Tether Holdings Limited
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British Virgin Islands

July 14, 2020

Financial Stability Board

Dear Financial Stability Board:

Re: Commentary on Addressing the regulatory, supervisory and oversight challenges raised by "global stablecoin" arrangements (the "Report")

On behalf of Tether Holdings Limited ("Tether"), I would like to thank the Financial Stability Board ("FSB") for the opportunity to provide comments with respect to the Report. Blockchain enabled crypto-assets have created a multitude of new and more inclusive financial services that give consumers more choices, lower fees, and raise the quality of services and innovation. The growth and adoption of these new financial services are bolstered by stable and secure transfer portals that encourage transparent price discovery and payment channels. Tether's stablecoin, USDT, serves this purpose. Launched in 2014, Tether has grown to become the largest stablecoin by volume and reserves.

Regulatory compliance and technological security have been fundamental to Tether's ability to attract customers and grow its market. Tether is governed by internal policies and procedures respecting regulatory compliance that are on par with those of global financial institutions. Tether identifies and reports suspicious activity to various regulators and works with industry leaders, law enforcement and government agencies to highlight and mitigate risks associated with crypto-assets.

We are in an optimal position to discuss stablecoin technology and risk mitigation efforts. We believe that responsible stablecoin projects can help to strengthen financial stability and extend global financial opportunities. In furtherance of Tether's commitment to sustainable and responsible financial participation, we offer the following comments in response to the questions posed in the Report.

Sincerely,

JL van der Velde
Chief Executive Officer

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

The FSB analysis of stablecoin characteristics focuses on three aspects: (1) stabilization mechanism, (2) a combination of functions, and (3) potential reach across multiple jurisdictions. While these are certainly areas of importance, we disagree with several aspects of the analysis. Of particular concern is the analysis of the stabilization mechanism, for which our perspective is provided in response to Question 2. Our response to aspects (2) and (3) is as follows:

The Report maintains that stablecoins "could share functional similarities with payment systems or financial services or products, such as deposit liabilities or securities (including collective investment schemes), and therefore be subject to the same risks." However, functional similarities do not always imply the same level or nature of risks, particularly where new technology is involved. For example, horse carriages, automobiles, and airplanes all perform the same function – transportation – but they are different to such an extent that the risks must be examined independently. With minimal comprehension of stablecoins - which represent a more efficient bank note rather than a new SWIFT system - regulators are contemplating the application of familiar banking rules to a new technology.

When there is major innovation, the usefulness of a mantra such as "same business, same risk" is greatly diminished. Automobiles required separate rules from horses, and airplanes required separate rules from automobiles. Crypto-assets represent an equally transformative innovation, but for financial services. As such, both society and law enforcement would be best served by a separate set of rules for stablecoins and other crypto-assets. This is especially true given the enhanced traceability features of public blockchains, which law enforcement has already leveraged to track down criminals on numerous occasions. Rather than infer risks based on functional similarities with other products, a sound risk analysis should freshly discern and analyze the specific risks presented by the new product offering.

The Report then distinguishes global stablecoins as those with potential reach and adoption across multiple jurisdictions and the potential to achieve substantial volume. Since the purpose of all stablecoin projects is to facilitate seamless global transactions of a stable value, the label of "global stablecoin" denotes merely a successful stablecoin. It may seem intuitive that a global stablecoin could present global risks, which may necessitate action from a global body.

However, the fact that a stablecoin is global in nature is no substitution for a risk analysis. Broad usage is not necessarily synonymous with increased systemic risk.

2. Are there stabilization 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.

The Report distinguishes between "Asset-linked" and "Algorithmic" stablecoins, but the descriptions provided do not adequately capture the similarities, nor the differences, between these hypothetical categories. No matter their structure, all existing stablecoins are intended to maintain a market price, or "value", which closely mimics that of a fiat currency (e.g. the USD) or a commodity – this is their essential function. Yet, in the Report's description of "Algorithm-based" stablecoins, this critical feature is omitted.

