

REGULATING LIBRA

Prof. Dr. Dirk A. Zetsche, LL.M.

ADA Chair in Financial Law (inclusive finance)

University of Luxembourg

Based on *Zetsche/Buckley/Arner*, Regulating LIBRA: The Transformative Potential of Facebook's Cryptocurrency and Possible Regulatory Responses, www.ssrn.com/abstract=3414401

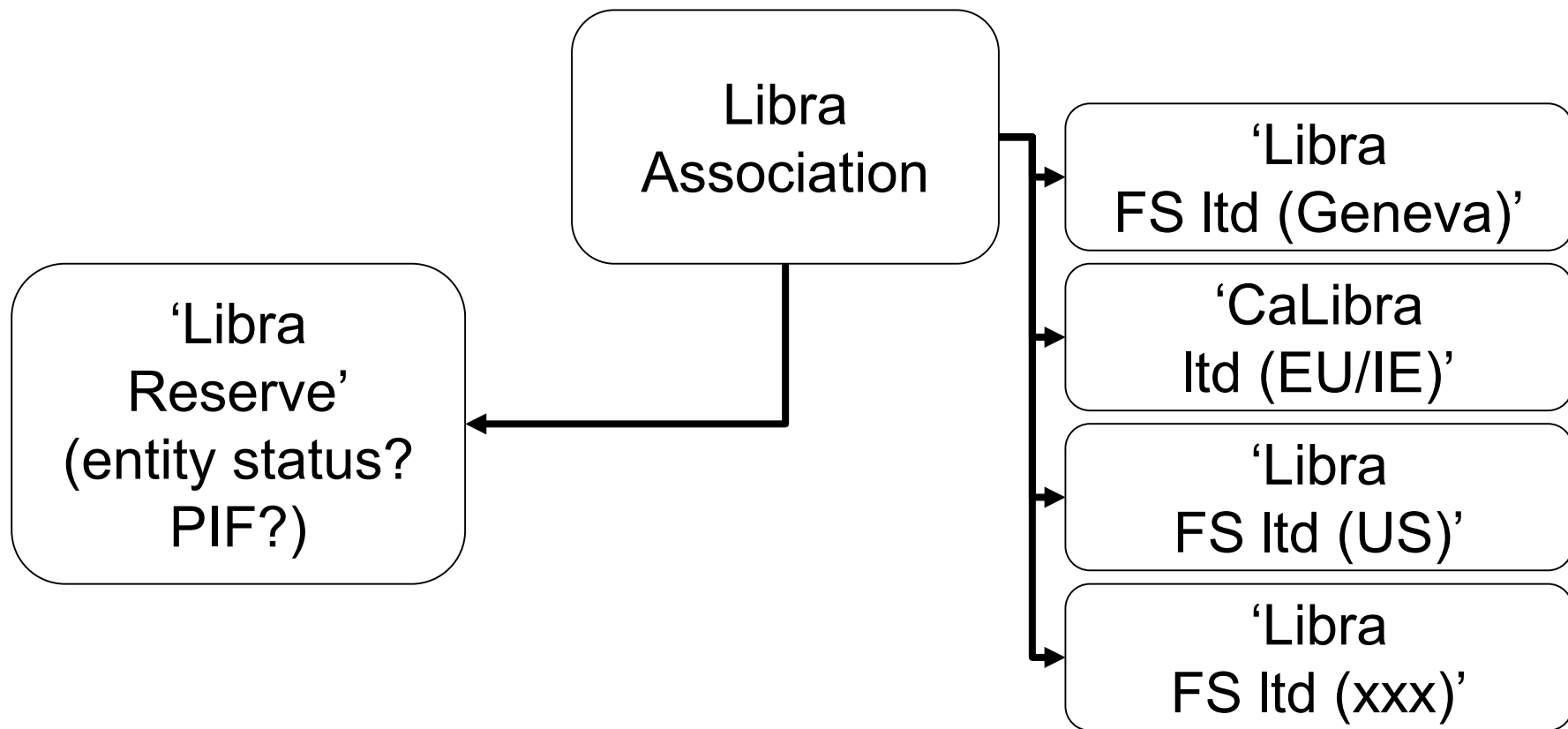
- § 1 - Introduction✓
- § 2 - The Libra consortium
- § 3 - Libra's Business Proposition
- § 4 - Regulatory Concerns
- § 5 - Crossborder Supervision
- § 6 - Conclusion & Theses

