Bigtech and Global Stablecoins: Regulatory Challenges

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Digital innovations has challenged conventional assumptions

• About money
  – Can physical currency be produced in digital form?
  – What constitutes a safe and reliable form of money?

• About the process through which value is transferred
  – Can distributed ledger technology provide new ways to transfer and settle assets?

• About the role of institutions in the transfer of assets
  – What role do non-financial institutions play in the transfer of assets?
  – How does the role of traditional financial institutions change with the introduction of new technology?
Forms of Money

- Central bank money (liability of a central bank)
  - Physical currency
  - Reserves at central banks
- Private money (liability of a private-sector entity)
  - Fractional-reserve banking model
    - Deposits at commercial banks (commercial bank money)
    - Deposit insurance approximates perfect substitute
  - Narrow-banking model (typically tied to central bank or commercial bank money)
    - Prepaid cards (e-money)
    - Omnibus accounts held at commercial banks (sometimes deposit insurance passes through)
    - Balances at non-banks (liability of a non-bank)
  - Stablecoin model (typically tied to range of “safe and liquid assets”)
Key Question: Can a stablecoin be a sufficiently safe form of money?

- Credibility and reputation matter for successful monetary scheme
  - Long-run benefit to an issuer of being credible in managing stock of money must outweigh the short-term benefit of overissue
  - TRUST

- Central bank money typically sets the standard for the highest quality money from a safety and soundness perspective
  - Other private monies are a near-perfect substitute for central bank money under certain conditions (convertibility at par)
    - Deposit insurance
    - Other safety and soundness measures

- For stablecoins, the question is whether safety and soundness measures are sufficient to provide a near-perfect substitute for central bank money absent deposit insurance
Essential Elements of an Electronic Payment Transfer

• Initiation by the sender (or other originator)

• Authorization of the transaction
  – Check that the originator has access to the units of value
  – Check that there is sufficient value available for the transfer

• Clearing
  – Information is transferred to relevant parties to prepare for the transfer

• Settlement
  – Value is transferred and typically final
Key Question: How does a stablecoin’s transfer mechanism impact payment system risks?

- Fraud risk
  - Impact on consumer protection
- Operational risk
  - Problems with human or technical error
  - Cyber attacks
- Legal risk
  - Uncertainty regarding the rights and obligations of all parties to a transaction
  - Uncertainty about governance
- Settlement risk
  - Liquidity risk: Inability to settle an obligation when it is due
  - Credit risk: Inability to settle an obligation due to insolvency
- Systemic (or financial stability) risk
  - Failure of a participant leads to other failures in the broader financial system
Examples of additional institutional services that could support stablecoins

• Custodial services
  – Maintains balances used to secure the value of a stablecoin

• Digital wallets (VASPs)
  – Secure storage with convenient access for payments
Key Question: How do existing regulations apply to key institutions?

- Some implementations could involve the traditional financial sector
  - Financial institutions would fall under their existing regulator

- Other implementations may result in the formation of new types of institutions performing “bank-like” or “payment-like” functions
  - In the US, these fall under state financial regulatory money transmitter laws
  - Must adhere to AML/BSA regulations
  - May have consumer protection provisions

- A stablecoin arrangement may not fit neatly in the traditional regulatory perimeter both within and across jurisdictions
  - Need for a holistic view
  - Importance of cooperation
Some Final Thoughts

- Safety and soundness of new forms of money
  - Convertibility into traditional forms
  - Adequate disclosure of risks
- Safety and soundness of the transfer mechanism
  - Operational risk and security around newer platforms (such as DLT) are important challenges
  - For some implementations, governance is an important issue
- Impact on the market structure of the financial system
  - Will new institutions change the way banking and payments are done?
  - What systemic or financial stability risks could emerge?
  - Changes to the regulatory framework may be necessary for a more holistic view of stablecoin arrangements