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Making the most of digital payments – a cross-border perspective

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Keynote speech by Dietrich Domanski, Secretary General, Financial Stability Board[1]

Thank you very much for having me today. It's a pleasure to be here in Frankfurt, especially after a period when travel restrictions and Covid precautions made even the short trip from Basel feel like a rather long journey. Thanks to digital innovation, we managed to get through the pandemic with virtual meetings. And thanks to innovation, we have an important topic to discuss today: the future of digital payments.

I will focus on the role of financial regulation in promoting efficient and safe cross-border digital payments. I've chosen this topic for three reasons. First, the Financial Stability Board's mandate is to coordinate financial policies to enhance global financial stability. Second, digital innovation is intrinsically borderless, so many of its implications are multi-jurisdictional if not global. And third, most importantly from an economic welfare point of view, digital payments promise particular benefits in a cross-border context. Many of us have grumblingly paid high transaction costs in cross border payments. But those who are most affected are emerging markets citizens working abroad, who still pay on average more than 6%[2] fees for a $200 remittance payment.

So, there is a big prize to be gained, not just in terms of lower cost, but also in terms of higher speed, security and transparency and more tailored financial services that serve a broad range of users, including the poor and unbanked, at scale. G20 Leaders have long recognised the need to enhance cross-border payments and, in 2020, tasked the FSB with developing and operationalizing a roadmap to achieve this goal. Considering the use of new technology is an essential element of this work.

Regulation is sometimes portrayed as an enemy of innovation, not least in the crypto asset world. The current 'crypto winter' has made these voices somewhat less vocal and may actually provide

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[1] The views expressed in these remarks are those of the speaker and do not necessarily reflect those of the FSB or its members.

[2] World Bank (2022), *Remittances Prices Worldwide*, March.

an opportunity to reflect on the relationship between regulation and innovation in a more nuanced way.

The overarching principle that guides the FSB's work on financial innovation is for financial authorities to act in a way that harnesses the benefits of innovation while containing its risks. These include risks to financial stability, but also to market integrity, consumer protection or perhaps even monetary sovereignty.

In my remarks today, I would like to discuss how to translate this principle into practical policy. I will first talk about the key elements that guide a policy approach that harnesses the benefits of innovation -- technology openness and technology neutrality -- and then discuss how to effectively contain associated risks, using our work on (private) crypto assets as illustration. My bottom line is that from a longer-term, societal perspective, regulation is a friend, rather than an enemy of innovation.

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Technology openness and neutrality underpin the FSB's work on financial innovation, including cross-border payments and crypto assets. These principles recognise that it is not the role of regulation to prescribe particular solutions to economic problems – in terms of technologies used, in terms of business models employed, etc --, but rather to focus on the economic functions performed through innovations and their potential associated risks.

The FSB's cross-border payments Roadmap is an example of technology openness. The Roadmap recognises that innovation could either build on existing payment arrangements or take new forms. On the one hand, therefore, the roadmap's building blocks cover enhancements to existing systems, for instance through increasing data quality and infrastructure or process arrangements that could mitigate current frictions, not least those arising from the limited harmonisation of existing systems. On the other hand, the roadmap also features building blocks on new, and at the current stage more exploratory forms of digital payments -- CBDCs and so-called stablecoins. With this approach, the Roadmap recognises that the global payments system is a diverse landscape and may well remain so. The Roadmap does not aim to create a single new global system. Instead, it aims to encourage improvements and interoperability across all types of payment technologies, including digital payments.

Let me turn to technology neutrality. As a starting point, it is useful to recall that innovation does not fundamentally alter the nature of financial risks. Consider destabilising runs on financial intermediaries. Bank runs are a phenomenon that is centuries old, as is the motive for running: a concern that one's assets may lose significant value, and a hope that moving early may contain losses. The assets that are subject to runs have evolved with technological innovation, including bank deposits, money market funds and, recently, crypto assets. But the underlying sources of risk have remained the same: maturity and liquidity mismatches, excessive risk taking and, of course, the use of leverage.

This is not to say that technology may not affect financial risks and that regulations should ignore such risks. But what matters is how technology affects the functions that financial services offer to their users. In other words, the lodestar for regulation should be 'same function, same risk, same regulatory outcome'. The FSB made this clear in its 11 July *Statement on International Regulation and Supervision of Crypto-asset Activities*, which says that: "An effective regulatory

framework must ensure that crypto-asset activities posing risks similar to traditional financial activities are subject to the same regulatory outcomes, while taking account of novel features of crypto-assets and harnessing their benefits."

Before I talk about our ongoing work on stablecoins and other crypto-assets, let me mention that the same basic considerations apply to CBDCs. The safe-haven features of a CBDC, and the ability to quickly convert bank and nonbank money into CBDC could under certain circumstance increase the frequency and severity of runs on private financial institutions and markets. Again, it is not the technology per se, but rather specific design features of a CBDC that may affect run risk, in particular the terms and conditions at which a CBDC would provide access to central bank balance sheets. Ensuring there are safeguards to address these, and potential other financial stability risks has been an integral part of central banks' CBDC design considerations.

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So, while technology openness and neutrality aim at harnessing the benefits of regulation, what to do to contain potential risks to financial stability associated with crypto-assets?