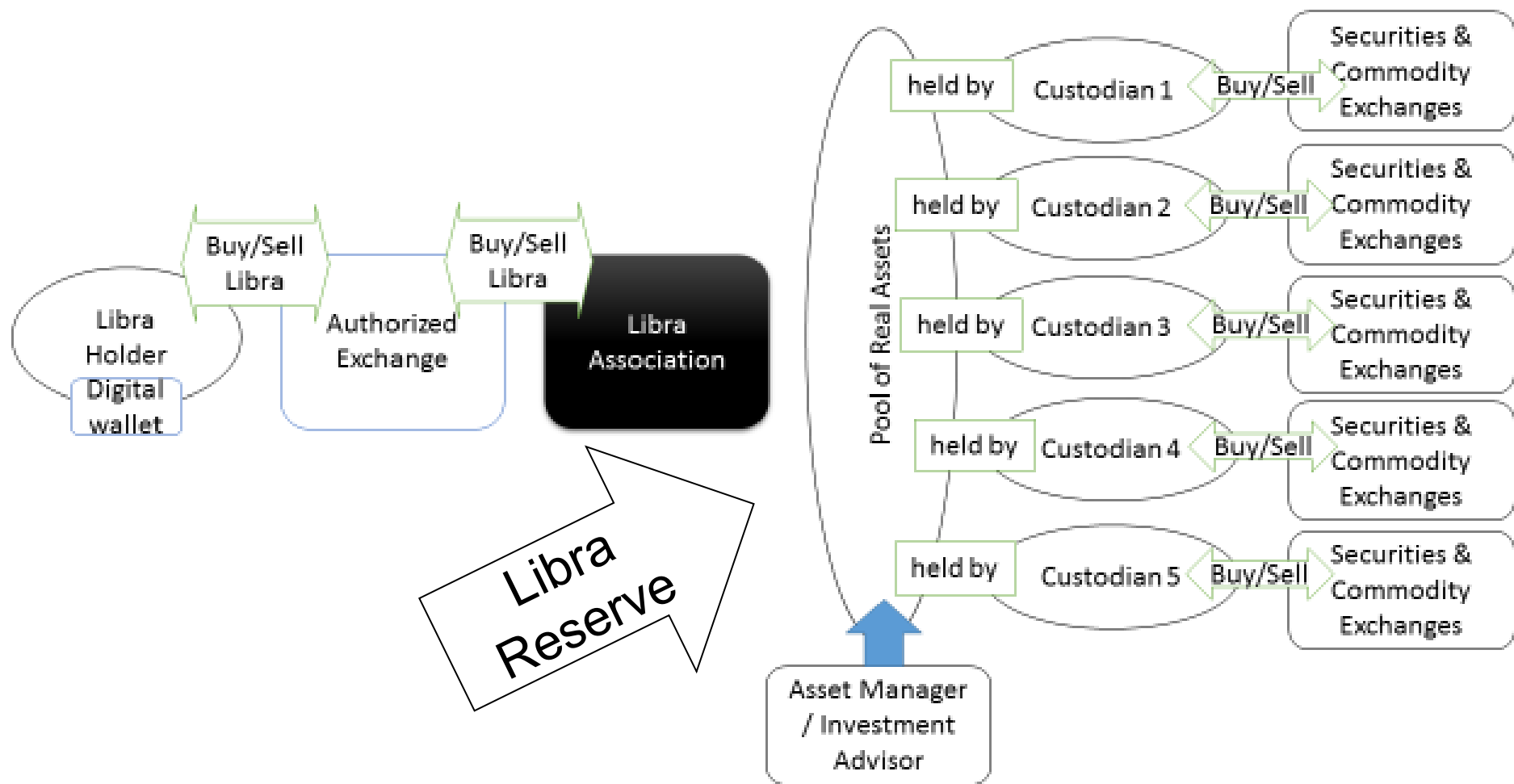
§ 2

The Libra Association and Consortium

§ 2 Libra Association and Consortium

- « The group of 30 »
- Lots of prominent payment and internet service firms (Uber etc.)
- Base investors in Libra development and technology
- Consortium members original 'nodes' of private Libra BC
- Promise: open for public BC within 5 years





