July 15, 2020

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Addressing the regulatory, supervisory and oversight challenges raised by "global stablecoin" arrangements

The Institute of International Finance (IIF) welcomes the Financial Stability Board (FSB) consultative document on global stablecoins (GSCs).[1] In the IIF's view, the document provides a thoughtful overview of how to identify and address the potential risks and issues that are considered to be within scope of GSCs, and proposes generally appropriate high-level recommendations to address those issues. We also welcome the involvement of the G20 and the FSB given the potential reach of GSCs.

In our response, we wish to record some high-level principles we believe should be kept firmly in mind as the FSB moves to finalize its recommendations, and against that backdrop make some high-level recommendations about terminology and taxonomy; clarifying the regulatory perimeter; strengthening oversight and transparency; and competition, consumer protection and other issues. We also annex detailed responses to the individual questions asked.

Our general comments on the paper are informed by the following **high-level regulatory principles** which are referenced by the FSB in the consultation document and which we commend:

- **Same activity, same risks, same regulation:** applying this principle consistently would provide a level playing field across the regulated and presently non-regulated sectors and increase opportunities for both new and existing actors to provide safer and better services for the broader financial industry.[2] Where new technology is used to facilitate traditional activities, the existing regulation should apply, but additional clarity may need to be provided. Further, additional regulatory oversight should be focused where new risks might arise or gaps exist in current frameworks, complementing rather than duplicating existing requirements. Where non-banking institutions issue stablecoins or participate in GSC arrangements and engage in regulated activities, they should be subject to rules based on the activities they engage in and the risks they pose.
- **Regulation should be technology-agnostic, and address the risks associated with the underlying activity / asset**: Regulation should be technology-agnostic to reflect the fact that the market is continually evolving, and to promote financial innovation. Increase in technology and operational risk – as with all digitization generally – should be mitigated with similar frameworks that are used

[1] Published 14 April 2020. See https://www.fsb.org/2020/04/addressing-the-regulatory-supervisory-and-oversight-challenges-raised-by-global-stablecoin-arrangements-consultative-document/.
[2] The principle is mentioned on p. 15 of the paper, 'The most common approach is to identify the activity performed by a stablecoin arrangement and the participants involved, and apply the relevant existing regulation for that activity or entity according to the "same business, same risks, same rules" principle.'

today, while acknowledging the risks of the underlying technologies may not yet be fully understood.

In consequence of these principles we propose the following **high-level recommendations** for the FSB's consideration.

Terminology and taxonomy

The term "stablecoin" needs to be considered with an appreciation of adjacent instruments and forms of digital money that are already or will be appropriately regulated, such as CBDCs, FMI settlement tokens, tokenized securities, and tokenized commercial bank money. It is expected that these instruments should continue to operate under existing rules and regulations, while regulatory gaps should be closed where apparent.

Ongoing work to establish a **taxonomy** for digital assets can help to drive a global consensus on key attributes and design considerations and how they intersect with existing regulatory frameworks; however, these new technologies and applications are still in a relatively early phase of development so these instruments may continue to evolve rapidly. As a result, these taxonomy efforts may require an agile approach to keep pace with developments.

The term "global stablecoin" could also be replaced with something more informative of their systemic nature, given that all stablecoins are globally available on a technical level.[3]

Clarifying the regulatory perimeter

The subcategory of "global stablecoins" that are subject to the FSB's recommendations needs to be clear. Disagreements among regulators across either sectoral or geographic boundaries on which stablecoins qualify as GSCs would be highly undesirable.

In the IIF's view, a methodological structure, such as the G-SIBs list published annually by the FSB, could be a viable approach; however, we note that the rapid evolution in GSCs may require a more frequent data gathering than annual, at least in the initial phases.

Any list of globally systemically important stablecoins could be published by the FSB on the basis of a methodology designed by the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) acting together, to reflect the broad scope of regulators with an appropriate interest in this subject-matter.