The mechanism by which stablecoins perform their essential function of mimicking the value of an underlying asset – the "stabilization mechanism" – is better understood when broken down into its' two distinct components: (1) *the basis of collateral*, and (2) *the means of price discovery*. By examining all stablecoin arrangements in these two respects, regulators will be better able to understand both the economics and risks of these projects. Whereas the labels "Asset-linked" and "Algorithm-based" loosely capture some of the relevant features and distinctions between the different stablecoins, they risk obscuring several important economic realities. Stabilization mechanisms differ in two main ways:

2.1 Basis of Collateral

This refers to the underlying asset against which the stablecoin is issued. In the context of what the Report describes as "Asset-linked stablecoins", these are the "reserve assets". The Report references a "pool" or "basket" of reserve assets, and speaks of issuers "buying" and "selling" these reserve assets. This language is minimally applicable to the currently predominant form of global stablecoins, which are collateralized predominantly by the same asset to which the tokens are pegged. Because of this, reserve assets are generally received and distributed rather than "bought" or "sold".

One of the Report's central concerns is the "management of reserve assets". From this perspective, it is important to distinguish between stablecoins for which the reserve asset – the basis of collateral – is predominantly the same asset to which the token is pegged, and all other arrangements. For stablecoins intended to mimic the value of one asset, but which are collateralized by an asset with a higher risk profile, the management of reserve assets becomes more complex. However, where the stablecoin is largely collateralized by the same asset to which it is pegged, or by an asset with a similar risk profile, the management of reserve assets is more a matter of custodianship.

For stablecoin arrangements without this characteristic – i.e. MakerDAI, which is intended to mimic the value of USD but is collateralized by ETH and other tokens – the management of reserve assets entails an ongoing re-balancing of assets, a fundamentally distinct activity which, by introducing new risks, threatens the continued stability of the coin's market price. Although non-collateralized stablecoins have yet to be implemented at scale, this category would likely pose the greatest systemic threat, should they proliferate globally. Operational issues with these projects would be more threatening, as the lack of collateral removes a vital backstop against operational failure.

2.2 Means of Price Discovery

The Report labels non-collateralized coins as being "algorithm-based", but the description does not capture their essential economic property, which is a lack of underlying collateral. For these projects, only the means of price discovery can be algorithm-based. This relates to how supply and demand interact to form market prices for the stablecoin in question. Collateral can be managed by an algorithm, such as with MakerDAI, but collateral cannot itself be algorithm based. The concept of price discovery is unique for stablecoins because they are designed to maintain a market price which deviates minimally from the asset to which they reference (typically USD). There are two general approaches to price discovery which loosely correspond to the Report's description of "Asset-linked" and "Algorithm-based" stablecoins:

2.2.1 Market-based Price Discovery

Price discovery for global stablecoins with a central issuer generally works as follows: Primary markets consist of verified customers who can be issued or redeem tokens with the issuer at the pegged rate. From the issuer's perspective, reserve assets are received from these customers upon new token issuance, and are disbursed upon their redemption of existing tokens. In secondary markets, prices are governed strictly by supply and demand, but hover closely around the pegged rate due to the arbitrage activity of primary market participants. If

prices meaningfully deviate in either direction, these verified entities can make a quick profit by exploiting the difference between primary and secondary markets. The result is an equilibrium seeking mechanism.

For these projects, the disbursement of received reserve assets is an ongoing and critical aspect of price discovery. Yet, the Report states that for "Asset-linked" stablecoins, there "may not be any assets in reserve if the stablecoin merely references another asset as a peg". This characterization misunderstands the nature of these projects' stabilization mechanism, for which the existence and distribution of reserve assets is vital. Such a description would only hold true for non-collateralized stablecoin projects (which the Report labels "algorithm-based").

