Application of the PFMI to stablecoin arrangements

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CPMI-IOSCO consultative report

- April 2012 CPMI-IOSCO Principles for Financial Market Infrastructures (PFMI)
- Review of applicability of PFMI for stablecoin arrangements (SAs)
- No new principles or standards
- Rather additional guidance on the application of the PFMI to SAs
- Support regulators and overseers as well as developers of SAs
Do the PFMI apply to a stablecoin arrangement?

- Yes – if:
  - it performs the transfer function, and
  - it is determined to be systemically important.

- In that case it would be expected to observe all relevant principles of the PFMI.

- “Same business, same risks or risk profile, same rules”
When are SAs systemically important?

- **Size**
  (eg number of users and number and value of transactions)

- **Interconnectedness and interdependencies**
  (eg with other FMIs, real economy, financial system)

- **Nature and risk profile**
  (eg types of users and type of transactions)

- **Substitutability**
  (availability of alternatives)

- **Potential growth and future state**
Notable and novel features of stablecoin arrangements

- Use of stablecoins as a settlement asset
- Performance of other non-FMI functions
- Use of distributed and/or automated technology protocols
- Decentralisation of operations and/or governance
Proposed new guidance in light of these novel features

- To provide clarity on how certain aspects of the PFMI could be observed by SAs
- No intention to create additional standards

- New guidance on 4 principles of the PFMI:
  - Principle 2 – Governance
  - Principle 3 – Comprehensive risk management
  - Principle 8 – Settlement finality
  - Principle 9 – Money settlements

- A systemically important SA is expected to observe all the relevant principles
Next steps and potential future work

- **Next steps**
  - Consultation closed 1 December
  - Final Stage 1 report envisaged in H1 2022

- **Potential topics for further work (Stage 2 work)**
  - Based on consultation input and members’ priorities
  - “Responsibilities” of relevant authorities
  - Different types of stablecoins (eg multicurrency & asset-backed)
  - Interactions with non-FMI functions/ non-FMI nonbank entities
Questions?
Principle 2: Governance

- **Principle:** A systemically important SA should have appropriate governance arrangements.

- **Challenges:** governance performed by software, interaction with governance of non-FMI functions.

- **The guidance:**
  - The SA’s governance structure should allow for clear and direct lines of responsibility and accountability.
  - The SA’s governance structure should meet Principle 2 holistically (irrespective of the governance arrangements of other interdependent functions).
Principle 3: Framework for comprehensive risk management

- **Challenges:** interaction with non-FMI functions and involvement of non-FMI entities.

- **Guidance:**
  - The SA should regularly review the risks that the transfer function bears from and poses to its other functions and service providers.
  - The SA should develop appropriate risk-management frameworks and tools to address these risks as part of its comprehensive risk management.
Principle 8: Settlement finality

- **Challenges**: potential of “probabilistic settlement”, ie misalignment between legal and technical finality.

- **Guidance**:
  - The SA should provide clear and final settlement, regardless of the operational settlement method used:
    - clearly define the point at which a transfer on the ledger becomes irrevocable (technical settlement);
    - make it transparent to what extent there could be a misalignment;
    - ensure proper mechanisms for reconciling the misalignment, and
    - have measures to address the potential losses created in case of reversal of transactions.
Principle 9: Money settlements (1)

- **Principle:** the settlement asset needs to carry little or no credit or liquidity risk.

- **Challenges:** stablecoins are neither central bank nor commercial bank money.

- **Guidance (1):**
  - The SA should provide its holders with:
    - a direct legal claim on the issuer,
    - and/or a claim on, title to or interest in the underlying reserve assets for timely convertibility at par into other liquid assets (such as central bank money),
    - and a clear and robust process for fulfilling holders’ claims in both normal and stressed times.
Principle 9: Money settlements (2)

- **Guidance (2):**
  - The SA should minimize and strictly control the credit and liquidity risks of the stablecoin such that the stablecoin is an acceptable alternative to the use of central bank money.

| The clarity and enforceability of the legal rights and protections | The nature and sufficiency of the reserve assets |
| The clarity, robustness and timeliness of conversion process | The creditworthiness, capitalisation, access to liquidity and operational reliability of issuers, account providers and custodians of reserve assets |
| The sufficiency of regulatory frameworks for issuers, managers and custodians of reserve assets | The existence of risk controls |