FSB GSC Consultation - Libra Association Answers

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

While we appreciate the distinction between asset-linked stablecoins and algorithm-based stablecoins, we believe that both types of stablecoin — and indeed all stablecoins — have some inherent backing. Algorithm-based stablecoins may, for example, rely upon collateral arrangements that adjust algorithmically. These collateral arrangements are no less backing than reserves held by a stablecoin issuer. Key differences across stablecoins lie in the composition of the backing and the nature of the stabilization mechanism, which vary widely.

We believe that focusing on the composition of and legal arrangements governing the stablecoin's backing brings to the forefront key underlying assumptions of a stablecoin arrangement and its stabilization mechanisms, such as the role of different market participants, monetary policy, and expectations about the future use and success of a stablecoin arrangement may play in its ability to preserve value and maintain stability. Attention to the backing also surfaces the critical link between a stablecoin arrangement and the monetary policy (if any) of its reference asset.

The backing of stablecoin arrangements vary widely in terms of the risks they introduce, from stablecoins that rely on cash and cash-equivalents (less risky), to those that use seigniorage shares (most risky). When regulators evaluate a stablecoin arrangement and its backing, they should ensure that regulation of the system addresses the following key questions: what is the price and liquidity relationship between the assets backing the stablecoin arrangement and the stablecoins's reference asset? How does this relationship change between normal versus stressed market conditions?

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 believe that, equally as important as considering which type of stabilization mechanism is employed by a stablecoin arrangement, any risk analysis should recognize that market, credit, liquidity and operational risks vary substantially across these stabilization mechanisms. These risks should be the focus of any regulatory approach.

As mentioned in relation to Question 1, a key dimension of a stablecoin arrangement is the relationship between the assets backing a stablecoin and the reference asset for that stablecoin. In particular, the riskiest stablecoin arrangements are backed by assets whose market price is not strongly correlated with the reference asset or whose value is positively correlated with the size of the reserve of assets backing the arrangement. This can lead to a self-fulfilling crisis and unraveling of the entire stablecoin.

Furthermore, stability requires aligned incentives among market participants and appropriate governance tools to support well functioning markets in the stablecoin and address the potential threat of systemic risk arising from a loss in market price of the stablecoin. These risks can be further exacerbated, and can have implications beyond the stablecoin arrangement itself, by the emergence of leverage in the system. Appropriate regulation should be developed to both protect users and limit financial instability. For example, the introduction of capital requirements and buffers can play a key role in mitigating risk.

3. Does the FSB properly identify the functions and activities of a stablecoin arrangement? Does the approach taken appropriately deal with the various degrees of decentralisation of stablecoin arrangements?

We agree with the four core functions and eight core activities of a stablecoin arrangement, as identified by the report. The FSB should consider the implications of the following dimensions of decentralization and diversification, in addition to that of the ledger used to record and validate transactions: the stabilization mechanism and competition in primary and secondary markets may operate under various degrees of centralization; multiple entities may participate in governance as determined by a process for membership formation and renewal; and coin issuance and management of assets backing the arrangement may be performed by a single centralized entity or multiple participants. In this last case, decentralization can have important implications for financial stability: when coins are meant to be fungible and multiple issuers are present, but there is no unified reserve, individual issuers may not be able to internalize the externality they impose on each other, and risks taken by one of the issuers (e.g. on custody and management of the backing assets) can negatively affect all participants.

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

We agree with the report's classification of GSC arrangements as those that pose financial stability risks because they have the potential to reach and be adopted in multiple jurisdictions and potential to achieve high volume. We would further include the following determinants: the nature of the reference assets and their reach (e.g. currencies, commodities, or other crypto-assets each offer varying possibilities of reaching global usage), the ability to complement existing payment networks, whether the stablecoin arrangement is designed for retail or wholesale use, and the utility provided (e.g. through merchant acceptance, integration with traditional rails and cash-in/cash-out options, etc.). Since not all stablecoin arrangements will reach global scale, recommendations should be implemented incrementally in order to ensure a healthy transition towards GSC status.