2.2.2 Algorithm-based Price Discovery

This refers to any form of automated buying or selling of reserve assets, or any automated form of issuing or redeeming the stablecoin tokens. Rather than rely on the external pursuit of arbitrage profits, alternative means are used to influence supply and demand, with the aim of achieving the target price. The Report describes "Algorithm-based" stablecoins as attempting "to maintain a stable value via protocols that provide for the increase or decrease of the supply of the stablecoins in response to changes in demand." Without collateral, the market price of a stablecoin is entirely dependent on such protocols. These projects may not be centrally controlled, but without collateral there is no recourse should the operation fail.

2.3 Conclusion

The descriptions provided for "asset-linked" and "algorithm-based" stablecoins are inadequate. Some aspects of how the dominant stablecoins maintain a stable market price are mentioned (e.g. "a peg to a single fiat currency", "the use of creation and redemption structures", and "arbitrage"), but how they work together to perform the stabilization function, in practice, is not adequately explained. Together, they facilitate a single concept at the root of the stabilisation mechanism, but which is not mentioned in the Report: *market-based price discovery*. This concept is vital to understanding how stablecoins function. Furthermore, having traditionally been the principal stabilizing mechanism for the prices of all financial assets, the concept of market-based price discovery should be of interest to all regulators concerned with managing financial systemic risk. The relationship between price discovery and financial stability will be further elaborated on below.

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 decentralization of stablecoin arrangements?

The Report does not give appropriate treatment to the concept of decentralization. For example, by characterizing stablecoins as "stablecoin arrangements", the Report implies that multiple entities are responsible for the functioning of the stablecoin, in a seemingly decentralized manner. This description risks mistaking the independent, decentralized activity of market participants for the centralized management of the stablecoin. This latter activity is the sole domain of the issuer.

When viewed in a manner that simultaneously takes into consideration many different forms, the business of stablecoins appears exceedingly complex. But in practice, the business is simple. The primary market consists of receiving and distributing assets to verified customers when issuing new tokens or processing redemptions. Primary market participants may interact with secondary markets – as is true for most mature financial markets – but secondary market activity should not be viewed as part of an "arrangement". Prices in these active markets are discovered rather than arranged.

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

Applying a certain name or label to a project is unrelated to conducting an analysis of the potential risks. Threats to financial stability should be analyzed independently, regardless of the name or label assigned to the products. It is appreciated that should systemic risks exist, it would be of greater consequence the more widely held the asset. But being traded globally is not a risk factor in and of itself. It is only something that would broaden the potential impact, should the risk exist. Widespread holdings of assets designed to fluctuate in value creates potential for systemic risk, but it does not follow that widespread holdings of assets designed to maintain a stable value, and which are fully collateralized, would produce a similar effect.

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

Before the potential risks of global stablecoins to financial stability can be adjudicated, the meaning of the phrase "financial stability" must be clearly defined. The FSB Report includes a glossary of definitions for key terms, but no definition is provided for either "financial stability", or "systemic risk". If private businesses are being singled out due to the threats they pose to financial stability, these terms should be clearly defined. However, nowhere in the Report, nor on the FSB website, is the meaning of these phrases explained. Many different purported risks are listed under the banner of "financial stability", but no explanation of this term, nor of how the listed risks relate to it, is given.

If a problem cannot be defined, it cannot be solved. Confusion surrounding the nature of the problem will undoubtedly obscure domestic attempts to provide legislative solutions. To avoid prohibiting useful products on the basis of an undefined risk, the FSB should clarify what is meant by "financial stability". Without this, it is impossible to adjudicate their analysis of potential risks to it. Given this omission, the following explanation is offered:

5.1 How Price Discovery Relates to Financial Stability

Financial stability is an absence of instability. Financial instability is caused by the propagation and realization of systemic risk, which is the risk of sudden and sharp price declines in widely held assets. The wider an asset is held, and the more leverage is employed by its holders, the greater the potential for financial instability should the asset's price fall. All periods of modern financial instability have been characterized by sharp downward movements in the prices of widely held assets. The reason for these price movements is closely related to the concept of price discovery - the process by which interactions between buyers and sellers produce a market price. It involves "discovering" where supply and demand meet, for a given asset, at a given time.

