The Federal Reserve Board

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

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- 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?

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- 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

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- 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?

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- 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

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- 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