Given the pace of change, consideration should be given to drawing up a list more frequently than annually. If the data gathering exercise is conducted annually or less frequently, there will be a consequently greater justification for judging systemic importance on the basis of projections and not merely past data. In this regard if the methodology references exclusively data that will be publicly available, market actors can determine the members of the list themselves as often as that information is updated, relieving the official sector from a potentially burdensome job.

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[3] We note in this regard that the Financial Action Task Force (FATF) 'considers that the term "stablecoin" is not a clear legal or technical category, but is primarily a marketing term used by promoters of such coins. … Those coins called "global stablecoins" in other G20 reports are named "so-called stablecoins with the potential for mass adoption" in this report for the same reason': see FATF (Jun. 2020), *Report to the G20 Finance Ministers and Central Bank Governors on So-called Stablecoins*, p. 2, fn 1, available at http://www.fatf-gafi.org/media/fatf/documents/recommendations/Virtual-Assets-FATF-Report-G20-So-Called-Stablecoins.pdf.

In our view, the metrics that will be used to identify whether an arrangement qualifies as a GSC could be clarified and thresholds defined, building on the useful list of indicators in Annex 5 to the paper. As measures of interconnectedness with regulated financial institutions, the various activities considered in the recent consultation by BCBS on crypto-assets could provide a framework.[4]

Strengthening oversight and transparency

GSCs that are globally systemic would likely require novel institutional arrangements to oversee them, and their activities would demand appropriate transparency to the market. While acknowledging the need for overall flexibility given rapidly evolving trends, the FSB should do more to clarify the respective roles of the various regulators involved in GSC oversight, and should also propose a more developed monitoring framework.

We acknowledge that the rapidly evolving nature of GSCs and digital payment instruments generally makes designing oversight systems *ex ante* very challenging. We also agree that the FSB should not act prematurely in this area. But it is important that a direction is established and we look forward to the FSB firming up an approach on this issue in the coming period, including potentially by setting up a review mechanism to consider the issue after an appropriate delay.

Given their *sui generis* nature and the potential for them to take many different legal forms, the IIF would support a fuller analysis of **the need for bespoke oversight arrangements to govern the oversight of those GSCs which lack (or will lack) supervisory colleges** with appropriate competence to effectively oversee the GSC.[5]

As for transparency, the FSB paper states that information pertaining to the amount of GSC in circulation and the value and the composition of the assets in the reserve backing the GSC should be subject to independent audit, and "disclosed on a regular basis in a comprehensive and transparent manner." We agree with these proposals and would add that is **important to clarify that these disclosures should be to the whole marketplace rather than solely to regulators or consortium members.**

These basic statistical disclosures could be supplemented by a more elaborate quantitative disclosure regime, which BCBS, CPMI and IOSCO could design, to ensure that all actors including the general public, central banks, parliaments and sovereigns are fully informed about the status of GSC arrangements.

Competition, consumer protection and other issues

For the reasons set out below, **we would urge the FSB to embed competition and consumer protection implications in its forward-looking financial stability monitoring framework for GSCs.** This monitoring framework would preferably set out publicly which financial stability risk dimensions – including but not limited to impacts on the regulated FI sector – are to be monitored in a regular, agile and forward-looking way. The monitoring should sit alongside mechanisms to identify in a timely way **appropriate mitigants for any significant financial stability risks that** are identified.

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[4] BCBS (Dec. 2019), *Designing a prudential treatment for crypto-assets*, at https://www.bis.org/bcbs/publ/d490.pdf .

[5] As referenced in p. 24 of the consultative document.

Some of the issues that are not tackled in the paper, including some which are said to be out of scope, may have global financial stability implications over the medium- or long-term and therefore need more attention now, by the FSB and/or by other competent authorities. Indeed, our preference would be that these issues or an agreed way forward are clearly addressed by the FSB in its final recommendations.