During the Global Financial Crisis (GFC) – the modern epitome of financial instability, and the reason the FSB was formed – these widely-held assets were subprime mortgage-backed

securities, other AAA-rated products, and residential real-estate. The price of these assets steeply declined during the GFC as a result of a prolonged inhibition of price discovery.

The GFC is best explained as the inevitable outcome of a prolonged breakdown of price discovery in markets for residential mortgage credit. Despite being the best positioned to perform credit analysis, mortgage originators had strong financial incentives to avoid doing so. Conversely, despite having the strongest financial incentives to conduct credit analysis, subprime investors were impossibly positioned to do so. The price discovery mechanism in this market was wholly inhibited by a blind and widespread reliance on AAA ratings. As the demand for high-yielding subprime securities grew wildly out of touch from the creditworthiness of residential borrowers, a painful "re-discovery" of these assets' prices became inevitable.

From this perspective, systemic risk is most usefully defined as being: the risk that (1) 'price re-discovery' – what occurs when a period of inhibited price discovery, in any given asset market, inevitably and abruptly comes to an end, requiring prices to be 're-discovered' – causes (2) contagion in the broader financial markets and real economy, due to (3) market participants' urgent adjustments to the newly 're-discovered' prices. Accordingly, the antidote to financial systemic risk is to facilitate and maintain healthy price discovery mechanisms in markets for widely held assets.

It is unclear how the FSB conceives of financial stability and systemic risk, but it is urged that they take a view which is centered on preventing an inhibition or breakdown of price discovery in markets for widely held assets. The risks listed under the heading "potential risks to financial stability from a GSC" may well be risks, but they mostly relate to the general issuer credit risk which is accepted by stablecoin users, rather than systemic risk. It is unclear how they relate to financial stability. Regardless of this uncertainty, each will be addressed:

5.2 "First, if a GSC were used as a common store of value, even a moderate variation in its value might cause significant fluctuations in users' wealth. Such wealth effects may be sizable enough to affect spending decisions and economic activity."

This concern does not seem to appreciate the equilibrium-seeking nature of the stabilization mechanism which works to keep secondary market prices hovering near the peg. Any meaningful deviations from this peg are quickly reversed by arbitrage activity of primary market participants. It is also a concern that applies to all stores of value. Unlike stocks and bonds – products widely relied on to store value – stablecoins are specifically designed to mimic the value of the underlying currency or commodity to which it is pegged. They are not

investments, and would not produce wealth effects in either direction. The emergent use of stablecoins neither creates new money, nor produces new wealth. Pre-existing money is simply being imbued with enhanced features for transacting. Across the broad ecosystem of traditional financial assets and crypto-assets, stablecoins have among the lowest potential to create wealth effects in either direction, making this concern unfounded.

5.3 "Second, if widely used for payments, any operational disruption in the GSC arrangement might have significant impacts on economic activity and financial system functioning… Large-scale flows of funds into or out of the GSC could test the ability of the supporting infrastructure to handle high transaction volumes and the financing conditions of the wider financial system."

Although issuance (creation) and redemption (destruction) of stablecoins happens in a centralized manner, the most popular stablecoins all operate on open-source, decentralized public blockchains. The potential for operational disruption of the token, once issued, is limited to disruptions in these more robust systems. Because stablecoins function on public financial infrastructure that is maintained in a decentralized manner, the risk of operational disruption does not lie within the centralized entity which issues and redeems the stablecoins. If this were the case – if all stablecoin transactions happened on centralized servers hosted by the issuer – there would be cause for concern. Large scale flows might then create strains on the issuing entities' internal infrastructure. However, the most common stablecoins in existence today leverage multiple public blockchains; even if problems were to occur on one blockchain, the tokens could seamlessly be transitioned to another.

