

Financial Services Regulation & Technology Webinar

Libra – New Dimensions for Money?

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Note: This is an extended version of the slide deck presented during the September 25, 2019 webinar. Please be aware that it differs from the presentation slide show.

Welcome and Introduction: Thomas P. Vartanian, Executive Director, Program on Financial Regulation & Technology



- Professor, Antonin Scalia Law School
- Formerly, Chair, Financial Institutions Practices, Dechert LLP and Fried, Frank, Harris, Shriver & Jacobson
- Formerly, General Counsel, Federal Home Loan Bank Board and General Counsel, Federal Savings and Loan Insurance Corporation
- Formerly, Chair, American Bar Association Cyberspace Law Committee

The Basics

- Who Needs Libra and Why?
- Stabilizing the Value of Libra
- Dealing with the Confidence Issue
- What Happens in a Crisis When No Government Comes to the Rescue?

Money, Security, Commodity, Deposit

- Securities analysis
- Broker-dealer considerations
- Mutual fund, ETF
- Commodities
- Bank deposits
- Money services businesses
- Monetary policy considerations

Precedents

- Late 1990s – Mondex, Digicash
- Bitcoin and other second generation virtual currencies
- FinCen, FDIC, State Authorities

Open Questions

- Will Success Kill Libra?
 - How to hold sufficient liquid collateral?
- Will Libra Refocus Regulation on Functions Performed?
- Does Libra Encourage Congress to Take Up the Issues?

Libra Association Points Regarding Product Structure and Operation

Libra Structure

- Libra Association - Governing body that manages Libra Reserve (Libra currency)
- Facebook will maintain a leadership role through 2019.
- Eventually, as other parties join, Facebook will have only 1 vote and will not be in a position to control the Association.

Libra Structure (cont.)

Calabria – Facebook subsidiary will provide a digital wallet for Libra that will allow a user to send Libra to almost anyone with a smart phone at low- to no-cost.

Libra Design (cont.)

- Intended to be a currency that can be used around the world
- Intended to be viewed as cash rather than an investment

Libra Design (cont.)

- Unlike current stablecoins that are pegged to a single asset, Libra will not have a fixed value in any single paper currency.
- Libra will be backed on a one-to-one basis by a basket of currencies in assets such as bank deposits and short-term government securities held by Libra Reserve.
- Currencies will include U.S. Dollar, British Pound, the Euro, and the Japanese Yen.

Libra Design (cont.)

- Assets in the Reserve will be held by a geographically distributed group of custodians.
- Libra expects that, as a result of the backing provided by the Reserve, Libra users should have a high degree of confidence that they will be able to sell Libra for local fiat currency based on an exchange rate.

Libra Design (cont.)

- The Reserve will be funded by purchases of Libra by users and investments by investors.
- Libra users will not receive a return from the Reserve. Earnings on the assets held in reserve will first go to cover operating expenses, then to a range of grants and projects, and finally to pay dividends to early investors.

Libra Design (cont.)

- Libra is intended to mitigate fluctuations in value and to focus on liquidity and capital preservation.
- Libra's value will be effectively linked to a basket of fiat currencies. From the perspective of any particular currency, there will be fluctuations in value.

Libra Design (cont.)

- Libra users will not directly interact with the Reserve. Instead, only authorized resellers will be permitted to transact large amounts of fiat currency and Libra in and out of the Reserve.
- Reseller will integrate with exchanges and other entities that buy and sell cryptocurrency to users and will provide entities with liquidity for users who wish to convert from cash to Libra and back again.
- Libra says its operation will not introduce inflation because, in order for new Libra to be minted, there must be a commensurate payment of fiat currency by a reseller into the Reserve. As demand contracts, coins will be destroyed.