5. **Do you agree with the analysis of potential risks to financial stability arising from GSC arrangements? What other relevant risks should regulators consider?**

See answer to Question 6.

6. **Do you agree with the analysis of the vulnerabilities arising from various stablecoin functions and activities (see Annex 2)? What, if any, amendments or alterations would you propose?**

We agree with the vulnerabilities of GSC arrangements identified in the report and the analysis of those vulnerabilities provided. Additional key risks and vulnerabilities associated with the rise of GSC arrangements include:

- Commercial effects on banks and other financial institutions. In particular, banking disintermediation and the effectiveness of monetary policy through credit channels.
- Vulnerabilities associated with macroprudential policy: the ability to implement existing capital controls and foreign exchange controls, to support financial stability and the flow of credit to the real economy, to support positive capital flows (e.g. remittances) while limiting currency substitution risk, destabilizing capital flows (hot money), and capital flight.
- Identifying idiosyncratic risks and vulnerabilities associated with design principles and mechanisms used by particular GSC arrangements, including with respect to: effective AML/CFT frameworks, ensuring competition in primary and secondary markets, proper reserve management and custody of the assets, capital requirements and buffers commensurate to the GSC arranagement's risk, recovery and resolution plans, mechanisms for ensuring liquidity, and cybersecurity.

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

We generally agree with the potential regulatory authorities, tools, and international standards identified by the report. However, many of the international standards mentioned under these sections relate to standards for banks and systemically important FMIs. As recognized otherwise in the report, that these standards should be applied by analogy to the extent they are suitable for a particular GSC arrangement. This includes, for example, regulators having the ability and working to tailor licensing regimes and regulatory requirements to address the activities, functions, and risks of a stablecoin arrangement. This may include tailoring existing bank regulatory requirements, such as Basel Framework capital requirements, or other existing regulatory frameworks such as payments or other financial market utility standards, to better address stablecoin arrangements. Similarly, disclosure requirements should be modified to address the specific distribution arrangements and customer relationships involved in a stablecoin arrangement.

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

Cross-border issues arising from GSC arrangements reinforce the importance of a harmonized framework to effectively address dimensions related to currency substitution risk, interference with local macroprudential policies, implementation of capital and foreign exchange controls, AML/CFT, financial responsibility requirements. Importantly, an effective, global, harmonized framework is key for detering regulatory arbitrage across jurisdictions leading to financial instability.

As a general matter, we believe that the concepts of "home supervisor" or "lead overseer" can be very relevant to GSC arrangements, and can play an important role in coordinating regulatory oversight of the arrangement across jurisdictions, including to help avoid duplicative or conflicting regulation. More decentralized GSC arrangements may raise additional cross-border regulatory challenges, as they may not be as susceptible to a home supervisor or a lead overseer approach.

9. **Are the proposed recommendations appropriate and proportionate with the risks? Do they promote financial stability, market integrity, and consumer protection without overly constraining beneficial financial and technological innovation? Are domestic regulatory, supervisory and oversight issues appropriately identified? Are cross-border regulatory, supervisory and oversight issues appropriately identified? Do the recommendations adequately anticipate and address potential developments and future innovation in this sector?**

We strongly agree with the guiding principle recognized in the report of "same business, same risk, same rules" and appreciate the FSB's recognition of this principle in developing its recommendations. As discussed in the report, a key consideration is to support innovation while minimizing threats to financial stability and promoting consumer protection. We also agree that regulation of a particular GSC arrangement should be grounded in an assessment of the specific activities it supports and risks it introduces rather than applying a one-size-fits-all approach. As mentioned above, market, credit, liquidity and operational risks vary substantially across different stablecoin arrangements. Any regulation should therefore give regulators latitude to adapt risk mitigation mechanisms to the actual level of risk of each stablecoin arrangement.

