Cryptocurrency Macro-Policy Trends 2019
The Collected Blogposts

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Preface

2019 proved to be a watershed year for FinTech regulation generally and cryptocurrency regulation in particular. This was the year that alternative payment systems and challengers to the established sovereign-issued reserve currencies hit the policy mainstream in a big way.

2019 was also the year that our patented policy risk measurement platform went live. This meant that we were able to catch each inflection point and policy pivot as it arose, globally and in real time. The activity generated endless opportunities to blog about the developments across multiple channels. From Duke Law School's FinReg Blog and the Atlantic Council's New Atlanticist to Finextra to Medium to our own company blog, we contributed analysis and policy trend projection at every stage along the way.

Many jump to the conclusion that Facebook's Libra proposal drove policy activity during 2019. Large segments of the cryptocurrency and stablecoin communities have been known to crow that the midsummer announcement galvanized policymaker activity. They are wrong.

The data tells a different story. The Financial Stability Board ("FSB") pivoted hard and fast towards a broad range of regulatory policy priorities in the digital space during the first quarter of 2019. They articulated a clear and comprehensive plan for exploring how to expand the financial regulation perimeter to cover the "big tech" sector even as they accelerated experimentation with central bank digital currency issuance.

Heads of state and government at the Group of Twenty in midsummer executed a parallel policy shift. But the focus on digital policy and artificial intelligence was overshadowed by media coverage regarding trade policy, personalities, and petty dramas. Only those paying close attention were prepared for the additional stablecoin policy developments during the third quarter of 2019 when FSB policymakers met for their last in-person plenary session of the year.

The data from our platform -- featured throughout the blogposts in this book -- suggest instead that the Facebook mid-summer proposal may have instead been triggered by the policy activity...not the other way around.

What will 2020 hold for alternative payments and currency issuers? An expanded regulatory perimeter seems inevitable. The contours of that perimeter have been coming into focus throughout 2019, with a clear trend premised on activity-based regulation. You can count on BCMstrategy, Inc. and our automated, patented process to monitor and measure daily global activity in this (and other) policy areas so that we can identify inflection points and policy pivots as they emerge....even if mainstream media misses the moves.

About BCMstrategy, Inc.

This ebook collects in one place all the blog posts we published during 2019 regarding FinTech and cryptocurrency regulation policy trends, with hyperlinks to the original postings, data visualizations (charts and graphs) and infographics. Organized by topic, the chapters provides a quick and easy way to catch up quickly (or refresh recollections) regarding the sequence of events that create the foundation for whatever happens next in 2020. We hope you find it helpful and interesting.

BCMstrategy, Inc. is a Virginia-based start-up company dedicated to bringing the data revolution to the policy intelligence business. We do this by using patented technology that automates both the process of monitoring policy developments and the process for generating quantified, analytical data. The result is a set of data visualizations and discovery tools that help investors, advocates, and journalists read smarter, connect the dots faster, and generate better strategic analysis than their competitors using more traditional monitoring and analysis mechanisms.

The platform began generating data in January 2019. This means we now have a full year of analytical data upon which we will build additional products and utilities as we grow.

Access to the data and related insights occurs through a variety of products designed to meet specific needs and interests. These are:

***Priority: Insight, Not Urgency**: A suite of analytical reports provides weekly and monthly analysis of policy trends. These products are designed for advocates and capital markets macro strategists seeking data-driven, objective, and transparent analysis of emerging policy trends. The research reports regarding global **FinTech RegTrends** (monthly) and cryptocurrency/payments regulation (the **C | P | C Report,** weekly on Friday afternoons) are distributed via the BCMstrategy, Inc. website as well as through the Interactive Brokers trader workstations. Analytical reports regarding **Brexit** policy shifts are distributed in partnership with, and exclusively to clients of, Brexit Partners.*

***Priority: Daily Access to Data**: Direct access to the daily data feeds and data visualizations. Designed for macrostrategists seeking daily insight into policy momentum and unlimited time series generation. Available through a **Pilot Program** and an **Early Adopter Program** exclusively through BCMstrategy, Inc. Current delivery methods via web access and daily email notifications will be expanded for enterprise-wide deployments via APIs in 2020. Participants will also receive opportunities to beta test new data visualizations and insight discovery tools as they become ready.*

February 2019 could rightly be called "FinTech Month" in Basel, Switzerland, given the number of documents put out by the Financial Stability Board (FSB) that point to a shift in priorities for the international standard setting body. While little noticed by the financial press, this post will analyze the FSB developments and forecast the next set of pressure points as policymakers struggle to keep pace with a rapidly evolving market that is fueled by new technology in the banking, securities, payments, currency and insurance sectors.

What Happened

First, the new FSB Chairman delivered a speech to central bank governors in Hong Kong proposing a post-crisis policy pivot for the FSB towards (i) increased public engagement, (ii) proactive issue identification, and (iii) assessing the impact of regulation rather than just articulating standards and assessing compliance with those standards .

Second, the FSB released its 2019 work programme. A cursory look at the programme reveals no significant shifts, as familiar issues feature prominently in the headings (financial stability, post-crisis reform implementation, etc.). But buried within the programme is clear language indicating the FSB intends to expand its role regarding cross-border FinTech regulation: "The FSB will also continue to assess the impact of evolving market structures and or technological innovation on global financial stability."

Third, the FSB issued a 33-page report: *FinTech and market structure in financial services: market developments and potential financial stability implications.* The report adds to the FinTech lexicon by referring to "Big Tech" firms (large, established technology firms). The FSB recognizes that BigTech could fundamentally disrupt the finance industry should these firms chose to provide financial services (some already are) and potentially threaten financial stability, thereby opening the door for future regulation. The report significantly expands upon the FSBs thinking from their 2017 report (analyzed here) regarding financial stability risks arising from FinTech credit.

Why It Matters

These three releases signal a shift in the focus and function of the cross-border policy process for financial regulation, with FinTech policy firmly in the crosshairs.

Since its elevation from a "forum" to a "board" during the Global Financial Crisis, the FSB has largely identified policy priorities in a reactive manner. The FSB simply responded to G20 directives and issued progress reports along the way. There was little by way of public consultation.

Releasing a work programme separate from a G20 ministerial meeting indicates that mean reversion is underway. Those of us who remember the Financial Stability *Forum* will remember as well that regulatory policymakers routinely operated independently of what was then only a ministerial-level Group of Twenty (G20). In that sense, the FSB is returning to its roots – even as it grows – as the new FSB Chairman noted in his speech. Significant policy expansions should be expected, as Quarles' speech indicates, the FSB will be increasing outreach and dialogue from entities beyond the official sector and beyond the FSB's membership. Consider this quote from the speech:

While we are directly accountable to the G20, we are, through the G20, accountable to all of the people affected by our actions. In my view, that means we must engage in genuine, substantial dialogue with all of these stakeholders, to a greater and more effective degree than we have in the past…The FSB must maintain its legitimacy in order to be effective, and to do that we have to work hard to hear from all relevant parties when deliberating. What's more, we have to do so publicly and methodically. Everyone around the world should understand that we only make recommendations once we have gathered and considered all points of view.

The FSB is now doing what the Basel Committee did in the 1990s: opening the door for real dialogue with what Europeans call "civil society." In so doing, they are creating a direct link between the legitimacy of their actions and the acceptability of those actions by "all of the people affected."

A commitment to traditional transparency, and outreach to the broader public, are not the only signs of a policy shift at the FSB. As indicated, the FSB may be considering extending the traditional financial system regulatory perimeter to include large technology companies that offer financial services. Thus far, these firms have been successful in avoiding direct supervision but their entrée into financial services may quickly change that.

To be sure, the FSB and other international groups have periodically assessed financial stability risks arising from "non-bank intermediation" during and after the Global Financial Crisis. Those assessments mostly sought to identify links between existing capital markets entities (hedge funds, private equity funds, and sovereign wealth funds) and financial stability risks. The current initiative is broader.

Much has been written about how artificial intelligence, process automation, alternative data, machine learning and blockchain are redefining capital, credit, and insurance markets; payment systems; and currency issuance. The FSB report defines the metric by which it will evaluate financial technology: financial stability.

Insurance regulators and securities regulators are bound to cringe. During the Global Financial Crisis, these sector regulators complained bitterly about the expansion of central bank financial stability priorities into their domains. The FSB report suggests that the FinTech sector may be next. The challenge here is that many providers of currency, payment, and intermediation services – not to mention blockchain innovators – have never been subject to supervision by a central bank or other financial regulatory agency.

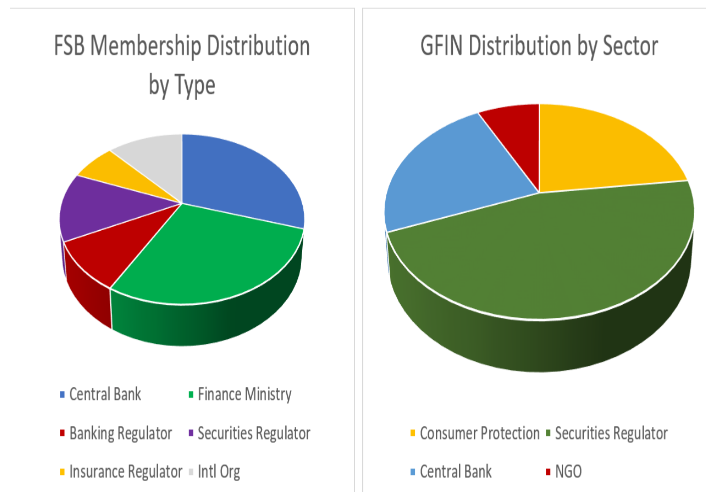
What Comes Next – Missing Pieces in the FinTech Policy Universe

Regular readers know that policymakers have been actively engaged in gently extending their jurisdiction into non-traditional areas through FinTech sandboxes, ICO regulation, MOUs, and other initiatives. The bigger question is: what happened to the proposed Global Financial Innovation Network (GFIN)?

In August 2018, thirteen policymakers proposed to unite under a GFIN banner to accelerate FinTech standard-setting and regulatory cooperation. A consultative paper was issued and the proposal was analyzed in this FinReg Blog piece. But no announcement was made, save for a little-noticed podcast which was analyzed here. In 2017, the Basel Committee on Banking Supervision proposed cross-border FinTech regulatory standards that would extend the perimeter of banking regulation to cover FinTech. Their final standards were issued one year ago but the FSB did not mention these standards or the GFIN in their recent releases.

This is not merely a petty bureaucratic turf battle among overlapping groups. It is a drama regarding the right prism through which FinTech firms should be regulated. And the drama is just beginning.

The FSB is dominated by central banks and finance ministries, with supporting roles for selected sectoral regulators. The GFIN structure, as proposed, was potentially quite radical by providing roles for one World Bank-affiliated NGO and a few consumer protection regulators with securities regulators in the driver's seat.



The composition of the groups matters. A focus on financial stability by entities responsible for spending official sector funds to safeguard financial stability (with mandatory restrictions on risk taking) is significantly different from a policy focus designed to foster industry development driven predominantly by securities market and consumer protection standards (with disclosure/buyer-beware standards at its core).

FSB policymakers, at present, seek to balance safeguarding financial stability and encouraging innovation. It is a good place to start. But the trajectory and velocity of market developments will soon place pressure on these good intentions. Pressure points include:

E-Currencies: Widespread use of cryptocurrencies will place pressure on central banks and other regulators to identify whether or not these currencies may be used within mainstream intermediation and payment systems as an alternative to central bank monies. If they achieve scale, they can also create challenges for monetary policy execution.

Data Privacy/AI: Expanded use of alternative data to make lending and insurance (health) policy decisions creates real pressure on the boundary between public information and private information, and how private information should be protected. Legitimate questions exist about whether and to what extent credit decisions made using alternative data and/or artificial intelligence incorporate (deliberately or accidentally) impermissible biases.

Regulatory Perimeter – The Uber/Airbnb and SWIFT Problems: Should central banks, finance ministries, and/or sectoral regulators require licensing and exercise oversight regarding financial system operations of technology companies? When is a platform a securities exchange and when is it just a technical communication mechanism? Even if it is just a communication mechanism, official sector jurisdiction can be justified on law enforcement/public safety grounds separate from sectoral financial regulation as the SWIFT example illustrates.

The FSB thus has a looming jurisdictional problem. Neither the FSB nor the proposed GFIN provides a cross-border platform for engagement with policymakers that currently loom largest in the FinTech universe: data protection regulators, consumer protection regulators, competition regulators, trade regulators, and law enforcement officials.

