



To:

CPMI Secretariat (cpmi@bis.org) and
IOSCO Secretariat
(consultation-03-2021@iosco.org)

Date:

December 10, 2021

Re: Comment in Response to the consultation on the Application of the Principles for Financial Market Infrastructures to stablecoin arrangements

Ladies and Gentlemen:

Coinbase, Inc. (Coinbase) welcomes the opportunity to comment on the CPMI-IOSCO's consultative report on the "Application of the Principles for Financial Market Infrastructures to stablecoin arrangements."

We appreciate your active engagement with industry and other stakeholders and look forward to working with you on this process.

Sincerely,

A handwritten signature in black ink, appearing to read "Faryar Shirzad".

Faryar Shirzad
Chief Policy Officer, Coinbase, Inc.
Email: faryar.shirzad@coinbase.com

Coinbase CPMI/IOSCO response

Coinbase appreciates CPMI and IOSCO's interest in recent stablecoin developments and its consideration of the important issue of whether and how to apply the Principles for Financial Market Infrastructures (PFMI) to stablecoin FMIs. We also commend your desire to consult with the many stakeholders, including the broader public, who would be affected by any regulatory initiative in this area. The application of the PFMI would have a strong impact on the development of stablecoin arrangements, and while we recognize the intent is to enhance safety and soundness, there is a significant risk that taking premature regulatory action could severely constrain positive innovations that would otherwise develop in this new ecosystem. Premature application of the PFMI could also result in regulations that do not fully account for the risks arising from stablecoin activities that are quickly evolving and not yet at scale.

Background on Coinbase

Coinbase's mission is to create an open financial system for the world—one that is fair, accessible, efficient, and transparent—by making cryptocurrency available to everyone. We believe that cryptocurrency is a pillar of financial inclusion: everyone deserves access to financial services that can help empower them to create a better life for themselves and their families, and we were founded in 2012 to allow anyone, anywhere, to be able to easily and securely send and receive bitcoin. We now provide a trusted and easy-to-use platform for accessing the broader crypto economy, and today, approximately 73 million verified users, 10,000 institutions, and 185,000 ecosystem partners in over 100 countries rely on Coinbase to easily and securely spend, save, earn, and use cryptocurrency.¹

Coinbase's platform allows customers to buy, sell, trade, and store stablecoins and other cryptocurrencies. We offer custody services for 158 digital assets and trading services for 103 digital assets on our platform. We consider ourselves to be a "one stop shop" for digital asset services; we offer wallets, exchanges, and merchant tools within one simple interface.²

¹ <https://www.coinbase.com/about>

² <https://help.coinbase.com/en/coinbase/getting-started/crypto-education/what-is-coinbase>

Coinbase favors a comprehensive approach to the regulation of digital asset activities, tailored to the benefits and risks raised by these activities. Carefully weighing the tradeoffs can avoid stifling the valuable innovations that digital assets represent while addressing important policy and regulatory considerations arising from digital asset activities. We strongly believe that regulation of digital asset activities should not simply seek to fit these new types of activities into existing regulatory categories—which are often ill-suited to the task. We have contributed to the policy and regulatory discussion by publishing a set of #dApp principles³ that describes how a comprehensive regulatory framework for digital asset exchange activities may be designed with these policy goals in mind.

Importance of a careful, methodical approach

CPMI and IOSCO should proceed carefully and methodically, with further rounds of consultation, in determining whether and how to apply the PFMI to stablecoin activities and to which institutions and activities the principles should apply. We strongly agree with CPMI and IOSCO on the importance of robust governance and risk management for stablecoin activities. But this is an evolving area, with important changes underway in stablecoin technologies, business models, and customer usage. What appears to be the best approach today may look very different in even one or two years.

