Thursday, 16 July, 2020

The Digital Regulator

The inexorable march of Central Bank Digital Currencies

Abstract

A growing number of Central banks around the globe are analysing, testing, and prototyping CBDCs. These initiatives are strongly backed by the Bank for International Settlements or the BIS (bank of the central banks). In this context, wholesale CBDCs emerge as low hanging fruit compared to retail CBDCs. The design and implementation of retail CBDCs (as compared to wholesale CBCDs) faces several additional challenges that need to be addressed before practical application is possible. The steadily growing CBDC initiatives from Central Banks globally, suggest that the official launch of the first wholesale CBDC may be near. It could be as soon as a matter of months, before the first official CBDC sees light. The concrete adoption of blockchain-based digital currencies by the official sector is expected to boost public trust in such technology and related monetary innovations.

Several other noticeable developments have characterised the digital regulatory space in recent weeks, such as the review by the FATF of the status of compliance to the "travel rules" by virtual asset providers (enacted 12 months ago), and the unanimous approval of the landmark Blockchain Act by the Swiss Parliament.

Central Bank Digital Currencies (CBDCs) are about to become reality

Over the last nine months, Central Banks (CBs) have become more outspoken about their interest regarding CBDCs and their CBDC plans and initiatives. The number of CBs working on CBDC projects has been growing steadily since then. This momentum has been endorsed and backed by the BIS. The official implementation of the first wholesale CBDC is near.

✓ *The BIS endorsement* – The BIS annual report 2019, released on 30 June 2020 contains[link1] extensive focus on CBDCs. The BIS favours innovation by Central Banks aimed at simplifying the provision of payment services, decreasing their prices, and improving their quality. The BIS recognises that such innovative attitude would foster competition within the private sector and enhance safety and risk management standards. The BIS distinguishes between wholesale and retail CBDCs. As compared to current systems, wholesale Distributed Ledger Technology (DLT)-based central bank digital currency, has the potential to increase the efficiency of the financial sector in accessing central bank money. Wholesale CBDCs simplify post-trade clearing and settlement, enhance speed of execution, and may improve risk management in the area of fraud and cyber-attacks. Retail CBDCs are different and depending on design, their introduction may have far-reaching implications. Retail CBDCs would be comparatively safer and more reliable than current cash but could lead to a larger central bank footprint in the financial system. Further, they could accelerate bank runs in times of stress. Retail CBDCs could yield interest and influence monetary policy transmission. Retail CBDCs would have to at least match current cash on various parameters, such as user-friendliness and resiliency to outages and cyber-attacks. Retail CBDCs would need to safeguard the user's privacy while improving traceability and facilitating anti-money laundering compliance. Their introduction could be phased, and it could co-exist with current cash, possibly over the longer term. On balance, wholesale CBDCs emerge as low-hanging fruits compared to retail CBDCs. Their introduction, in practice, is simpler.

- ✓ *Most recent initiatives* – The number of CBs working on CBDC projects are growing steadily. During the last few weeks:
  - ✓ The Bank of Canada announced[link1] plans to pilot a retail CBDC. They anticipate that the CBDC could be available to all citizens and grant privacy while ensuring compliance with anti-money laundering regulations.
  - ✓ The Bank of Thailand announced[link1] plans to develop a CBDC prototype and test real-life use cases with large-scale enterprises. Their aim is to increase the efficiency of fund transfers and payment settlement between suppliers.
  - ✓ The Bank of Korea followed the launch of a CBDC pilot program in April 2020 with the announcement[link1] of a legal advisory panel focused on identifying and

  - overcoming regulatory hurdles associated with CBDCs. This work should pave the way for CBDC roadmap.

  - The Bank of Ghana reiterated[link1] its commitment to pilot a CBDC. The plan was first announced in late 2019.

- *A long but solid gestation* – Over the last nine months, CBs have become more outspoken about CBDCs. During the fourth quarter of 2019, we recall the announcement of the creation of a BIS Innovation Hub Centre in Switzerland[link1] and the recognition by the BIS that the digitalization[link1] of means of payment is unavoidable. Earlier this year, the BIS released a survey[link1] showing the extensive work being carried out by CBs on CBDCs. The BIS also brought together the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Sveriges Riksbank and the Swiss National Bank to form an official group[link1] for the purpose of sharing CBDC experiences. In Europe, the European Central Bank[link1] committed to pursue the issuance of a CBDC during 2020. In Asia, the People's Bank of China[link1] reiterated the continuation of its CBDC work in 2020. In the Americas, the US Federal Reserve[link1] confirmed its research and experimentation activities related to DLTs and their potential use in connection with CBDCs.

