Roll Call

Facebook’s Libra concessions to regulators raise new questions

Caitlin Reilly

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The new model for Facebook Inc.’s proposed digital currency could help it squeak by regulators, but the social media giant and the others launching Libra will have to resolve big questions about its move to so-called single-currency stablecoins before that can happen, according to economists and at least one lawmaker.

The Libra Association, a group of companies launching the cryptocurrency that includes Facebook, said it’s scrapping the idea of a digital coin tied to many world currencies in favor of multiple coins, each tied to a single currency.

The Libra Association last month released the modified plan that it says reflects conversations with policymakers and regulators, after its initial cryptocurrency idea faced bipartisan backlash last year.

Instead of one stablecoin based on many assets, Libra will now take the form of multiple coins each tied to a sovereign currency such as the dollar, the euro, the English pound and Singapore dollar, the association said.

Stablecoins have a fixed value derived from another asset. They differ from cryptocurrencies like bitcoin, which have floating values based on demand.

Among the concessions to appease policymakers included in the paper were a promise to limit the number of unregulated entities on the Libra network, and restrict access and verification of the blockchain ledger tracking transactions to members of the association.

The association also downplayed Facebook’s role in the updated model, noting the company that first proposed the cryptocurrency would be only one of many equal partners overseeing the stablecoins.

For some, the updates ease concerns.

An aide to a Republican member of Congress working on the issue said the switch to single-currency stablecoins would likely appeal to lawmakers, who last year warned that a universal global currency could undermine monetary policy and dollar dominance.

The changes are likely to win support among a camp of lawmakers who see stablecoins as an inevitable evolution of the payments system and a way to allow consumers more choice, said the aide, who wasn’t authorized to speak publicly and asked to remain anonymous.

Lawmakers distrustful of Facebook's involvement will likely remain unconvinced, the aide told CQ Roll Call in an interview.

Regulatory hurdles

Rep. Warren Davidson, R-Ohio, says the switch to single-currency tokens could allow Libra to avoid regulation as a security, which was an issue with the earlier structure. The congressman serves on the House Financial Services Committee's financial technology task force.

The decision ultimately lies with the Securities and Exchange Commission, and without action from Congress it's hard to say for certain how Libra and other stablecoins will be regulated, he told CQ Roll Call.

"My hope is that this does finally create the momentum to say Congress needs to pass a law," he said. "This space is lacking legal clarity, and it's long overdue for Congress to provide it."

Diego Zuluaga, associate director of financial regulation studies at the Cato Institute, says the updated version of Libra, with its multiple currencies and enhanced gatekeeping, is more likely to clear regulatory hurdles, especially in the U.K. and the EU, and eventually the U.S.

"I think all those things together make Libra much more like an existing electronic money product," he said. "I think it's going to be difficult from the perspective of the law to be opposed to it now because it's compliant with existing practice and indeed is proposing to compete in a very similar way with existing digital wallets."

The switch to single-currency coins away from an amalgam of international currencies may make Libra more appealing to customers, too, Zuluaga said in an interview.

"You and I earn in dollars and we spend in dollars," he said. "So keeping a balance in something that is not just dollars is a little bit impractical because, yes, it can go up in value with respect to dollars, but it can also lose value."

"Now I can have my Libras in dollars," he said. "It's a bit like keeping a balance at PayPal or Venmo, which I can spend at any moment, wherever I like, just using my phone."

Questions remain

Ariel Zetlin-Jones, an associate professor of economics at Carnegie Mellon University, says that while the updated plan is an improvement, several aspects of the proposal lack clarity. Zetlin-Jones specializes in the design of stable-price cryptocurrencies.

For starters, the association still plans to release a universal Libra stablecoin for cross-border payments and for use in jurisdictions where the association hasn't released a currency-specific digital token yet, Zetlin-Jones noted.

In a policy paper describing the Libra changes, the association said for cross-border payments the Libra token would be a smart contract determining the exchange rate between two currencies, rather than a separate digital token. However, the paper is less clear on how the amalgam Libra token will function in countries without single-currency options, Zetlin-Jones said.

If someone in Venezuela wants to buy a Libra coin, what does the association do with the bolivars it receives in exchange, he asked. Does the association hold the bolivar in reserve? Does it immediately convert the bolivar into one of the currencies tied to the single-currency coins?

The option for a universal Libra token preserves many of the problems with the original proposal, he said. “It doesn't quite sound like they fixed it, even though they're claiming they have.”

Barry Eichengreen, a professor of economics and political science at the University of California, Berkeley, says the modified proposal still has the potential to undermine monetary policy in small countries where people will see a dollar stablecoin more appealing than the local currency.

“Moving to a set of single-currency stable coins has absolutely no bearing on fears that small country central banks will see their leverage over local monetary conditions destroyed by the introduction of Libra,” he said in an email.

While the modifications might make Libra more appealing to customers, Eichengreen said he thinks the cryptocurrency would still run into problems with regulators.

It was unclear from the modified plan whether the association could fulfill know-your-customer requirements, he said. The regulations require financial services professionals to make an effort to verify the identity, suitability and risk of customers.

The paper also didn’t identify a lender of last resort to provide emergency liquidity to Libra in case of financial trouble, Eichengreen said. In U.S. derivatives markets, the Federal Reserve occupies that role to prevent a panic.

The complex transactions Libra’s financial partners will have to take on to keep the value of the digital tokens stable mean the association will need to find such a lender, Eichengreen said, and the absence of such a lender would pose a “serious” concern for financial stability.