With the exception of trade policy (WTO) and law enforcement (FATF), national policymakers in other disciplines do not have a tradition of working together to set common standards. These three policy areas (data protection, consumer protection, competition) have traditionally been seen as the province of national regulators. Many, if not most, of the national entities may have limited or nonexistent authority to engage with counterparts internationally.

The FSB initiative to focus on the systemic impact of rapidly accelerating financial technology is understandable. Its efforts to become more transparent and engaged in dialogue beyond its members should be welcome. But the pace of market developments will soon press the FSB into new territory.

Regulators may be setting their sights on how to regulate Big Tech – as discussed in last month's FinReg Blog post – but, as central banks and finance ministers prepare to convene in Washington in April for the IMF/World Bank Spring Meetings, the issue poised to generate the most interest from the cryptocurrency community is whether, how, and why central banks might accelerate their ability to issue central bank digital currencies (CBDC).

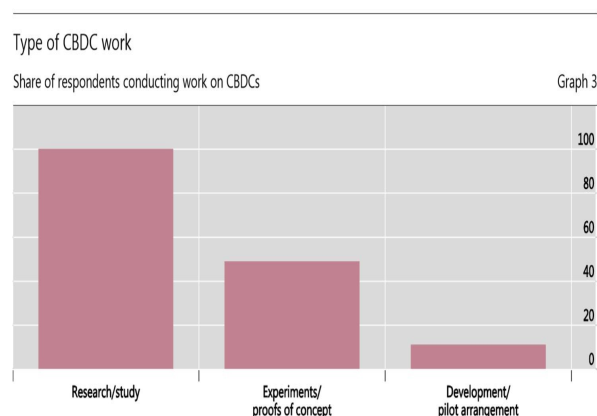
Regulators may be setting their sights on how to regulate Big Tech – as discussed in last month's FinReg Blog post – but, as central banks and finance ministers prepare to convene in Washington in April for the IMF/World Bank Spring Meetings, the issue poised to generate the most interest from the cryptocurrency community is whether, how, and why central banks might accelerate their ability to issue central bank digital currencies (CBDC).

On March 22nd, the General Manager of the Bank for International Settlements (BIS), Augustine Carstens, delivered a speech that provided hints about the preferred approach within the central bank community. The bottom line is that momentum continues to build towards central bank participation in the digital currency trend. Regulatory policy regarding payment systems and competition/antitrust law are only just starting to surface in the public policy dialogue. This post looks at the current state of play.

What the BIS General Manager Said

Carstens's speech covered some familiar ground. The General Manager noted that technically, central banks already issue some CBDC through their settlement operations for commercial banks. He also distinguished between wholesale and retail CBDC, delineating the operational challenges associated with a retail CBDC.

The speech provides intriguing data about current CBDC activity by central banks globally. The data show that 100% of all BIS member central banks are actively conducting research on CBDCs. This should come as no surprise. Both the BIS and the IMF – as well as leading central banks – over the last two years have been publishing analysis regarding CBDCs. The more interesting data shows that roughly 50% of central banks have reached the proof of concept stage and roughly 10% of central banks have reach the pilot program/development stage. The chart from the speech on the next page:



The BIS data was generated by a 2018 study conducted by the BIS's Committee on Payments and Market Infrastructures (CPMI) covering more than 60 central banks which cover 80% of the world's population.

The data suggests that at least 6 central banks are actively engaged in development and pilot arrangements for issuing a CBDC that goes beyond the current bank payment system operations and at least 30 central banks are working on proofs of concept. Sadly, Mr. Carsten's speech does not provide details – much less a comparative analysis – on what kind of pilot programs or proofs of concept are underway at central banks globally. While surveys indicate that the majority of central banks do not plan to issue CBDC in the medium term, the level of activity suggests that an impressive number of central banks will be ready to issue CBDCs sooner than most expect.

What It Means – Regulatory & Antitrust Challenges for Banks and Cryptocurrency Issuers

After last year's CPMI Report, it should come as no surprise that central banks fret over the potential monetary policy implications associated with issuing official CBDCs. Carstens acknowledged this worry, noting in passing that a CBDC "would change the demand for base money and its composition in unpredictable ways."

This is not a hypothetical statement. As he notes in the speech, in countries where digital payments are the norm at the retail level (e.g., Sweden, Denmark), "the demand for cash has fallen substantially." The shift in demand for cash has a material impact on monetary policy targeting. IMF research released on March 1, 2019 agrees, but also indicates that a CBDC will only materially impact the demand for cash in economies where reliance on digital payments at the retail level is low.

The more interesting policy implications arise, indirectly, in the realm of payment systems regulation.

If policy formulation follows Carsten's logic, central banks will leave the retail interface to private commercial banks and other providers of payment services (e.g., debit card issuers and credit card issuers). This would place central banks directly in competition with private cryptocurrency issuers, particularly if those issuers are themselves commercial banks.

The challenge, of course, is that commercial banks are starting to experiment with digital currency issuance at the wholesale level, not the retail level. As this FinTech RegTrends blogpost recently noted, JPMorgan's JPM Coin promises "instantaneous" settlement synced to smart contract execution, all driven by blockchain technology which creates real competition for payment services between the commercial bank and the Federal Reserve's Real Time Gross Settlement System. At the retail level, the only digital currencies currently available are issued by non-state actors and conversion to fiat currency remains complicated, in large part because most payment systems restrict access to currencies only issued by sovereigns. Leaks to the New York Times last month indicate that non-bank messaging platforms like Facebook are also exploring digital currency issuance.

Creation of a CBDC would thus add to the types of technology-powered items being exchanged for value within economies. No serious research has yet surfaced regarding exchange rate issues if, and when, non-state issuers (or their users) seek to convert their digital currencies into fiat currencies at commercial banks. Beyond the valuation issues, concrete regulatory policy issues will also arise because central banks will have to define whether, and under what conditions, privately issued cryptocurrencies will be permitted to flow between banks through the official sector payment system.

Policymakers are starting to debate these issues indirectly by providing views on whether or not individuals should have direct access to, and accounts with, the central bank in order to use a CBDC. Carstens argued that the Soviet experience with having the central bank serve retail customers illustrates why it is far from optimal for central banks to be so closely connected to consumers. IMF economists seem to be more friendly to the idea.

The March 2019 IMF research suggests that central banks should provide digital cash "at no cost to those that use it or retailers and billers that accept payments from it" in order to increase reliance on CBDCs relative to cash. By reducing the transaction cost, the lower fee would create incentives for retailers "to encourage consumers to adopt" the CBDC. They further suggest that policymakers rely on antitrust/competition law enforcement actions based on payment services fees in order to "provide a check on the market power of suppliers of other payment instruments." The implication is that CBDC issuers will want to ensure that their own currency crowds out alternative issuers.

We are still very far away from concrete policy proposals. Shifts in policy in this area will remain incremental throughout 2019, and possibly 2020. The best way to manage exposure to unanticipated policy shifts is to watch closely the evolution of technical payment systems policy over the near to medium term.

Readers of this blog know that at BCMstrategy, Inc. 2019 is proving to be a watershed year as the Distributed Age accelerates, delivering profound shifts in our understanding of sovereignty, forcing the Bretton Woods institutions and regulators to adapt. Nowhere is this more evident than in the cryptocurrency sector, as this Globcoin White Paper and this AltCoin Magazine essay illustrate. Rapid innovation forces the G20 and financial regulators at the Financial Stability Board to sit up and take notice.

Conclusion

The policy debate regarding CBDCs and cryptocurrency regulation is just getting started. However, as noted above, research and official speeches – thus far – indicate that policymakers will first address payment system access and antitrust regulatory policy issues as they prepare to issue electronic currencies. Monetary policy will of course also remain a key focal point.

The next inflection point comes in April, when central bank governors and finance ministers meet in various formations during the IMF/World Bank Spring Meetings. Various ministerial meetings also occur at this time, notably the Group of Twenty and the Financial Stability Board.

This is a problem. The cryptocurrency sector and, more generally, the underlying technology within distributed ledgers (DLTs) is designed to keep confidential the identity of the transacting parties. DLTs shift the locus of identity ownership to individuals, leaving authentication to an automated algorithmic process. The IOSCO CTP Proposal released this week implies that the very anonymity that makes the sector attractive to many participants is precisely the element that must recede in order to assert regulatory jurisdiction effectively.

Industry participants are familiar with this debate. Some entities (like JP Morgan Chase, which just launched the JPMCoin) are launching their own DLTs which serve as gateways to instant payments, with the company serving as the identity verification agent. These large firms effectively vouch for the individuals entering the DLT. To the extent that they permit transactions outside the self-contained company distributed ledger, they will do so only with counterparts that have similarly robust identity verification standards.

If banking is fundamentally about trust, then a gated DLT is an excellent way to evolve the banking business model, particularly if it delivers instantaneous payments that eliminate settlement and credit risks the bank might otherwise have to absorb. The problem, of course, is that much of the cryptocurrency universe is allergic to the kind of centralization and audit trail elements incorporated into these closed systems.

Viewed from this perspective, the IOSCO CTP Proposal presents a “bank shot” effort to establish authentication requirements in the cryptocurrency sector through the trading gateway rather than through direct regulation of the underlying digital assets themselves. This approach eliminates the need for policymakers to get drawn into messy, often polemical, debates regarding fiat currencies and central banks. The question is whether cryptocurrency market participants are savvy enough to realize the implications of these proposals.

It will be interesting to watch this debate unfold over the next 18-24 months.

While headlines from the Group of Twenty (G20) summit in Osaka, Japan understandably focused on the latest trade war truce between the powerhouse economies of China and the United States, media coverage unfortunately overlooked a strategically significant trade policy pivot at the summit.

The group of global policy makers in Osaka acknowledged the growing importance that the digital economy plays for supporting economic growth and innovation, and the need for the trade policy paradigm to account for this shift. While a substantial number of key policies needed to complete this shift remain incomplete, by turning their attention toward the digital economy global policy makers could help reignite discussion at the global multilateral trade level at a time when most are obsessed with bilateral negotiations.

For the last year, the *New Atlanticist* has consistently highlighted the important nexus among trade, the digital economy, and services for advanced economies (particularly the United States and the European Union) as well as China. My colleagues and I argued in July 2018 that commonly agreed standards for trade in services can create the foundation for a more constructive set of transatlantic trade relationships while providing support for Chinese growth. The key to progress regarding services trade is as much about finding ways to make domestic regulatory frameworks interoperable as it is about successes in the World Trade Organization regarding the Trade in Services Agreement.

Policy makers have been making quiet, steady progress throughout 2019 so far regarding these issues. The WTO has taken steps to increase transparency regarding non-tariff regulatory barriers in order to provide a foundation for concrete, data-based policy discussions. The European Commission has been quietly increasing its efforts to enhance transatlantic regulatory cooperation, starting with technical standards that support the broader ongoing discussions regarding manufacturing sector conformity assessments.

Additionally, the bilateral US-China trade tensions that have been much on display this year have not just been about tariffs on old-economy sectors. The most intractable issues have been focused on services policy issues in sectors strategically significant for supporting twenty-first century growth as noted in this post and as highlighted in the White Paper released by the Chinese government on June 2, which championed the importance of "economic sovereignty" and national standards.

These actions laid the foundation for the policy shift articulated in Osaka on June 29, as discussed on the next page.

The Osaka Declaration

Traditional trade policy experts will find the Osaka Declaration underwhelming. The Declaration notes the importance of addressing the dispute resolution problems at the WTO without identifying how the impasse can be resolved.

The Declaration indirectly recognizes accelerating centrifugal forces away from centralized, multilateral solutions by noting that bilateral and regional free trade agreements are "complementary" to the broader goal of promoting free trade. G20 leaders chose not to repeat their trade ministers' language from earlier this month identifying "urgency" regarding WTO reforms generally (Ministerial para. 54) or the WTO committee work reforms specifically (Ministerial para. 56).

In other words, G20 leaders implicitly underscored the impasse at the multilateral level by failing to identify concrete measures that might break the impasse.

To be fair, G20 leaders in these areas only repeated verbatim the Ministerial Statement on Trade Policy issued in advance of the summit earlier this month. The news cycle fixation on the bilateral China/US trade truce illustrates the scale of the challenge. It is not just policy makers focused on bilateral (rather than multilateral) issues; pundits, experts, and stakeholders are also focused primarily on bilateral matters.

