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Speech

I was going to talk today a little bit about crypto. I am going to talk about crypto, broadly defined, but I will concentrate some of the remarks on stablecoins, which is one aspect of the use of crypto technology in financial services.

Last week, the Financial Stability Board (FSB) released its latest assessment of the risks to financial stability from crypto assets. In a nutshell, the assessment was, 'Well, this is not a financial stability risk globally at present, but crypto markets are evolving rapidly and could reach a point where they pose a threat to financial stability. Given the speed and the breadth of the evolution of crypto technology in financial services, it may now be time for the regulatory community to go up a gear or two and act in a pre-emptive and timely manner. That judgement was endorsed by the finance ministers at the G20.

The FSB report, which echoes a number of similar calls from national regulators, including myself, is in my view an inflexion point in the way in which, in the regulatory community, we approach this technology and the possibilities for its use. Today, I wanted to talk briefly about three things: what lies behind that inflection point, on which I will be brief, because you can read the report and it goes into more detail than I can possibly do today; what 'pre-emptive and timely' consideration of policy means in practice for the people who have to do it; and what crypto and crypto technology could offer us in finance in terms of efficiency, functionality and competition.

Looking first at what has brought us to this point, I would highlight three things. One is simply the growth in crypto assets. We are talking here mainly about unbacked crypto and Bitcoin and, to a lesser extent, Ether. Over 2021, it grew, depending on how you calculate it, by 3.5 times to $2.6 trillion, which is still a relatively small part of the financial system but substantial enough to make a difference. There are 9,000 crypto coins. When I spoke in this matter in October, it was 8,000. They are, of course, highly volatile. Bitcoin doubled in value between July and November of last year, and then halved in value by late January this year, as yield curves went up and prospects of higher inflation became apparent.

I will just observe in passing, to those who have claimed to me over the years that Bitcoin is a hedge against inflation for central bankers in particular, that it is behaving like a risky asset and is correlated much more with moves in equity markets than with moves in gold, which you might think of as the traditional hedge. Certainly at the moment, is not acting as a hedge against central bankers. Alongside this, we have seen growing use of stablecoin as a means of payment within crypto markets.

The second point is that we have seen fast growth in the integration of the conventional financial sector with the crypto world. There are a number of points here. Banks want to offer more crypto services to wholesale trading banks. Some of that is custody and trading, which does not involve balance sheet, but also a number of banks are thinking about offering market-making and on balance sheet services. Payment firms are offering on-ramps and off-ramps between crypto and fiat. Institutional investors are starting to think about whether they should have some crypto in their portfolio and what form it could be in to enable them to invest, hence some of the interest in exchange-traded funds (ETFs). We have had crypto hedge funds for a while, but the bigger, conventional hedge funds are now getting more involved in this, and incorporating the asset class into some of their trading strategies. None of this is large-scale yet but it is definitely happening, and seems to be happening quite quickly.

The third driver behind that G20 FSB assessment is that we are seeing the emergence of what you could call an alternative financial system that sits within the crypto world. This is going further than the creation of cryptoassets. Through the use of the public blockchain and distributed ledger technology (DLT), smart contracts, financial services like credit, derivatives and insurance are now being offered on the public blockchain, using crypto assets as the means of settlement. There is a lot of hype about it, and it is in its infancy, but it does raise the prospect that we could have an alternative financial system operating, offering the sorts of things we see in conventional finance and outside the perimeters of existing regulation.

Those are the drivers behind the G20 FSB assessment. I said the key words are 'pre-emptive consideration of financial regulatory responses'. As regulators, we want to have the benefit of the technology, but we do not want to repeat the experience that we have seen in other areas of technological disruption, in that, by the time we understand the risks and think about the regulation, the technology has become established in one particular form and we then have to retrofit the regulation on it. If you look at some of the things that are happening, for example, around social platforms and social media, you can see just how difficult it can be to retrofit standard on privacy, competition and other areas of regulation once an innovation has taken root in a particular form.

What does 'pre-emptive consideration of policy action' mean? I will make a general point and then some specific lessons from the experience of the Committee on Payments and Market Infrastructures (CPMI). First, I am going to start with the regulator's mantra of 'same risk, same regulation'. For me, this has to be the starting point of how we think about this. Regulators should aim to be technology-blind and should focus on what is being done, not what technology is being used to do it. Of course, the technology itself may have particular risks and we need to address that, but when we think about whether there are risks here to be managed, it is the function being performed, not the way it is being performed, that should guide us.

In that respect, I have heard calls, directly and indirectly, for specific crypto regulation and the setting up of a specific crypto regulator, the argument being that people like me, who are used to regulating the conventional financial system, just do not understand what is going on here and, as a result, if it is left to us to do the regulation, we will stifle innovation. I have to say that that would be an enormous error, because it opens the possibility of massive regulatory arbitrage between a financial service offered using one technology and the same service being with a different technology. If we allow technology to drive differences in regulation, we will be in for a very difficult time indeed.

In my view, it is imperative that the standards for risk management that are applied to financial services in the conventional world, if I can call it that, are applied to the crypto world. In other words, 'same risk, same regulation'. While that is easy for me to say, it is very hard in practice, for a number of reasons, and I will give two examples. First, the existing regulation may just not work in the crypto world, and you cannot apply it. In terms of 'same risk, same regulation', if it means the same regulation, we may find that very difficult to do.

The second is that functions that are integrated in conventional finance can be deconstructed in the crypto world and put together in a different way or distributed among different entities, or sometimes no entities at all. As a result, the financial service being offered can cross or blur regulatory boundaries, or sometimes just fall between the cracks of regulatory boundaries, deliberately or otherwise.

