Comments on the FSB consultative paper "Addressing the regulatory, supervisory and oversight challenges raised by global stablecoin arrangements"

Comments by:

Dr Iwa Salami
Programme Director for Postgraduate Research Degrees
Royal Docks School of Business and Law
University of East London

Financial technology is changing the face of financial services globally. Alongside changing the quality and cost of financial services, it is also improving accessibility to these services. It, as such, facilitates financial inclusion which, although not mentioned as a UN Sustainable Development Goal scheduled to be achieved by 2030, is at the heart of a good number of them.

Nonetheless, regulation is key for the continued safe growth of financial technology and innovation and should be seen as a facilitator of further innovation rather than as an obstacle to it. As such, I commend the FSB for this comprehensive consultative document addressing the challenges of regulating global stablecoins (GSC) arrangements and I largely welcome the recommendations.

Much of my comments focus on the impact of GSCs on developing and emerging markets – whose financial regulatory regimes are at varying stages of development but which have a growing virtual assets industry of which global stable coins are likely to feature very strongly in future.

My comments are made in view of stable coins which are powered by DLT/blockchain and issued by unregulated decentralised networks and backed by crypto-assets and stable coins that are issued by regulated centralised platforms and backed by a currency or a currency basket. Both of these have the potential to be global.

I would, however, want to highlight a few areas which would be worthy of consideration by the FSB and other standard setters including the Basel committee, IOSCO and the Committee on Payments and Market Infrastructure (CPMI), as they look to formulate international standards for global stable coins and digital assets in general.

My comments on the recommendations are made under three headings which deserve further evaluation for the adoption of robust international standards.

Decentralised finance and stablecoins

R1 Authorities should have and utilise the necessary powers and tools, and adequate resources, to comprehensively regulate, supervise, and oversee a GSC arrangement and its multi-functional activities, and enforce relevant laws and regulations effectively.

This recommendation indicates that regulators should have the power to regulate and supervise the operation and use of GSCs across both decentralized and centralized platforms. This suggests that regulatory authorities should have the power to withdraw the license of centralized platforms facilitating their use, as well as the power to shut down their operation on decentralized platforms. While this is a necessary approach for the adoption of a holistic approach to regulating the industry (as I argue in a recent article Salami, I (2020) 'Decentralised Finance: A Holistic Approach to regulating the Crypto Industry' *Journal of International Banking and Financial Law,* Vol. 35, Issue.7:496-499), the implementation of this should be thought through. This is so as transactions involving stablecoins occurring on decentralised platforms cannot be easily shut down. For this to be possible, it would require a number of physical actions to censor networks such as: the ability to access Internet Protocol (IP) addresses; cooperation from local Internet Service Providers (ISP); identifying / tracing the physical location of individuals; and involving the use of enforcement powers such as the police to effectively shut down such platforms /activities.

Although it is not impossible to shut-off a decentralized system, it is very difficult to achieve and would require heavy reliance on government/regulatory authority's resources to achieve. Locating every one within their jurisdiction utilizing, for example, the bitcoin network or decentralized network to punish them would not be an easy task. Although this would significantly achieve deterrence of transactions on such platforms and result in slow adoption, it would be difficult to achieve on a global scale – thus threatening the robustness of the international standards. Nonetheless, the robustness of international standards is critical to prevent regulatory arbitrage. As such, the FSB, in addition to highlighting the need for regulators to have this power, should recognize the need for a global coordination mechanism for investigating and enforcing violations of regulatory standards. Where they involve financial crime, they would necessarily require collaboration with organisations such as the INTERPOL. This point is particularly relevant to prevent regulatory arbitrage to jurisdictions with weak legal and financial regulatory systems. I examine these issues in a 2017 study which was later published (see Salami, I (2018) 'Terrorism Financing with Virtual Currencies: Can Regulatory Technology Solutions Combat This', *Studies in Conflict and Terrorism*, Vol. 41, Issue 12: 968 - 989; also available at https://www.tandfonline.com/doi/abs/10.1080/1057610X.2017.1365464?journalCode=uter20).

Digital assets regulation and regional cooperation in emerging and developing markets

R3 Authorities should ensure that there is comprehensive regulation, supervision and oversight of the GSC arrangement across borders and sectors. Authorities should cooperate and

coordinate with each other, both domestically and internationally, to foster efficient and effective communication and consultation in order to support each other in fulfilling their respective mandates and to facilitate comprehensive regulation, supervision, and oversight of a GSC arrangement across borders and sectors.

As highlighted in the paper, most jurisdictions do not currently have a regulatory framework for crypto-assets or stablecoins, but most can apply existing regulatory frameworks to address some of the risks associated with them. As stated in the consultative document, the most common approach is to "apply the relevant existing regulation for that activity or entity performed by a stablecoin and the users of it, according to the 'same business, same risks, same rules' principle."

While the breath of the financial regulatory framework in advanced economies is likely to cater, in one way or another, for all or most aspects of crypto-assets and GSCs, the same cannot be said of emerging and developing economies. In fact, it may be the case that in some jurisdictions no suitable regulatory provisions exist to cover these services. With this state of affairs, regional integration can play a key role in achieving speedy and consistent adoption of regional standards for crypto-assets and stablecoins in developing and emerging regions. These regional standards for the regulation of digital assets, including stablecoins, would be formulated primarily on the basis of the stages of regulatory development and the peculiarities of the development of the digital assets industry in those regions. Given the significance of achieving global standards for GSC, the regional standards would necessarily be aligned with international standards, so they would ideally be formulated as 'internationally acceptable regional standards.' These regional standards should, as such, be devised through close collaboration between international standard setters and regional financial regulatory bodies comprising domestic financial regulators.

This would assist domestic regulatory regimes that may not be well-versed in the space to fully encapsulate GSC activities and to be guided by regional standards providing direction for domestic regulation. This, of course, would be most effective in regions with strong regional arrangements and regions such as Africa, Latin America and the Middle East can benefit from such an approach. The approach to regional financial regulation and integration, done from an African perspective can be found in the book, Salami, I., Financial Regulation in Africa: An Assessment of Financial Integration Arrangements in African Emerging and Frontier Markets (Routledge 2012). This can be a model adopted for other emerging and developing country regions.

<u>Global stablecoins use in developing and poorer economies</u>

R4 Authorities should ensure that GSC arrangements have in place a comprehensive governance framework with a clear allocation of accountability for the functions and activities within the GSC arrangement.

In furtherance to Recommendation 4 and in the light of the potential challenges to monetary systems and the resulting economic implications that GSCs can have in jurisdictions with weaker domestic currencies, the governance framework of such GSCs arrangements should necessarily embrace international public-private partnerships. This should ideally comprise the Financial Stability Board (FSB) including its member institutions, comprising ministries of finance, central banks, and supervisory and regulatory authorities from G20 jurisdictions as well as 10 international organizations (including the IMF) and standard-setting bodies. It should also include the monetary authorities of developing and emerging economies where these GSC would be in use.

This truly global governance framework would be fitting for GSC arrangements given their global reach. A governance framework excluding the monetary authorities of the countries where GSCs are likely to have huge adoption can hardly be described as robust enough.

I discussed this in an article published before Libra 2.0 was released see Salami, I (2019) 'From Bitcoin to Libra: A Global Public – Private Partnership Approach to Regulation,' *European Financial Review* August – September 2019 available at https://www.europeanfinancialreview.com/from-bitcoin-to-libra-a-global-public-private-partnership-approach-to-regulation/