A Shift Towards Services and The Digital Economy

The good news from the Osaka Declaration is that policy makers are pivoting hard and fast towards a new set of issues on trade where policy interests may be more aligned. New issue areas traditionally provide opportunities for constructive engagement because entrenched positions have not yet had a chance to develop.

Trade policy experts focused on the services sector and the digital economy will be delighted with the Osaka Declaration because it indicates that policy makers are shifting their attention away from trade in goods in order to craft a new policy foundation focused on the twenty-first century digital economy. For example:

1. Paragraph 6 underscores the importance of taking a holistic perspective that includes "all components of the current account, including services trade and income balances" when evaluating economic and trade policies. As many have noted, the United States holds a persistent and substantial bilateral trade surplus with China when services are included. Data from the United States Trade Representative indicates that in 2018 the United States also held a $60 billion surplus in services trade with European Union countries as compared with a $169 billion goods deficit. Consequently, a shift to a more comprehensive assessment of trade relationships holds potentially constructive implications for transatlantic trade talks.
2. Paragraph 11 stresses the "importance of interface between trade and digital economy" and indicates that G20 policy makers seek to "further facilitate data free flow."

These are small but significant shifts in policy attention.

The Challenges from Here

Yet it is too soon to celebrate. The policy shift articulated in the Osaka Declaration is not backed by concrete initiatives. Moreover, the policy issues raised by increased attention to digital economy issues promise to highlight the growing tension between national standards and multilateral efforts to generate cross-border consensus.

The Osaka Declaration confirms that the Distributed Age featuring less centralized decision-making structures has indeed arrived. The Osaka Declaration indicates the international system is evolving accordingly, with a pivot to non-tariff regulatory barriers at its core.

For example, G20 policy makers committed in Osaka only to "support the sharing of good practices on effective policy and regulatory approaches and frameworks...including regulatory sandboxes" (para. 12). These are profoundly national regulatory initiatives which to date have be used at least as much by policy makers to foster competition across jurisdictions as opposed to promoting consistency in standards across borders.

The "AI Principles" originally articulated by the Organization for Economic Cooperation and Development (OECD) were also endorsed, but the Declaration underscores that the principles are "non-binding" (para. 12).

Finally, efforts to promote increased cross-border data flows have been positioned with the goal of achieving "interoperability" (Osaka Declaration Para. 11, Ministerial Statement para. 16). This goal lays the foundation for intense bargaining among Chinese policy priorities for national standards regarding intellectual property rights, US national security priorities, and European priorities for privacy and data protection. These competing interests all point towards tactical tensions in future talks.

Conclusion

Increased transparency regarding good practices and interoperability among different national systems may generate a pragmatic way forward for the global economy. It may also provide an opening for renewed transatlantic leadership, where many of the relevant standards are far more well-developed and in many cases are compatible with each other. Engaging in open, honest exchanges of view may also reinvigorate the multilateral process at the WTO and elsewhere because these entities provide the only structures for sustained discussion.

Expectations for quick action, however, need to be tempered. The differences in values and priorities at national level run deep. Trust among the major participants in the trade policy debate is running low even as rhetorical heat runs high. The current climate for policy volatility lurching between trade wars and trade truces seems set to continue even as policy makers agree to shift gears to focus on strategically significant digital economy policy priorities.

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So when the Atlantic Council asked me to participate in a panel discussion regarding the Libra proposal last month, I welcomed the opportunity to engage in a structured discussion of the issues. It did not occur to me that the issues raised in that discussion would dominate my summer.

This blogpost in Section I sprints through our various macrotrend analysis contributions regarding the Libra proposal this summer, with hyperlinks and videos if you want to delve into the details. Section II extends the analysis by asking whether all this activity has moved the policy needle. We answer that question with concrete data from our patented platform.

Section I --MacroTrend Analysis: Recap from July and August

The Atantic Council panel discussion and questions paired with the intense regulatory policy debate show a great need for concrete analysis not only of the actual proposal but also of the implications.

Let's start with the Atlantic Council discussion in early July. Occurring at the edges of the Congressional hearings regarding the Libra proposal, the room was packed. Those of us on the panel were all veterans of the public policy process, having served in leadership positions at the Treasury Department, the State Department, and the Congress. We covered AML/compliance issues, data privacy, data governance and, of course sovereignty.

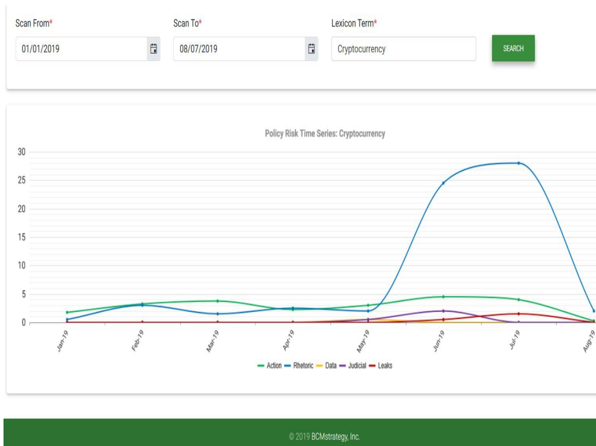
This is only the tip of the iceberg. The issues are significant. But have they moved the policy needle? Let's look at what the alternative data from our patented process tells us.

Section II -- Data-Driven Predictive Analytics

So far, the data tells us that the policy reaction function has not yet played out fully.

Policy activity regarding cryptocurrency has been steady and intense throughout 2019, but the activity mostly relates to initiatives put into play back in February. Moreover, the Libra proposal is not yet a reality; the Association and its ecosystem will not be up and running until spring 2020 at the earliest.

In other words: the time horizon for the Libra ripple effect to be seen in the policy process operate along a 12-18 month time horizon in the future. This makes the situation ripe for superforecasting opportunities by using our advanced technology to track and analyze automatically incremental policy moves.



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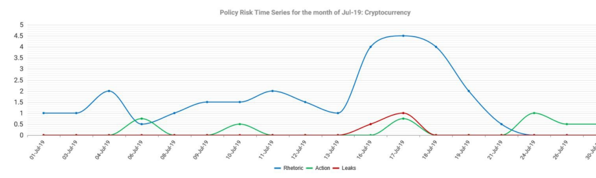
Consider where we started this year -- The spike in rhetoric during the summer was driven by the combination of the Libra proposal release and the annual G20 summit which saw global leaders pivoting fast and hard towards policy initiatives relevant to artificial intelligence, distributed ledger technology and, yes, cryptocurrency.



Date	Action Type	External URL	PDF
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10-Jul-19	Action	https://www.ecb.europa.eu//press/inter/date/2019/html/ecb.in190709~9be44c3161.en.html	
17-Jul-19	Action	https://www.esma.europa.eu/sites/default/files/library/esma32-63-672_report_on_enforcement_activities_2018.pdf	
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30-Jul-19	Action	https://www.sec.gov/news/press-release/2019-142	

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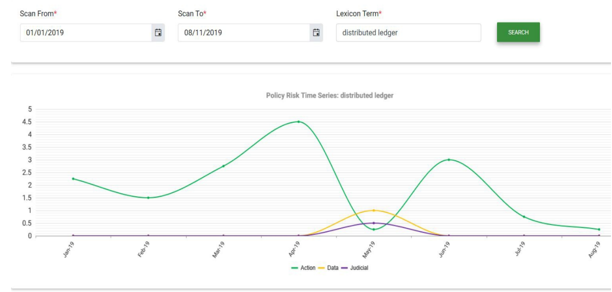
Zooming in on the month of July illustrates well the scope of policy activity. **A broad range of policymakers globally were taking action regarding pre-existing initiatives even as Congressional hearings on Libra added new issues to the policy discussion globally.** Every few days saw a new action, and not all of those actions were related to the Libra proposal even when Libra dominated news coverage. Assessing the Libra regulatory reaction function requires looking at activity in related policy sectors even when Libra is not directly mentioned. Moreover, tracking these additional issues provides insight into how policymakers will evaluate Libra-related activity by regulated financial institutions.

Policy initiatives regarding distributed ledgers are more technical and attract less media attention, so the comparable YTD chart for those issues looks more lumpy:



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In other words: August predictably delivers a drop-off in activity from the official sector. Do not be fooled by this annual lull. The autumn will deliver to us a bumper crop of policy activity in the cryptocurrency and distributed ledger arenas.

A new European Parliament and new leadership at the European Commission, the European Central Bank, the World Bank, and (after the October annual meetings) the International Monetary Fund will coincide with the Libra Association's race to launch its cryptocurrency platform/ecosystem next spring. Newly minted leadership will have multiple incentives to respond dynamically to cryptocurrency challengers across a broad range of issues.

Which issues can we expect to take center stage? Conventional wisdom holds that anti-money laundering and data privacy issues will be top priorities. These issues will certainly generate headlines (and headline risk for investors in the sector).

Those of us that have been tracking these issues for years know that far more important macroprudential issues are in play alongside nearly existential questions about the role of a central bank in society, systemic risk/spillover issues, the regulatory and supervision perimeter, Home/Host supervision and the role of regulated intermediaries within the crypto space.

These themes have largely dominated our contributions to Duke Law School's FinReg Blog for over a year. Now that the G20 leaders formally endorsed the pivot towards AI and FinTech policy issues, the autumn will provide a clear inflection point for policymakers to respond to the Libra Association proposal before the entity is even up and running.

You can count on BCMstrategy, Inc. to keep a keen eye on these developments, quantifying the risks and identifying inflection points as they arise.

Every once in a while, the daily momentum measurement delivered by our platform delivers an unexpected result. Take **Monday morning, September 16, 2019**. The most active issues on the platform were in FinTech regulation and banking....far outpacing trade and Brexit policy issues *for a change. On a Monday morning.*

***Spoiler Alert** -- if you did not realize that major stablecoin issuers met with global central banks from G7 and G20 countries in the last 24 hours, you are in for a surprise. When we Googled it after the fact, the only major media outlet reporting on the meeting (repeating the press release, actually) was PYMTS.com*
Our platform users greeted the day with the following chart on their smartphones this morning.

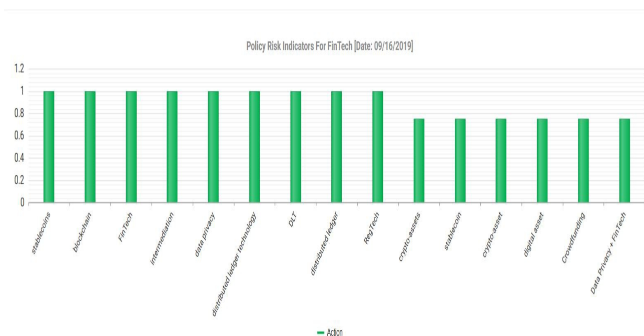
***Super Spoiler Alert** -- using our platform on Monday morning also made it possible to discern the specific policy trajectory likely discussed behind closed doors in Basel. If you took the additional effort of actually reading the materials, then you would also have known the direction policymakers are likely to take. All before breakfast.*

This is the kind of picture that delivers significant information triage opportunities, because the first thing any reasonable person would ask is: what happened in the last 24 hours to knock Brexit and trade off the top spots?

And so follows the Case Study paired with predictive analytics at the end.

Note that policymakers were taking action and, when the chart was generated, no media had reported on it. Traders reading this blogpost at this stage could be excused for doing a happy dance at the idea of being able to trade from publicly available, credible information that so far has not hit the media.

Less than 5 seconds after seeing the chart above, most people would take the next logical step and click on the FinTech column. This action generates the following detail chart guaranteed to wake up any cryptocurrency enthusiast long before the caffeine has hit their system: So much action on so many key issues.



(c) 2019 BCMstrategy, Inc.

The FinTech policy space was lighting up with many terms flagged earlier this year by the Financial Stability Board as being key to the policy process.

The third click would be on any one of the issues above. The fourth click would be to the source document...either on a live link to the source document in its natural habitat or to the PDF stored in our data lake....with all the metadata tags highlighted of course. **By the way, those source documents included a dense research paper positing a framework for expanding the regulatory perimeter in the blockchain space.**

So four clicks and less than 30 seconds delivered platform users to the knowledge that big things were happening in Basel. An inflection point is upon us.

Connecting the Dots

This is why subject matter experts and people with concrete policy experience are crucial to the machine interface. There are certain dots that machines programmed from the kitchen sink of the news cycle, blogs, and Twitter cannot (yet) connect.

