Stablecoins and crypto-assets

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Crypto-assets, acknowledging the potential benefits, tackling the actual challenges

In the past 10 years, a new class of assets has emerged, the so-called crypto-assets. If the first generation, like the Bitcoin, was essentially of speculative nature, we are now seeing a number of market initiatives, still building on the potential offered by the DLT technology but based on mechanisms designed to ensure the stability of their value, and for this reason generally referred to as stablecoins.

These initiatives are diverse in their nature and features, but aim at bringing improvements in payments. Some intend inter alia to make cross-payments quicker and cheaper and to improve financial inclusion – and progress is indisputably needed there. Others tend to pave the way for faster settlements between financial intermediaries. As such, the various projects must be looked at with lucidity and technological neutrality.

At the same time, we must be fully aware of the challenges they raise. The stablecoins indeed form settlement assets that may compete against commercial and central bank money at the center of our payment systems. As many central bankers have stressed, today's crypto-assets do not satisfactorily offer the qualities expected from a settlement asset to be used interchangeably with commercial bank and central bank money. This highlights the misleading nature of the name of "crypto-currency".

From that perspective, as pointed out by the G7 in its October 2019 report under the French presidency, stablecoins of potential large size and reach may not only pose risks in terms of legal certainty, money laundering and terrorist financing, consumer and investor protection, but also raise additional challenges to competition policy, financial and monetary stability.

The preferred response should be to establish appropriate regulations to reconcile the need to address risks and the preservation of the potential for technological innovation offered by crypto-assets. This has to be done according to the "same business, same risk, same rule" principle so that a risk-based and proportionate regulation and oversight be applied to stablecoins.

We need proper regulation and oversight to make them part of the solution, not part of the problem. At global level, the Financial Stability Board has been mandated to assess potential regulatory and supervisory gaps and to suggest a potential way forward to handle them.

This does not mean that the sole response from the public authorities should be defensive. Where innovation helps the financial system function more efficiently, it must be supported, as central banks have kept doing since decades. The private sector, to the extent that it does bring improvements without inducing unaddressed new risks, is of course best placed here, be it for front-end or back-end payment solutions. Central banks have also a role to play, as issuers of the reference settlement asset and operators of critical payments infrastructures. This is why Banque de France will experiment a wholesale Central bank digital currency, with a view to fooding Eurosystem thoughts. This is why also it fully supports - and actively contributes to - the G20 roadmap on the improvement of cross-border payments. ●

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Covid-19, digitalization of payments, and the crypto assets

The outbreak of Covid-19 and subsequent lockdown of many societies have reinforced the necessity to promote digitalization in payments. Today, as of the end of March 2020, one-third of the global population is said to be under some sort of lockdowns, and any payments using physical measures are subject to significant constraints. Some retailers try to avoid touching banknotes and coins. Bank checks are subject to the delivery constraints. Furthermore, even for the electronic remittance by corporations and financial institutions, physical security measures such as token devices, or a dedicated computer terminal with an exclusive IP address, which are kept or installed in the office premises, prohibit the parties from making remittance once their employees are suddenly required to work from home. I believe that people who felt inconvenience will look for the digital solutions. ▶

Should we consider the crypto assets, including the stable coins, in our new regime? Why not. Once such time comes, we will need to use every piece of wisdom to recover from the consequence of this pandemic. If the decentralized and digital encryption features, which are common in many crypto assets/coins, can serve the purpose of elimination of physical devices with good security, it is worth pursuing.

Having said that, I also would like to pay attention to the risks. The obvious challenges to crypto assets are the cyber security, AML checks, and the backstops when things go wrong. Also, the stableness of the stable coin may be questioned during the severe market turmoil. In fact, some of so-called stable coins experienced unusual value fluctuations in March 2020 amid the spike of the volatility in financial markets. These issues also lead to the question about the consumer protections.

Also, if we assume the wider usage of stable coins operated outside of the banking system, it may reduce the presence of the banks, then we will need to consider who will replace the functions banks are currently providing. For example, under the current crisis, in order for the financial compensations to support curtailing the social contacts, or, in later days, to support the recovery of damaged economic sectors, data to identify the most needed recipients and the swift and effective measures to remit money to them are vital. The substantial part of this financial support is expected to take the form of loans, the traditional bank products. In countries where digital neo money platforms are already in full broom, these functions maybe supplemented by them, but I myself am not sure whether the currently suggested stable coin frameworks will function in a similar manner.

As discussed above, I believe the current crisis will make us think more about the digitalization of payments, which may include the crypto assets, but the risks and points of governance will not change in crisis from the peaceful time. I hope that the discussion about the crypto assets, or more specifically about the embedded decentralization and digital encryption technologies will help us to improve the efficiency of the incumbent payment system as well. ●

Nicole Sandler

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Stablecoins – refining the regulatory landscape of crypto-assets

Blockchain and crypto-assets have changed the way people think about money, and this technology is a focus area for policymakers globally. To date there exist over 2000 different types of crypto-assets, with no precise definition of what these are, rather there are a variety of terms that describe more or less overlapping phenomena. The understanding in regulatory terms of what we are dealing with is varied, with some current classifications, commonly used by EU policymakers ie exchange/payment, security and utility tokens, being too broad and requiring further clarification based on a token's characteristics.

Today, the United Nations recognises 180 currencies worldwide from the US dollar to the British Pound to the European Euro, and more, with these currencies being used to buy goods and services. The value of most of these currencies is subject to minor changes on a daily basis, for instance a pint of milk will standardly cost £1 in the supermarket and one does not have to worry that it will be £2 on any day that same month. However, one of the criticisms of a number of cryptocurrencies (a sub-type of crypto-assets) as a means of payment, is the volatility in price fluctuations – the same pint of milk could cost anywhere between 20p - £10 in a given week.

'Stablecoins', another subset of crypto-assets, have characteristics that distinguish them from the categories mentioned above, most notably their stabilisation functionality with underlying or reference asset - what that underlying or reference asset may be varies from coin to coin. To date, the key distinctions among stablecoins have been the governance and the mechanisms for maintaining stability. However, it is important to flag that there are many different types of so-called stablecoins with some being neither stable nor a coin. That aside, the main benefit generally associated with stablecoins, is that depending on how and what they are pegged to, they may not be subject to the extreme price volatility that other crypto-assets are affected by.

In addition, they could potentially offer decentralisation, and in some cases global reach, with the ability to help the unbanked. These reasons are why this class of crypto-assets are seen by some as an attractive means of payment. Whilst there are a lot of discussions about the use of stablecoins, particularly from a policy perspective, the majority of industry participants are not yet launching anything in this space, primarily because of the lack of regulatory clarity on how such assets should be treated. Whilst there are benefits which warrant further discussion, this does not mean they are free from risks.

These include (i) risks to consumer protection, data privacy and financial stability, (ii) they could promote illicit activities, (iii) threats to weaker currencies and (iv) banks may lose their place as intermediaries if they lose deposits to stablecoin providers. The current financial markets uncertainty (brought upon by the COVID-19 crisis) has the potential for changing habits across all society in looking for technological 'safe havens'. While this may hasten some of the debate and support for certain crypto-assets, this still needs to be a measured and strategic response.

It is important that given the cross-border nature of many types of crypto-assets, that the industry and policymakers work together across jurisdictions to have agreed definitions and regulations to minimise the risks and maximise the benefits. Further, it is essential that the approach policymakers take is a uniform one that applies the principle of 'same activity, same risk, same regulation' in order to avoid fragmentation and allow market participants to benefit from scaling effects. ●