Sarah Jane Hughes, University Scholar and Fellow in Commercial Law, Indiana University Maurer School of Law



- Reporter, Uniform Regulation of Virtual Currency Business Act, Uniform Law Commission (2015-present)
- Reporter, Standing Committee on Payments Systems, Permanent Editorial Board for the Uniform Commercial Code (2003-present)
- Member, Consultative Group, ALI Project on Technology and the Uniform Commercial Code (2019-until completion)
- American Bar Association Advisor to the Money Services Act Drafting Committee (2000 to completion)



What Facebook's Libra Faces -- Governments' Objections or Competition

by Sarah Jane Hughes

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Prepared for the Webinar "Libra—New Dimensions for Money?"

Sponsored by George Mason University

September 25, 2019

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Reactions from France and Germany

“Absolument non” – Bruno le Maire, Minister of Economy and Finance, September 13, 2019 – adding, “Our monetary sovereignty is at stake.”

“We cannot accept a parallel currency,” Olaf Scholz, Vice Chancellor and Finance Minister, September 17, 2019 – adding, “We have to reject that clearly.”

“No private entity can claim monetary power, which is inherent to the sovereignty of nations.” Joint Statement by German and French Finance Ministers at the Helsinki meeting of all Eurozone finance ministers, during the week of September 9, 2019.

Should Facebook Have Been Surprised by Governments' Reactions? NO!

Why? Because for Anglo-American law, *The Case of Mixed Money in Ireland*, Trin. 2 James I (1605) [Davies's Reports] announced what has become the guiding principle: that the three key elements of money are “the prince, the stamp, and the value.”

Queen Elizabeth I had declared coin minted with lower metal value to be lawful tender for the payment of taxes and debts – even if her declaration worked the deterioration of the metal value that counter-parties may have expected as they concluded contracts for sale of goods or services.

But the court upheld the sovereign prerogative to declare what is legal tender, identify it with a “stamp,” and decide its value vis-à-vis alternatives.

Other Sovereign Efforts to Control “Money”

- Since “wampum” was used as “money” in the early Colonial period, government forces – both the Crown’s representatives and our federal government – have taken decisive steps to curb uses of parallel, non-“legal tender,” currencies.
- One of the most fascinating issues involves the federal prosecution of S&H Green Stamps in the early 20th Century.
- In the late 1990’s, our hosts, Tom Vartanian and Bob Ledig, predicted some skirmishes between the federal government and issuers of early virtual currencies in their article on the still-in-force federal Stamps Payments Act of 1862.

How does this translate into likely governmental responses to Libra?

- China has been reported to be moving faster to get its own government-sponsored, gold-backed cryptocurrency to market.
- The European Central Bank (ECB) may revive its work on faster, real-time payments and may create a government-sponsored cryptocurrency.
- Switzerland, the home turf of Libra, talks about how Libra can be regulated under its laws and EU laws.
- 26 national regulators apparently met with Libra's representatives in Basel on Monday, September 17, 2019. These included the Bank of England and the Board of Governors of the Federal Reserve.

Will FINMA's Approval Help (Enough)?

Finma apparently has told Libra that:

(a) Libra will fall under Finma's "financial market infrastructure regulation," and that Finma will require a payment system license under its Financial Market Infrastructure Act (FMIA).

(b) Libra, as a payments system, will need to comply with Swiss requirements for cyber-risk management and the AML Act.

(c) Swiss law might impose additional requirements on Libra because it appears to go beyond a traditional "payments system."

(d) Returns and risks associated with the Libra reserve should not be borne by holders of the Libra stablecoin – which is a really interesting facet of being regulated as a payment system under Swiss law.

(e) Other aspects of Swiss law, and plausibly of other national laws, may apply – securities trading, banking, fund management, and other financial infrastructure regulations.

What Other Regulatory Issues May Arise?

- Antitrust issues are among the commonly mentioned issues – will Facebook operate Libra in a cartel-like environment?
- Privacy issues abound – as members of the United States Congress mentioned in the July hearings held by the Senate Banking and House Financial Services Committees.
- What consumer/holder rights will apply? Will traditional stored-value systems rules apply or will Libra set forth or be subject to specific consumer/ holder rights?
- Will the lack of a global lender of last resort or “deposit” guarantee system for Libra matter? How will the limited liability of the Swiss-based Libra Association matter?