In this case, only an experienced policy professional that had had pulled together a few confidential sessions at the BIS would realize that it is no coincidence that a research paper on a relevant topic was released at the same time as the notice of a meeting with industry representatives. When I was pulling those meetings together, press releases were never issued.

Yes, the conversation with the private sector was confidential....but it is a safe bet to assume that at least some official sector participants in the meeting had read (or edited) the research paper. Expanding the regulatory perimeter was certainly on the table. Because our system pulled together the information from multiple sources (not just the media), any experience professional could assemble these puzzle pieces.

Predictive Analytics v.1

Our early stage platform in the hands of a superforecaster or even your garden variety policy geek delivers predictive anaytics. It does not take rocket science or artificial intelligence to anticipate what happens next.

Media attention to FinTech and cryptocurrency will skyrocket tomorrow (September 17) and in the run-up to the next Financial Stability Board meetings (in October). Regular readers of our blog (see this August 2019 post as an example), platform users, and report subscribers won't be surprised. They will have spent the last few weeks getting ready for acceleraating momentum in the autumn.

Just wait until we start using the structured data from our patented process within ML/AI utilities. If VCs funded this kind of technology the way they fund hip scooters, apps, games, and salad bars, we would get there faster.

The Bottom Line

Four clicks.

Less than 30 seconds.

That is how long it took to put these puzzle pieces together....and that is even before diving in to the research paper itself.

This is what it looks like to "read smarter." We do it every day for all the issues covered by our platform which focuses like a laser on the fact that words count, but context counts more.

What does it all mean? Until we can get serious funding to deliver the next step in our automated patented process, we are providing the analysis the old fashioned way -- through a report. The good news is that you can subscribe. In this case, our C | P | C Report subscribers will have the full analysis powered by quantitative risk measures on Friday, once the complete reaction function has played out.

Do you have more questions? Don't hesitate to reach out.

Global Macro Policy -- OECD Data

This morning, while evaluating official activity over the last 24 hours globally regarding cryptocurrency and FinTech regulation, this speech in Malaysia caught our attention. The speech highlighted impressively high crypto usage data. The data was eye-popping enough to justify delving into the 60+ page report released by the OECD today.

Background: Earlier this year, the OECD conducted a series of online surveys in three Asian nations (Malaysia, Philippines, and Vietnam). They collected responses from 3006 individuals (roughly 1000 per country). Gender and age cohorts were limited in order to maintain equivalence with the broader population in each country.

Crypto Holdings: If the responses are indicative of the rest of the population in these countries, the distribution of cryptocurrency holdings is both broad and deep....despite signfiicant restrictions (and bans) on using cryptocurrencies in the economy. Specifically, the high water mark was in Vietnam, where 35% of respondents claim to own cryptocurrencies compared with 32% in the Philippines and 23% in Malaysia.

Questions About The Survey Sample: Demographic data released by the OECD within the report raises some obvious questions about whether the suvey sampling was indeed representative of the population. While controlling for age and gender, the survey did not control for education levels. It seems the distribution of crypto ownership in the three countries is dramatically skewed to educated elites.

In Malaysia, 20% of respondents held PhDs and 27% held bachelors degrees. Similar skewness can be seen in the Philippines, where a whopping 53% of respondents claimed to hold PhDs and another 35% held bachelors. Vietnam was even more skewed, with 54% holding PhDs and 40% holding Bachelors degrees.

In most countries, highly educated individuals would be considered sophisticated investors for which consumer protection regulations would be assumed to hold minimal importance. Yet when the OECD asked these respondents to assess how well they think they understood cryptoassets, significantly fewer people indicated they believed they understood these instruments "very well": 11% in Malaysia, 17% in Philippines, 23% in Vietnam.

Potentially more problematically, the sources of information regarding tehse assets were predominantly online resources (e.g., white papers) and social media. As discussed HERE last week on our company blog, the shift in information consumption patterns increases reader vulnerability to being misled in general. Therefore, ti is reassuring to see that respondents also relied predominantly on professional advisors or accountants before making purchase decisions (46% Malaysia, 45% Philippines, 46% Vietnam)

Levels of ownership and understanding regarding ICOs were much lower.

Policy Implications: *The OECD findings are being used to identify additional regulatory engagement in the cryptoassets space beyond banning the use of the assets to effect transactions in the "real" economy. Beyond the predictable proposals to pursue enhanced financial literacy initiatives, OECD experts are also now recommending that policymakers begin collecting more data regarding both consumer behavior and market developments in order to provide a foundation for additional rule-making not only to enhance consumer protection but also to ensure compliance with anti-money laundering standards.*

Other areas for potential increases in regulatory activity include: online advertising and investor solicitations (particularly on social media) and requiring specific disclosures within whitepapers that increasingly function as offering circulars.

Conclusion

The OECD report may not (yet) have generated much attention, and the markets in question may not be large compared with the United States and Europe. But quiet initiatives in small markets can serve as springboards for broader standards on the global stage. Technical moves in tech-savvy jurisdictions like Malaysia particularly merit close attention. As we noted back in February and have noted periodically since then, policymakers have been persistent in executing a year-long pivot towards expanding the regulatory perimeter regarding cryptoassets. The trend began before the Libra stablecoin proposals. Indeed, the OECD survey was undertaken BEFORE the summertime stablecoin proposal was floated. We expect continued acceleration and expansion by policymakers throughout 2020.

Table 3.1. Cryptocurrency ownership

Cryptocurrency Ownership	Total	Malaysia	Philippines	Viet Nam
Currently holds	30%	23%	32%	35%
Does not hold	70%	77%	68%	65%
Base	3006	1000	1003	1003

Sample: Main sample, no booster.
Question: Which of the following statements applies to you? "I currently hold digital or cryptocurrencies (such as Bitcoin or Ethereum)".

CRYPTOASSETS IN ASIA

Consumer attitudes, behaviours and experiences

December 2019

It seems somehow ironic and fitting that the economic sector most hostile to centralized governments – cryptocurrency and initial coin offerings (ICOs) – faces renewed regulatory activity despite the UK Brexit and US shutdown chaos. On January 23, the Financial Conduct Authority (FCA) in the United Kingdom issued a new consultative paper regarding ICO regulation. Since comments are due in April, final decisions will be made after the current March 2019 Brexit deadline has passed.

The UK proposals suggest British policymakers are determined to go their own way regarding ICO regulation. If the proposals become regulation without any changes, the UK ICO regulatory framework will conflict with the emerging ICO regulatory framework in other major jurisdictions. The potential policy divergence creates an additional layer of irony given that the FCA was the prime mover behind last year's proposal to create a Global Financial Innovation Network (GFIN).

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This post highlights the main areas of policy divergence and analyzes the global policy implications.

The UK Proposal

The proposal starts from the proposition that the cryptocurrency market continues to evolve, creating market segmentation along the way. The proposal indicates that three segments exist:

1. Exchange Tokens: items used as a means of exchange "without traditional intermediaries" that are not "issued or backed by any central authority."
2. Security Tokens: items that fall within the definition of "debt" or equity."
3. Utility Tokens: items that "grant holders access to a current or prospective product or service but do not grant holders" the same rights as debt or equity. The proposal notes that such tokens could meet the definition of "e-money" in certain circumstances.

These categories converge with those identified by Switzerland's Financial Market Supervisory Authority in February 2018. However, FINMA expressly indicated that determinations regarding the regulatory perimeter would be undertaken on a "case-by-case basis."

The FCA, however, has now clearly indicated that at least in England, Exchange Tokens and most Utility Tokens – aside from e-money – are outside the regulatory perimeter. This effectively creates incentives for ICOs and cryptocurrency issuers to shift activity to London and to structure their instruments in a manner that qualifies for this blanket exemption from securities regulation.

UK policymakers are not shy about touting the potential benefits of alternative mechanisms for intermediation, specifically citing "increased speed and a reduction in cost of cross border money remittance with cryptoassets as a vehicle for exchange." (Section 2.19.) However, the guidance also acknowledges a much longer list of potential side-effects, including issues familiar to regulatory policy experts and commentators: (i) consumer protection concerns due to non-standard documentation, insufficient disclosure, and high market volatility/high potential loss rates; (ii) inability to enforce international anti-money laundering standards; and (iii) high potential for market manipulation and insider dealing due to high volatility and low liquidity.

The proposed guidance recommends that policymakers vigorously enforce consumer protection, AML/CFT, and market integrity/competition regulatory standards in the cryptoasset sector. However, the proposal makes clear that enforcement will only apply to instruments that are already within the scope of regulation. Consequently, all blockchain-based instruments that do not rely on central bank payment systems ("traditional intermediaries") are deemed to fall outside the scope of regulation.

Potential Policy Divergences

By expressly exempting blockchain-based intermediation from the scope of regulation, the FCA creates the foundation for significant policy divergences globally. A more lenient, and clear, regulatory framework favoring cryptocurrency issuers would generate significant incentives for issuers to flock to the UK in order to conduct their intermediation activities.

In the United States, policymakers have been less willing to provide explicit guidance on cryptoassets. They have consistently taken the position that existing regulation is flexible enough to encompass these new instruments. This stance allows for significant regulatory discretion and has led to divergent outcomes across agencies. For instance, the Commodity Futures Trading Commission (CFTC) permitted the introduction of cash-settled bitcoin futures contracts through existing self-certification processes for new commodity derivatives. The Securities and Exchange Commission (SEC) has also actively used its enforcement authority regarding a range of cryptocurrency entities. The CFTC self-certification process has attracted criticism from leading commentators, but that criticism has not deterred market participants from issuing new trading instruments based on self-certification. The CFTC's leniency is tempered by the SEC's informal position – backed by concrete high profile enforcement actions in 2017 and 2019 – that all ICOs are investment contracts subject to U.S. securities laws. The SEC has also thus far resisted attempts to list a bitcoin exchange-traded fund.

American banking regulators have been similarly stringent in their approach to a range of blockchain-based FinTech innovations. While the Office of the Comptroller of the Currency finally created a "FinTech charter" option in 2018, the regulatory requirements for that charter have been criticized as not generating sufficient regulatory incentives to attract innovative firms in the payments and banking sectors.

Singapore policymakers are also less generous than the UK regarding the regulatory perimeter for ICOs and cryptoassets. In December 2018, their updated formal guidance to ICO and cryptocurrency issuers stops short of creating a blanket exemption for instruments that do not use "traditional intermediaries." Like the SEC and Switzerland, policymakers in Singapore expressly retain the option to determine that an instrument meets the definition of a security. The only ex ante exceptions available to potential issuers relate to offerings that target traditionally defined accredited investors. Moreover, even if the securities laws do not apply, Singapore policymakers have made clear that issuers must still comply with AML/CFT regulations.

Japanese policymakers have also recently started changing the trajectory of regulatory policy regarding cryptocurrency issuers and ICO issuers. In December 2018, the Financial Services Agency's Study Group On Virtual Currency Exchanges released a report laying the groundwork for substantial *expansions* of the regulatory perimeter. No formal guidance has been proposed or released yet in Japan. But the general trend in the Study Group report suggests strongly that policymakers in Tokyo may not adopt as lenient a position as the proposed FCA guidance.

Regulators in Dubai and Abu Dhabi are expected to provide a regulatory framework for cryptocurrency and ICO issuers in the middle of 2019. Public speeches indicate that their approach to the regulatory perimeter could be even more restrictive than other jurisdictions. Issuers will only be able to operate within an official sandbox structure which, by definition, would limit the scope of product offerings to third parties.

Ironic Implications

In 2018, a range of policymakers with jurisdiction over various FinTech market segments proposed creation of a GFIN to facilitate cross-border consensus building activities with the UK's FCA serving as the secretariat for the group. The proposal arguably raised more issues than it would resolve, as noted in this analysis. The commentary period closed in October 2018, but no formal organizational announcement has yet been made.

Addressing divergence in regulatory standards regarding ICO and cryptocurrency issuers would initially seem to be the ideal first project for the GFIN. However, the FCA remains silent regarding forward direction for the international group.

The most comprehensive statement provided on behalf of the GFIN occurred on January 16, 2019 from an official at the Abu Dhabi Global Markets in a podcast. The official indicated that the GFIN's initial high priority tasks would be more administrative in nature (creating lists of relevant officials, providing increased transparency regarding market entry requirements for individual markets). Neither of those deliverables is expected before "early 2020." Regarding standard-setting, the podcast interview indicates GFIN officials seek to provide "expert opinion" to existing international organizations. The precise example provided was with respect to "security tokens." The GFIN would in this case provide expert opinion to the International Organization of Securities Commissions (IOSCO) rather than create its own standards. IOSCO provides on its website a collection of statements issued by individual regulators regarding ICOs, but there is no indication that an active workstream aimed at cross-border regulatory policy consensus-building is underway.