Libra Association Council

- each member to have one individual representative; voting power of members proportionate to stake in Libra, but capped for founders at 1%
 - to have « ultimate power » and overriding capacity (e.g. right and remove managing director; set up committees etc.)
 - to approve material changes with 2/3 majority



Libra Association Board

- (5 to 19 board members, all council representatives or MD)
- steer and monitor management in lieu of the Council
 - to have one Managing Director presiding



Executives (led by the Managing Director)

Function of Libra Association

- Shielding against
 - Liability
 - Regulatory obligations
 - Allocation of influence to Facebook
- Substance over form?

§ 3

Libra's Business Proposition

§ 3.1. Financial Inclusion

- Cash-in, cash-out (+): consortium ensures acceptance
- Libra as liquid currency for the unbanked?
- Consider
 - ban of Facebook in some countries
 - illiquidity of scarcely traded currency
 - clients to pay the illiquidity bill

§ 3.2. Cost Savings

- Remittances to exceed global development assistance
- Costs of remittances 5-15% of wired amount
- Uber: 800 million reasons for Libra
- Who does save the costs?
- How will the money get back on the ground? (agents?)

§ 3.3. 'Stable Coins'

- Stability matter of perspective
- Less so in developed, more so in developing countries
- Individual perspective: Forex risk
- Libra as large-scale global basket could find appeal among multi-nationals

50% USD	
18% EUR	
14% JYEN	?
11% BPD	
7% SG\$	

§ 3.4. Disruptive Potential

- Libra's link to Facebook promises scale
- Banks to loose out against Libra for lack of scale and data
- Facebook/Calibra: the latest TechFin

§ 4

Regulatory Concerns

Libra as payment provider?

- Libra has applied for a payment service provider license in Switzerland (10 Sept 2019)
- Swiss Finma: more requirements than that of a PSPs, but doable if international cooperation secured
- Swiss PSP regulation?
- Irish Calibra regulation?
- Libra Exchanges?

*The faster you go, the further you need
to look down the road.*

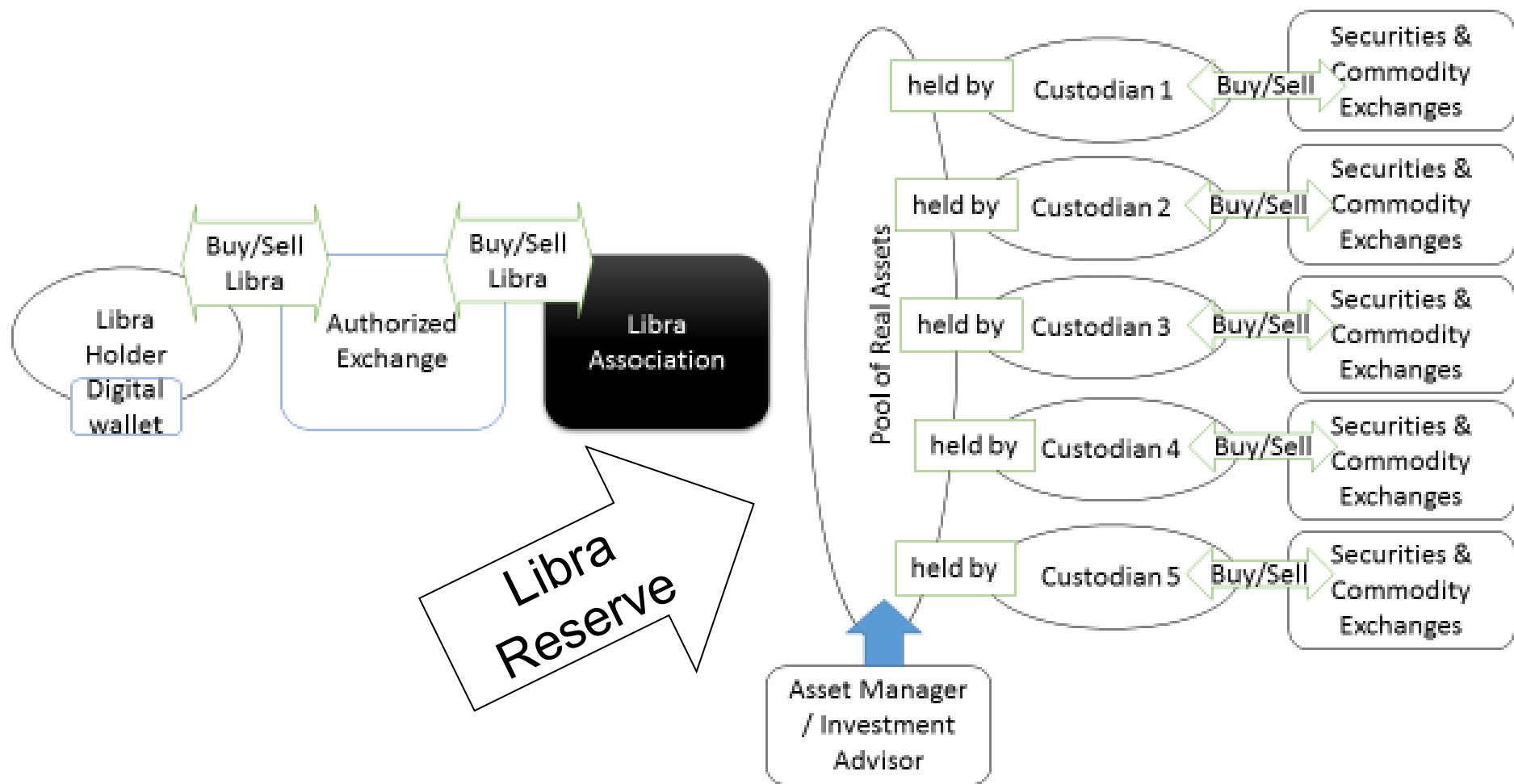
*Prof. Zetsche instructing Australian colleague (& friend)
Prof. Ross P. Buckley (UNSW Sydney) on how to drive on
German Autobahns famous for their lack of speed limits.*