GSC arrangements present important opportunities to reach a broad set of users, bringing financial services to additional populations while also creating new products, and establishing a safe, robust, and competitive market. These arrangements may also give rise to risks that, as described in the second recommendation, should be addressed by appropriate regulation that is both proportionate and tailored to a GSC's particular activities, functions, and stabilization mechanisms. We also strongly support, as discussed above, cross-border coordination and harmonization of regulatory requirements, given the potential for the application of disparate and conflicting regulatory requirements to deter and hinder the innovation and benefits embodied by GSC arrangements.

Last, the term "GSC arrangements" as defined in the report includes various activities and functions related to a stablecoin arrangement that can be provided by different actors (e.g. issuers, operators of infrastructure, market makers, wallet providers, exchanges etc.; cf. the glossary on p. 4). While the recommendations do not distinguish between these different actors, functions and activities, we believe that not all of the recommendations are appropriate for all of these different actors. For example, we are of the view that not every wallet provider or exchange should be required to prepare recovery and resolution plans or be subject to a syndicated supervision across borders and sectors. Rather the report could clarify that the recommendations only apply to the different actors of a GSC arrangement to the extent suitable based on the functions they perform and the risks they pose.

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

Both retail and wholesale GSC arrangements will likely co-exist and will compete with other types of crypto-assets and existing payment systems. We believe the recommendations are appropriate for both wholesale and retail GSC arrangements, so long as the recommendations are implemented to take into account the differences in activity, function, and vulnerabilities between retail and wholesale stablecoins. In addition, regulators should consider connections between wholesale and retail systems. These connections determine the channels of financial contagion and, accordingly, the potential for systemic risks arising from interconnected payment systems.

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

We believe that the recommendations both accurately identify the key activities and functions of GSC arrangements and address vulnerabilities and risks that may arise from these systems. We encourage regulators to focus on cross-border regulatory harmonization, to ensure interoperability of GSC arrangements across jurisdictions. Harmonization is particularly important with respect to the legal classification of stablecoins, the rules governing settlement finality, privacy and consumer protection, AML/CFT standards, and tools to withstand cybersecurity threats.

Regulatory harmonization should also address the roles of various entities within GSC arrangements, including issuers, distributors (e.g. consumer-facing VASPs), and validators, which can each play key roles in the safety and integrity of the system. Cross-border agreement on standards for effective disclosure to consumers and financial responsibility requirements for VASPs can enhance a GSC arranagement’s resilience.

Finally, the interface between stablecoins and central banks (especially with regard to CBDCs) can help eliminate, or at least mitigate, risks to financial instability, and designing cross-country standards will help understand how CBDCs may operate in an international environment. Each of these aspects of a GSC arranagement's regulation should be harmonized to avoid duplicative or contradictory requirements, which would impose unnecessary costs on GSC arrangements and would impede responsible innovation.

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

The main cost-benefit consideration to be addressed is the trade-off between financial innovation versus consumer protection and financial stability. Importantly, the ability to provide access to a wider population, foster innovation and competition, and ensure access to innovative products, while limiting the risks to the financial system and to consumers, are not at odds with regulatory compliance.

Recommendations should be implemented incrementally in order to ensure an orderly transition of a stablecoin arrangement towards GSC status. While a strict regulatory environment applied from the outset to all stablecoins with global potential may restrain the emergence of such arrangements, a phased regulatory approach can both encourage growth and innovation and ensure proper risk considerations at each stage. The degree of regulatory oversight should be commensurate with risks posed, to avoid preventing the evolution of a competitive cross-border payment system.

The future innovations that will be built on stablecoin infrastructure, and all of the benefits consumers, in addition to the creation of a low-fee payments system, are hard to predict at this time. It is important to facilitate responsible innovation that can improve financial services at lower costs and expand access to a broader set of consumers while committing to financial stability and user protection at each stage.