In January 2020, Christian Noyer, former governor of the Banque de France, went on record, forecasting that wholesale CBDCs would soon become a reality; time will most probably prove him right. There is considerable interest and traction amongst a growing number of CBs around issuing CBDCs, and wholesale CBDCs emerge as low hanging fruits compared to retail CBDCs. This is because retail CBDCs require more analysis and care of design, due to their potential ability to interact with monetary policies. CBDC initiatives are strongly backed by the BIS and fundamentally supported by the need to upgrade the quality and cost of the provision of payment services globally.

Other noteworthy developments

The*FATF assessed*[link1] *compliance to requirements on virtual assets and virtual asset service providers (VASPs) after a period of 12 months from their issuance, and revealed progress.*

- ✓ One year ago, the FATF extended the anti-money laundering standards applicable to traditional banking transactions, to digital and crypto transactions. It has reviewed, in June 2020, the state of adoption and implementation of such standards. The review established that both the public and private sectors have made progress in implementing the revised standards. The FATF welcomed the development of technological solutions to enable VASPs[1] to comply with the "travel rule[link1]". The FATF highlighted the need for further guidance on virtual assets and VASPs to help implementation and compliance. The FATF will perform a second 12-month review by June 2021.

Swiss House of Representatives unanimously passed the proposed Blockchain Act.

- ✓ The unanimous approval by the House of Representatives is surprising and displays high degree of consistency at all levels in the country in support of the Cryptonation. The Senate will give its view in the autumn, clearing the way for the law to enter into force early next year. Switzerland will become one of the first in the world to provide clear rules to blockchain technology and its applications, and to provide official legal status to cryptoassets. The law allows for legal ownership, clarifies the consequences of this when it comes to bankruptcies, and introduces a new regulatory category of DLT stock exchange to trade tokenized digital securities.

The taxation of cyptoassets may well be the next hot topic.

- ✓ On 4 June 2020 Japan's finance minister T. Aso, opposed[link1] the proposal to reduce the tax rate on bitcoin income from 55% to 20%, setting it at par with stock dividends.

- On 5 June 2020 the authorities of Kyrgyzstan proposed[link1] to introduce a 15% flat tax rate on cryptoasset sales by miners.

Back in the second half of 2019, the UK tax authority concluded that cryptocurrencies were not stock or marketable securities and France decided not to tax crypto-to-crypto transactions. In general, tax authorities have faced significant difficulties in taxing crypto gains in the past, when such gains have been important, due to limited data histories at crypto exchanges.

India and Russia confirm their status as two of the most uncertain crypto jurisdictions

- Three months after the Supreme Court ruled to lift the banking ban, India's Ministry of Finance proposed[link1] to ban cryptocurrencies by law.
- The Russian economy ministry pushed back[link1] against the nation's planned ban on cryptocurrency, just after the government had announced considering banning the issuance and circulation of cryptoassets (March 2020) and considering penalising cryptocurrency transactions (May 2020).

Mauritius consolidates its role as a legally advanced crypto island

- Its regulatory authority announced[link1] a securities token regulatory framework enabling their trading in a fully regulated environment. The guidance recognizes securities tokens, and the broader cryptocurrency bucket, as an asset class in its own right. Licensed exchanges must adhere to strict anti-money laundering requirements.

Estonia cracks down on money laundering crypto activities

The country's Financial Intelligence Unit revoked[link1] the license of 500 cryptocurrency firms (about 30% of the total), following the illicit financial flows revealed by the USD 220 billion money-laundering scandal involving Danske Bank.

Conlcusion

The adoption of blockchain-based technology by central banks and the issuance of related CBDCs to improve the current flow between commercial banks and central banks (wholesale CBDCs) or to digitalise fiat money (retail CBDCs) began – in a noticeable way - nine months ago. It has since then, grown at a steady pace globally, fuelled by the full support of the BIS and by the opportunity to upgrade the quality and cost of the provision of payment services internationally. The strong trend in experimenting and piloting CBDCs indicates clearly, that the first CBDC will be wholesale in nature and that implementation will happen soon. The implementation of concrete applications of blockchain-based digital currencies at the level of the official sector is then likely to boost the credibility and popularity of such technologies and monetary innovations.

[1] In essence, the 'travel rule' requires any VA transfer (minimum of USD/EUR 1,000) between a VASP and any other obliged entities to share i) the originator's name, ii) the originator's account number, iii) the originator's physical address, national identity number or customer identification number, or date and place of birth, iv) the beneficiary's name, and v) the beneficiary's account number.

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