Global stablecoin initiatives. International Bulletin of June 2020.

In mid-2019, the Board of the International Organization of Securities Commissions (IOSCO) agreed to set up a specific working group within its FinTech Network to consider and evaluate global “stablecoin” proposals, which are referred to either as “stable crypto-assets” or by its English term “stablecoins”, such as the well-known Libra project. This working group drafted a paper that included a regulatory risk analysis on the features of an offer similar to this coin and considered how IOSCO Principles and Standards could be applied to the ecosystem of a crypto-asset of this type. The paper was submitted to the IOSCO Board for the purpose of contributing to a substantive discussion among its members, who agreed to publish it internally in November 2019 in order to further develop its analysis, reviewing different types of structures of stablecoins enabling IOSCO to contribute to the ongoing global debate at various forums, e.g. the working group set up by the Financial Stability Board on this matter.
IOSCO published this report on 23 March 2020 with the title: Global Stablecoin Initiatives.

This document is the first paper published by lOSCO on stable crypto-assets and contributes to the ongoing public debate in the international financial community, at international organisations and standard-setting bodies, on global proposals with regard to these stablecoins within the G7 area and the aforementioned Financial Stability Board (FSB)[1].
The working group set up by IOSCO will continue to assess key issues arising from the analysis of this paper, as well as other proposals related to coins. With this initiative, IOSCO encourages a globally coordinated cross-sector response to international regulatory challenges posed by stable crypto-asset proposals.

This paper shows that global initiatives on the issue of stablecoins may, depending on their structure, present features that are typical of regulated securities or other regulated financial instruments or services. It also identifies possible implications that global stablecoin proposals could have for securities market regulators and supervisors.

The paper includes some background to early crypto-assets designed as a means of payment, such as the bitcoin, which have suffered from high volatility with respect to established fiat currencies. In order to harness the potential benefits of payments using crypto-assets, various private entities have endeavoured to design a low-volatility crypto-asset. These initiatives include proposals with potential global reach and adoption, known as "global stablecoins", which are likely to be issued by large technology firms.

The paper discusses potential issues that may arise from these crypto-assets with global reach and adoption, and includes a hypothetical case study that raises many global financial regulatory issues. In any case, such a hypothetical case study, or its conclusions, is not intended as guidance or conclusions as to any potential stablecoin project. It analyses a potential stablecoin which could act as a global currency, with a potential financial infrastructure for domestic and cross-border payments, which uses a reserve fund and intermediaries as a means to achieve a stablecoin price, and intermediaries to obtain a stablecoin price.

This hypothetical case study describes the potential interaction with the area of competence of securities market regulators and supervisors, and discusses how some IOSCO Principles and Standards could apply.

However, it does not analyse any domestic regulation that may apply.

In this document, it has been agreed to use the term "crypto-asset" rather than "cryptocurrency", as it is considered to be a more neutral term that captures a broader range of tokens. The use of the term "cryptocurrency" could be considered as inappropriate since these assets, in general, do not fulfil the core criteria of money: as a unit of account, a stable store of value and efficient means of exchange. Therefore, "stablecoins" are often considered to be a type of crypto-asset.

According to the paper, the term "stablecoin" is a broad term which encompasses different types of assets, including assets that may be considered securities in certain jurisdictions. It has no legal or agreed definition for this term. Stablecoins are marketed as having less price volatility than other crypto-assets, and it is argued, are more appropriate for certain cases.

While stablecoins seek to reflect a set of characteristics (i.e. price stability), they do not form a self-contained type of crypto-asset. Stablecoins may be pegged to and/or backed by particular assets, algorithmically controlled, or their value can float freely. It should be noted that several currently-traded stablecoins are not "backed" by reference assets and stablecoin holders are not entitled to redemptions of these crypto-assets at face value.

The above-mentioned hypothetical case study describes a situation where a company has determined to design a platform using distributed ledger technology (DLT) to issue a crypto-asset, which is intended to act as a "stable crypto-asset" and as a means of exchange on a platform also accessible by third parties. The company (issuer) and third-party participants may offer goods and services on the platform in exchange for the stablecoin. The company states that the stablecoin will be backed by assets that are held in accounts at various global financial institutions (constituting a reserve fund), which are managed by the company, and that the market value of this coin will be maintained in line with the value of the assets held in the reserve fund. In this hypothetical case study, the reserve fund will be managed with the goal of preserving the value and liquidity of the coin, and will be composed of low volatility currencies, bank deposits and sovereign debt instruments. In this hypothetical case study, the company expects that the financial instruments held in the reserve fund will be stable and liquid and their value will be reflected in the total value of the outstanding number of coins, through an authorised participant mechanism.

The hypothetical case study offers other aspects and particularities, and in this context, the paper analyses it from two standpoints:

– The so-called *"front-end"*, which would allow users to make payments using the stablecoin, which would correspond to the payment services offered by banking institutions, payment systems or services, or to other financial infrastructure services, to which the Principles issued jointly by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (CPMI-IOSCO) for market infrastructures could apply.

– The so-called "*back-end*" would involve the management and structuring of the reserve fund, including the role and relationship of the authorised participants in the creation, distribution and redemption of the stablecoin, as well as their role in keeping the coin price in line with the value of the reserve (fund) basket. Depending on how this is done in practice, including the legal relationships and operational processes, the combination of the coin and the reserve fund has the potential to represent or be similar to some common types of investment structures. For example, the coin may be considered as a share or unit in a collective investment scheme, resembling: (1) a money market fund (MMF) in some aspects of its portfolio construction; and/or (2) an Exchange Traded Fund or Exchange Traded Product (ETF or ETP) in the mechanisms in place to create and redeem crypto-assets. It could also represent some type of security or securitised investment product.