While the FSB's consultative document notes that along with the work done by the FSB, the G20 asked the IMF to consider the macroeconomic implications including monetary sovereignty issues in IMF member countries, and the Financial Action Task Force (FATF) to consider AML/CFT issues, we see a **potential gap around the assessment of competition, consumer protection, data privacy issues and micro-economic effects generally** that may have global financial stability implications and impact the intended end users of stablecoins.

The FSB has rightly identified that changes in competition dynamics could endanger the resilience of the financial sector and adversely impact financial stability. The dynamics of digital markets could lead to a situation in which the provision of financial services becomes more concentrated, rather than more diversified, with a small number of new providers becoming new sources of systemic risk. Moreover, there could be additional new implications for financial stability from stablecoins and BigTech firms with strong network effects and access to data. Links to BigTech firms and GSC design considerations, such as openness of the arrangements and proprietary advantage, could amplify stability concerns.[6] Fair and non-discriminatory access to data held in such arrangements will be paramount.

The IIF and its members note that should a GSC come to form a dominant and systemically integral source of cross-border payments globally, clients of regulated financial institutions may expect these institutions to provide various services such as wallets. To be able to provide these services and compete with other actors, regulatory clarity may need to be provided and additional oversight for non-regulated institutions may be required to ensure that new GSC providers contribute their fair share to the cost of onboarding and maintaining clients and mitigating risk throughout the financial system. **Consistent access to data across sectors** is one example of measures that can be taken to ensure that all actors are supporting a safe and sound financial system. This is particularly important given the potential for payment flow data to be impeded by different sector-based rules and different regional data privacy requirements.

Relatedly, we also acknowledge that to the extent that the PFMI are expected to apply to a GSC, Principles 18 (Access and participation requirements), 19 (Tiered participation arrangements) and 20 (FMI links) may be engaged.[7] In their preliminary analysis, the CPMI and IOSCO concluded that these Principles were "Applicable but challenging to observe". **CPMI and IOSCO should therefore be tasked with promptly clarifying these**

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[6] See FSB (Feb. 2019), *FinTech and market structure in financial services: Market developments and potential financial stability implications* available at https://www.fsb.org/2019/02/fintech-and-market-structure-in-financial-services-market-developments-and-potential-financial-stability-implications/. See also FSB (Dec. 2019), *BigTech in finance: Market developments and potential financial stability implications* at https://www.fsb.org/wp-content/uploads/P091219-1.pdf.

[7] Principle 18: Access and participation requirements. An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.
Principle 19: Tiered participation arrangements. An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.
Principle 20: FMI links. An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks. See https://www.bis.org/cpmi/publ/d101a.pdf

observations and with preparing more detailed guidance on how these principles (and indeed the other PFMIs) would apply to GSCs in general.

In a similar vein, as noted in our recent *Money Redesigned* paper on asymmetric disintermediation, any potential reduction in the role of commercial and central bank money, including in times of stress, may have significant consequences (on the global or domestic levels) for financial institutions and in turn the real economy, including through **a lower availability and higher cost of credit,** with the additional impact on **procyclicality** in cases of market turmoil. Lending may be transferred to non-banks or alternative financial services, with potential implications for the system as a whole. The coming period will of course see policymakers and politicians place great emphasis on the ability of the banking sector to finance recovery from the impact of the global pandemic and eventually to replenish capital buffers.[8]

While the topics of competition and consumer protection extend across sectors and beyond financial services, there is an important opportunity for the FSB and other financial standard-setting bodies to champion these issues within the G20 conversation.

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The IIF looks forward to further engagement with the FSB, G20 and standard-setting bodies on this important topic, and to contributing to the further development of safe and effective innovations that can benefit the economy and support stability. My colleague Laurence White (lwhite@iif.com) and I (bcarr@iif.com) stand ready to engage in additional discussions and consultations.