Before the PFMI can be appropriately tailored to stablecoin arrangements, jurisdictions need to further develop their regulatory approaches to stablecoin activities. For example, global regulators are currently considering how best to regulate stablecoin issuance, including whether those activities should be limited to insured banks or otherwise to entities regulated like credit institutions.⁴ If stablecoin issuance is regulated as a banking activity and conducted only by banks or entities subject to similar types of prudential

³ Coinbase Digital Asset Policy Proposal (#dApp)

<https://assets.ctfassets.net/c5bd0wqjc7v0/7FhSemtQvq4P4yS7sJCKMj/a98939d651d7ee24a56a897e2d37ef30/coinbase-digital-asset-policy-proposal.pdf>

⁴ President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, November 2021,

https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf

Regulation of the European Parliament and of the Council on Markets in Crypto-assets, September 2020

https://eur-lex.europa.eu/resource.html?uri=cellar:f69f89bb-fe54-11ea-b44f-01aa75ed71a1.0001.02/DOC_1&format=PDF

regulation, the need to apply the PFMI, and the ways in which the principles should be tailored, could be very different than in the current heterogeneous regulatory environment.

The coherent application of the PFMI to stablecoin arrangements across jurisdictions also requires that their regulation be clear and consistent across regulatory bodies and jurisdictions. For example, if a specific type of charter or license is to be required for stablecoin issuance and management, then there needs to be a realistic regulatory path to obtain that charter or license. Further, stablecoins are part of a wider digital asset ecosystem, which we believe requires a more modern regulatory approach for its ongoing development. All of this must be properly coordinated and appropriately reflected in applying the PFMI.

Finally, stablecoin arrangements are sufficiently far from being systemically important that there is ample time to do this right. It is important to remember that international regulatory work on stablecoins, including the work behind this consultation, was initiated in response to concerns that a global, systemically important stablecoin could become a major part of the payments system within a relatively short period of time⁵. Given that no such stablecoins have yet emerged, we urge authorities to proceed more deliberately.

Background on usage and regulatory treatment of stablecoins

The appropriate treatment of stablecoin arrangements, and the consideration of their relevant aspects as potential FMIs, should depend predominantly on how stablecoins are actually used. They are primarily a store of value and liquidity for participants in the digital asset ecosystem and used by investors as a stable value asset to hold while moving between cryptoassets. Stablecoins are also beginning to emerge, in limited settings, as a

⁵ See, e.g., Financial Stability Board, Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements, Oct. 2020, available at <https://www.fsb.org/2020/10/regulation-supervision-and-oversight-of-global-stablecoin-arrangements/> (“However, a widely adopted stablecoin with a potential reach and use across multiple jurisdictions (a so-called ‘global stablecoin’ or GSC) could become systemically important in and across one or many jurisdictions, including as a means of making payments.”); The Board of the International Organization of Securities Commissions, Public Report on Global Stablecoin Initiatives, Mar. 2020, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD650.pdf>.

means to facilitate payments, either on-chain for blockchain-related services or for more conventional payments.

Stablecoins currently represent only a tiny segment of the global payments market, well under 1%⁶. The source of their attention is their high growth rate – 65% from Q1 2021 to Q2 2021 and 1,490% from a very low base in Q2 of 2020 to Q2 of 2021⁷ – but it represents only a small fraction of global payment transaction volume and it will still be a number of years, in our view, before stablecoins could be considered systemically important.

Potential application of the PFMI to stablecoin arrangements also depend critically on their eventual regulatory treatment, which is undergoing an active review by regulators globally. The United States provides a striking example of the range and importance of changes being considered. In the U.S., stablecoin issuers are licensed under state's money transmitter regimes, or as trust banks, and are registered money service businesses with the Financial Crimes Enforcement Network (FinCEN). Other participants in the stablecoin arrangements may be regulated by the federal banking regulators – if, for example, the participant maintains the reserve assets backing the stablecoin – or as a state trust bank providing custodial services to customers. A number of states, such as Wyoming and Nebraska, have developed or are developing novel digital currency-oriented state bank charters, although it remains unclear whether they will be constrained or blocked by pressure from the Securities and Exchange Commission (SEC) or prudential banking agencies.

The U.S. Congress is also giving increased attention to what the regulatory regime for stablecoins should be. U.S. federal regulators, operating through the President's Working Group (PWG) on Financial Markets, recently recommended reforms including legislation that would require all entities that issue, redeem, or maintain reserve assets for stablecoin to be insured depository institutions. In the absence of legislation, the U.S. federal regulators recommend that the Financial Stability Oversight Council (FSOC) consider

⁶ Global payments transaction volume stands at \$821TN annually as measured in gross merchandise value (source: BIS, World Bank reports, Oliver Wyman analysis, ECB statistical Data Warehouse, Morgan Stanley, Ibis World). Stablecoin transaction volume across all use cases, whether or not related to payments, for Q3 2020 – Q2 2021 was at ~\$4 TN (source: Messari and Coinmetrics; <https://messari.io/article/q2-21-defi-review>), which is less than 1% of annual global payment transaction volume.