And, to return to age-old questions . . .

Should regulators treat Libra as “e-money”? Probably not – there appears to be an ability for holders to make claims for redemption of value against the Libra Association.

Should regulators treat Libra as a “financial instrument” that holders can trade on recognized or OTC markets? Possibly – but this would make Libra a “security” or a “financial instrument commodity.”

Age-old questions (continued)

Is Libra a “virtual currency”? If so, then the EU’s Anti-Money Laundering Directive, FATF’s 2019 Guidance, and U.S. AML and OFAC laws and regulations apply.

Libra would need to register as a money services business with FinCEN and obtain money services business or money transmitter licenses from most states (key word here is “most”).

Sarah Jane Hughes sjhughes@Indiana.edu

SSRN author = 408848 (easy access to most works on virtual currency subjects).

Reporter for the Uniform Law Commission's Uniform Regulation of Virtual-Currency Businesses Act (ULC, 2017).

Reporter for the Uniform Law Commission's Supplemental Commercial Law for the Uniform Regulation of Virtual-Currency Businesses Act (ULC, 2018).

Member, Consultative Group, on the ALI's Project on Technology and the Uniform Commercial Code, 2019 until completion; Observer, Uniform Law Commission's participation in the same project.

Author of numerous scholarly articles on virtual-currencies since BTC's birth.



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Angela Angelovska-Wilson, Co-Founder and Principal, DLx Law



- Co-founder, Sila Inc.
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- Formerly, Chief Legal & Compliance Officer, Digital Asset
- Formerly, Partner, Reed Smith

Libra: Throwing the Monetary System Off Balance???

Angela Angelovska-Wilson, DLx Law



Walking down memory lane – The Rise and Sudden End of Facebook Credits

Facebook Credits – the initial attempt

- Virtual currency development has been steadily increasing over the last 10+ years.
- Examples of the early Internet platform efforts to develop virtual currency include Facebook Credits, Microsoft Points and Amazon Coins.
- In general, virtual currencies have the characteristics of money, offering a unit of account, a medium of exchange and a store of value.
- There is no physical counterpart and very importantly virtual currencies are most often not a claim on real assets.

Facebook Credits – the initial attempt

- Facebook Credits , Facebook’s virtual currency was introduced in 2009 to allow users to buy virtual goods in any application on the Facebook platform.
- Facebook partnered with PayPal, accepted credit card and a variety of other payment methods. Facebook Credits were also available for purchase at major retailers as gift cards.
- A purchase made using any other currency than US dollars would undergo a conversion into US dollars using a daily exchange rate, before being exchanged for Facebook Credits at the rate of FB 1 = USD 0.10.



Facebook Credits – the initial attempt

- Facebook users were able to gain additional Facebook Credits through special promotions, for instance if they made online purchases.
- Facebook Credits were available in 15 currencies including U.S. dollars. The terms on the website did not provide for a conversion back to the available currencies
- In March 2011, Facebook created an official subsidiary to handle payments: Facebook Payments Inc.
- Facebook Payments Inc. is still active and a licensed money transmitter in all US states as well as the Virgin Islands and Puerto Rico. See https://www.facebook.com/payments_terms/licenses
- Surprisingly, in June 2012 Facebook announced that it would “update the payments product,” and that it would convert all prices and balances that were quoted in Facebook Credits into local currency amounts starting in July 2012

