



**ADDRESSING THE REGULATORY, SUPERVISORY AND OVERSIGHT CHALLENGES
RAISED BY “GLOBAL STABLECOIN” ARRANGEMENTS**

FINANCIAL STABILITY BOARD CONSULTATIVE DOCUMENT

BNP Paribas would like to begin by thanking the Financial Stability Board (FSB) for this opportunity to provide its views on how to address the various challenges raised by stablecoins.

Benefits, risks and need for regulations

Considering that stablecoins could have very important implications for the financial sector in terms of potential opportunities and benefits as well as in terms of new risks related, for example, to financial stability, monetary policy transmission or fight against money laundering and financing of terrorist activities, we are deeply convinced of the need to regulate stablecoins.

The main expected benefits of stablecoins, compared to other crypto-assets, are: (i) their relative stability and the essential trust that may result from this stability and (ii) the fact that they are “programmable”.

(i) Concretely, the core value proposition of stablecoins is to provide a better store of value to allow to carry out transactions related to crypto-assets without leaving the DLT environment. Stablecoins could also participate to financial inclusion, in countries with volatile currencies and low rates of bank penetration, and facilitate international transactions.

(ii) “Programmable stablecoin”¹ could potentially introduce a major disruption.

Smart contracts will specify both the characteristics of the “programmable stablecoin” and the conditions of the transactions.

The terms and conditions are programmed according to how the parties want to transact. They are part of the stablecoin at the time of issuance, then enforced during all stages (secure, verify and authorize the transactions).

However, alongside these potential benefits, stablecoins could also bring material risks, some of which are particularly significant.

¹ “Programmable money” is the most commonly used expression. However, we prefer the expression “Programmable stablecoin” as all of these tokens do not fully perform all the functions of a money.

Indeed, as emphasized by the G7 Working Group on Stablecoins, a stablecoin widely used as a store of value could potentially weaken the impact of monetary policy on domestic interest rates and credit conditions, particularly in countries whose currencies are not part of the reserve assets².

The larger the balance sheet of central banks, the lower is the quantity of sovereign debt securities or, more generally, of financial instruments eligible as collateral for repurchase agreements (refinancing operations) granted by central banks or for their asset purchase programs (quantitative easing). A growing quantity of sovereign securities is frozen or pledged in commercial and central banks' balance sheets. A further potential source of scarcity has come from the new liquidity coverage ratio (LCR) which requires banks to hold central bank reserves or other high quality financial assets. Admittedly, this constraint has not yet materialized given the current abundance of central bank reserves but it should be taken into account in the longer run. Since stablecoins are backed more or less by the same financial assets, they may reduce even more the volume of high quality liquid instruments or assets usable as collateral which are freely negotiable on the market. Hence, in case of a financial or economic stress, a sudden reallocation towards less risky assets may result in higher prices, lower yields and risk premia (or spreads). On the contrary, in the context of an improvement of the economic outlook, a shift out from less risky assets would amplify changes in the opposite direction : lower prices, higher yields and spreads which could in turn exacerbate the fiscal constraint weighing on governments and dampen the economic recovery. This increased volatility may accordingly pose risks to financial stability and monetary transmission. This point is of particular relevance since central banks are seeking to strengthen their influence on long-term interest rates by their forward guidance and quantitative easing strategies. Furthermore, this rarefaction in high quality collateral for banks could result in a necessary broadening of the eligible collateral which, beyond a certain limit, raises the question of the quality of central banks' balance sheets and, to an extreme extent, that of base money and broad money (whose value only relies to the fact that it is always convertible at parity into fiduciary money which is a form of base -or central bank- money).

Furthermore, none of the existing type of stablecoins - i.e. tokenised funds, off-chain collateralised stablecoins, on-chain collateralised stablecoins and algorithmic stablecoins - are as stable as a central bank or a commercial bank money (still 80% of the money created in the euro area) can be. Indeed, even in the case of tokenised funds, which are supposed to be the most efficient stablecoin in terms of stability, according to an ECB study, volatility risks still exist in the cases of fraud and operational accident.