To address this, we have to take the mantra of 'same risk, same regulation' and develop it a little bit. First, we should talk about 'same risk, same regulatory outcome'. In other words, the risk is managed and mitigated to the same level, even if the regulation has to operate in a different way. On the second point, the crossing or falling between the boundaries of regulatory perimeters, the different standard setters and regulators for banking, payments, securities and possibly for insurance need to work very closely together to ensure that crypto financial services that cross boundaries are regulated consistently in a manner that ensures risks are mitigated to the same level.

I do not think that there will ever be one crypto regulator naturally, because it is a technology that can be applied to so many different things, but if we want to implement 'same risk, same regulation' and extend our existing standards to this new world, we have to work together from the outset.

That is why the role of the FSB is crucially important, because only the FSB has the vantage point to say, 'where are the overlaps, the gaps and inconsistencies?' and can ask the regulators and standard setters to address them. It is equally important that the standard setters work together from the outset to share their approaches to particular aspects of the regulation and to try to build in that consistency as they do the detailed work of extending the standards to this new area.

I am pleased to say that last week's FSB statement really established the FSB role across the spectrum of crypto activities, which deals with my first point, and I am also pleased to say, speaking with my CPMI hat on, that the standard setters – the Basel Committee, IOSCO and the CPMI – recognised the need to work together and we are already putting in place the mechanisms to enable us to have those conversations.

I will give two examples of both of those things from the stablecoin world, where CPMI/IOSCO have issued guidance on how we apply the international standards for payment systems – or principles for financial market infrastructures (PFMI), as they are called – to stablecoins being used in systemic payment systems.

The first example is around the fact that regulation does not really work in a crypto world. The PFMI says that systemic payment systems should settle in central-bank money or in commercial bank money. That is to manage the risk around the settlement assets. Stablecoins will not be central bank money, and many of its proponents do not propose it to be commercial-bank money, so what standards should apply if a stablecoin is being used as a settlement asset in a systemic payment system?

What the CPMI consultative report proposes is that stablecoins that are used in that way must have some of the features that make

particularly commercial-bank money robust enough to be used as a settlement asset. This means that they have to give the holder a legal claim to redeem the coin for fiat money, at par, on demand and within the day. If you set up a stablecoin to do that, you bring about the robustness that you have in commercial-bank money and ensure that you get the same level of resilience that you have in a different way. This moves us on from 'same regulation' to 'same regulatory outcome' as you cannot just apply the standard there.

On the second point about blurring the boundaries, the consultation paper proposes that, for systemic stablecoin payments systems, we deal with that in two ways. The first is that we make the operators of the payment itself – the mechanism that transfers the settlement asset from one entity to another – responsible, as we make banks and others responsible, for managing the risks in the whole chain on which the operation depends. That can include the issuers of the stablecoin if it is issued by one entity and transferred by another. It can include the wallets in which the stablecoins are held because, unlike commercial-bank money, where the claim is on a commercial bank, and you have to hold it in an account at that bank, stablecoins offer the prospect that the settlement asset can be issued by one entity and held in a completely different one. We could make the operator of the payment function responsible for managing the risks across the chain.

Second, the consultation document proposes further work that I hope we will be set in train this year between the different standard setters, so that, where other standard setters have responsibilities and we could rely on their standards, we would be able to do that. We would also be able to ensure that there was no inconsistency between the way we were treating the same thing. I will give you an example. The PFMI say you should settle in commercial-bank money if you cannot settle in central-bank money. As payment systems regulators, we do not regulate commercial bank money. We leave it to the Basel Committee and the banking regulators and supervisors to do that. Would we be able, in talking to them, to get to a point where we could depend upon other standards where something is crossing a number of boundaries? This work is crucial to 'same risk, same regulation', and the work has begun. We have started those conversations.

I have said a great deal about risk but I have not said anything about opportunity, because my comfort zone is to talk about risk and it is less comfortable for central bankers and regulators to talk about opportunity. In taking this forward, it is equally important that we do not lose sight of some of the benefits that these developments can bring. I talked about the CPMI/IOSCO work to extend international standards for payments to stablecoin payment systems, but as part of our work on the G20 agenda to improve cross-border payments, the CPMI is also looking to assess what benefits cross border stablecoins could bring to improving cross-border payments.

We will be producing a report later on in the year to assess the benefits that a well-managed and well-regulated stablecoin could bring to cross-border payments. I do not know yet what the assessment will be, but I am sure that we should not rule out or close down the possibility now that new technology and new players, including non-bank and non traditional payment service players, can make a huge contribution to some of the improvements in cross-border payments in terms of speed, reliability, access and cost, which we need particularly for low-level and low-value retail payments and remittances.

I do not want to go into all the frictions that exist in the cross-border payments system or to suggest that stablecoins or other new technologies like central bank digital currencies (CBDCs) are a silver bullet that will solve all of these problems. I talked about CBDC this morning and observed that I have never seen anything that is a silver bullet, but it is clear to me that we will need a number of approaches to deal with cross-border payments. There is plenty of room for improvement in correspondent banking, including by using some of these new technologies, and there is plenty of opportunity in linking up the faster payment services that have now been set up in a number of jurisdictions, without even turning to the new technologies. New technologies and new players could give us some much-needed competition in this area, and they may, by offering alternative rails, be able to offer solutions in some of the areas where we need them.

To conclude, while I think last week's FSB statement helps in terms of putting in place the regulatory framework, it also helps because, if we can put in place that framework, and if we can think about the risks and how to manage them in a consistent way – 'same risk, same regulation' – we can create a framework in which innovation can flourish and we can reach some of the benefits that I think this technology may have to offer. I will stop there. Thank you.