Yours sincerely,

Brad Carr
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[8] https://www.iif.com/Publications/ID/3951/Money-Redesigned-Part-One

Annex

Addressing the regulatory, supervisory and oversight challenges raised by "global stablecoin" arrangements

IIF members' answers to FSB's numbered questions

1. Do you agree with the analysis of the characteristics of stablecoins that distinguish them from other crypto-assets?

The definition of a stablecoin should be more precise to indicate what features would make it fall within a particular regulatory category. We refer to and repeat our remarks in the "Terminology and taxonomy" section of the covering letter. As we there say, the term "stablecoin" needs to be considered with an appreciation of adjacent instruments and forms of digital money that are already or will be appropriately regulated, such as CBDCs, FMI settlement tokens, tokenized securities, and tokenized commercial bank money. It is expected that these instruments should continue to operate under existing rules and regulations, while regulatory gaps should be closed where apparent.

As we mention in the "Clarifying the regulatory perimeter" section of the covering letter, in our view, the metrics that will be used to identify whether an arrangement qualifies as a GSC could be clarified and thresholds defined, building on the useful list of indicators in Annex 5 to the consultative document. As measures of interconnectedness with regulated financial institutions, the various activities considered in the BCBS's recent consultation on crypto-assets could provide a framework.

We note that a GSC could, in the interest of consumers and consumer protection, have multiple functions, namely a method of payment and/or a store of value:

- We note that a GSC could be used as a means of payment, as a store of value, and for other functions. For each of these functions, different regulatory frameworks may apply. As mentioned on p. 1 of the cover letter, the IIF would encourage regulators to view stablecoins through the lens of 'same risk, same activity, same treatment' and apply the same principles to stablecoins. This will help ensure there is limited risk of regulatory arbitrage and that consumers are protected with the robust frameworks currently being implemented.
- For example, it is possible that a GSC arrangement may fall under the definition of 'electronic money' given that the regulatory framework in many jurisdictions permits electronic money to be used both as a payment method and a store of value, however, GSC arrangements that have the dual function of payment method and store of value may raise the risk of regulatory arbitrage given the different regimes that could be applied even under the 'same business same risk principle same rules' principle. The appropriateness of those regimes may need to be further re-evaluated based on the potential for systemic risk and the extent of potential consumer detriment.

The differences detailed above result in different consumer protection provisions. For this reason we believe that it is important to have transparency on the roles and regulated activity that is undertaken by participants in a GSC arrangement. This is of particular importance if one entity is undertaking more than one activity. As the FSB has determined, a GSC arrangement could be a combination of multiple activities and it is paramount for ensuring end user protection that entities undertaking more than one activity have sufficient and appropriate oversight and controls to mitigate against the risks and vulnerabilities identified in the consultation paper.

2. Are there stabilisation mechanisms other than the ones described, including emerging ones, that may have implications on the analysis of risks and vulnerabilities? Please describe and provide further information about such mechanisms.

   We agree that asset-linked and algorithm-based are two stabilization methods in the market today, but we recommend the FSB frequently review emerging stablecoins and their structuring and stabilization mechanisms, as the landscape is constantly evolving and hybrid versions could emerge as well that do not clearly fit into these proposed categories.

3. Does the FSB properly identify the functions and activities of a stablecoin arrangement? –

   The various functions and activities, and the suitability of particular entities to perform these, need to each be considered on their respective attributes, for instance noting the need for sufficient safeguarding of reserve assets. Regulators should carefully consider whether for prudential reasons, the same entity should be permitted to both issue coins and hold reserve assets in custody, and whether different entities in the same group should only be permitted to perform these functions subject to strict conflicts of interest management protocols.

   Does the approach taken appropriately deal with the various degrees of decentralisation of stablecoin arrangements?

   No comment.

4. What criteria or characteristics differentiate GSC arrangements from other stablecoin arrangements?

   We refer to and repeat the answer given in answer to Question 1 and the material in our "Terminology and taxonomy" section of our covering letter. As we say in that section, ongoing work to establish a taxonomy for digital assets can help to drive a global consensus on key attributes and design considerations and how they intersect with existing regulatory frameworks; however, these new technologies and applications are still in a relatively early phase of development so these instruments may continue to evolve rapidly. As a result, these taxonomy efforts may require an agile approach to keep pace with developments.