[©Ross.Buckley@unsw.edu.au]



§ 4.1. Licensing - Libra's services

- Money transmitter (US) / Payment Service Provider (EU) (consuming E-money)
- Bank (non-US/EU)
- Calibra:
 - bank or credit institution if acceptings deposits
 - Investment firm if implicit investment decision (derivative/ F.I.)
 - AIFM / UCITS ManCo if selling fund unit (MmF)



§ 4.1. Licensing – Libra's services

- PSD only would require 'safe-only investments'; but Forex risk
 - Forex derivatives ≠ retail product under MiFID
 - Money Market product
- ⇒ Libra as money market fund, with Libra exchanges as Libra's transfer agents?
- Arg: « pool of assets », Libra is reflecting value of asset pool; investment in Forex basket
- ⇒ US: Libra as regulated investment company
- ⇒ EU: UCITS under the UCITSD and MMF regulation

§ 4.1. Licensing – stable coin characteristic

- Money?
- Currency?
- Securities?
- Commodities?
- (Financial) Derivatives?
- Financial instrument?
- MMF unit?

§ 4.1. Licensing – coin characteristics

- **US perspective**: Libra holders: speculating on increase in value?
 - US perspective: ‘security’ subject to Howey test?
 - (+) if benefitting of other people’s work;
 - ‘functional’ view (+): cross-currency stability as ‘benefit’? [replaces currency hedges, and currency hedges would qualify as derivative]
 - isolated view (?)
- **EU perspective**: ‘financial instrument’ (+), since Libra is linked as derivative to financial instruments through participation in the Libra reserve; MMF as financial instrument.

§ 4.2. Risk Management

- Hedging within the Libra reserve very challenging enterprise; if provided to third parties (eg. clients) the asset/ risk management requires fully licensed investment advisers
- Safekeeping provided by custodians regulated activity; if provided by Libra to third parties (eg. clients) the custody requires fully licensed custodians (credit institutions, banks, investment firms)

§ 4.3. Capital Requirements

- No shortage of capital; all legislation ask for capital
- Libra's main concern: Op Risk and financial currency risks
- Since most currency risk in the IMF basket is likely to even out:
Substantial Op Risk to be covered by Libra association

§ 4.4. Identity & AML

- Libra subject to challenges if financial inclusion is truly an objective: the « lands of the unbanked » suffer from lack of identity and AML checks
- Libra could become new identity provider in itself; 'Business ID' to replace 'Base ID'