⁷ Stablecoin transaction volumes increased from \$1,077 BN in Q1 2021 to \$1,715 BN in Q2 2021, representing a 65% increase. Comparatively, stablecoin transaction volumes increased from \$144 BN in Q2 2020 to \$1,715 BN in Q2 2021, representing a 1,490% increase.

steps available to it to address the risks outlined in the PWG report, which may include designation of certain activities conducted within a stablecoin arrangement as, or as likely to become, systemically important payment, clearing, and settlement activities. However, there is no indication of whether or when federal legislation or comprehensive regulatory approaches might be implemented, and it seems likely that regulatory approaches to stablecoins will evolve as the industry matures and regulators further develop their views.

The regulatory uncertainty surrounding stablecoins in the U.S., and within other jurisdictions⁸, underscores our suggestion that CPMI and IOSCO take great care not to move prematurely in applying the PFMI.

High level concerns

Two high level points frame our comments about the consultation document. First, “stablecoin arrangement” is a vague and broad term, excessively so in our view. It appears to capture a wide range of activities, including those outside the typical purview of financial market infrastructures or that raise very different risks than the PFMI were designed to address. These activities, including, for example, digital wallet and exchange services involving stablecoins, could be inappropriately pulled into the scope of the PFMI simply by virtue of being in the vicinity of the core stablecoin transfer activities described in the consultation as “comparable to the transfer function performed by other types of financial market infrastructure.” Clearer definitions of the stablecoin activities that are intended to be in the scope of the PFMI are a necessary predicate to their application, especially because of the danger of overlapping and even conflicting regulatory requirements for parts of the “arrangement” that are regulated by other authorities.

We urge CPMI and IOSCO to more precisely and narrowly define which entities within a “stablecoin arrangement” it believes should be subject to the PFMI because they are engaged in financial market infrastructure activities — that is, which entities are “stablecoin FMIs”. In this response, we nonetheless use the term “stablecoin arrangement” for consistency with the consultation document.

⁸ The EU, the UK, and Singapore, among other jurisdictions, are still in the process of determining their regulatory approaches

Second, it is important to closely examine whether there are biases in favor of incumbent institutions and technologies built into the PFMI. The PFMI were formulated well in advance of the development of stablecoins and rely on regulatory and governance frameworks designed for legacy institutions and practices. Although the PFMI are intended to be general principles relevant across a broad range of FMIs, application of some of its principles without adequate focus on offsetting benefits of stablecoins and their underlying technology could unduly curtail economic innovations and the development of more efficient market practices.

Many of the risks addressed by the PFMI relate to the fact that FMI processes historically have been built around the sequential exchange of messages and the requirement to reconcile and coordinate asset transfers (e.g., clearing, settlement, matching). New distributed ledger technologies (DLT) eliminate some of the key risks of legacy systems and can provide broader system resilience. For example, distributed ledgers and the networks built around them eliminate the need for message-based information exchange separate from asset transfers and reduce the risk that failures of one participant in the system may result in information losses because each node of the system holds a complete set of records.

The presence or potential consequence of biases in the PFMI treatment of stablecoin arrangements may not become apparent until more detailed decisions are considered about the specific application of the principles. One subtle way in which these biases may occur is in explicitly focusing on certain risks without giving weight to the offsetting benefits. For example, as discussed further below, stablecoins are often used within digital asset ecosystems to dramatically reduce credit and liquidity risk.

Two areas that already represent challenges in applying the original principles to new technology are related to the governance of permissionless DLT systems and the probabilistic nature of settlement finality. The consultation strongly implies that permissionless DLT technology may not be acceptable to regulators due to governance concerns or because of the probabilistic nature of settlements on blockchain. We appreciate the fundamental importance to financial activities of settlement finality and the need to further develop legal and contractual frameworks to ensure settlement finality. However, these innovative systems continue to evolve rapidly, including by implementing more robust governance mechanisms and through ongoing work to develop settlement

finality frameworks under law,⁹ suggesting that the guidance on Principle 8 regarding settlement finality as formulated in the consultation may need to be updated to more accurately reflect these ongoing developments.

