Global Systemic-Risk Standards for Stablecoin Arrangements

Cite

Committee on Payments and Market Infrastructure (CPMI), Board of the International Organization of Securities Commissions (IOSCO); Consultative Report, Application of the Principles for Financial Market Infrastructures to Stablecoin Arrangements

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Website

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Impact Assessment

- Although global regulators have not decided how to handle stablecoin's systemic risk, they have clearly decided that at least some stablecoin arrangements pose systemic risk that requires targeted regulation.
- Unless the final report is more prescriptive, significant jurisdictional differences in systemic standards may encourage regulatory arbitrage posing particularly severe risk given the decentralized, stateless nature of at least some stablecoin arrangements.
- Regulators in key markets may thus use global standards to identify inter-connected and interdependent nodes to govern interfaces with regulated companies and infrastructure and thus choke off stablecoin access to financial market infrastructure.
- Although aimed at medium-of-exchange and store-of-value risk, the proposed standards focus principally on the payment system. The paper assumes investor or consumer risks may also prove systemic does generally does not address how these could be countered.

Overview

Responding to requests from the G7, G20, and FSB, this report addresses market-infrastructure considerations related to systemically-important stablecoins that do not involve multi-currency baskets (e.g., Facebook's Diem). The report builds on the FSB's current principles[1] and those on cross-border payments,[2] but generally does not propose specific standards. Instead, it lays out how current global principles in this area should guide both stablecoin developers and regulators. These principles are sure to guide national regulators, including the U.S. President's Working Group on Financial markets, which is expected shortly to elaborate on its paper earlier this year with specific policy recommendations.[3]

Impact

The CPMI and IOSCO focus here on stablecoin arrangements that combine functions to make stablecoins a medium of exchange or store of value. They reflect the FSB's "same business, same risks" construct.[4] However, the report expands on its principle because of novel stablecoin considerations such as the fact that settlement is in neither central-bank nor commercial-bank money, is often handled through decentralized agencies, and these arrangements often have extensive inter-dependencies among their own functions and with potentially-systemic notes of the financial system and infrastructure.

However, despite extensive discussion of potential systemic risk and how national regulators can spot it, the CPMI/IOSCO consultation offers only a few specific suggestions for dealing with it for governance, inter-connectedness, and settlement. Questions suggest that the final report could be both more specific and prescriptive, but the often-diffident nature of global pronouncements may lead the CPMI and IOSCO to give member jurisdictions considerable latitude.

This could create opportunities for regulatory arbitrage as the combination of the essentially-stateless nature of stablecoins interacts with key entry and exit points across the payment system unless the major hubs in which the most systemic financial infrastructure is located act to disconnect risky stablecoins from banks via new capital rules,[5] custody requirements, or other restrictions.

Any such financial-system "disconnectors" could well protect payment-system integrity not only from a global perspective, but also in major markets. However, as noted, the CPMI and IOSCO want their standards to go beyond payment-system protection also to address stablecoins that purport to be stores of value. This requires standards to ensure both investor and consumer protection, but this report provides only limited insight into these arenas. For example, its standards on reserve assets may enhance consumer protection by limiting the extent to which stablecoin holdings lose value compared to central-bank or commercial-bank money. This would preserve stablecoin's cash equivalence, but not ensure that stablecoin products that also offer some sort of return include investor protections unless global regulators advance national efforts such as those in the U.S.[6]

1 See **CRYPTO14**, *Financial Services Management*, April 23, 2020.

2 See **PAYMENT23**, *Financial Services Management*, June 27, 2021.

3 See *Client Report* **CRYPTO16**, December 28, 2020.

4 See *Client Report* **NBFI**, November 17, 2020.

5 See **CRYPTO19**, *Financial Services Management*, June 15, 2021.

6 See *Client Report* **INVESTOR18**, September 14, 2021.

What's Next

This report was released on October 7, with comments due by December 1. Unaddressed issues will be considered in future reports. Most notably, this report expressly does not cover multi-currency stablecoins. This may well be because these raise additional issues (e.g., who bears foreign-exchange risk). However, much in this report appears applicable to such stablecoins, making it at least somewhat unclear why they are excluded.

Analysis

A. Systemic Assessment

In addition to using existing systemic-identification principles for payment systems, those for stablecoins should take into account:

- size of the stablecoin arrangement and whether the stablecoin is used as a principal payment instrument or settlement mechanism;
- activity nature and risk;
- users;
- transaction and activity type based on indicators that track concerns such as disruption risk, reserve assets;
- inter-connectedness and -dependencies;
- structural and operational complexity; and
- substitutability.

B. General Principles

The consultation also states that stablecoin arrangements should be considered in the overall context of relevant global principles, especially CPMI's work on the payment systems. It goes on to lay out key stablecoin concerns such as:

- the impact decentralization has on effective and accountable governance;
- software's inability to adjust key operations or strategies as markets change and under stress;
- reliance on third parties (e.g., settlement banks) for key and even systemic functions;
- uncertain finality; and
- settlement assets with uncertain values in relation to central- or commercial-bank money.

The consultation also lays out proposed guidance for national regulators on these issues, focusing principally on novel risk. This guidance is most specific when it comes to the treatment of reserve assets, detailing how stablecoins must not only ensure that assets suffice, but also that they pose no credit or liquidity risk after also taking any risks germane to a custodian into account. Options such as collateral pools are also outlined.

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C. Request for Comment

Views are expressly sought on:

- the extent to which systemic criteria should apply;
- whether the governance guidance is sufficiently clear and effective;
- challenges due to distributive and/or automated technology protocols and decentralization;
- if the inter-dependency-risk analysis suffices;
- whether the settlement guidance is clear and actionable;
- proposals regarding settlement-asset choice; and
- other issues that need to be addressed to reduce systemic risk.