§ 4.5. Monetary Policy

- Monetary regulators (central banks) to loose some influence over monetary policy
- Major concern in non-US countries
- Crisis management measures:
 - Capital controls unlikely to work
 - Global custodians under other government's (US?) control

§ 4.6. Data Protection

- Major concern in EU
- Facebook as the 'ugly kid in town': many violations, lots of enforcement proceeding, little trust by regulators
- Merging Facebook's data with Calibra's data creating unprecedented market power in digital financial services, hence regulators expect further breachers of data protection rules
- Severe penalties to be expected (4% of turnover); who will be identified as violator? Facebook officially has no control over libra
=> Libra (reserve) to pay the bill?

§ 4.7. Tax

- Subjecting individual profits from holding Libra to income tax?
 - Subjecting Libra transactions to VAT?
- ⇒ Depends on qualification.
- ⇒ At least, income tax on realized profits likely.
- ⇒ Regulators to have part of Libra's future in their hands.

§ 4.8. Disclosures

- Money transmitter / PSP disclosures patchy at best
- Investment-style disclosures justified: portfolio of Libra reserve, exposures to single currencies, hedging costs, use of proceeds, cost and fee allocation, agent reimbursement etc.
- Ensured if Libra qualifies as MMF.

§ 5

Crossborder Supervision

§ 5 – Crossborder Supervision

- Recognition of other licenses across the globe limited to very few instances (financial derivatives, for once)
- Equivalence-based substituted compliance widely spread in EU, but nowhere else

§ 5 – Crossborder Supervision

- Global cooperation in regulating Libra a ‘must have’ for cross-regional interoperability and global risk management (TBTF)
 - Regionally fragmented currency basket does not work
 - Lack of legal framework outside of derivative / bank context
- ⇒ Joint supervisory college?
- ⇒ Who is leading the regulators?
- ⇒ Who will set the tone?

§ 6

Conclusion & Theses

§ 6 – Conclusion & Thesis

- Libra's expected growth: towards «too large too fail» within seconds
- Licensing depends on interpreting vague disclosures; Libra 'outsources' assessment to regulators; more than PSP; Libra as MMF?
- New test case for global collaboration; inconsistent regulation barrier to Libra's growth
- Libra: the unfair lady
 - EU/D: very restrictive approach likely for monetary policy reasons
 - US: less friendly reception ensured.
- Libra as door-opener for more successful clones by more welcome later movers? (Alibaba, Apple, Google & the likes)

Recommended Readings on FinTech

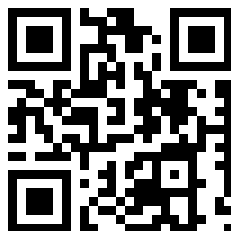
TechFin / Data-driven Finance

www.ssrn.com/abstract=2959925



Corporate Technologies

www.ssrn.com/abstract=3392321



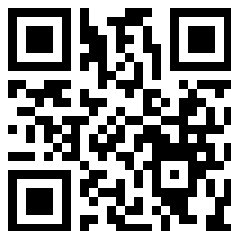
Regulatory Sandboxes

www.ssrn.com/abstract=3018534



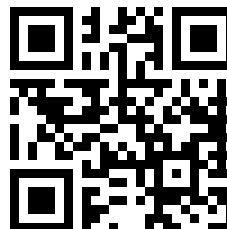
Regulating Libra

www.ssrn.com/abstract=3414401



ICO Gold Rush

www.ssrn.com/abstract=3072298



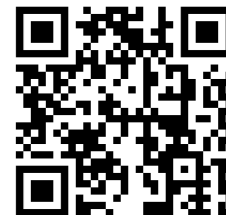
Distributed Ledgers / Blockchain

www.ssrn.com/abstract=3018214



KYC Utilities

www.ssrn.com/abstract=3224115



Thanks!

Prof. Dr. Dirk Zetsche, LL.M.
ADA Chair in Financial Law (Inclusive Finance)
Faculty of Law, Economics & Finance
University of Luxembourg
Dirk.Zetsche@uni.lu

RUL | RESEARCH UNIT
IN LAW

□ FACULTY OF LAW, ECONOMICS AND FINANCE


UNIVERSITÉ DU
LUXEMBOURG