Conclusion

Inertia at the international level leaves open the possibility for domestic policymakers to continue pursuing policy trajectories in support of local objectives. This week's proposal from the UK suggests that policymakers in London seek to maximize their attractiveness to ICO and cryptocurrency issuers as they build a post-Brexit financial system. Since the Bank of England's Financial Policy Committee concluded in March 2018 that electronic currency issuers "do not currently pose a material risk to UK financial stability," it seems that at least in England, a policy consensus is emerging that is more friendly to blockchain-based intermediation than in other sectors.

"Hi! I'm from the government. I'm here to help."

The regulatory perimeter regarding crypto-assets continues to expand. The latest move comes from the International Organization of Securities Commissions (IOSCO) which released for comment on 28 May, 2019 suggested regulatory oversight standards [1] to govern crypto-asset trading platforms (the "IOSCO CTP Proposals"). Many in the cryptocurrency sector are likely cringing, if they noticed. Comments are due to IOSCO by 29 July, 2019.

First, the good news. Policymakers globally are clearly pivoting away from policy stances seeking to ban, or otherwise constrain, innovation in digital asset trading. Every digital asset issuer and trader should be celebrating this fact. After two years of regularly asserting that policymakers should recognize the legitimacy of non-fiat currency trading, IOSCO seems to have finally agreed.

Now the bad news. When policymakers agree that shutting down a market is not advisable, they then traditionally begin to assert jurisdiction over that market in order to ensure: (i) investor protection, (ii) fair access, (iii) market integrity, and (iv) free flow of supervisory information across borders. In other words, the regulatory perimeter expands. Welcome to cryptocurrency trading regulation.

Background

Financial regulators across all sectors have been scrambling to keep up with innovation in the FinTech and digital asset sectors for the last two years; securities regulators are no exception. 2018 was a frenetic year with six major international regulatory policy groups weighing in on crypto-asset trading in addition to activities at the national level for at least six of the twelve calendar months.

During the second half of 2018, IOSCO conducted a survey exploring a range of regulatory standards applicable to trading cryptocurrencies. They received substantial participation from all major jurisdictions globally except for Australia. The geographic distribution was as follows:

High levels of participation from Europe reflect the engagement by regulators at the national level but not the European Securities Markets Authority. The sole African participant was from the largest trading market on the sub-continent (South Africa).

The survey was conducted by IOSCO's "Committee 2" which includes, but is not limited to, the membership of the newly established "ICO Network" of securities regulators created in 2018. The survey had a broad remit, asking detailed questions concerning every aspect of the trading process, from access to price discovery; to custody; to clearing and settlement; to systems integrity/operational risk and, of course, cybersecurity.

Dwindling Regulation-Free Zones

As noted periodically on this blog (particularly in August 2018, January 2019, and February 2019) financial regulators have been methodically signaling the direction and scope of their engagement with the FinTech/BigTech sectors generally and cryptocurrency trading specifically. This week's consultative paper solidifies that policy trajectory by making clear how far the regulatory perimeter will soon extend to the cryptocurrency trading sector.

The IOSCO CTP Proposal suggests strongly that cross-border consensus now exists on a position long held by the Securities and Exchange Commission in the United States and like-minded regulators globally. Namely, the policy community is making clear that cryptocurrency trading is like any other trading activity in the capital markets. The IOSCO CTP Proposal implies strongly that these platforms should be subject to the full range of regulatory oversight as other trading platforms.

Policymakers effectively are endorsing the validity of CTPs. Having done so, however, they are pivoting towards expanding the regulatory perimeter in order to fulfill their statutory missions that require them to safeguard market integrity and investor protection.

What Comes Next

The proposal indicates policymakers are preparing to pivot towards applying regulatory capital, audit trail, conflict of interest, custody, clearing and settlement, and cybersecurity standards to all CTP operators. The comment period expires in July of this year. Traditionally, the timing would then suggest that final standards would be articulated in the autumn, or by year-end 2019.

Not all policymakers will wait until the final standards have been articulated internationally. Therefore, we can expect some volatility in the regulatory environment from 3Q2019 into the early part of 2020 as the new approaches become part of the cryptocurrency ecosystem.

Industry members seeking to avoid the most burdensome impacts will need to pivot as well. Arguments resisting regulatory requirements will need to shift towards identifying why specific technical aspects of the CTP sector require separate or unique standards rather than application of standards crafted for traditional securities trading.

Consider, for example, the proposals regarding treatment of custody standards in the CTP context. The IOSCO CTP Proposal accepts that custody regarding cryptocurrency trading presents unique characteristics not easily addressed by existing rules. They isolate three specific types of custody arrangements (hot or cold storage, self-custody through private electronic wallets, and third-party service providers) that likely will require additional elaboration.

The overriding public purpose is to prevent fraud and loss due to operational risks like systems failures and bankruptcy. Cryptocurrency hardliners will see the effort as intrusive. But CTP operators (as opposed to issuers) may pivot towards their traditional counterparts and support some regulatory engagement as a mean of sparking confidence among revenue-generating traders and investors by highlighting their credibility due to regulation.

The market pivot is already starting, if my conversations at the Collision technology conference last week are any indication. Cryptocurrency issuers and trading platforms were at the conference in force, alongside many FinTech companies. While a handful of firms continued to articulate the traditional anti-regulation ("they can't stop us!") slogans, far more firms proudly indicated that they are regulated and subject to regulatory oversight in their home country. The message was clear: regulatory oversight makes our firm more trustworthy than the competition.

Three Notable Carve-Outs

Three areas stand out as being exempt from the cross-border consensus standards so far. The three areas are: (i) national standards about whether the underlying cryptocurrency asset is a permissible subject for secondary market trading, (ii) price discovery processes, and (iii) clearing and settlement.

The IOSCO CTP Proposal indicates that policy reluctance regarding price discovery and the post-trade environment have more to do with the nascent state of market development than they do with any regulatory perspectives suggesting these areas should be exempt from regulatory oversight. Consequently, when an industry standard has emerged in these areas, policymakers will likely move to extend existing regulatory standards as well. These are not permanent carve-outs.

One Major Pressure Point

The IOSCO CTP Proposal fails to acknowledge the one major pressure point that permeates the sector. It seems to assume that CTP operators can, *and will,* embrace the need for customer verification and audit trails that underpin many, if not most, of the proposed applications of existing regulatory standards to the CTP context.

This is a problem. The cryptocurrency sector and, more generally, the underlying technology within distributed ledgers (DLTs) is designed to keep confidential the identity of the transacting parties. DLTs shift the locus of identity ownership to individuals, leaving authentication to an automated algorithmic process. The IOSCO CTP Proposal released this week implies that the very anonymity that makes the sector attractive to many participants is precisely the element that must recede in order to assert regulatory jurisdiction effectively.

Industry participants are familiar with this debate. Some entities (like JP Morgan Chase, which just launched the JPMCoin) are launching their own DLTs which serve as gateways to instant payments, with the company serving as the identity verification agent. These large firms effectively vouch for the individuals entering the DLT. To the extent that they permit transactions outside the self-contained company distributed ledger, they will do so only with counterparts that have similarly robust identity verification standards.

If banking is fundamentally about trust, then a gated DLT is an excellent way to evolve the banking business model, particularly if it delivers instantaneous payments that eliminate settlement and credit risks the bank might otherwise have to absorb. The problem, of course, is that much of the cryptocurrency universe is allergic to the kind of centralization and audit trail elements incorporated into these closed systems.

Viewed from this perspective, the IOSCO CTP Proposal presents a "bank shot" effort to establish authentication requirements in the cryptocurrency sector through the trading gateway rather than through direct regulation of the underlying digital assets themselves. This approach eliminates the need for policymakers to get drawn into messy, often polemical, debates regarding fiat currencies and central banks. The question is whether cryptocurrency market participants are savvy enough to realize the implications of these proposals.

It will be interesting to watch this debate unfold over the next 18-24 months.

Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms

Consultation Report

BOARD OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

CR02/2019	MAY 2019

This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Board or any of its members.

At the beginning of the week, a Securities and Exchange Commission (SEC) enforcement action generated attention mostly by levying a large fine ($24 million) in the Initial Coin Offering (ICO) sector. Many shrugged, seeing this as another example of regulatory hostility to cryptocurrency.

The reality is more nuanced. The complaint itself is remarkably restrained. The details suggest strongly that ICOs may actually be approaching the mainstream in US capital markets. Let's look at the details.

1. Fine Size: Yes, the $24 million is one of the largest fines assessed in the blockchain/cryptocurrency arena. But in the broader context of the company puts the fine size in a slightly different perspective. In a relatively short period of time (roughly one year), the company in question managed to raise "several billion" in digital assets. Regardless of the denomination, this is an impressive fundraising feat.

The SEC press release indicates that some of the investors were in the United States. But it does not provide perspective on how many of the investors were in the United States. Nor does it provide perspective on how much they invested. It is possible that the $24 million reflects the proportion of U.S. investors relative to other investors, but there is no concrete detail to support this supposition.

2. Not Fraud: The cause of action is for violating the registration, exemption, and disclosure portions of U.S. securities laws....not fraud. In other words: this is a rather run-of-the-mill enforcement action.

The enforcement action provides a potential factual basis for a cause of action in fraud. It indicates that the company promised to spend over 1 billion raised in Ether from investors to build a blockchain platform that would have a positive impact on investors' ICO holdings.

The enforcement order indicates that "urchasers thus would have understood that Block.one's success in building and promoting the EOSIO software and promoting the launch of one or more EOSIO-based blockchains would make their token purchase profitable" but is silent on whether --or not -- the blockchain platform actually was built. Even more positive for the ICO and cryptocurrency sectors, the SEC enforcement order does not attempt to suggest that creating a security in a cryptocurrency is automatically suspicious from a fraud perspective.

3. Narrow Cease and Desist Order: The enforcement action did not merely levy a fine. It also issued a "cease and desist" order. But since the violation is only one of registration and disclosure, compliance with the court order is fairly simple. The company must register its ICO with the SEC and it must provide appropriate disclosures to investors. Alternatively, it can cease fundraising in the United States. It is not required to close its operations.

4. International Dimension: Capital markets have become accustomed to seeing the SEC assert its jurisdiction abroad based on potential harm to investors and markets located inside the United States. The current enforcement order fits well within that pattern. Consider these quotes from the press release: "A number of US investors participated in Block.one's ICO," said Stephanie Avakian, Co-Director of the SEC's Division of Enforcement. "Companies that offer or sell securities to US investors must comply with the securities laws, irrespective of the industry they operate in or the labels they place on the investment products they offer."

One action does not create a trend. It is possible that with headquarters in the Cayman Islands and a large investor base abroad the blockchain company presented limited threats to U.S. securities market integrity, providing the basis for the SEC to pull its punches in this enforcement action. But it is also possible that blockchain companies and ICOs are becoming just another part of the securities market landscape in the United States, warranting a more measured response from the SEC.

Press Release

SEC Orders Blockchain Company to Pay $24 Million Penalty for Unregistered ICO

FOR IMMEDIATE RELEASE
2019-202

Washington D.C., Sept. 30, 2019 — The Securities and Exchange Commission today announced settled charges against blockchain technology company Block.one for conducting an unregistered initial coin offering of digital tokens (ICO) that raised the equivalent of several billion dollars over approximately one year. The company agreed to settle the charges by paying a $24 million civil penalty.

According to the SEC's order, Block.one, which has operations in Virginia and Hong Kong, conducted an ICO between June 2017 and June 2018. The order finds that Block.one stated it would use the capital raised in the ICO for general expenses, and also to develop software and promote blockchains based on that software. Block.one's offer and sale of 900 million tokens began shortly before the SEC released the DAO Report of Investigation and continued for nearly a year after the report's publication, eventually raising several billion dollars worth of digital assets globally, including a portion from US investors. Block.one did not register its ICO as a securities offering pursuant to the federal securities laws, nor did it qualify for or seek an exemption from the registration requirements.

"A number of US investors participated in Block.one's ICO," said Stephanie Avakian, Co-Director of the SEC's Division of Enforcement. "Companies that offer or sell securities to US investors must comply with the securities laws, irrespective of the industry they operate in or the labels they place on the investment products they offer."