5.4 "Third, exposures of financial institutions might increase in scale and change in nature – particularly if financial institutions played multiple roles within a GSC arrangement (for example as resellers, wallet providers, managers or custodians/trustees of reserve assets). This may be a source of market, credit and operational risks to those institutions."

For the most popular stablecoin projects, the role of traditional financial institutions – e.g. bank license holders – is limited to the provision of basic banking services. This consists of safeguarding the received reserve assets, and processing withdrawals and deposits. The

provision of basic banking services is a low risk activity. Given that most banks operate on a fractional reserve, it is possible that banks could use the funds deposited by stablecoin providers to make risky loans or investments. However, these added credit and market risks would not be caused by accepting stablecoin deposits. Whereas lending to stablecoin providers might increase risk to banks, accepting their deposits would not. The provision of basic banking services to stablecoin providers would lower the risk profile of traditional financial institutions rather than heighten it.

5.5 "In addition, the large-scale use of GSCs might magnify confidence effects. A greater sensitivity to confidence effects could also reflect the extent of the use of a GSC as a store of value and/or means of payment. Moreover, closer linkages to financial institutions might also expose a GSC to adverse confidence effects, such as when a financial institution that acts as reseller/market maker of the GSC arrangement comes under financial distress."

It is unclear what is meant by "confidence effects", as no definition was provided in the Report. Regardless of meaning, this is something that applies to all financial institutions. It should also be noted that the magnification of something does not imply a greater sensitivity to it, as these are distinct words with different meanings. One does not follow the other. The only confidence relied on by stablecoin issuers is derived from their history of reliably processing redemptions, which is contingent upon maintaining basic banking service relationships.

While it is true that stablecoin issuers are vulnerable to disruptions to the basic banking services they require to operate, this risk is mitigated by maintaining relationships with numerous banking partners. As for market makers, stablecoin issuers do not rely on any specific groups or entities to perform this function. They are not exposed to the financial risks of these entities; should a primary market participant become insolvent for any reason, others will enter the market to take advantage of the available arbitrage profits. It is only through failures and disruptions to the provision of basic banking services that stablecoin issuers are exposed to the business risk of other financial institutions. When compared to the risk exposures of other institutions and industries, the risk that a banking partner would fail in their safeguarding of deposited funds is relatively small.

5.6 “The reverse may also be true - the potential failure of a GSC might expose the financial institutions involved in the GSC arrangement to adverse confidence effects.”

Since financial institutions are necessary to stablecoin providers only for the provision of basic banking services, particularly the safeguarding of large deposits, the failure of a GSC would not expose the bank to any serious risks. In the history of modern banking, accepting deposits has always been considered a safe and risk-lowering practice, and the making of loans has always been considered the more dangerous, risk-heightening practice. The global financial system may have changed significantly in recent decades, but the basic premises of banking remain the same: Accepting deposits is safe. Making loans is risky. With respect to stablecoins, financial institutions need only be involved with the former activity.

5.7 “These channels may also interact. For example, disruption to payments may cause further decline in confidence, which in turn could prompt further redemptions and decline in the GSC’s value, compounding wealth effects.”

This concern misunderstands the relationship between stablecoins’ operational infrastructure (the source of any potential disruption to payments) and their stabilization mechanism (the basis of confidence). Some parts of the stabilization mechanism could be said to be decentralized – i.e. the market-based price discovery occurring in secondary markets – but the operational infrastructure upon which stablecoins depend for transactions is fully decentralized.

Where the payments network is controlled by the same entity or entities that customers place their confidence in, such a disruption to payments might cause confidence in these entities to decline. However, for stablecoins leveraging multiple public financial infrastructures, a disruption to any of these blockchains would not be an indicator of possible problems with the issuing entity. Users’ confidence in their ability to transact on open, public blockchains is fundamentally distinct from the confidence of primary market participants in the stablecoin issuers’ ability to process redemptions. It does not follow that a reduction in the former would produce a reduction in the latter.