This question became acute in June 2019, when Facebook announced its "Libra" project. The FSB had been monitoring the financial stability implications of crypto assets since the beginning of 2018[3]. Its assessment at that time was that crypto assets did not yet pose a risk to global financial stability, not least to their relatively few interconnections with the established financial system and their limited use for payments purposes. The prospect of the launch of a stablecoin of potential global reach changed this picture. The widespread adoption of a global stablecoin, or GSC, could give rise to risks to global financial stability through different channels:

- First, if a GSC is widely used as a common store of value, even a moderate variation in its value could cause significant fluctuations in users' wealth. Such wealth effects – if sizeable enough – could impact spending decisions and, consequently, economic activity.

- Second, if a GSC is widely used for payments, any operational disruption in the GSC arrangement might significantly impact economic activity, for example, through blocking remittances and other payments, and financial system functioning.

- Third, exposures of financial institutions might increase in scale and change in nature – particularly where financial institutions play multiple roles within a GSC arrangement (for example as resellers, wallet providers, managers or custodians/trustees of reserve assets). This may be a source of market, credit and operational risks to those institutions and, eventually, may end up having systemic implications.

- Fourth, the large-scale use of GSCs might magnify confidence effects, reflecting the extent to which a GSC is used as a store of value and/or means of payment, as well as the interlinkages between traditional financial institutions and global stablecoin operators.

[3] See Financial Stability Board, *Crypto-assets: Report to the G20 on the work of the FSB and standard-setting bodies*, July 2018.

For these reasons, the FSB's starting position has been that stablecoins must be subject to comprehensive regulation, supervision, and oversight, comparable to the regulations that already apply to traditional payment systems.

In October 2020, we published ten high-level recommendations that seek to promote coordinated and effective regulation, supervision and oversight of GSC arrangements. These aim to address the financial stability risks posed by GSCs, while supporting responsible innovation and providing sufficient flexibility for jurisdictions to implement domestic approaches. The recommendations call for regulation, supervision and oversight that is proportionate to the risks. They also stress the value of flexible, efficient, inclusive, and multi-sectoral cross-border cooperation, coordination, and information sharing arrangements among authorities, taking into account the evolving nature of GSC arrangements and the risks they may pose over time.

The 2022 crypto market turmoil has shed new light on the financial stability implications of existing stablecoins. These developments have illustrated:

- that stablecoins, regardless of the type of stabilization mechanism, are highly susceptible to runs and cannot always ensure redemption at par; the most prominent case is the collapse of Terra USD.
- that existing stablecoins arrangements may lack sufficiently robust governance frameworks with clear allocation of accountability;
- the critical role stablecoins play in maintaining the stability of crypto-asset markets; last year 75% of all trades on crypto-asset trading platforms involved a stablecoin.
- the highly interconnected nature of the crypto-asset sector, across unbacked crypto-assets, stablecoins and DeFi. Failure in one actor, quickly spreads across the entire eco-system;
- the potential financial stability risks arising from existing or potentially growing interconnectedness between crypto-asset markets and the traditional financial system;
- the important role played by crypto-asset trading platforms and the need to better understand their intermediation role and linkages with stablecoin arrangements.

The turmoil has also demonstrated the lack of transparency in crypto asset markets and raised market integrity issues that may in turn have implications for financial stability.

These developments underline the need for a comprehensive and consistent regulatory approach to address the potential financial stability risks posed by crypto-assets, including, but not limited to, stablecoins.

Such a holistic approach faces several challenges. One is that crypto-asset activities and markets are often unregulated or not compliant with applicable regulations. In some jurisdictions, crypto-asset activities fall outside of the regulatory perimeter whereas in others, certain crypto-assets qualify as regulated financial instruments. Another challenge is that participants in crypto-assets often combine activities that fall under different sectoral regimes. For example, trading platforms often integrate vertically activities such as trading, order pairing, settlement, lending provisioning, proprietary trading, brokerage and custody services. They may also issue their own

native crypto-assets or develop blockchains. This may require the cumulative application of different sectoral regulation and not capture fully the risks arising from the compounding effects of different functions.

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The FSB is working to ensure that crypto-assets are subject to robust regulation and supervision. We are facilitating cross-border and cross-sectoral cooperation among national financial authorities and international standard-setting bodies -- including CPMI, IOSCO and the Basel Committee -- as they work towards developing a common understanding of the wide spectrum of crypto-assets as well as regulatory and supervisory policies that are grounded in the principle of "same activity, same risk, same regulation". This work includes: the assessment of existing applicable standards; the identification of potential gaps with a view to inform possible adaptations of existing standards; and the development of new standards or implementing guidance to address new types of risks that may not adequately be captured by the existing regulatory frameworks in a manner that promotes international consistency and responsible innovation.

The FSB will report to the G20 Finance Ministers and Central Bank Governors in October 2022 on regulatory and supervisory approaches to stablecoins and other crypto-assets. At that time, it will submit – for public consultation – a review of its high-level recommendations for the regulation, supervision and oversight of "global stablecoin" arrangements, including how existing frameworks may be extended to close gaps and implement the high-level recommendations. The FSB will also begin a public consultation on its proposed recommendations for promoting international consistency of regulatory and supervisory approaches to other crypto-assets and crypto-asset markets and strengthening international cooperation and coordination.

This extensive consultation underlines the FSB's goal to harness the benefits of digital innovation while containing its risks. Regulatory action to achieve this goal may be perceived by some as unduly constraining economic freedom. History suggests that the opposite is true. Financial instability and its enormous costs for society tend to undermine support for innovation and open markets. That's why good regulation is the friend of innovation.