"Block.one did not provide ICO investors the information they were entitled to as participants in a securities offering," said Steven Peikin, Co-Director of the SEC's Division of Enforcement. "The SEC remains committed to bringing enforcement cases when investors are deprived of material information they need to make informed investment decisions."

The SEC's order finds that Block.one violated the registration provisions of the federal securities laws and requires it to pay a $24 million civil monetary penalty. Block.one consented to the order without admitting or denying its findings.

The investigation was conducted by Luke M. Fitzgerald and Tuongvy Le, and was supervised by John O. Enright, of the SEC's Cyber Unit and New York Regional Office.

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SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 81207 / July 25, 2017

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO

I. Introduction and Summary

The United States Securities and Exchange Commission's ("Commission") Division of Enforcement ("Division") has investigated whether The DAO, an unincorporated organization; Slock.it UG ("Slock.it"), a German corporation; Slock.it's co-founders; and intermediaries may have violated the federal securities laws. The Commission has determined not to pursue an enforcement action in this matter based on the conduct and activities known to the Commission at this time.

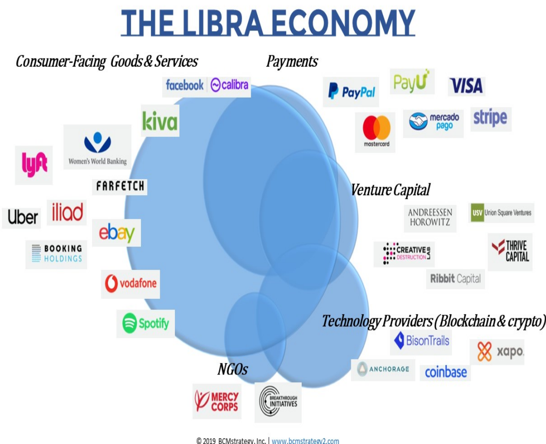
As described more fully below, The DAO is one example of a Decentralized Autonomous Organization, which is a term used to describe a "virtual" organization embodied in computer code and executed on a distributed ledger or blockchain. The DAO was created by Slock.it and Slock.it's co-founders, with the objective of operating as a for-profit entity that would create and hold a corpus of assets through the sale of DAO Tokens to investors, which assets would then be used to fund "projects." The holders of DAO Tokens stood to share in the anticipated earnings from these projects as a return on their investment in DAO Tokens. In addition, DAO Token holders could monetize their investments in DAO Tokens by re-selling DAO Tokens on a number of web-based platforms ("Platforms") that supported secondary trading in the DAO Tokens.

After DAO Tokens were sold, but before The DAO was able to commence funding projects, an attacker used a flaw in The DAO's code to steal approximately one-third of The DAO's assets. Slock.it's co-founders and others responded by creating a work-around whereby DAO Token holders could opt to have their investment returned to them, as described in more detail below.

The investigation raised questions regarding the application of the U.S. federal securities laws to the offer and sale of DAO Tokens, including the threshold question whether DAO Tokens are securities. Based on the investigation, and under the facts presented, the Commission has determined that DAO Tokens are securities under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[1] The Commission deems it appropriate and in the public interest to issue this report of investigation ("Report") pursuant to

The quiet lull of August before central bankers convene for their annual conference at Jackson Hole, Wyoming provides time for thinking seriously about what the Libra proposal tells us regarding the evolution of the economy in the Distributed Age. Policymakers should worry for four reasons: Jurisdiction, Competition/Antitrust, Systemic Risk, and Monetary Policy.

Let's start with some concrete data. Twenty eight (28) companies comprise the initial Libra Association. If we count Facebook and Calibra as two separate companies, the total is 29. They fall into five categories: consumer-facing goods and services (11), payment services providers (6), venture capital (5), blockchain/cryptocurrency technology (4) and non-governmental organizations (NGOs)(2).



This constellation of companies creates profound policy dilemmas far beyond the well-known data privacy and anti-money laundering issues raised by Congressional and European policymakers this summer.

Four Reasons for Policymakers to Worry -- Distributed Age Challenges

1. Jurisdiction

As discussed in this Atlantic Council blogpost, the Libra Association creates jurisdictional challenges for policymakers. By choosing Switzerland as its headquarters, two powerhouse jurisdictions regarding the digital economy (the United States and the European Union) have been shut out from exercising primary oversight authority over Libra. Under certain scenarios, transatlantic regulatory policy competition could ensue as the US and the EU seek to influence Swiss authorities to favor one policy over another.

Swiss authorities will be in the lead regarding creation/issuance of the Libra currency and its management. This is no small task. True to its distributed ledger roots, the Libra Association will create a secondary market for the purchase and sale of Libra tokens through "authorized resellers" that functionally look and sound a great deal like traditional intermediaries (broker-dealers, investment banks, exchanges). These intermediaries will "transact large amounts of fiat (currency) and Libra in and out of the reserve."

Market operations may thus end up being subject to local laws in BOTH the EU and the US even as decisions about those operations are made at the central headquarters in Switzerland. Libra Association members themselves will remain subject to jurisdiction in their Home countries.

> This is just the beginning of the jurisdictional challenges raised by the Distributed Age. The Sovereignty issues are real and deeply problematic.

When individual tasks are split up into different types of entities spread around the world, the jigsaw puzzle of overlapping jurisdictions challenges the ability of sovereign authorities to exercise their responsibilities.

2. Competition/Antitrust Law

Many initially jumped to the conclusion earlier this summer that the Libra proposal must be anti-competitive due to the vertical integration between the issuer of the payment token, the recipient consumers, and the merchants. It is tempting to see the potential for market dominance and pricing abuse given the recent history of competitive problems associated with winner-take-all platform business models (e.g., Google, Amazon).

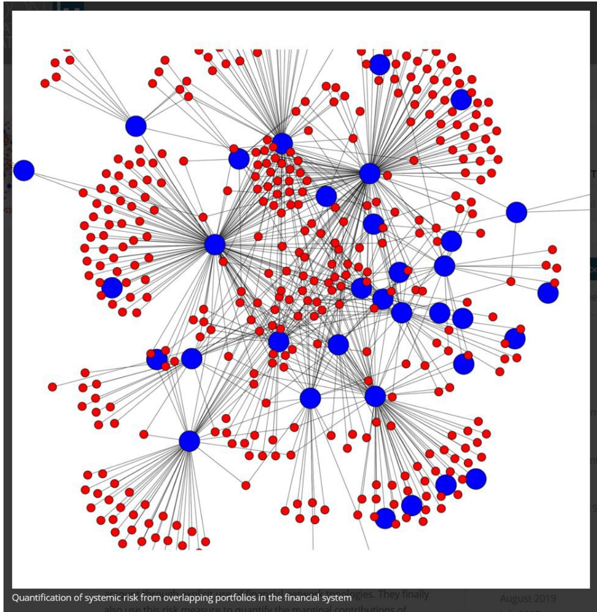
But it's just not that simple. Consider the relatively skimpy White Paper released by Facebook (which remains the sole source document). The White Paper indicates that Libra will only operate a parallel payments system, not *require* payment in Libra. Proving anti-competitive or monopolistic pricing will require real-life examples of price divergences for the same product across currencies used to settle the purchase transaction.

Monopoly may also be challenging to prove, at least initially. Remember that the key to competition law is the definition of "the market" in order to determine whether a company has achieved a dominant or monopoly position in that market.

It is hard to see that the current configuration of companies assembled under the Libra platform create anti-competitive pressures in the market for hotel rooms because a large range of alternative hotel platforms (e.g., AirBnB, Hotels.com) are not included. The same is true for taxi services, even though Uber and Lyft will bristle at the notion that they are taxi services. Ebay may be a massive online platform for used goods, but they are not the only one… Amazon and Alibaba also play in this space and they remain outside the Libra project….at least for now.

3. Systemic Risk

In its simplest form, systemic risk is the transmission of destabilizing agents across boundaries. The best analogy in the physical world is with infectious diseases and chemical chain reactions; linguisitically, policymakers even speak of "contagion risk". For an excellent and wry long read on systemic risk, see this 2017 Medium post. For an excellent mathematical description of systemic risk, see this post from the London Mathematical Library whose image I happily borrow and display on the next page.

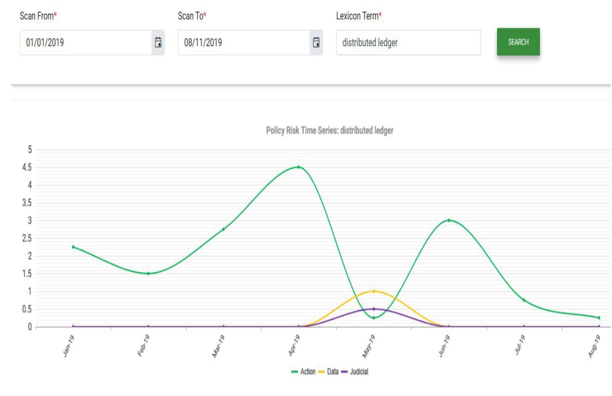

Quantification of systemic risk from overlapping portfolios in the financial system

Traditionally, central banks and financial stability regulators (including multilateral institutions like the International Monetary Fund and the Bank for International Settlements) assess systemic risk vulnerabilities and articulate rules to rein in risky practices at financial firms that can generate systemic risk. Twice a year, the IMF's Financial Stability Report assesses a parade of horribles denoting global systemic risks. Major central banks publish similar reports regularly.

"Big Tech" creates big headaches because technology companies that avoid serving an intermediary role deprive regulators of jurisdiction.

The Financial Stability Board earlier this year in February, May, and June publicly fretted about the policy challenges raised by such Big Tech companies which increasingly provide intermediary-like functions but sit just outside the regulatory perimeter. This Medium post analyzes those statements and provides a good starting point when considering the jurisdictional jujitsu that policymakers will have to execute in order to address potential systemic risks raised by the Libra proposal.

Policymakers globally have been taking action far more than they have been talking about distributed ledger technology all year as this activity chart indicates:



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Cryptocurrency and blockchain enthusiasts will tell us there is no reason to fret because if Libra transactions occur through a distributed ledger then the automatic authentication and instant payments execution eliminate potential systemic contagion risks like bank runs.

> But wait….***significant parts of this ecosystem will not operate on an instant payments basis***. The ecosystem includes significant lending activity at the microfinance level, the retail credit card level, possibly wholesale merchant invoice-based finance AND institutional/VC lending/investment.

Lending requires repayments at specific points in the future. The risk of non-payment (i.e., default) and the consequences of non-payment generate ripple effects across balance sheets and trading platforms. The same is true for multi-year grants because recipients rely on grant funding to enter into multi-year supplier contracts. The nodes of the distributed ledger can transmit a chain reaction of failed payments due to default.

What happens to intermediaries if the Libra credit chain breaks down?

How will intermediaries cover Libra losses in the event of defaults?

Can Libra-denominated loss recognition be insulated from the broader balance sheet exposures denominated in traditional "hard" currencies?

How do banks and securities regulators set capital requirements for the risks associated with intermediating Libra-denominated transactions so that risks and losses in one jurisdiction do not generate cross-border spillovers?

The Libra White Paper provides no insight into these questions.

4. Monetary Policy

The composition of the Libra Association sketches an outline for an alternative kind of economy for the 21st century. The Libra rhetoric regarding inclusiveness is not just hot air. It is real

The ecosystem envisions individuals around the world paying in Libra for travel, transportation, luxury goods, used goods, and music — but not real property, education or food.

It envisions those individuals borrowing and repaying debt in Libra at the micro-level (Kiva, Women's World Banking) and through credit cards (Visa, MasterCard) even as it envisions their merchants accepting payment and perhaps obtaining receivables-based finance in Libra (Stripe, Mercado Pago, PayU).

And it envisions a range of humanitarian and scientific research being positively impacted by Libra through donations and grants (although the White Paper is fuzzy on whether NGOs would receive donations in Libra).

(c) 2019 BCMstrategy, Inc.

> It is a lovely, idealistic world in which people happily exchange their hard currencies for Libra which in turn sets off a chain reaction of financial inclusion and charitable donations because high volumes of hard currency redemptions to the Libra Association increase the volume of Libra tokens in distribution.

But note that the exchange rate will not be at parity: Libra Association documents regarding "The Reserve" indicate Libra will be issued to individuals at an undetermined "narrow spread above or below the value of the" currency basket backing the Libra token.