It also does not follow that redemptions by primary market participants would cause a decline in the stablecoin’s market value. This premise misunderstands the market-based stabilization

mechanism. The redemption of stablecoins removes them from the secondary market, thus lowering supply. Furthermore, when the market price of the stablecoins falls below the pegged rate, demand is immediately stimulated – and in proportion to the decline – by the opportunities for arbitrage profits that become available to primary market participants. This creates, in effect, a race between primary market participants over who gets to realize these profits by purchasing stablecoins in secondary markets (at rates below the peg) and redeeming them with the issuer. Together, the forces of supply and demand stabilize price.

5.8 "Macro-financial risks may arise particularly if, over time, households and businesses in some economies (e.g. EMDEs) come to hold substantial portions of their wealth in GSCs, rather than in local currencies. During periods of stress, households in some countries might come to regard GSCs as a safe store of value over existing fiat currencies and exacerbate destabilizing capital flows. Volatile capital flows can have a destabilizing effect on exchange rates and on domestic bank funding and intermediation."

Macro-financial risks are well captured by the 1997 Asian financial crisis, perhaps the best modern example of volatile capital flows producing a destabilizing effect on exchange rates and domestic banking sectors. Much like the 2007-2008 GFC, the 1997 Asian crisis was precipitated by a distortion of incentives within the lender-borrower relationship – a breakdown of price discovery. But the borrowers were sovereign states, and they were borrowing foreign currency. There is an important distinction to be made between local currency substitution – the purported risk described above – and the accrual of large, foreign currency-denominated debts by sovereign states. Whereas the former activity involves the market exchange of one currency for another, the latter involves the wholesale creation of new money through the monetization of sovereign debt. It is only the latter activity, the frenzied influx of newly created foreign investment capital into emerging markets, that can produce such a destabilizing effect.

When citizens perceive that the value of their domestic currencies will depreciate significantly over time, it is natural for them to exchange this money for assets which they expect to better maintain value. Foreign currency has long been relied on by households for such purposes. Global stablecoins merely remove expensive friction traditionally associated with foreign exchange, democratizing the ability of citizens to protect their wealth and savings. The destabilization of exchange rates and bank funding is a valid concern, but local currency

substitution is merely a response to this problem. It is wrong to characterize the preservation of household balance sheets as a factor contributing to volatile capital flows – this behavior is a result of these volatile flows rather than a cause.

5.9 "If a GSC were adopted as a widespread means of payment, but not as a store of value, its potential implications for financial stability may be narrower. If, however, a GSC also became adopted as a significant store of value by some of its users, other channels – including those pertaining to confidence effects, interlinkages to financial institutions and macroeconomic stability – may become more prominent."

This purported risk is based upon a false dichotomy. By treating the "means of payment" (medium of exchange) function as being distinct from the "store of value" function, this characterization fails to appreciate their necessarily interrelated nature. Anything that is used as a means of payment must also be a store of value – at least temporarily. Conversely, any store of value must ultimately be able to be converted into something that can be used to make payments. Emphasis can be placed on either function, but the distinction being drawn between them is both unfounded and unrelated to the propagation of any new risks.

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?

As mentioned above, by attempting to capture all the possible vulnerabilities for a wide array of possible stablecoin businesses, the Report's analysis overlooks the central vulnerability for the most popular form of stablecoin business: failures or deficiencies in the provision of basic banking services by third parties. Nevertheless, each of the vulnerabilities listed in Annex 2 will be addressed:

6.1 Establishing rules governing the stablecoin arrangement

The most commonly used form of stablecoin is better characterized as a business then as an arrangement. This is because a single issuer retains full control over issuance and redemption of the tokens. The Report is concerned about a "lack of contractual arrangements among the entities of the GSC arrangement", but there is only a single entity which controls the issuance and redemption of the tokens. Rather than be part of any arrangement which would benefit from the certainty of contractual underpinning, involvement on the part of other entities is merely independent market participation on the part of the issuing entity's customers. The Report is concerned about there being an "unclear definition of roles and responsibilities within the GSC arrangement" and an "inadequate governance framework". However, these concerns misunderstand the basic business model of the most common stablecoins. The decentralized market participation of independent agents is being mistaken for some form of business partnership that would benefit from legal certainty. This is not the case.

