Regulatory responses to issues raised by Libra

Interview with Ryozo Himino, Vice Minister for International Affairs, Financial Services Agency, Japan, published in the EUROFI Magazine on September 11, 2019

In Osaka, the G20 leaders referred to the existing and emerging risks of crypto-assets and asked the FSB and other standard setters to advice on "additional multilateral responses as needed." How strongly should the global regulatory community be alerted by the Libra white paper?

I am not prepared to comment on whether the Libra project is a viable one or not, but I do not believe it will be the last one of its kind. Although we need a better understanding of its technology, business model and governance, the Libra proposal seems to have many interesting features and the regulatory community should benefit a great deal from carefully studying various issues it poses. Libra will help us to think about many key challenges of the future of finance in a more specific manner than before.

Could you elaborate on the many interesting features?

I would cite six. First is that it intends to become a private currency unit. Libra could become a unit of account, a store of value, and a medium of exchange without being a sovereign currency.

Second is (relatively) stable value. Libra is to be backed by a reserve composed of bank deposits and short-term government securities in major currencies.

Third, it may tap a large global customer base. Facebook's network alone reaches 2.4 billion and Libra Association members such as Paypal, Spotify and Uber have 1.3 billion users in total.

Fourth is a big tech business model. Libra could work as an element in a big tech platform's business model of offering free services to access personal data and to generate high switching costs and network externalities.

Fifth is real sector involvement. The Libra ecosystem may extend beyond the financial sector and include players such as Uber and Spotify.

Sixth would be a decentralized system. It has been claimed that Libra will be transformed into a system based on permissionless blockchain within five years of its launch.

But none of those are new. Bitcoin is a new non-sovereign currency unit and based on a decentralized system. Tether has a stable value. Visa and Mastercard have enormous customer bases and involve the real sector. Alibaba and Tencent have incorporated payment services into their business models.

You are right, but no one else has proposed a project which combines all of these six things so far. The combined effect may make Libra a totally different creature.

When motorcycles were invented, regulations on bicycles and motors alone could not have ensured traffic safety. Similarly, the existing regulations might not suffice to address key policy issues Libra poses.

What would be the key policy issues?

They could range from issues related to financial stability, safe payment systems, customer protection, and AML/CFT to issues involving monetary policy, taxation, data protection, and competition policies. In Chantilly, G7 ministers and governors referred to monetary sovereignty and the international monetary system.

Although some aspects are partially addressed by the past or ongoing work of the FSB and other standard setters, there may be issues which have not been anticipated by those who drafted the existing regulations and standards.

Moreover, even if individual policy issues are properly addressed, new issues arising from a cross-sectoral nexus may remain unaddressed, resulting in a fallacy of composition. We need both an individual and a holistic review of the policy issues.

Should regulators around the world make a unified response to those issues?

I do not know if we need a unified response, but at least we do need cross-border coordination. With the help of Facebook's strong global platform, an entity located

in a jurisdiction with lenient regulation may be able to provide Libra related services to the whole world without establishing local legal entities.
One possible idea may be creating a supervisory college on Libra, but even that might not be enough. The Libra white paper envisions that the system will be decentralized in five years. If that happens, the regulators may be left without anyone specific to regulate or enforce laws upon.

So you're saying that the global regulatory community was ill-prepared to deal with those important issues?

No, Japan as the 2019 G20 presidency asked the FSB to prepare a crypto regulator's directory, analyze gaps in existing regulations and standards, and start thinking about decentralized financial technology which eliminates intermediaries. We also asked the IOSCO to produce a handbook for crypto platform regulators. The directory, reports and handbook were submitted to the G20 finance ministers and governors and were welcomed in their Fukuoka communique. Japan hosted a high-level symposium in Fukuoka and had a session with a panel composed of big tech companies and a big bank.

I would not say that we were fully prepared for the emergence of Libra, but at least we had started to address all of the key issues well before the Libra white paper was published.

Are you primarily concerned about Libra? Do you see any positive aspects of it?

In Osaka, leaders confirmed that technological innovations can deliver significant benefits to the financial system and the broader economy. Regulatory review exercises should aim at a transparent framework which calibrates requirements according to the risk posed by the activities and reduces discrepancies resulting from the current entity based regulations. Those efforts should contribute to establishing a sound environment for technological innovation. Debate over Libra may help us to reach such a result.

The Libra proposal identified unmet customer needs, and presented a solution which would potentially make business sense for the provider. I suppose this is something the financial industry should learn from.

We talk about "same risk, same regulation," but we have not seen what such a regulatory framework would look like.

It might be useful to start by looking at the issues which lie beyond the traditional perimeter of national regulations or international standards.

For example, most banking regulations do not treat the combination of digital wallets, MMF and payment services as a bank, even if it functions almost like a bank.

The FSB report on crypto-assets in May noted that gaps may arise in cases where crypto-assets are outside the perimeter of market regulators and payment system oversight. We may want to pay attention to the gaps so as not to let Libra and other future projects fall into them.

Existing and proposed crypto-asset related regulations address exchanges and wallet providers. However, governance over the design of crypto-assets is beyond the current regulatory perimeter.

Rigidity arising from entity- or product-based regulations seems to limit our capacity to deal with such issues, even though we will confront such issues more often as innovations continue moving forward.

One year ago, in an interview with *Eurofi Magazine*, you argued that the global regulatory community should try to find remedies for conflicting regulatory demands. The Japanese G20 presidency then selected addressing market fragmentation as one of its priorities for 2019. How do you assess the progress since then?

The FSB and IOSCO produced reports on market fragmentation. I chaired the FSB workshop on fragmentation and Jun Mizuguchi, my colleague at the JFSA, co-chaired the IOSCO group jointly with Chris Giancarlo, who then was the U.S. CFTC chair. My comments thus may be somewhat biased, but the reports went further than I had expected one year ago. The G20 leaders in Osaka declared, "We welcome the work on market fragmentation, and will address its unintended, negative effects, including through regulatory and supervisory cooperation." I think this is a very strong message.

So do you expect that market fragmentation will be properly addressed in the coming period?

In the first stage, we brought back market fragmentation on the global agenda, and set good programs to be pursued in the second stage, which is starting this autumn. The FSB report discusses possible mechanisms and approaches to prevent and alleviate unintended, negative fragmentation. It also proposes work on ring-fencing. The IOSCO report, which is narrower but deeper and focuses on the wholesale securities and derivatives markets, proposes a future work to extract good or sound practices from members' current practices on deference. We now need to turn the programs into specific actions. The second stage is the pivotal one.