Also, as explained in the G7 Working Group on stablecoins report issued in October 2019 ("Investigating the impact of global stablecoins"), stablecoins, particularly payment tokens, may also have important implications for the funding of banks: "First, if users hold stablecoins permanently in deposit-like accounts, retail deposits at banks may decline, increasing bank dependence on more costly and volatile sources of funding, including wholesale funding. In those countries whose currencies are part of the reserve, a portion of deposits drained from the banking system (when retail users buy stablecoins) may revert to

² As an example, during the Covid crisis and under FX pressure, cryptocurrencies have been gaining momentum as hedging assets against "traditional" currencies. This has been in particular the case for Turkish Lira (TRY).

domestic bank deposits and short-term government securities. This implies that some banks may have larger wholesale deposits from stablecoin issuers rather than numerous small retail deposits”.

Finally, as a means of payment, stablecoins may have material negative impacts on safety, efficiency and integrity of payment systems, and thus on the financial stability. If they are not properly regulated, stablecoins may become a weak link jeopardising the payment system, whether at domestic or international level.

National regimes should fit into a larger framework to be adopted at regional (e.g. European) and eventually global level

For all of these reasons, it seems essential to establish appropriate regulations that address these risks while preserving the potential for technological innovation offered by crypto-assets.

In this respect, there is a crucial need for overall consistency. The rules adopted in the various jurisdictions must be consistent, to preserve level playing field and to prevent market fragmentation and regulatory arbitrage. For these reasons, we strongly support the FSB initiative, its global approach and its set of recommendations.

Taxonomy as a prerequisite

As a first step, to be able to define the precise scope of the rules which could be applicable to stablecoins, we deem it necessary to develop a classification of the various types of crypto-assets. Such a classification, which would make it possible to define rules adapted to each of the different categories of assets thus defined, could be based primarily on the crypto-asset’s economic function. It should follow the “same business, same risks, same rules, same supervision” principle. In other terms, if the economic function and purpose of a crypto-asset are the same as a regulated asset class, it should be subject to the same set of financial and prudential rules. Moreover, any entity or intermediary engaging in activities that are equivalent to those performed by regulated financial entities or intermediaries, should be subject to the same legal requirements, in particular with respect to prudential and anti-money laundering issues.

In this respect, with regard to the distinction proposed between stablecoins and global stablecoins, we consider that any stablecoin arrangement has the potential to become systemic and that most of the risks induced by stablecoins are not only related to their international scale of adoption. Legal uncertainty, money laundering, financing of terrorism, stability of payment systems, cyber security, operational resilience, market integrity, data privacy, consumer protection, tax compliance: these different issues, taken individually or together, can create a potential threat to financial stability even at a domestic level. A distinction that seems more relevant to us for the design of appropriate regulations is that which can be made between wholesale and retail stablecoins. Indeed, the latter, given the users concerned, i.e. retail customers, implies specific rules, for example in terms of consumer protection or with regard to rules on combating money-laundering and the financing of terrorism, which could imply for instance limits in terms of amount for retail payment tokens.

Programmable stablecoin from a regulatory standpoint

As for “programmable stablecoin”, in order to properly regulate their development, the following issues should be carefully assessed:

- provide legal certainty to smart contracts (considered as legal contracts);
- compatibility between smart contracts, “traditional” contract law and international law;
- provide clarifications in terms of applicable regulation to programmable stablecoin (EMD2, bespoke regime...);
- provide clear conditions in term of issuance and the governance;
- ensure no bias, in particular in terms of discrimination, are introduced (in a way similar to the use of artificial Intelligence for personal/consumer data);
- ensure prudential and accounting issues are properly addressed for “programmable stablecoins”;
- ensure anti-money laundering and terrorism financing provisions are enforced.

Competition and financial stability: a need for an open ecosystem and a real level playing field

We also believe that the competition issues have important implications in terms of financial stability.

For example, if a stablecoin was to become a dominant source of payments, it would be critical for all players to have equal access to it, as in the case of fiat moneys, in particular to enable them to continue to serve their clients. This of course implies that the concept of a “dominant position” for stablecoins is carefully and fairly assessed and defined – which might imply in particular the use of market thresholds – globally or in certain regions/geographies. An abuse of a dominant position could undermine systemic financial players, threaten the functioning of the payment system as a whole and thereby put at risk financial stability.