Stablecoin Initiatives

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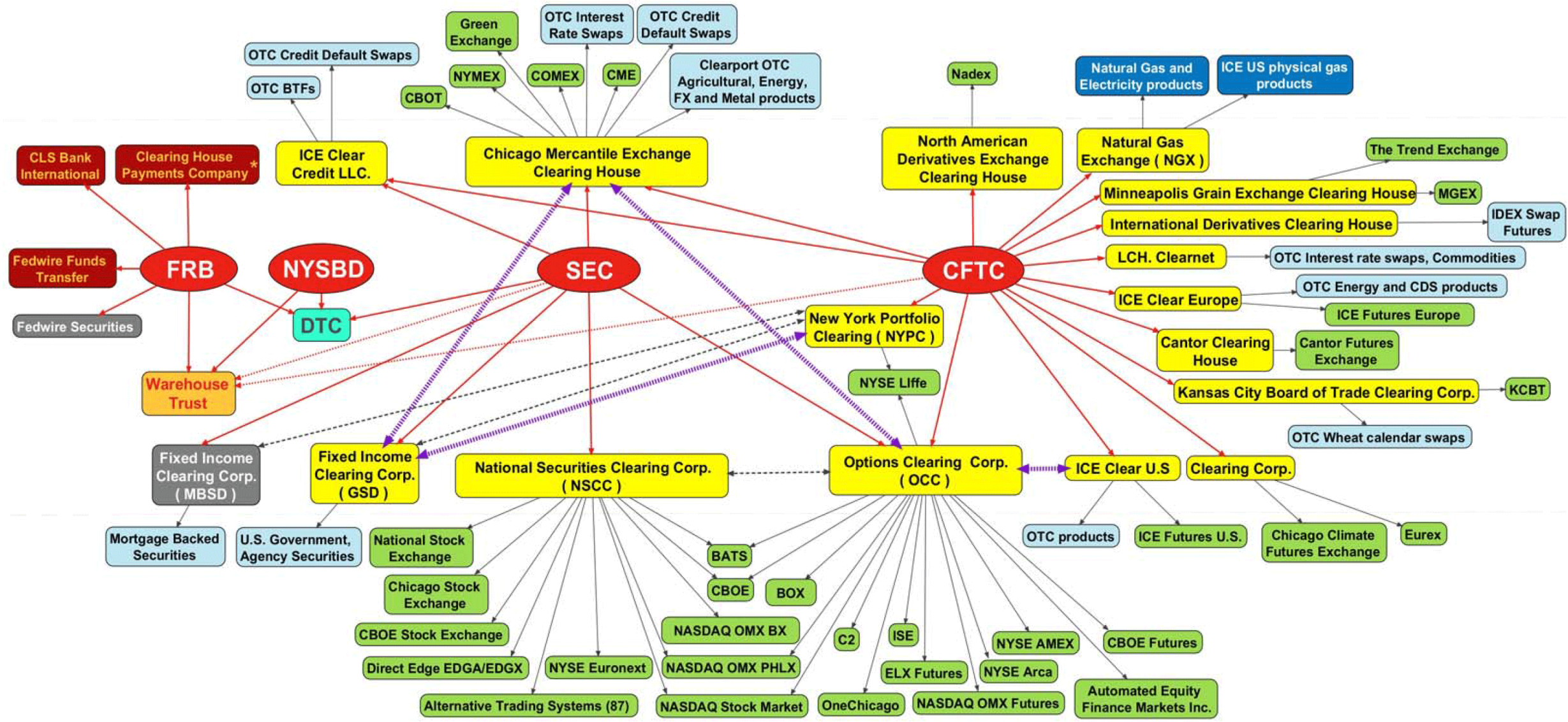
- A stablecoin is a class of digital asset that is designed to hold constant value relative to another asset. This other asset could be a commodity like an ounce of gold; a US Treasury-minted dollar (USD) or other currency; or another stablecoin.
- Created primarily to solve the volatility issue that is perceived as one of the biggest obstacles for the adoption of cryptocurrencies for everyday payment purposes.
- Types of Stablecoins – asset backed off-chain, asset backed on-chain, and algorithmic
- There are currently 66 Active Stablecoins, 134 in development and 26 that have closed. See : <https://www.blockdata.tech/stablecoin-report/>