What counts as a narrow spread? More importantly, if the system is designed to generate fewer Libra than hard currencies who benefits — individuals holding the scarce currency (Libra) or entities holding and investing the hard baseline currencies (the Libra Association)?
If you are a citizen in a country subject to exchange controls (ahem, China, Venezuela, North Korea, Iran, etc.) or a country whose currency traditionally has experienced high levels of inflation (ahem, many emerging economies) you are likely to run, not walk, to exchange your local currency for a Libra token. Presto! Instant increased purchasing power because you unloaded risky currency and acquired a token accepted by certain merchants globally which is pegged to stable (but so far not-yet-named) currencies issued by countries half a world away.

If the Libra Association limits convertibility only to the currencies represented in its basket, some very real, practical limits may exist on the extent of the inclusion benefits promoted by the Libra sponsors. How can someone in an emerging market repay a Libra microloan in Libra if that person does not have hard currency to exchange for the repayment and if that person cannot earn Libra through retail transactions?

Limiting the kind of currencies eligible for exchange into Libra may also generate increased demand for the currencies in question, creating pressure on exchange rates in the hard currencies. This would create real headaches for monetary policy.

Central bankers should worry about these potential new supply & demand dynamics. And there is more.

> If the Libra token goes viral as its sponsors hope, then a significant volume of economic activity will occur in a parallel economy through a distributed ledger which generates little to zero information for the formulation of economic policy.

Consider the following policy conundrums created by a parallel but opaque pegged economy:

How can an economist assess aggregate demand or price elasticities if a substantial amount of payments for, say, taxi services and hotel bookings occur outside the formal economy?

What kind of transparency and data will the Libra Association and its intermediaries provide to markets, central banks, and regulators regarding redemption rates, exchange rates, transaction volumes, etc.?

How can economists measure the impact on demand for individual currencies in the Libra basket without access to an audit trail in the distributed ledger?

How can economists and central bankers make good decisions about optimal interest rates if the transmission of those interest rates in the economy is buffered by the fact that some substantial percentage of the transactions will be immune from the tightening or loosening of the price of money?

Crypto enthusiasts will crow that central banks will soon face real competition from free markets. Even if they don’t like the stablecoin, pegged nature of the Libra token, they will love the idea that a parallel economy can operate independently of monetary pricing managed by central banks.

Maybe.

Libra Revenue Streams — What We Know So Far And Our Questions

But for so long as Libra remains pegged to "fiat" currencies ***there will be be a feedback loop***. Trouble in "hard" currencies will generate pricing and transaction dynamics for Libra and its authorized distributors that even instant payments in a distributed ledger will find difficult to contain. The history of pegged currencies and currency boards is not pretty. Pegs break, often dramatically.

Monetary policy has been in uncharted (zero lower bound) waters ever since the financial crisis of 2008. It is about to head into open, deep water if the Libra token takes off.

Last week, The Libra Economy essay generated a fair amount of interest. It was interesting to see, however, that so many otherwise informed commentators remain unclear on Libra's anticipated revenue streams. For a good summary of the current questions, consider this Bloomberg story.

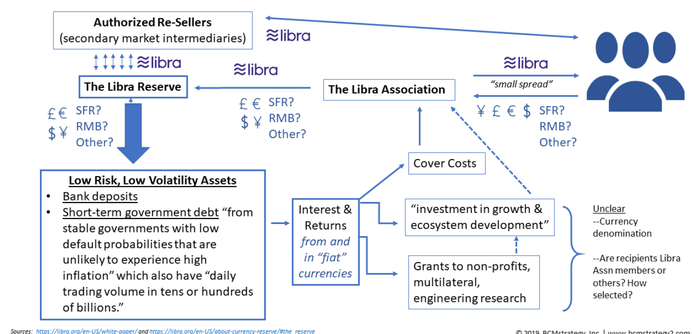
So today's essay hopes to shed some light on how the Libra Association intends to generate revenue that will finance its ambitious vision for an alternative, post-sovereign economy. The sources are simple: The Libra White Paper (of course) and the Libra Reserve paper embedded within Section 4.

The good news is that the Libra Association White Paper provides some transparency about anticipated revenues streams. But then there is the bad news.

— **Bad News 1**: The bad news is that some of the information is buried within embedded hyperlinks, which means people have to be very dedicated readers in order to find the information.

— **Bad News 2**: A fair amount of knowledge regarding the traditional financial system is needed to understand the White Paper.

— **Bad News 3**: The Libra White Paper is generally skimpy and fails to address many details. So the White Paper in many places raises far more questions than it answers.



But the further good news is that enough information exists to draw out a rough sketch of the Libra financial system. It looks something like this:

Plowing through the details makes a few things clear from the beginning.

Libra Requires Hard, Fiat Currencies To Function: Throughout the ecosystem's intermediation chains, hard, fiat currencies are the centerpiece of the system. How do people acquire Libra tokens?

Libra Revenue Streams — What We Know So Far And Our Questions

> The primary or first entry point is by delivering to the Libra Association sovereign issued currency. The Libra Association will then issue to the individuals some Libra tokens at a "small spread."

The exact quote is: "On the user side, for new Libra coins to be created, there must be an equivalent purchase of Libra for fiat and transfer of that fiat to the reserve. Hence, the reserve will grow as users' demand for Libra increases." Skip to the next section if you are curious about how the FX market will function.

Already, the questions start flying.

— Which currencies will the Libra Association accept in exchange for Libra tokens? Will the Libra Association accept gold coins as Globcoin and X8X do? Will the currencies be limited to reserve currencies represented in the IMF's Special Drawing Rights currency basket? Will the currencies accepted be broader and include countries like India, South Korea, Australia, Russia, Taiwan, Turkey, Indonesia and Mexico like Globcoin?

— What counts as a "small spread"?

— Who determines what the "small spread" should be?

— How will the exchange rate mechanism function? Will the "small spread" represents a bilateral exchange rate between the hard currency and Libra (like Terra coins)? Or will the spread be between the anticipated basket and the individual hard currency?

Sadly, the Libra documents are silent on all these crucial issues. Let's soldier on. The answers will hold significant implications for the formulation of monetary and economic policy, as discussed in this Bretton Woods Committee essay.

> The Libra Association will put the hard, reserve currencies to work in the capital markets by using the acquired cash funding to purchase bank deposits and short-term government debt.

This raises yet more questions, including:

— Will market purchases be limited to, and synchronized with, the underlying currencies collected by Libra? For example, if Libra takes in far more USD than any other currency, will it buy Treasury Bills with all those dollars or will it diversify its investments and use (or convert) USD to purchase short-term debt issued by other governments?

— How will the Libra Association determine which bank deposits it will purchase? And how long will the anticipated holding period be?

Libra Revenue Streams — What We Know So Far And Our Questions

— What kind of risk management controls will govern the basis and exchange rate risks embedded in this kind of sovereign bond portfolio?

When one invests, one hopefully earns a rate of return in excess of the risk of loss. The Libra Association has planned for this.

> Interest income and investment returns will be used for three purposes: (i) to cover the costs of the Libra Association; (ii) ecosystem improvements; and (iii) grants to scientific research and humanitarian organizations.

— Will ecosystem investments and grants be distributed in Libra or in hard, fiat currencies?

A secondary market is under construction which makes the Libra Association look quite a bit like a classic central bank.

Secondary markets are a key infrastructure component for currency markets and a fixture in the cryptocurrency sector. In the Libra project, they provide the second major point of interaction with retail customers.

The White Paper assiduously avoids using terminology that would trigger regulatory scrutiny. The secondary market does not have intermediaries, market makers, broker-dealers or investment advisors. It only has "re-sellers."

The altruism and self-funding nature of this architecture are lovely. But again the structure raises far more questions than it answers, including:

— What happens in a down market? What kind of risk mitigation and risk management systems will be in place to ensure that the ecosystem is not excessively exposed to market risk?

— How will beneficiaries be selected to receive funding? Note that the Founding Members of the Libra Association include blockchain companies, a humanitarian relief organization, and a scientific research/prize-awarding organization. Is this a closed economy or will non-members be eligible to receive funding?

The Libra Association looks like a classic central bank, with no direct legal relationship between retail users: *"Users will not directly interface with the reserve. Rather, to support higher efficiency, there will be authorized resellers who will be the only entities authorized by the association to transact large amounts of fiat and Libra in and out of the reserve."*

Libra Revenue Streams — What We Know So Far And Our Questions

> In other words, like every central bank in a market economy, there is no direct relationship (and of course no consumer protection liability) between the Libra Association and the retail users of the token.

And as noted in this Atlantic Council post, the net effect is that a distributed web of regulatory jurisdiction will attach to Libra transactions with retail customers based on the location of each individual "reseller" which we assume will be major financial institutions as well as microlenders like Kiva and Women's World Banking (which are Founding Members of Libra).

Supply Side Issues and Questions

Without a doubt, the most intriguing part of the Libra financing structure relates to the relationship between the Libra Association and its Founding Members. Initial members have apparently committed to contributing an undisclosed amount of capital (in hard, fiat currencies, of course). It seems they will receive in return some Libra for distribution into the Libra economy:

> Let's start with the obvious question……will Founding Members receive Libra at parity (a 1:1 exchange rate) for their contribution of hard, fiat currencies? Or will they also be subject to a "small spread"? The questions just multiply like rabbits after this….

— Will Founding Members deliver preferential pricing to retail customers when goods and services are denominated in Libra? If so, this could raise competition law issues at some point if the platform achieves scale.

— What kind of incentives are we talking about exactly? The term is not defined in the Libra White Paper.

— How exactly will the Libra Association "prime the pump" to facilitate distribution of its tokens? On Day 1, the Libra Association in theory at least faces the same challenge as a classic central bank during periods of depressed demand….many of the policy challenges raised at the Zero Lower Bound of interest rate/monetary policy will apply as the Libra Association and its resellers try to entice users to spend the token and boost circulation.

— When (if ever) do member incentives to use the token at the corporate level to spark demand expire?

Libra Revenue Streams — What We Know So Far And Our Questions

The real innovation in the Libra project is to conceive of a fully integrated retail market and secondary trading market in an alternative currency at the global level. This will create challenges and demands on the Libra Association which far exceed traditional business projects. It will require policymakers to execute jurisdictional jujitsu to avoid instability in the Libra economy from spilling over into what economists call the “real” economy. Far more transparency will be needed for the project to generate trust and credibility.

The Libra White Papers are a poor start. They read more like marketing materials than real White Papers. This is particularly disappointing since other crypto issuers go out of their way to issue robust, technical White Papers that sometimes mimic formatting and font choices used by the Federal Reserve for research papers (see this example).

Cynics will suggest that the Libra proposal is a canny way for Facebook to diversify its own corporate revenue stream away from advertising revenue which increasingly raises privacy and political risk issues. This is too cynical. The Libra White Paper sketches in broad strokes a bold vision for an alternative economy. If the Libra Association and its members are serious about realizing this vision, they will need to contribute far more detail about their plans and operational priorities.

An Introduction to Libra

White Paper • From the Libra Association Members

Libra's mission is to enable a simple global currency and financial infrastructure that empowers billions of people.

This document outlines our plans for a new decentralized blockchain, a low-volatility cryptocurrency, and a smart contract platform that together aim to create a new opportunity for responsible financial services innovation.

Problem Statement

The advent of the internet and mobile broadband has empowered billions of people globally to have access to the world's knowledge and information, high-fidelity communications, and a wide range of lower-cost, more convenient services. These services are now accessible using a $40 smartphone from almost anywhere in the world.[1] This connectivity has driven economic empowerment by enabling more people to access the financial ecosystem. Working together, technology companies and financial institutions have also found solutions to help increase economic empowerment around the world. Despite this progress, large swaths of the world's population are still left behind — 1.7 billion adults globally remain outside of the financial system with no access to a traditional bank, even though one billion have a mobile phone and nearly half a billion have internet access.[2]

For too many, parts of the financial system look like telecommunication networks pre-internet. Twenty years ago, the average price to send a text message in Europe was 16 cents per message.[3] Now everyone with a smartphone can communicate across the world for free with a basic data plan. Back then, telecommunications prices were high but uniform, whereas today, access to financial services is limited or restricted for those who need it most — those impacted by cost, reliability, and the ability to seamlessly send money.

