give more time for CBDC implementation.
- A significant transformation of global payments will continue even if GSCs play a smaller role than initially anticipated with Libra’s launch due to CBDC and other crypto-asset products in national and cross-border venues.
- FSB for the first time has clearly established a “same-business, same rules” construct likely to guide its post-pandemic work on nonbank financial intermediation and asset management.

Overview

Responding to a request from G20 heads of state in 2019 and renewed focus earlier this year, the FSB has outlined its approach to global stablecoins (GSCs) of which Facebook’s Libra is the most prominent, if troubled, example. The governing body of global banking, securities, and insurance regulators has identified many issues of initial concern with Libra and other GSCs – e.g., liquidity risk governance, how stablecoin values will be derived, reserve requirements – but left many others – e.g., standards for wholesale GSCs, impact on global finance and emerging market economies (EMEs), and monetary-policy impact – largely unaddressed. The FSB framework also does not govern central bank digital currencies (CBDCs), doubtless on grounds that digital fiat currencies raise different questions than GSCs and, in any case, are outside the reach of FSB agencies and national authorities. Although

limited to GSCs, the FSB principles may also be applied to other crypto-assets by national jurisdictions, creating an initial framework for digital ledger technology (DLT) aimed at retail finance. Like many other sets of FSB “high-level principles,” those proposed here are often aspirational rather than clear guides for national authorities. They do, however, establish a principal of “same-business, same-rule” that will likely guide post-pandemic work in areas now highlighted by the FSB as top priorities in light of current financial-market risk. This may lead to tougher standards in areas such as asset management and nonbank financial intermediation, but many nations (e.g., the U.S.) will not be able to act on recommendations along these lines without significant statutory changes.

Impact

Reflecting the shock that Libra’s introduction gave to central bankers and financial regulators across the globe, this FSB document focuses on cross-border stablecoins that are targeted at retail customers with a particular focus on EMEs. The FSB concedes that GSCs are not currently systemic threats, but it fears that they quickly could be absent structural change to the way they would be supervised and regulated. However, the FSB does not address national stablecoins, those aimed at wholesale payments, or variations on all of these concepts, including CBDC.¹ The consultation also focuses on regulatory and supervisory concerns, not broader issues affecting monetary policy, monetary sovereignty, currency substitutions (i.e., the end of cash), data privacy, competition, and taxation. Anti-money laundering (AML) concerns are addressed only by reference to work under way by other global regulators. As a result, it is only a partial response to the many challenges raised not only by GSCs, but also by many other new forms of payment systems, currency, and financial-product offerings. To the extent that only the problems highlighted by this FSB consultation are addressed, GSCs could advance under new constraints that nonetheless fail to address pressing concerns raised by the G20 or those emerging in other forms of crypto-assets.

However, it is clear that the FSB is deeply concerned about GSCs and, were it to have its way, Libra and any similar ventures would be subject to extensive safety-and-soundness regulation before being allowed to advance. After confronting numerous challenges to offering its stablecoin,² Facebook and Libra have committed to abide by all of the rules imposed on them. The scope of those outlined by the FSB would, however, require structural redesign with significant profit implications. Although it states that many GSC issues are already well defined in current rules in advanced nations, it also fears that GSCs’ decentralized nature poses an array of risks that remain unaddressed despite a prior FSB report highlighting ways in which decentralized fintech often evades rules designed for clearly-identified responsibilities housed in a single corporate entity.³ These challenges are, as the FSB notes, still more acute in EMEs, especially those with volatile, thinly-traded currencies. Significant opportunities for cross-sectoral and cross-border arbitrage are thus of immediate concern.

¹ See **CBDC**, *Financial Services Management*, April 16, 2020.

² See *Client Report CRYPTO12*, October 23, 2019.

³ See *Client Report FINTECH24*, June 17, 2019.

The consultation establishes, but does not seek comment on, a policy increasingly evident in FSB statements: that is, the same risk warrants the same rules. The FSB had sought to implement different rules that took into account long-term structural differences in asset management and finance companies in its post-2010 work,⁴ but little of that work advanced to final form, let alone national implementation, because banks felt the nonbank rules were too generous and nonbanks strongly objected to them. Developing a taxonomy of which functions are the same and thus should come under which rules may prove challenging to a global agency wrestling with many competing interests, but the pandemic has made it clear that some nonbank sectors again required taxpayer support that will reinvigorate global regulatory action.

What's Next

This consultation was released on April 14; comments are due by July 15. A final report will be released in October, 2020.