6.2 Issuing, creating, and destroying stablecoins

The Report is concerned with an "inability to meet redemptions in stressed conditions". This concern is exclusively related to the vulnerability that was overlooked by the Report: failures or deficiencies in the provision of basic banking services by third parties.

6.3 Managing reserve assets

As mentioned, where the stablecoin is collateralized predominantly by the asset to which it is pegged, or an asset with a similar risk profile, the management of reserve assets requires little more than the provision of basic banking services. The vulnerabilities listed under this heading are mitigated to the extent that reserve assets are either the same, or have a similar risk profile, to the asset to which the coin is pegged.

6.4 Providing custody/trust for reserve assets

This is the principal vulnerability of the most common global stablecoins in existence today. The Report lists "custodian failure", "fraud", "liquidity", and "lack of legal clarity regarding rights to reserve assets" as vulnerabilities. The first three vulnerabilities all fall under the main overlooked issue referenced above: failures or deficiencies in the provision of basic banking services by third parties. The latter purported vulnerability can easily be addressed as a contractual matter in the GSC's terms and conditions.

6.5 Operating the infrastructure

As mentioned above, the most prominent stablecoins utilize multiple public financial infrastructures. Being open-source and maintained in a decentralized manner, the infrastructure upon which stablecoins operate is highly robust. Under this heading, the Report lists “disruption to the mechanism that links the value of the stablecoin and the value of its reserves, for example a cyber incident”. This premise confuses price discovery activity with the technical venues in which the price discovery occurs. Contrary to what is being implied, there is no formal technological mechanism which links the value of the stablecoin to the value of the reserve asset. It is a matter of market-based incentives rather than of technology.

6.6 Validating transactions

This function executes in a decentralized manner with no single point of failure. Should one form of public financial infrastructure (open blockchain) experience operational problems, the stablecoin issuer can seamlessly transition the tokens to a better-functioning blockchain. The open-source nature of these infrastructures, and the competition that exists between them, are an especially strong guarantor of the soundness of transaction validation. Furthermore, the properties of these public infrastructures are such that the longer they exist, the stronger and more robust is their security and operational integrity.

6.7 Storing the private keys providing access to the stablecoins

Rather than be considered as part of any stablecoin business, this aspect is solely the responsibility of the customers of a stablecoin issuer and the users of the stablecoin.

6.8 Exchanging, trading, reselling and market-making of stablecoins

As previously mentioned, while these activities play an indirect role in the stabilization of the market price of stablecoins, they do not fall within the umbrella of the stablecoin business or “arrangement”. This purported vulnerability misunderstands the role of independent market participation in the stablecoin business, conflating this activity with that of a business partner.

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

The Report maintains that "for GSC arrangements involving banks, the prudential risks and operational resilience vulnerabilities would be subject to the Basel Framework and Principles for the sound management of operational risk." Although the Report lists numerous ways that financial institutions could potentially be involved with stablecoin arrangements (e.g. resellers, wallet providers, managers or custodians/trustees of reserve assets, etc.), it is only the provision of basic banking services that is critical to the functioning of stablecoin businesses. Most businesses rely on the provision of basic banking services to function.

From the perspective of Basel III, the global regulatory framework for banks introduced in 2009, the provision of basic banking services to stablecoin issuers would lower the riskiness of the deposit-taking banks. Basel III requires banks to maintain proper leverage ratios and to keep certain levels of reserve capital on hand. The provision of basic banking services to stablecoin issuers is closely aligned with these pending requirements. By accepting large cash deposits from stablecoin issuers, banks can increase their levels of reserve capital. As already mentioned, the acceptance of deposits has long been recognized as the least risky form of bank activity. By providing basic banking services to stablecoin issuers, traditional financial institutions will be better able to satisfy the reserve requirements mandated by Basel III.

