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Libra's regulatory hurdles appear taller after House hearing

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WASHINGTON-Facebook CEO Mark Zuckerberg provided only a few additional details about the company's proposed cryptocurrency to a House Financial Services Committee on Oct. 23 that generally didn't like what it heard.

Zuckerberg said Facebook wouldn't proceed with the proposed Libra until it had satisfied regulators' concerns. That pledge and the harsh criticism from lawmakers on both sides the aisle appears to narrow, if not eliminate, the company's path to approval, at least for a project as sweepingly ambitious as Libra is.

"Frankly, I don't trust it," Republican Rep. Anthony Gonzalez of Ohio told Zuckerberg about Facebook being part of the project, giving a flavor of the bipartisan committee skepticism about the Libra project and Facebook generally. The company has also been widely criticized for its use of customer data and its role in Russia's alleged meddling in 2016 elections.

The Securities and Exchange Commission, the Federal Reserve, the Commodity Futures Trading Commission and the Treasury Department are among the regulators Facebook would have to satisfy. The Financial Stability Oversight Council, comprising the heads of those agencies and other financial regulators and chaired by the Treasury secretary, created a task force in response to Libra's announcement. Treasury Secretary Steven Mnuchin said the day before Zuckerberg testified that Libra questions haven't been answered.

"I've met multiple times with representatives of Facebook," Mnuchin told the House Financial Services Committee at a separate hearing Oct. 22. "We told them we thought their launch was premature, that they had not addressed fundamental issues around money laundering, Bank Secrecy Act requirements, and other (issues)."

Libra, known as a stablecoin, would be backed by a basket of dollars, euros and other traditional currencies called the Libra Reserve, which would be overseen by the Libra Association. Facebook has established a subsidiary, Calibra, that is developing a digital wallet app to let consumers use Libra for transactions.

That makes Libra a payment processor, Zuckerberg said, meaning it should be regulated like PayPal or Venmo. But the SEC is reportedly considering whether Libra would operate like an exchange-traded fund, and need to follow broker-dealer regulations, or a security, and require SEC registration. Other policymakers have suggested the Libra Reserve resembles a bank and that the Libra Association looks like an investment adviser. And Fed Chairman Jerome Powell has suggested that, by dint of its size, Libra might be a systemically important financial institution, with large capital reserve requirements.

Any of those regulations would add friction to Libra's attempt to make money transfers as quick and easy as text messaging.

"I'm curious to see how much the product strategy will change based on what regulators decide," said Diego Zuluaga, a policy analyst at the Cato Institute, asking if Libra would accept an ETF designation or instead peg the cryptocurrency to just one denomination in an attempt to convince regulators it's not.

As regulators decide, they are likely to be aware of the hostility in Congress and in the administration.

"The administrative state takes cues from political leaders and Congress," said David Beckwith, a senior research fellow at George Mason University's Mercatus Center. "That's part of doing business in America. There's a big administrative state. You've got to get to the regulators that's where corporate relations come into play."

Beckwith lamented what this means for Facebook. "All the grief Libra's gotten has been overblown," he said.

Missing on the middle ground

Zuckerberg sought to find middle ground with lawmakers, on one hand telling them the project would proceed only with U.S. approval and on the other hand telling them the Libra Association that would run the project was a separate, independent entity based in Switzerland. Democratic Rep. Juan C. Vargas of California wasn't buying that, saying the Libra Association wouldn't "exist without you you're the big dog in this fight."

Cryptocurrency experts also scoffed at the argument that Libra might continue without Facebook's support.

"I don't buy that. That is, in my opinion, form over substance," said Felix Shipkevich, partner at Shipkevich Law and adjunct professor at Hofstra Law. "But for Facebook, there would be no Libra Association."

He said the idea originated with Facebook, the company is the only financial contributor, and would remain the largest participant, holding leverage over other companies and nonprofit groups because of unrelated corporate relationships, business opportunities and potential donations.

"If it's not Facebook, who would be at the helm of this project?" Shipkevich asked. "And who would essentially be in charge?"

Even if regulators decide Libra met their requirements, the project could be halted by Congress. Democrats on the Financial Services Committee are circulating five draft bills, three of which would likely derail Libra's development.

One, from Rep. Jesus "Chuy" Garcia of Illinois, would block social media platforms like Facebook from creating or operating digital assets that act like money, and prevent them from getting bank charters or partnering with licensed financial firms. One from Texas Rep. Sylvia R. Garcia, would label cryptocurrencies like Libra as securities, which are heavily regulated in a manner that would make their use as money impossible, and a third bill by Del. Michael F.Q. San Nicolas of Guam would block companies using stablecoins from trading on U.S. stock exchanges.

A measure from Rep. Bill Foster of Illinois and a companion to a bill introduced by Sens. Mark Warner, a Virginia Democrat, and Josh Hawley, a Missouri Republican, would require firms to disclose how they collect, protect, and monetize consumer data.

Zuckerberg found a few Republican defenders at his hearing, but most also criticized the Libra aspirations.

Even those who said they didn't want to stifle financial innovation, like ranking member Patrick T. McHenry, a North Carolina Republican, said the scrutiny was justified. Republican Rep. French Hill of Arkansas joined Foster in a letter urging the Fed to consider developing its own stablecoin and Republican Rep. Blaine Luetkemeyer of Missouri pressed Zuckerberg on the danger Libra posed to the dollar as the world's dominant currency. They expressed a conservative distrust of concentrated power over the financial system in the hands of a social media platform accused of silencing right-wing voices.

Democratic Rep. Madeleine Dean of Pennsylvania used Zuckerberg's own words at him. " 'In a lot of ways, Facebook is more like a government than a traditional company,' " she quoted the CEO. "Given your history, why should Congress, regulators, and the public trust you to create what amounts to the world's largest bank what really amounts to a shadow sovereign government?"

The nascent cryptocurrency industry has largely tried to distance itself from Libra. The Blockchain Association, a trade group, has said its goal is to keep the rest of the developing sector from being swept up in Libra-focused attacks.