CRYPTO-ASSETS AND STABLECOINS: PROSPECTS AND WAY FORWARD

1. Multiple private and public initiatives underway on diverse parts of the payment value chain

A representative of the public sector stated that, at the back end of the system, central banks have moved to fast payments architectures and are now working on connecting their fast payments architectures between themselves. More recently, new private closed-loop solutions have emerged, using, in particular, stablecoins. At the front end of the system, there are new interfaces, mobile payments, face recognition and QR codes, and new means of payment through stablecoins and possibly crypto. Initiatives may lead to faster, cheaper payments, an improvement in the customer experience and more efficient ways to support the economy, but may risk instability or harm to the investor, maybe from fragmentation. The new world of payments and money can be summed up by a quotation from Antonio Gramsci: 'The old world is dying and the new world struggles to be born. Now is the time of monsters.'

2. Current international coordination and initiatives regarding innovation in payments

The representative informed that the Bank for International Settlements (BIS) is part of the current coordination around innovation in payments. There is a G20 mandate on enhancing cross-border payments. There has been active work on stablecoin regulation at global level, at the Financial Stability Board (FSB) and in each jurisdiction. Practical initiatives are being launched by different central banks. BIS is active in its convening role, creating an innovation hub and innovation network to produce proofs of concept and prototypes meeting problem statements identified by central banks and regulators.

3. The current challenge for banks is to preserve the efficiency of existing payment means while contributing to reassuring and providing trust in the uncertain context of the many possible (r)evolutions in the area

An representative of the industry commented the institutions have probably changed more in the last 10 years than it did in its first 189 years. In addition, the institutions have changed the way they think much more in the last 14 months than in the 10 years prior to that. As traditional banks, attacking the future is all about optionality. A bank needs to continue to evolve, ensuring that what already works for society continues to work, but also to see "how deep the loophole goes". In 30, 20 or maybe 10 years, it is not unreasonable that payments will take place without middlemen, because the recipe is out there. Experimentation and always being on the edge to provide for optionality is important. The future is uncertain, so a portfolio of options is the best choice. Change should be seen as an opportunity, not just a threat.

4. Covid has brought payments trends and infrastructures beyond convenience improvement

An industry representative commented that Covid has changed human behaviour and payments behaviour. People plan so that they do not have to touch things. Use of cash is declining. Experimentation with pay with your face and pay with your voice is underway. In addition to convenience, there are now deeper drivers for these changes, such as anxiety. This might change the adoption curve of new technologies. Subscription-based and pay-as-you-go offerings have been accelerated due to the pandemic. The first glimpse of micropayments is being seen and, subsequently, machine-to-machine payments. That is relevant in terms of shaping the payments system to cater for emerging trends.

5. Incumbent banks and infrastructure focus on their distinctive added value on payments

An industry representative stated that the finest characteristic that the banking and finance industry has to offer is trust. There should be control, not anarchy, in the new payment world.

An industry representative commented that international card networks are one of the original disruptors, or the oldest fintechs. The institution represented was indeed built on the electronic movement of money. Now money is evolving through stablecoins, retail central bank digital currency (CBDC), emergence of new networks and underlying technologies. The international institution will evolve with it as a payments network, but also as a technology provider to other networks. The transactions handled are a promise of a secure payment and international acceptance and, as such, a promise that goes beyond the mere movement of money.

A representative of the public sector noted that substitution between CBDC and bank deposits could undermine deposit banking. Central banks are working on possible mitigants such as caps on CBDC holdings.

An industry representative stated that these concerns should be left to industry banks.

A Central Bank official added that there is the possible danger of an outflow of the deposits of the banks. In the case of a possible CBDC, there is a liability directly against the central bank and this must be addressed from a central bank perspective.

6. The role of policy makers regarding trust, security and resilience is essential to enable stablecoin initiatives

An industry representative indicated that their institution has decided to allow for the settlement of USD Coin (USDC) over its network. USDC is a regulated stablecoin backed by the US dollar and transacted over the Ethereum blockchain network. It is expected that both stablecoin and regional CBDCs will be part of the changing payment landscape. New use cases have emerged around stablecoins, notably with respect to cross-border business-to-business payments, trade settlements and remittances. Stability should be considered. New forms of digital money will only be widely used if they can maintain a stable value. Visa welcomes the focus of regulators on consumer protection aspects of stablecoin. Appropriate anti-money laundering (AML) and safety checks are needed across this new ecosystem.