5. Do you agree with the analysis of potential risks to financial stability arising from GSC arrangements?

   See our comments in the covering letter under the heading "Competition, consumer protection and other issues." In summary terms, for the reasons there stated, we see a potential gap around the assessment of competition and consumer protection, data privacy issues and micro-economic effects generally that may have global financial stability implications and impact the intended end users of stablecoins.

   What other relevant risks should regulators consider?

   The FSB has identified a list of issues outside the scope of the consultative document. Aside from competition, data privacy and taxation, the FSB states that the wider monetary policy, monetary sovereignty and currency substitution questions, the issue of public versus private provision of digital money and payment services and issues related to central bank digital currencies are also outside the scope of the analysis.

   We also add to these the risks posed:

- by a demand for safe short term assets as outlined by the ECB in its paper 'A regulatory and financial stability perspective on global stablecoins'[9]; and
- the creation of global closed loop ecosystems that in time remove liquidity from the everyday banking and payments systems.

It is important that with the FSB's help, the G20 maps out a comprehensive plan for these issues to be dealt with and resolved by governments, central banks, standard-setters or national authorities, in consultation with industry and end users.

6. Do you agree with the analysis of the vulnerabilities arising from various stablecoin functions and activities (see Annex 2)?

Yes, with the qualification that important financial stability effects can arise from the issues referred to in the "Competition, consumer protection and other issues" section of our covering letter which the FSB has stated are out of scope of the consultation.

As we there state, the FSB has rightly identified in previous work that changes in competition dynamics could endanger the resilience of the financial sector and adversely impact financial stability.

What, if any, amendments or alterations would you propose? –

We would urge the FSB to embed the competition implications in its forward-looking financial stability monitoring framework for GSCs. This monitoring framework would preferably set out publicly which financial stability risk dimensions – including but not limited to impacts on the regulated FI sector – are to be monitored in a regular, agile and forward-looking way. The monitoring should sit alongside mechanisms to identify in a timely way appropriate mitigants for any significant financial stability risks that are identified.

We also acknowledge that to the extent that the PFMI are expected to apply to a GSC, Principles 18 (Access and participation requirements), 19 (Tiered participation arrangements) and 20 (FMI links) may be engaged.10 In their preliminary analysis, the CPMI and IOSCO concluded that these Principles were "Applicable but challenging to observe". CPMI and IOSCO should therefore be tasked with promptly clarifying these observations and with preparing more detailed guidance on how these principles (and indeed the other PFMIs) would apply to GSCs in general.

7. Do you have comments on the potential regulatory authorities and tools and international standards applicable to GSC activities presented in Annex 2?

See the general comments in the covering letter under the heading "Competition, consumer protection and other issues" and the remarks under question 6 about the PFMI.

The FSB has outlined the regulatory authorities and tools that can be applied to mitigate the vulnerabilities arising from GSC arrangements and all or some are applicable depending upon the characteristic of a particular GSC arrangement.

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[9] See https://www.ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202005_1~3e9ac10eb1.en.html .

[10] Principle 18: Access and participation requirements. An FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access.
Principle 19: Tiered participation arrangements. An FMI should identify, monitor, and manage the material risks to the FMI arising from tiered participation arrangements.
Principle 20: FMI links. An FMI that establishes a link with one or more FMIs should identify, monitor, and manage link-related risks. See https://www.bis.org/cpmi/publ/d101a.pdf

We think it is possible that despite these overarching regulatory frameworks, there will be gaps in the regulation and supervision of GCS arrangements, given that it is not always possible for jurisdictions to apply these frameworks in their entirety because of national law or lack or regulator mandate.

We also note the possibility that these various regulatory frameworks do not neatly align to ensure that there are no gaps in the regulatory regime for GSCs.