Key Considerations

Key Regulatory Issue – Multiple, Non- Uniform Regulatory Regimes

- Libra will face a range of regulatory challenges based on the classification of its activities, the products and services that it will ultimately offer in each jurisdiction and the licenses they hold and plan to obtain.
- Payments-related activities are subject to regulation under US federal and state laws and regulations and various national regimes.
- Payments-related activities are also subject to compliance requirements imposed by various industry associations and participants such as: (i) the payment card associations (Visa, MasterCard, Discover, American Express); and (ii) industry groups (e.g. NACHA and the Payment Card Industry Data Security Standard).
- Particular types of payments are subject to specific laws (e.g. the Electronic Funds Transfer Act and CFPB Regulation E).

U.S. Regulatory Authority over Payment, Clearing and Settlement Systems



Regulatory Agency
 Central Counterparties (CCP)
 Securities Settlement Systems (SSS)
 Central Securities Depository (CSD)
 Payment Systems
 Trade Repository
 Exchanges or other trading venues
 Selected OTC Products
 Selected Listed Products

→ Regulatory Authority
 → Clearing Agreement
 ↔ Cross Margining Arrangement

- - - - - Information Sharing
 ····· Proposed Supervision
 * Supervised by other agencies (not shown)

Current* as of April 09, 2012
 Source: Federal Reserve Bank of Chicago Financial Markets Group
 * Derived from publicly available information

U.S. Financial Regulatory Landscape

Federal Regulators

- Board of Governors of the Federal Reserve System (Federal Reserve)
- Office of the Comptroller of the Currency (OCC)
- Federal Deposit Insurance Corporation (FDIC)
- Consumer Financial Protection Bureau (CFPB)
- US Securities and Exchange Commission (SEC)
- Commodity Futures Trading Commission (CFTC)
- Financial Crimes Enforcement Network (FinCEN) and Office of Foreign Asset Control (OFAC)

State Regulators

- State Banking Departments
 - Money Transmitter Regulations
 - Consumer Protection Regulations
- State Insurance Departments

Key Considerations for Success of Libra

For Libra to be successful it will need to assure that it is able to overcome challenges across a broad range of domains:

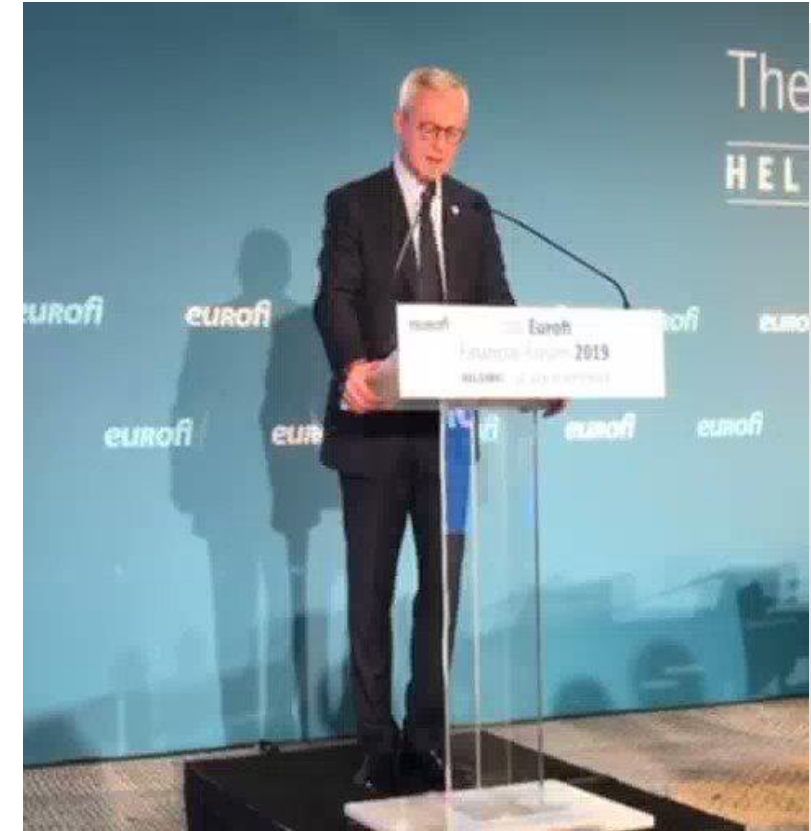
- Regulatory approvals and licenses
- Operational and technical robustness
- Safety and soundness as payment systems
- Customer protection
- Risks to financial stability and monetary sovereignty
- Data protection
- Compliance with anti-money laundering and terrorism financing rules
- Rate and ease of adoption