7. International and EU cooperation for removing technical and regulatory obstacles and improving the operational and cost efficiency of existing and future cross-border payment avenues is a key contribution to the necessary innovation which enables further interoperability and competition

The industry representative commented that the FSB roadmap notes that stablecoins are one avenue to make cross-border payments faster, cheaper, more transparent, and inclusive. However, they are just one avenue. Their institution supports work being done to remove regulatory and technical obstacles. Visa continues to innovate on the infrastructure side. Visa has a real-time payments platform that pushes digital remittances and has allowed for the cost of remittances to drop below the 3% target for 2030. The institution has also launched a non-card platform, B2B Connect, which is an alternative to correspondent banking and allows banks to connect directly.

There is a risk that different jurisdictions will use different technologies and technological protocols. The institution would like to contribute to the interoperability of new payments systems through universal payment channels. There should and will be a multitude of different payment systems, technologies and solutions for cross-border payments and it is welcomed that regulators and central banks focus on ensuring payment systems are open and interoperable. The institution does not want to rely on any one solution.

International cooperation is key. AML and countering the financing of terrorism (CFT) laws are often seen as an obstacle for efficient cross-border payments. There is new momentum at the European level, and it is hoped that this extends to the international level, with respect to regulation of stablecoins.

8. Regulators have no choice but to address the regulatory challenges – consumer protection, AML, liability sharing in the value chain, reliability, etc – of the whole landscapes regarding digital currencies and assets

A public sector representative noted that there has been a great deal of discussion about stablecoin regulation. Recently, there have also been many developments in the crypto world. Decentralised finance is vibrant and lots of new financial services are being provided. From a regulatory perspective, that could represent a new shadow banking emerging.

A policymaker commented that the developments in crypto markets, with the currently exploding valuations that by now also attract serious business, are mostly in the non stablecoin area. The current global market valuation recently exceeded $2 trillion US and is now at around €2 trillion. Only a small fraction of that market, probably less than 5%, is made up of crypto-assets that have a stabilisation mechanism. Crypto-assets are mostly not used for payments. The policymaker added that the Commission's proposal on markets in crypto-assets covers the entire crypto asset space and not just the area of stablecoins. Stablecoins are covered by the proposal, but the proposal is not limited to them. The Commission aims to provide legal certainty and an enabling framework for crypto-asset markets. Should crypto-assets in general, or stablecoins more specifically, become a significant feature in payments in the European Union, opportunities and risks can be addressed through payments legislation.

It is still too early to talk about flourishing private initiatives regarding stable-coins. Stablecoins on the market have proven to be relatively stable but are still very small compared to the overall size of the crypto asset markets and are used mainly as settlement coins on crypto-asset trading venues. CBDCs, including a potential future digital euro, could enable future developments. There are opportunities for plenty of innovation and competition, for example between wallet providers. The Commission is working closely with the European Central Bank (ECB) to explore the best way to issue a potential digital euro. The roles existing financial institutions might play are being explored. Crypto-assets and the potential CBDCs of the future are complementary, not mutually exclusive.

The existing EU AML framework is currently under review. The framework should leave the internal market intact and allow for the free movement of capital for legitimate purposes while ensuring an effective fight against money laundering and terrorist financing.

9. A swift adaptation, in the EU and globally, of central banks to the blockchain developments in the payments and security transaction settlement areas, is necessary

A public sector representative noted that there has been very fast progress on CBDC globally, with the Bahamas as the trailblazer and China moving fast with pilot projects. In its work on CBDC, the Bundesbank recently tested the interface between a blockchain platform and the conventional real-time gross settlement (RTGS) system to settle securities in central bank money. The Bundesbank can settle tokenised assets without CBDC, but the digital euro project is also underway.

A Central Bank official explained that the recent experimental project built a technical bridge between the blockchain technology and the TARGET2 system. Security transactions on a private distributed ledger technology (DLT) system were settled in central bank money. This is a so-called trigger solution: the security transaction on DLT automatically triggers the corresponding payment via the trigger chain operated by the Bundesbank into TARGET2. There is a strong demand in the market for a solution that enables the settlement of the cash leg of DLT-based transactions. In the context of CBDC, this provides an additional way to bring efficiency and innovation into the market for securities settlement and could be complementary to the digital euro. The solution uses infrastructures that are already in existence. As such, the Eurosystem could implement such a solution in a relatively short space of time.