Analysis

A. GSC Construct

Much in the consultation maps out current GSC activities and their relationship to applicable national rules and global standards. GSCs are generally defined as instruments that have a stabilization mechanism (regardless of its success), many functions, and reach across many countries. Stablecoins may thus be analogous to deposit products, payment systems, securities, or investment funds. Core infrastructure is also required, with those relying on DLT raising additional considerations. Each of these criteria is described by the FSB, with the consultation also noting that stablecoins may lack the liquidity, reserves, guarantees, or other safeguards needed to ensure stability. The consultation also includes a possible methodology to identify GSCs that pose systemic risk based in part on the extent to which it is used as a means of payment or store of value in numerous jurisdictions.

B. GSC Risks

As noted, the FSB believes that GSCs now pose no systemic risk because use is limited. Over time, potential systemic risks could arise due to:

- changes to stablecoin value if widely used as a store of value, especially in EMEs;
- payment-system disruption;
- contagion risk in the financial system (e.g., to custodians, seller-servicers);
- magnified confidence effects; and
- macro-financial risks (e.g., EME run to GSCs in ways that destabilize fiat currency under stress).

⁴ See *Client Reports* in the **SHADOWS** series.

In addition, GSCs are likely to pose activity-and-practice risks in individual jurisdictions, including:

- traditional financial risks;
- governance, operational, and design fragility; and
- risks related to DLT (e.g., key storage).

The consultation also addresses risks specific to GSCs due to gaps in national regimes, different product classifications, and opportunities for regulatory arbitrage. Different approaches for cross-border supervision and regulation are outlined (e.g., consolidated home-country supervision). No conclusions are drawn, but the FSB says that existing cross-border practices (e.g., colleges) may be of use.

C. Current Regulatory Regime

The FSB paper includes a detailed description of how nations now govern stablecoins and applicability to GSCs. In general, GSCs would come under current financial rules to some extent in some countries, but most would be essentially unregulated. The consultation also details plans by various international bodies, including ongoing work by the Basel Committee to govern bank exposures to their own or other crypto-assets.⁵ AML standards from the FATF are due to the G20 later this summer. IOSCO and the BIS Committee on Payments and Market Infrastructures are also establishing stablecoin principles and working towards a definitive framework. IOSCO's schedule for action appears dependent in large part on the extent to which stablecoins come to market, after which it may act to address how these new ventures interact with securities regulation.

D. High-Level Recommendations

These recommendations, intended only for national authorities, are:

- Authorities should have the powers and tools needed to deal with GSCs and other crypto-assets with cross-border reach, repairing gaps ahead of broader adoption.
- Regulatory requirements should govern GSCs on a functional basis proportionate to risk.
- Cross-border and cross-sector coordination arrangements should be flexible to reflect evolving risk. Memoranda of understanding on specific issues (e.g., information sharing, crisis resolution) are encouraged.
- Governance frameworks should be transparent, establish accountability for specific GSC functions, and set rules for participants. Fully open ledgers may not be suitable for governance purposes because of the lack of accountability and oversight.
- Risk management frameworks should address reserve management, operational resilience, cyber security, and AML/CFT safeguards. Strict capital and liquidity requirements may apply to GSC reserve management, with the market risk framework potentially applying if the risk from reserve asset value fluctuation is borne by the GSC operator.

⁵ See CRYPTO13, *Financial Services Management*, December 19, 2019.

-
- While data-management systems should allow authorities to obtain timely and complete access to relevant data, GSCs should also conform to all applicable data privacy requirements.
 - Resolution plans should support an orderly wind-down or resolution that allows continuity or recovery of any critical functions within the GSC arrangement. Plans should also outline contractual obligations among the entities in the GSC network.
 - Users and stakeholders should be periodically provided with detailed information on GSC governance, operator and service provider responsibilities, stabilization-mechanism design, reserve investment and custody, and available dispute-resolution mechanisms. The value and composition of reserve assets should be regularly audited and disclosed.
 - The nature and enforceability of redemption rights, including how claims may be treated in insolvency or after a cyber-attack, should be transparent. Authorities should consider whether direct legal claims against the GSC issuer or its reserve portfolio creates run risks.
 - GSCs must meet all regulatory and supervisory expectations of a jurisdiction before launching in it. GSC systems must be able to adapt to new regulatory requirements as necessary.

E. Request for Comment

Specific questions are posed on:

- the characteristics of stablecoin that differentiate them from other crypto-assets;
- alternative stabilization arrangements;
- stablecoin functions and activities and the degree of decentralization;
- GSC differences from other stablecoins;
- potential systemic risk;
- potential regulatory solutions; and
- the characterization of cross-border issues.