As examples, matters that we feel require further attention are:

- Governance: all the relevant international standards apply to regulated firms. If a GSC arrangement has unregulated firms as participants it is possible that supervisory bodies will have no remit or oversight of these firms; this may create gaps in mitigating vulnerabilities, unless all the activities within stablecoin arrangements are made subject to adequate activity-specific regulatory frameworks.
- Managing reserve assets: we think that further analysis is necessary for the protection for consumers. GSC reserves should ensure that the assets that back single currency stablecoins are in the same currency to mitigate against mismatches on redemption or guarantee redemption at par.
- Unhosted wallets: we have concerns about unhosted wallets and the risks those may introduce. See further our answer to question 11 below.
- Consumer protection issues that may not be within the remit of global organizations: it is important to ensure that consumers have a right of redemption in a timely manner, especially during times of stress.

8. Do you agree with the characterisation of cross-border issues arising from GSC arrangements?

   Yes. We also recommend that the FSB promote international consistency in the regulation of GSCs and associated entities in order to encourage innovation, adoption, and competition. To do so, we believe the FSB should coordinate closely the activities of the standard-setting bodies including with FATF.

9. Are the proposed recommendations appropriate and proportionate with the risks?

   See the general remarks set out in our covering letter. In summary terms, we believe that the FSB should address terminology and taxonomy issues; clarify the regulatory perimeter; strengthen oversight and transparency arrangements for GSCs; and acknowledge and deal with financial stability aspects of competition and also address consumer protection and data privacy issues.

   Do they promote financial stability, market integrity, and consumer protection without overly constraining beneficial financial and technological innovation?

   a. Are domestic regulatory, supervisory and oversight issues appropriately identified?

      We believe that there needs to be further analysis of the competition, consumer protection and privacy issues flowing from GSC arrangements in the ways indicated in our covering letter and elsewhere in these Q&A.

   b. Are cross-border regulatory, supervisory and oversight issues appropriately identified?

      We believe that there needs to be further analysis of the consumer protection and privacy issues flowing from GSC arrangements. We recommend the FSB coordinate with international standard-setting bodies to identify and better understand cross-border issues.

c. Do the recommendations adequately anticipate and address potential developments and future innovation in this sector?

We are strongly in favour of ecosystems that support innovation and inclusion. The possibility of GSC arrangements creating systems that may fall outside of regulation for openness and accessibility is likely to hinder innovation and competition.

10. Do you think that the recommendations would be appropriate for stablecoins predominately used for wholesale purposes and other types of crypto-assets?

No. While the recommendations may be helpful for national authorities in designing approaches for other stablecoins, it should be clear that arrangements that are not GSCs are outside scope of the FSB's recommendations.

To do otherwise would be to risk stifling financial innovation without a thorough costs:benefits or risk:reward analysis.

11. Are there additional recommendations that should be included or recommendations that should be removed?

The recommendations address the matters within the remit of the FSB and other regulatory bodies.

As well as the points we have made about competition dynamics and their relevance to financial stability monitoring and risk mitigation, we would reiterate our view that further consideration needs to be given to the consumer protection and privacy issues flowing from GSC arrangements. For example:

- In a GSC transaction, how will consumers be protected in a cross border dispute?
- How will consumers be able to obtain refunds?
- The applicability or otherwise of deposit insurance to GSC arrangements should be clarified for each scheme before launch. Moral hazard and false assumptions that may drive demand should be avoided as much as possible.
- What responsibility and liability is placed on consumers holding 'unhosted' wallets, for example for cyber-incidents or fraud?
- If participants in a GSC arrangement are part of a corporate group, what consumer protections are appropriate for the sharing of data between these participants?

It is important that with the FSB's help, the G20 maps out a comprehensive plan for these issues to be dealt with and resolved by governments, central banks, standard-setters or national authorities, in consultation with industry and end users.

12. Are there cost-benefit considerations that can and should be addressed at this stage?

See our answer to question 10.