The paper discusses how current IOSCO Principles, Standards and Recommendations, as well as those

mentioned above related to market infrastructures, could be applied to global stablecoin proposals, and in this regard, those that could be applied are analysed in detail below:

- *IOSCO Policy Recommendations for Money Market Funds (2012)*
- *Recommendations Regarding the Protection of Client Assets (2013)*
- *Principles for the Regulation of Exchange Traded Funds (2013)*
- *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms (2020)*
- *Principles for Financial Benchmarks (2013)*
- *Principles for the Regulation and Supervision of Commodity Derivatives Markets*

This analysis highlights the greater importance of some Principles versus others, and also analyses general considerations that must be taken into account, for example, the application of Principles related to financial intermediaries, since, as stated in the hypothetical case study, which could be applicable to various proposals based on similar structures, activities are included involving participants within the scope of some recommendations applicable to intermediaries (i.e. an investment firm that is subject to supervision by a regulatory or supervisory authority), and therefore, depending on the case, attention should be given to these Principles applicable to intermediaries, together with the relevant domestic rules and regulations.

In this context of general considerations and in view of the features of the coins and their global and cross-border nature, upon issuance, also considered applicable would be IOSCO's Principles on cooperation and the use of IOSCO multilateral memoranda of understanding (MoU) or multilateral memoranda of understanding on the cooperation and exchange of information among securities market regulators and supervisors from different jurisdictions.

In a specific section, the implications for securities regulators and supervisors are analysed from the standpoint of IOSCO's three core objectives regarding investor protection: the efficiency, transparency and fairness of financial markets, as well as reducing systemic risk. The hypothetical case study sets out key potential issues that would arise in the context of designing other global stable crypto-assets.

The issues are grouped into four broad categories. The first three correspond to IOSCO's objectives mentioned above. Given the broad implications of potential stablecoin structures, such as those contained in the hypothetical case study, other relevant risk categories are also assessed, which should be considered in detail by other standard-setting bodies (in particular those related to financial stability).

The nature and extent of issues and risks, not only for investors but also for consumers of financial services in general, depends on various factors, including the type of product in question. Ultimately, the degree of protection available to investors and consumers will be highly dependent on the nature of the product and the regulatory regime that applies. For example, if the hypothetical case study or another stablecoin were to amount to the issuance of electronic money in a European Union Member State, the measures contained in the Second Electronic Money Directive, as implemented by national law, would likely apply to the proposal, including initial capital requirements, safeguarding obligations, reporting requirements and disclosure and notification obligations.

Within this area of investor protection, there is a list of safeguards that a potential stablecoin initiative should include if it were subject to the regulatory requirements for securities.

The paper also contains certain general observations related to governance, which are considered important for the control and success of these types of initiatives, and which can be a source of risk when the necessary controls do not exist or do not operative effectively. Therefore, issues such as conflict of interests and the checks and balances that exist in traditional firm governance and risk management structures should be considered.

The paper also contains issues related to anti-money laundering and combating terrorist financing and indicates that while the DLT system provides an immutable record of transactions, certain crypto-assets can offer potential anonymity and the ability to move money between jurisdictions and individuals. Furthermore, emerging forms of "crypto-laundering" make detection more challenging and increasingly more people are engaging in illegal practices using "crypto-assets". This lack of transparency and regulatory supervision, as well as the complexity in terms of the number and type of market participants, can give rise to certain risks which can lead to financial crime, including money laundering and terrorist financing. Therefore, market participants should ensure that effective financial crime controls are in place.

This includes adopting measures to identify their clients (through due diligence, known as *"know your client"*). It also includes monitoring transactions, identifying and reporting suspicious transactions, as well as having clear structures in place in terms of who is responsible for financial crime systems and controls. Market participants must also consider the risks of different client categories, the use of different types of stablecoins and the distribution channels used for their delivery. The type, complexity, speed and volume of transactions can also influence the likelihood of financial crimes being committed or being detected. Accordingly, it is necessary to determine what authorities will regulate and supervise this area in an impartial and independent manner.

The paper reaches the following conclusions:

A widely adopted global crypto-asset has significant potential to create benefits to market participants, including consumers and investors, but also to increase existing risks and create new risks in financial markets. Proposals to issue global stablecoins could, in the long-term, replicate existing financial products and services with the stablecoin ecosystem as a new method of payment or core component of market infrastructure.

The document sets out risks across a range of areas, including consumer protection, market integrity, transparency, conflicts of interest, financial crime, systemic implications and economic impacts. The use of stablecoins in financial services could entail significant changes to how financial markets work, and therefore, could generate risks that would have to be managed by participants in the management and issue of stablecoins, requiring careful consideration by regulators and legislators.

In view of the potential cross-border reach and the need for coordination among organisations with regard to existing and new stablecoin structures, IOSCO and its members intend to coordinate a global approach, as necessary, and is prepared to work with other international bodies and with legislators on stablecoin proposals and risks. IOSCO will seek to provide a forum for regulators to discuss issues relevant to the supervision of a global and widely adopted stablecoin ecosystem.

Useful link:

Global Stablecoin Initiatives

1 www.fsb.org/wp-content/uploads/P181019.pdf