Beyond this issue of non-discriminatory access to stablecoins, measures that rebalance the level playing field between non-regulated new players, such as big techs, and heavily regulated entities, like banks, covering topics such as capital requirements, anti-money laundering and data privacy issues, would be essential to preserve the integrity and stability of the payments ecosystem.

Incidentally, it should be pointed out that, particularly in a time where technologies can rapidly evolve, regulation should remain technology neutral.

Status of the issuers: central bank and commercial bank digital currencies

Two other very important issues are (i) the specific role of Central Bank Digital Currencies (CBDC) in this new environment; (ii) the status of the issuers of stablecoins and the conditions of access to stablecoins and (ii) the articulation between CBDCs and stablecoins.

- (i) Given the potential impacts for monetary policy transmission and financial stability, we believe that **to date, only a CBDC or a commercial bank digital currency, since they are different forms of a genuine money, can fully perform the functions of money: store of value, means of payment, unit of account.** However, it seems that the

impact that CBDCs or commercial banks stablecoins could have both in terms of financial stability (risk of “digital” bank run) and on the monetary policy transmission (cost and volume of bank lending and money creation) should be carefully monitored. Moreover, as regards the financial markets, in order to carry out end-to-end transactions with “tokenised” assets on the blockchain, financial institutions need a liquid and safe asset for making settlements. A detailed analysis should be conducted to assess whether a CBDC and/or a wholesale ledger for commercial bank digital currencies (that would be convertible at parity with a fiat money³) would be the best solution to satisfy this need.

Needless to say, **the question of who could/should have access to CBDC is a major one**. One option would be to envisage a level playing field by opening CBDC to both banks and non-banks. However, the consequences in terms of impact on monetary policy transmission as well as on financial stability should be very carefully assessed. We believe CBDC could be an effective way to allow the circulation of money on a blockchain and make a safe and liquid payment instrument. However, it should not jeopardize the current framework of monetary policy which has very much proved its worth.

(ii) At last, the issue of **who should have access to stablecoins is also of paramount importance**. In the existing financial world, the only type of money available to non-banks is fiduciary (FIAT) money. By nature, the quantity of FIAT money is limited which implies that banks are granted a major role for the use of central banks money in the form of Central Banks reserves that they negotiate on the interbank market, playing a key role in the setting of short-term interest rates on the money market and hence on monetary policy transmission. As discussed above, the introduction of CBDCs could challenge this scheme – whether the CBDC are **directly** made available to customers and/or to banks and non-banks.

One major competition issue is whether (and how) stablecoins, whether issued by a bank or by a non-bank, should be made available to all players⁴.

We believe that, **in case a stablecoin would get a major importance marketwise, all stakeholders should be granted to right to use the stablecoin**, whether regulated commercial bank or a currently unregulated Fintech or BigTech (cf. paragraphs re: “Competition and financial stability” above). This scheme would clearly require a specific attention since it does not necessarily replicate the traditional model organized around central banks and commercial banks.

(iii) The question of the **necessary coordination between CBDCs and stablecoins during all stages**, id est from (i) the time of issuance to (ii) their use journey and (iii) the

³ Such a ledger - which could be named “e-euro” -, accessible only to financial intermediaries, could help for the unlocking of the full potential of the blockchain technology.

⁴ Prudential issues are also a very important. In particular :

- (i) how should CBDCs and stablecoins considered both from a prudential and accounting standpoint?
- (ii) From a prudential standpoint, we believe that, as far as CBDC and stablecoins are concerned, regulatory regimes between banks and non-banks should converge.

conditions of convertibility is of strategic importance⁵. In particular, the possibility for customers (whether retail or corporates) to access and use a stablecoin is crucial. The coordination between the issuance of CBDCs and stablecoins should be very carefully assessed, since it could in particular have a major impact on the role of commercial banks and on monetary policy transmission in the future. One major question would be the future role of commercial banks and the potential new role that non-banks could play in terms of financing and monetary creation.

In any case, we believe that the “same activity, same risks, same regulation, same supervision” principle should apply.

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⁵ Incidentally, new regulatory issues would appear when considering trading between two of the three following financial instruments: a CBDC; a stablecoin and a “traditional” fiat money, including hedging, instruments and derivatives.