More broadly, it is important to recognize and accept that blockchain technology introduces a new economic and infrastructural framework that strikes a different trade-off between disintermediation, efficiency, and interoperability. By definition, a distributed ledger does not have a central entity that provides liability protection and legal finality. Consensus is decentralized and end users face protocol risk instead of entity-specific risk. The result is a decentralized financial system that drastically reduces the single-point-of-failure security concerns, lessens the market power and the ability for a handful of intermediaries to extract excessive economic rents, and provides incentives to innovate, compete, and enhance the welfare of consumers.

Judging systemic importance

Coinbase generally agrees with the proposed criteria for determining systemic importance. However, we are concerned that there is an unfounded urgency in applying these criteria in a way that would be premature and could lead to incorrect determinations and unintended consequences.

First, there is the danger that allowing the systemic importance to be judged by its *potential* significance could essentially create a far lower threshold than is warranted. At a minimum, the principles should indicate that there needs to be a strong weight of evidence that this potential will be reached and that the point in time when systemic importance may be reached is reasonably soon after the determination of potential systemic importance.

⁹ For example, in the United States, the Uniform Law Commission is developing recommendations for new commercial law provisions to address settlement finality (among other topics) for “controllable electronic records,” which would include digital assets. See, Committee on the Uniform Commercial Code and Emerging Technologies, Memorandum, Jul. 2021, *available at* <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=9afdf04c-04f8-5b6c-0ee6-8610af6ffe71&forceDialog=0>.

Second, due weight should be given to the low level of interconnectedness between stablecoin FMIs and systemically important financial institutions. This contrasts with many FMIs whose primary counterparties are large financial institutions. The difference is mostly due to the retail nature of most stablecoin users and that stablecoin infrastructure—that is, DLT—is new and operates separately from legacy financial systems. Stablecoin *issuers* may have connections to systemically important financial institutions if they provide deposit or custody services to those issuers. But the consultation appropriately focuses on stablecoin *transfer* activities, which are separated from legacy FMIs. While interconnectedness to large systemic institutions is not the only determinant of systemic importance, it raises an important issue that policymakers need to more clearly identify and address – the transmission mechanisms that would be of systemic risk with respect to stablecoin arrangements.

Third, stablecoin arrangements are part of digital asset ecosystems that eliminate or dramatically mitigate risks that exist with incumbent FMIs. The current systems for trading financial instruments and for foreign exchange transfers across borders include large volumes of credit and raise liquidity risk due to historic structural and institutional choices that leave a considerable gap of time between the initiation and completion of the chain of related transactions. In addition, many of these systems create credit risk between participants and the FMI operator. In contrast, stablecoin arrangements settle stablecoin transfers much more quickly, providing real-time gross settlement for these transfers. Moreover, stablecoin transfers do not involve credit risk as between the sender and receiver of a stablecoin payment because all on-chain transfers are executed only when the assets to be transferred are fully available and verified. This is a feature inherent to blockchain-based systems, which facilitate transfer of digital assets already held in blockchain addresses. These features result in significantly lower risks as compared to existing cash and asset transfer systems. It will be crucial to consider this risk reduction when evaluating systemic importance.

Fourth, the increasing adoption of stablecoins for use in payments will provide additional resilience to the overall payments system by offering an alternative payments mechanism to traditional payment rails. This competition with existing systemically important institutions will not only serve to potentially reduce total systemic risk, but it will also increase consumer benefits and lower overall system costs.

Fifth, there are already a number of competing stablecoins, including ones that use different blockchains as transfer mechanisms, that could easily be used as substitutes in the event that a problem develops with one of them. Moreover, the continued availability of fiat payment options is of course another important substitute should any issues that may arise with respect to a specific stablecoin. This is one of the factors suggested in the consultation document and we believe it will be important to give it due weight.

Conclusion

Coinbase appreciates CPMI and IOSCO's active engagement in the ongoing discussions on designing a prudential framework for stablecoins. We look forward to continuing to share our unique experience and expertise and being a part of future consultations.

We thank CPMI-IOSCO for addressing this important issue and for considering our response.

Sincerely,



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