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

Cross-border issues exist throughout the global financial system and are not unique to stablecoins nor other crypto-assets. Over the last four decades, many of the world's largest domestic banks have become global conglomerates with widespread operations. This has created many cross-border regulatory issues, particularly surrounding correspondent banking relationships. The Report's concerns about "regulatory arbitrage" and "fragmentation" have been playing out in the traditional financial sector for decades. Financial globalization has long

been recognized as undermining the authority and control of regulators, with at times disastrous consequences.

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?

The recommendations employ broad and vague language which precludes an analysis of their relationship to any purported risks. For example, the first recommendation includes the words “necessary”, “adequate”, “comprehensively”, “relevant”, and “effectively”. None of these words lend themselves to specific interpretation. The second recommendation maintains that requirements should be applied “on a functional basis and proportionate to their risks”. It is unclear what a “functional basis” means, and how this concept relates to risk. The functions performed by an activity are distinct from the risks involved. As mentioned, the Report did not provide a definition of financial stability, so there is no basis upon which to adjudicate whether their recommendations would promote it. There is also no basis upon which to connect the listed risks to any potential threat to financial stability.

Without a clear definition being provided for the concept of “financial stability”, and without reasons being given which rationally connect the listed risks in the Report to such a concept, one cannot conduct an analysis of the tradeoffs. If the profitability of incumbent financial institutions is a significant component of the FSB’s conception of “financial stability”, then there is a warranted concern that the proliferation of global stablecoins could be a threat. However, if “financial stability” is conceived of as an absence of large price movements in widely held assets, then global stablecoins would work to mitigate threats to financial stability by facilitating enhanced price discovery in global markets.

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

Without knowing how the FSB conceptualizes “financial stability” and “systemic risk”, it is impossible to know whether the appropriate issues have been identified. The Report works

to build a case that even where no individual domestic authorities perceive stablecoins as a threat to financial stability, that there could be a global threat which necessitates global monitoring and response. As such, even where there are no domestic issues identified, domestic regulators can expect to be called on to implement legislation to address risks they do not perceive, and which the FSB maintains they may not be capable of perceiving. This issue of domestic legislative sovereignty and accountability has not been addressed in the Report.

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

As mentioned above, the globalization of financial services – particularly since the communications technology boom of the early 1980's – has introduced cross-border issues in the provision of financial services on an unprecedented scale. This is an issue that applies to all financial services, regardless of technology. However, since stablecoins and other crypto-assets leverage public, open-source financial infrastructure, there is greater potential for monitoring and oversight than the opaque, private networks of global banking conglomerates and their foreign correspondent banks.

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

Since the Report and recommendations do not adequately capture the sector as it currently exists, it does not adequately anticipate future developments and innovation. It is unlikely that any report could do this.

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

All products require independent risk analysis.

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

Promoting and safeguarding the ability of global stablecoin issuers to access basic banking services would ameliorate many of the specific concerns listed in the Report. It is well within the scope and mandate of the FSB to promote this aim, as they have extensive commercial banking expertise and relationships. By working to facilitate global stablecoin issuers' access to basic banking services from reputable third parties, the FSB could significantly mitigate any potential threats to financial stability posed by these businesses.

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

If it is true that systemic risk ultimately propagates due to a breakdown or inhibition of the price discovery mechanism in markets for widely held assets, then the threats purported to be posed by global stablecoins should be analyzed from this perspective. As for the broader issue of financial stability, the cost-benefit question revolves around the meaning of "financial stability". If a reduction in the profitability of traditionally incumbent financial institutions is considered a "cost" to financial stability, this should be weighed against the benefits to households and businesses of having a much lower cost way to send and receive funds globally. The benefits to citizens and local businesses of vastly more efficient financial and monetary services should be weighed against the potential reduction in profits for multinational financial institutions.