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STABLECOINS:
A SNAPSHOT OF GLOBAL REGULATION

– THOUGHT LEADERSHIP

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STABLECOINS: A SNAPSHOT OF GLOBAL REGULATION

Facebook's proposed stablecoin, Libra, is dominating the headlines. However, growing interest means increased regulatory and political scrutiny. As digital assets transcend national borders, what does this mean for those interested in issuing or participating in a stablecoin project?

What is a stablecoin?

A stablecoin is a type of virtual currency or cryptocurrency with a mechanism to minimise price fluctuations and 'stabilise' its value. Historically, stablecoins have been used to pay for purchases of other virtual currencies (e.g., Bitcoin) on cryptocurrency exchanges that did not accept cash, and as a safe-haven asset during periods when other virtual currencies experienced significant price declines. Companies like Facebook, with its recently proposed Libra stablecoin, are betting that they can overcome the regulatory and political challenges to achieve widespread adoption and change how people make cross-border remittances and payments for consumer goods and services.

To date, the main distinctions among stablecoins have been the mechanisms for maintaining stability (collateralised or uncollateralised) and of governance (centralised or decentralised). Collateralised stablecoins are often backed by fiat currency, commodities or other assets, or other virtual currencies held in a reserve. Uncollateralised stablecoins rely on computer algorithms to make monetary policy decisions (e.g., adjusting supply by "burning" or selling the coins) to maintain a stable value. In either case, governance arrangements – including the role of the issuer or promoter – can vary.

Applicable regulatory regimes

Although regulation varies significantly between countries, stablecoins potentially raise at least four broad types of regulatory issues in relevant jurisdictions:

- Money movement issues (e.g., money laundering, payments and money services business regulation).
- Investment and trading frameworks (e.g., regulation as securities or commodities).
- Banking issues (e.g., deposit-taking, bank registration).
- Virtual currency-specific regulation (e.g., New York's BitLicense, or outright prohibitions in some countries).

Global regulatory snapshot

The attitude of international governments and regulators towards cryptoassets generally and stablecoins more specifically varies dramatically. At one of the spectrum are jurisdictions such as China, where activities relating to virtual or cryptocurrencies including stablecoins are strictly regulated and scrutinised including prohibitions on licensed financial institutions, payment institutions and digital token financing and trading platforms (including websites and apps) on trading, exchanging or providing other financial services in relation to virtual currencies.

While most jurisdictions sit somewhere in the middle by applying existing regulatory frameworks that pre-date the concept of digital assets (and which vary in their suitability to do so), at the other end of the spectrum, jurisdictions including Malta and Gibraltar, are one step ahead and have already developed bespoke cryptocurrency regimes. In France, the "loi Pacte", enacted in May 2019, introduced a comprehensive new regulatory framework for digital assets. It covers tokens in the primary and secondary markets, establishing an optional licensing regime alongside a mandatory registration requirement with the French Autorité des marchés financiers (AMF) for providers of custody fiat to cryptoasset exchange services. It is likely that stablecoins would fall within the scope of the definition of digital assets laid down by the "loi Pacte", thus triggering either the mandatory or optional registration provisions for relevant parties, depending on the type of services being provided.

Regardless of the jurisdiction, considering how a proposed stablecoin could be characterised and how it could trigger the various types of regulatory regime described above are crucial. Bespoke crypto legislative regimes may provide greater flexibility than regimes where existing frameworks are being stretched to fit cryptoassets, but in each case application will need to be considered carefully on a jurisdiction-by-jurisdiction basis.

A significant portion of the regulatory activity in relation to stablecoins to date has involved the

US. While the US legal and regulatory framework for virtual currencies continues to evolve, a key issue is whether a stablecoin might be deemed to be a 'security' and, consequently, subject to US securities laws and the jurisdiction of the Securities and Exchange Commission (SEC). This depends on the application of the now infamous Howey test. SEC officials have noted that labelling a digital asset a 'stablecoin' does not affect its regulatory status, which instead depends on a facts-and-circumstances analysis of economic reality. Fiat-collateralised stablecoins which do not have a fixed redemption value and stablecoins relying on mechanisms other than fiat currency collateral both raise particularly difficult issues under the Howey test. Stablecoins would also likely constitute spot commodities subject to the anti-fraud and anti-manipulation authority of the Commodity Futures Trading Commission (CFTC).

Within the EU, there are no harmonised rules around stablecoins under the existing legislative framework and most Member States do not specifically regulate stablecoins, or cryptoassets more broadly. However, other existing regulatory frameworks will apply. Collateralised stablecoins backed by a pool of assets have the hallmarks of a collective investment undertaking or scheme. The issuance of, and intermediaries providing services with respect to, stablecoins to EU customers will need to be mindful of fund and investment services legislation as well as regulations governing the authorisation of intermediaries and trading venues, fund marketing and securities offers, the distribution of packaged products to retail investors and market abuse. The application of the EU payment services framework and electronic money rules will also need to be considered.

While crucial, the characterisation process is only part of the regulatory picture. Many other regulatory questions arise, such as how will financial crime regulations apply to transactions involving stablecoins? What contractual and transparency requirements – such as the need for a written agreement, and statements of transactions, to be provided – apply to intermediaries providing services relating to stablecoins and can these be discharged in practice? Will users benefit from government insurance or deposit guarantee schemes in respect of their stablecoin holdings? From an institutional perspective, what is the regulatory capital or liquidity treatment of banks or other regulated financial institutions holding or trading in stablecoins? The thorny issue of data privacy and consideration of the myriad overlapping and ever-evolving international data and cyber regimes will also be critical.

Asking the right regulatory questions

Issuers of stablecoins with a projected global reach (like Facebook's Libra) clearly face a challenging future in navigating this patchwork of international frameworks.

What does this mean for those issuing or marketing stablecoins today? There is no one-size-fits-all solution for designing a regulatory analysis framework for stablecoins. The regulatory analysis will be affected by the laws and regulations of the relevant jurisdictions, the nature and characteristics of the stablecoin, and the activities and/or services relating to such stablecoin. Undertaking a detailed factual and legal assessment is a necessary step for issuers to assess relevant regulatory requirements and potential risks.

Overall, stablecoin issuers must think broadly about what could impact their regulatory position and ask the right regulatory questions. In addition to their home jurisdiction for the initial issuance of the stablecoin, issuers should always consider potentially relevant regulations which have an extraterritorial effect – for example, the regulations of the potential subscribers', users', and other service providers' jurisdictions may affect how an issuer may market to, or accept payments from, such jurisdictions. They should also assess the legal nature of the stablecoin being offered or used in each relevant jurisdiction – the stablecoin may be considered a regulated instrument in one jurisdiction but not another. The issuance, usage, maintenance and/or transfer of the stablecoin by any stakeholder may trigger different regulatory considerations. Furthermore, in light of the potential global operation and usage of successful stablecoins and the increasingly stringent regulatory scrutiny and sanctions around anti-money laundering and counter-financing of terrorism, issuers should also ensure that financial crime concerns are carefully analysed to comply with applicable regulatory obligations as well as manage reputational risks.

Howey "investment contract" test

Generally, an offer and sale of tokens will be subject to US securities laws and the jurisdiction of the US Securities and Exchange Commission (SEC) where: (i) an investment of money; (ii) is made with an expectation of profits; (iii) arising from a common enterprise; (iv) which depends solely on the efforts of others.

SEC v. W.J. Howey Co., 328 U.S. 293 (1946)

Find our comprehensive report on the global regulation of stablecoins produced in collaboration with enterprise blockchain pioneer R3 at **www.cliffordchance.com/fintech**

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