All over the world, people with less money pay more for financial services. Hard-earned income is eroded by fees, from remittances and wire costs to overdraft and ATM charges. Payday loans can charge annualized interest rates of 400 percent or more, and finance charges can be as high as $30 just to borrow $100.[4] When people are asked why they remain on the fringe of the existing financial system, those who remain "unbanked" point to not having sufficient funds, high and unpredictable fees, banks being too far away, and lacking the necessary documentation.[5]

Vision Association Developers Partners

The Reserve

The Reserve

Christian Catalini, Oliver Gratry, J. Mark Hou, Sunita Parasuraman, Nils Wernerfelt*

This document contains several parts: (1) What is the purpose of the reserve? (2) How is it getting set up? (3) How do entities interact with it? And (4) How will it change over time?

1 What Is the Purpose of the Reserve?

Many cryptocurrencies today (e.g., Bitcoin and Ether) have no underlying assets to back them. As a result, speculation and investment have been primary use cases, as with a potential for substantial appreciation many people have acquired these coins hoping to sell them at a higher price later. As beliefs over the longterm value of these currencies and success of their networks fluctuate, so too have their prices, yielding at times massive swings in value.

Stablecoin Dramas -- The Empire Strikes Back

The week before Facebook CEO Mark Zuckerberg testifies to the House Financial Services Committee, cryptocurrency enthusiasts and stablecoin issuers must be disappointed, but they should not be surprised. All year, policymakers have consistently been expressing interest in extending the regulatory perimeter to cover "Big Tech," blockchain, and stablecoin issuers. We wrote about it HERE and HERE and HERE and HERE.

The velocity of policy activity increased directly in response to the Libra Association's proposals in mid-summer. So when today's Financial Stability Board (FSB) report to the G20 was issued today, few should have been surprised. The press release delivered a likely deliberately clear statement designed to make the cryptocurrency and stabecoin sectors sit up and take notice:

> "Stablecoin projects of potentially global reach and magnitude must meet the highest regulatory standards and be subject to prudential supervision and oversight."

This statement is NOT just aimed at the Libra Association. JPMorgan's stable coin is also in the crosshairs, as discussed HERE in March.

> The FSB report makes clear that policymakers are methodically creating a roadmap for increased regulation with pre-set inflection points.

Anyone implementing our How To Trade The News framework probably is already setting in place trading strategies in relation to these inflection points.

But before we get to the future, let's look at the policy activity in the last few days.

> The developments provide another helpful case study in why and how measuring policy momentum can generate superior insights.

Activity in the last few days

It has been a busy few days in the stablecoin universe, with multiple entities releasing information in the "graveyard" time slots of Friday afternoon and Sunday afternoon. Fortunately for those that follow Rule 5 (Be Relentless) and use our patented technology, the updates and inflection points have been easy to spot.

Stablecoin Dramas -- The Empire Strikes Back

1. **Friday Afternoon**: Visa, Ebay, Stripe, and MasterCard all announced that they are withdrawing from the Libra Association. Leaks to the Wall Street Journal earlier this month suggested this move was possible.

2. **Sunday Afternoon**: The FSB releases its report to the G20 indicating not only that stablecoin issuers will be subject to significant regulatory scrutiny but that a specific timeline will govern the rule-making process well into 2020.

Now consider the **Wednesday** news item that Facebook CEO Mark Zuckerberg has agreed to testify before the House Financial Services Committee.

The news cycle thus encompasses Wednesday afternoon to Sunday afternoon. The net impact is clear: an inflection point is approaching rapidly regarding stablecoin regulation.

Of course, "rapid" in regulator terms means months. The cycle will extend well into 2020.

What It Means (Business)

Our blog readers from the summer of 2019 will remember THIS POST analyzing the potentially significant economic reach of the Libra Association proposal. The proposal was remakable in ambition, incorporating every major global consumer payments company alongside major retailers of consumer goods and services.

The defection of PayPal, MasterCard, Visa, Ebay, and Stripe diminish significantly the immediate economic reach of the Libra Proposal. The new Libra Economy now looks like this:

> *There is no clear global provider of payment services for transactions denominated in Libra at this stage. PayU and Mercado Pago are niche players.*

Now compare the sectoral distribution of companies from the original proposal (on the left) and the current configuration (on the right:

The proportion of Venture Capital and Retail have increased significantly with the departure of one retailer and three payments companies. If the data were weighted by economic size, the shifts would be far more dramatic. With all due respect to UPay and Mercado Pago, the reality is that they do not have the same scale and ubiquitous reach of PayPal, MasterCard and Visa.

A more subtle business impact arises from the elimination of global payment companies. The Libra Association originally sought to operate as a global board of directors, effectively offloading to the major payment systems companies the responsibility for regulatory compliance. This is not longer possible.

> The Swiss regulatory decision last month to require the Libra Association to apply for a payment system license effectively requires the Libra Association to take direct responsibility for the daily activities of the payment system. The defection of existing payments providers implies that the potentially revolutionary Distributed Age business model is giving way to more traditional structures.

This is not all bad news for the Libra Association.

The defection of globally significant payment systems companies means that the stablecoin overnight has ceased to become systemically significant. With apologies to Uber, Lyft, and AirBnB, the reality is that consumer now can only pay for an economically small set of services and no goods using the Libra stablecoin. Mr. Zucerkberg can now truthfully testify to Confress that the Libra Assciation and the stablecoin project are not at risk of replacing the global reserve currency.

Before regulatory enthusiasts break out the champagne, it is important to note a few potential side-effects from the “real economy” defection from this stablecoin project. If the Libra Association successfully floats a new global currency that achieves scale in the altruistic economy sectors and in the alternative transportation/tourism sectors, the real possibility exists that a parallel economy will gain traction globally.

The policy issues from here become extremely difficult:

1. Will these transactions be subject to taxation?
2. How should policymakers evaluate the competitive landscape for antitrust purposes if the parallel economy grows significantly?
3. How will routine anti-money laundering and counter-terrorism finance regulatory reporting frameworks operate in this parallel economy?

Market evolution will not follow a linear path. As the events in September and this weekend illustrate, a profound reaction function exists between market structure and regulatory policy at the innovation frontier. Get out the popcorn. Both markets and regulators are literally going to make up the rules as they move forward.

What it Means (Regulatory Policy)

Global policymakers have been actively engaged in expanding the regulatory perimeter all year, as noted above. When Swiss regulators last month made clear that the Libra Association would be required to apply for a payment system license and potentially could be subject to a broad range of additional regulatory requirements not just in Switzerland but also internationally, we noticed and alerted our customers and blog readers HERE.

The following week saw policymakers meeting with stablecoin issuers in Basel and the month closed with a major policy conference hosted in Paris by the Organization for Economic Cooperation and Development (OECD). We told our subscribers in the C | P | C Report and the FinTech RegTrends Report that the writing on the wall was clear: policymakers were pivoting actively towards expanding the regulatory perimeter.

This is a slow moving train. Long periods of inactivity will be punctuated by significant statements. Stay tuned. Our patented technology is focused like a laser on the language and movement of these policy areas. Our customers and subscribers will be ready for each twist in the trajectory.

The Empire Strikes Back Redux -- Stablecoin Policy On The Move

On Sunday, when the Financial Stability Board (FSB) released its annual report to the Group of Twenty (G20) finance ministers and central bank governors, they devoted nearly a full page to stablecoin regulation policy. We noticed and published THIS POST analyzing the report.

The week so far has been full of important policy statements on this topic from key policymakers. Mostly notably, last night the Federal Reserve finally broke its months-long silence on stablecoins, cryptocurrency, and CDBCs (central bank digital currencies).

For today's blog, let's focus on what policymakers have said in the 72 hours from Sunday night to Wednesday night. Remember in the process that private issuers of value tokens pre-date central banks and that the ability to manage a currency (reserve, basket, or board) is far from easy as the infographic below indicates.

The policy trajectory is clear: the policy crosshairs point first to stablecoins whose value is most closely linked to global reserve currencies. Our Early Adopter customers have an informational advantage, as they watch the policy trajectory unfoled in real time. C | P | C Report and FinTech RegTrends Report subscribers will receive the full analysis of course.

Financial Stability Board: "Stablecoin projects of potentially global reach and magnitude must meet the highest regulatory standards and be subject to prudential supervision and oversight. Possible regulatory gaps should be assessed and addressed as a matter of priority."

Banque de France: "it is clear that crypto-assets undergoing technical and economic trials bring about opportunities to improve our payment systems, they can also bring material risks to our payment systems which, if unaddressed, might introduce new sources of fragmentation, instability and fraud. In that context, beyond contributing to the adaptation of the regulatory framework to address those risks, central banks may contribute further in revisiting and possibly improving the conditions under which they make available central bank money for settlement purposes."

European Central Bank: "The list of issues raised by all stablecoin projects is already quite long, as you know from our July report. They relate to legal certainty to put it simply, on what or whom is the stablecoin a claim and also to the governance and the architecture of each project. Other aspects have to do with compliance with money laundering and anti-terrorism financing rules and the question of whether a stablecoin payment system is safe and efficient enough. We can use existing international standards as a reference in this regard. Then there are issues related to operational resilience and cybersecurity, market integrity and investor protection, and data protection, particularly segregation between payment data and data being produced in a social network. And you have issues with tax compliance. Whenever these projects are based on existing global networks, theres a chance that they may reach a critical size very quickly, which raises additional potential issues relating to financial stability, monetary policy and the functioning of the international monetary system."

Federal Reserve: "Libra, and indeed any stablecoin project with global scale and scope, must address a core set of legal and regulatory challenges before it can facilitate a first payment...First, compliance with know-your-customer rules and regulations are essential to ensure stablecoins are not used for illegal activities and illicit finance...Second, issuers of stablecoins designed to facilitate consumer payments must clearly demonstrate how consumer protections would be assured. ..Third, it will be necessary to define the financial activities that the various players in the Libra ecosystem are conducting in order for jurisdictions to assess whether existing regulatory and enforcement mechanisms are adequate...Finally, there are likely to be financial stability risks for a stablecoin network with global reach. If not managed effectively, liquidity, credit, market, or operational risks—alone or in combination—could trigger a loss of confidence and a classic run."

Compliance Cold Feet? The Evolving Payments and Blockchain Landscape

This week, three major regulated financial firms (PayPal, MasterCard, Visa) all reportedly are getting cold feet about their participation in the Libra Association project. Can anyone really be suprised after last month's policy moves? Consider:

--As noted in this analysis on Medium over the summer, the revenue streams for the Libra Association raise significant monetary and economic policy issues that go well past the financial regulation and cryptocurrency issues raised more frequently by commentators.

--During September, three stablecoin issuers met with central bank officials under the umbrella of both the Group of Seven and the Bank for International Settlements. The agenda for that meeting (released publicy by the BIS after the fact) made clear that the public policy interest in the Libra Association project goes well past traditional financial regulation to include many of the issues rasied in the Medium post above.

--Also during September, Switzerland made clear that the Libra Association will be required to apply for a payment system license and be subject to regulatory oversight. In addition, activities beyond payment system services (e.g., intermediation services like lending as noted in teh Medium post above) could easily attract other regulatory requirements, like the the Basel 3 rules. Policymakers are just getting warmed up, since Swiss authorities also flagged additional issues beyond their authority that will also require attention, not the least of which are tax and AML issues.

--Finally, half a dozen central bank governors participated in a multi-day conference on blockchain policy issues at the OECD at the end of September.

The three payment systems providers reportedly getting cold feet may have realized that signfiicant competition issues could arise from their participation in this project, as suggested in this analysis from the summer. Or perhaps the full weight of potential regulatory compliance obligations have only just now become clear to the three companies.

Would the loss of three major payment systems/credit card operators be fatal to the Libra Association? Not necessarily. It is true that to function the Libra Econnomy requires a payment system. The Libra Association as proposed would have difficulty serving that function since the Association has been structured as an board of directors/policy entity rather than an operational company.

Replacing the functions provided by the three payment systems companies in the Libra Economy would require that the Libra Association (or Facebook, or both) to consent to regulatory oversight not only in Switzerland but in every jurisdiction where payment services are offered.How the Libra Association responds if one more payment providers leave its ecosystem will likely hold significant implications for the shape of the regulatory perimeter regarding both blockchain and stablecoin innovators.

This is really becoming interesting.

Conclusion

During 2019, policymakers began defining a regulatory framework regarding FinTech, cryptocurrency, central bank digital currencies, and the broad range of big tech engagement in the business of intermediation. Key elements include: systemic risk/macroprudential, consumer protection, data privacy, and disclosure policy priorities.

Our time series data will help identify additional pivots and inflection points as they emerge. Since our baseline data set is 2019, we will also be able to provide insight into how policy activity is shifting in the aggregate. Stay tuned!

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