The public sector representative stated that the Swiss centre of the BIS innovation hub has compared settlement with a central bank token that is a wholesale CBDC and settlement through the traditional RTGS.

10. The digital euro is another form of the single currency intended to ensure safety (KYC, AML, CFT) and privacy, as well as systemic financial and operational resilience, while supporting innovation in the retail digital landscape

The public sector representative noted that privacy is a priority for consumers when considering a CBDC.

A Central Bank official commented that central banks have developed centralised systems and are now moving towards decentralised infrastructure. Interoperability between decentralised and centralised infrastructure will be needed. Developing a token-based CBDC is a possibility. The Eurosystem and the ECB are working on the development of a retail CBDC. The outcome of a consultation demonstrated the importance of privacy and security for users. The systemicity of digital euro infrastructure must be considered, aiming to ensure resilience by design. Implementation through different technologies or infrastructures avoids a single point of failure. Financial security of a digital euro will be substantial, since it will be a perfectly safe central bank liability. It will be another form of the single currency.

Compliance with know your customer (KYC), AML, CFT and tax evasion regulations is also necessary. Privacy does not imply anonymity. Digital euro transactions could be visible to intermediaries in order to allow them to comply with AML CFT requirements while ensuring the protection of data. DLT is a potential solution in this area. Selective privacy could be applied for low value payments.

An industry representative commented that an offline supported CBDC might address issues around privacy and anonymity.

11. Defining the appropriate timeline and shape of a digital euro is a complex pragmatism challenge, the solutions to which involve both innovative technology and existing intermediaries and infrastructures

A Central Bank official commented that there should be a readiness to swiftly issue a digital euro should the need arise to safeguard monetary sovereignty. However, a digital euro could pose risks to the financial system and impact financial intermediaries. The benefits and risks must be measured holistically. Mitigation measures can be considered as regards the risk of bank deposit substitution, but these measures could have consequences for the attractiveness of a digital euro. Some risk might be mitigated with proper design and calibration. It is important to preserve the role of private intermediaries as interfaces in the distribution of a digital euro. The digital euro will be discussed at governing council level by mid-2021.

An industry representative agreed with the need to preserve the role of existing private intermediaries. Integration of a potential digital euro with the existing payment system will be important for acceptance.

12. The technical solution and arrangement architecture underpinning the digital euro will depend on priority use cases still to be chosen

An industry representative stated that initial reflections on offline usage rely on using existing payments systems. A digital euro could be additive to a digital payment mix if it is viewed as a digital equivalent to cash. Visa can also envisage a tokenised digital euro.

A public sector representative emphasised that offline capability is very important for retail CBDC.

A Central Bank official stated that an offline capability for CBDC is an important aspect. A digital euro will have to include such a function. This will help that people have the same degree of trust in a digital currency as they have currently in cash.

Another Central Bank official commented that a cash-like digital euro will need to have offline capability. Offline capability will be less important for some other use cases. As such, a step approach for the development of the digital euro might be necessary, with not all use cases being accommodated from the beginning. Cross-border payments are among the envisaged use cases, but more understanding is needed around interplay and interoperability. Another interesting use case relates to smart contracts. Private monies could provide these types of services. This is also true for wholesale payments. There could be complementarity between private commercial money, or even stablecoin payments, and CBDC payments. Banque de France has experimented with issuing CBDC on blockchain in order to settle securitised tokens.

13. A digital solution that plays the same role as cash is required

An industry representative commented that offline support of a digital euro is a key design characteristic. Customers will likely require a digital parallel to cash. Otherwise, there is a position to be taken by the free-floating cryptocurrencies of the world, which might not be in the interest of the greater good. In Scandinavia, very little cash was used before the pandemic, and it has now almost disappeared. If digital is a person’s preference, they will use some kind of digital alternative to physical cash. It is necessary to develop a solution that is backed by central banks.

A public sector representative noted that all central banks have stated that they want to retain banknotes in light of their importance for some use cases and some communities.

14. Possible consequences of digital money on the international monetary system

A Central Bank official commented that the digital transformation is also a way to move flows, maybe of currency. The distribution of stablecoins through big techs is concerning for regulators, because it could be very powerful through the social network. There is a question of monetary sovereignty. Big techs are either American or Chinese, so there is a link with the question of the international monetary system and international competition. Europe does not have any big techs, so it is important to support the international role of the euro, develop pan-European solutions and be ready to issue a CBDC if needed.