Key Considerations for Success of Libra

Bruno Le Maire
@BrunoLeMaire

In the current conditions, we should refuse the development of **#Libra** in Europe while working on improving the efficiency of our common payment system. We should also work on the creation of a digital public currency **#Eurofi2019**

Libra must win the competition from Central Bank Digital Currencies (CBDC). *For more information on CBDC see <https://www.bis.org/cpmi/publ/d174.pdf>*



Key Success Factors for Libra

- **It may be the right time** - global commerce and payments have historically centered around the needs of commercial enterprises, not individual consumers. Globalization and internet commerce have shifted the focus and opportunity for dominance of a currency from the needs of commercial enterprises (mainly efficient and stable means of payment) to consumers and their demand for payment services that work across borders and that are also faster, cheaper and easier to use than what the current financial system offers. JPM and Wells Fargo seem to agree with their bank coin efforts.
- **The network effect** – since the adoption of a new currency and payment system is focused on individual consumers, and Facebook has a large portion of the world population on its platform, the Libra initiative as well as other virtual currency initiatives will spread and be adopted much more quickly.
- **Other Considerations** - Stability is a must but seamless integration into digital lives coupled with speed and low cost will take the center stage.
- **Programmable Money** is the future and the current payment networks can not accommodate the needs of the 21st century. Ability to integrate and seamlessly transfer value is hindering innovation.

Change is Inevitable

Regardless of the ultimate fate of Libra, there is no doubt that Libra and other similar current and future virtual currency initiatives will force significant change on the global monetary and financial system – either directly or by pushing global central banks to innovate and meet the demand for a global seamless currency.



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Angela Angelovska-Wilson, co-founded DLx Law with Lewis R. Cohen. Angela is an early distributed ledger technology adopter and a leading authority in the evolving global legal and regulatory landscape surrounding distributed ledger technology and smart contracts. Angela and the DLx team provide strategic legal advice with an emphasis on emerging regulatory and public policy affecting distributed ledger technology, financial regulation, intellectual property, and information technology.

In addition, to DLx Law Angela is also co-founder of Sila Inc., (www.silamoney.com), an innovative technology company.

Prior to co-founding DLx Law and Sila Inc., Angela served as the Chief Legal & Compliance Officer of Digital Asset and was part of the founding team. Angela was a partner at Reed Smith where she regularly advised clients on the implementation of new technologies to finance and the complex regulatory schemes involved in the development, creation, marketing, sale and servicing of various financial services and products. Before Reed Smith, Angela spent most of her career in various roles at Fried, Frank and Latham & Watkins, where she was recognized by the The Legal 500 US among the top finance attorneys in the U.S.

Angela has a deep understanding of the Fin-Tech industry and in particular the distributed ledger industry, having been involved in a number of startups in various roles, as an employee, entrepreneur and advisor.

Brian Brooks, Chief Legal & Risk Officer, Coinbase



- Formerly, General Counsel and Executive Vice-President, Fannie Mae
- Founding Advisor, Spring Labs
- Member, Board of Directors, Avant LLC
- Member, Board of Directors, Fannie Mae
- Formerly, Managing Partner, O'Melveny & Myers

**Brian Brooks, Chief Legal & Risk Officer,
Coinbase**



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