EUROPEAN CENTRAL BANK

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Money and private currencies: reflections on Libra

Speech by Yves Mersch, Member of the Executive Board of the ECB, at the ESCB Legal Conference, Frankfurt am Main, 2 September 2019

In 1787, during the debates on adopting the US Constitution, James Madison stated that "[t]he circulation of confidence is better than the circulation of money". It's telling that Madison chose to use public trust in money as the yardstick for trust in public institutions – money and trust are as inextricably intertwined as money and the state. Money is an "indispensable social convention" that can only work if the public trusts in its stability and acceptability and, no less importantly, if the public has confidence in the resolve of its issuing authorities to stand behind it, in bad times as well as in good.

Madison's 18th century remark on the link between money and trust has lost none of its relevance in the 21st century. The issue of trust in money has resurfaced in the public debate on privately issued, stateless currencies, such as bitcoin, and their promise to serve as reliable substitutes for public money. Today's conference is neither the place nor the time for me to repeat my past statements on the shortcomings of cryptocurrencies[1] and why they do not fulfil the basic tests of what constitutes "money".

Instead, I will today talk about Libra, Facebook's newly announced private currency. It is scheduled for release in the first half of 2020 by the very same people who had to explain themselves in front of legislators in the United States and the European Union on the threats to our democracies resulting from their handling of personal data on their social media platform.

There are three key questions here. First, how does Libra differ from other private currencies and from public money? Second, what legal and regulatory challenges does it pose? And third, in the light of its mandate, what position should a central bank like the ECB take towards Libra?

The remainder of my speech will be dedicated to these three questions, not with a view to conclusively answering them, but merely to raise awareness of some of the risks of Libra, to question its main premises and, in the process, to highlight the perils of entrusting the smooth processing of payments, the savings of citizens and the stability of the global monetary and financial systems to unaccountable private entities with a questionable track record in matters of trust.

So let me turn to my three questions.

First, how is Libra different from other private currencies and from public money?

Despite the hype surrounding it, Libra is, in some respects, no different from other, established private currencies. Similar to cryptocurrencies, Libra will be issued through a public ledger running on a form of blockchain technology. And similar to e-money, Libra will be distributed to end users electronically in exchange for funds denominated in fiat currencies.

But there are some notable differences that are extremely concerning. Libra's ecosystem is not only complex, it is actually cartel-like. To begin with, Libra coins will be issued by the Libra Association – a group of global players in the fields of payments, technology, e-commerce and telecommunications. The Libra Association will control the Libra blockchain and collect the digital money equivalent of seignorage income on Libra. The Libra Association Council will take decisions on the Libra network's governance and on the Libra Reserve, which will consist of a basket of bank deposits and short-term government securities backing Libra coins. Libra-based payment services will be managed by a fully owned subsidiary of Facebook, called Calibra. Finally, Libra coins will be exclusively distributed through a network of authorised resellers, centralising control over public access to Libra. With such a set-up, it is difficult to discern the foundational promises of decentralisation and disintermediation normally associated with cryptocurrencies and other digital currencies. On the contrary, similarly to public money Libra will actually be highly centralised, with Facebook and its partners acting as quasi-sovereign issuers of currency.

You may be wondering what the problem is with Libra's centralisation. If public money is also centralised, why should Libra be any different?

What the advocates of Libra and other private currencies conveniently gloss over is that, because of its nature as a public good, money has traditionally been an expression of state sovereignty. It is no coincidence that, throughout history, sovereign actors have underpinned all credible and durable currencies. This historical fact, affirmed in G.F. Knapp's state theory of money and in the Chartalist school of economic thought, has had a lasting impact on orthodox perceptions of the concept of money as a public good and has found its way into statutory definitions of legal tender.

When it comes to money, centralisation is only a virtue in the right institutional environment, which is that of a sovereign entity and a central issuance authority. Conglomerates of corporate entities, on the other hand, are only accountable to their shareholders and members. They have privileged access to private data that they can abusively monetise. And they have complete control over the currency distribution network. They can hardly be seen as repositories of public trust or legitimate issuers of instruments with the attributes of "money".

The high degree of centralisation that is Libra's hallmark, and the concentration of its issuance and distribution networks, are not the only features inhibiting trust. Despite its audacious global currency aspirations, Libra lacks a global lender of last resort. Who will stand behind it in a liquidity crisis situation? Libra is also devoid of the equivalent of a deposit guarantee scheme to protect its holders' interests during a crisis. Moreover, the limited liability of the Libra Association members raises serious questions about their resolve to satisfy the claims of Libra holders with their full faith and credit, as central banks do with public money. Finally, the fact that Libra is backed by a basket of sovereign currency-denominated assets appears to defeat the very purpose of its issuance as a private currency. Why bank on a proxy when one can put one's trust in the genuine article? And how will the potential volume of payment transactions settled in Libra affect the monetary aggregates of its underlying currencies, their objectives and intermediate targets?

Let me now turn to my second question, on some of Libra's legal and regulatory challenges.

By straddling the divide separating currencies from commodities and payment systems, digitalised private currencies inevitably raise legal and regulatory questions. Libra is no exception. To keep my speech short, I will only address three of these challenges, but rest assured that there are many more.

The first challenge concerns Libra's fundamental legal nature. The choice is, essentially, whether to treat Libra as e-money, as a financial instrument or as a virtual currency. Libra does not appear to qualify as e-money, as it does not embody a claim of its holders against the Libra Association. If Libra were to be treated as a transferable security or a different type of financial instrument, both the Libra Association and any other entities engaged in providing investment services through Libra coins would fall within the remit of the Markets in Financial Instruments Directive (MiFID II). Alternatively, if Libra were to qualify as a virtual currency then, under the Fourth Anti-Money Laundering Directive, both Calibra and its authorised resellers would become subject to the Directive's anti-money laundering and counter-terrorism financing obligations, and to its registration requirement. Given the different regulatory implications of Libra's legal characterisation, regulatory intervention is essential, to either confirm Libra's classification under one of the existing legal and regulatory frameworks, or to create a dedicated regime adjusted to its specificities.

A second challenge is to ensure that the relevant EU and Member State regulatory and supervisory authorities can assert jurisdiction over Libra and its network. But how can this be done when the entities behind Libra are located outside the EU? One way would be to require national custody of a share of the

Libra Reserve funds equivalent to the amount of Libra in circulation in any given EU Member State. But there may be other ways to ensure effective public control over Libra and its network, and these are worth exploring. Ensuring that payment systems are safe and accessible and exercising control over the financial market infrastructures that underpin our economies will remain public good objectives. And the conditions under which collateral or settlement finality are accepted will remain prerogatives of the regulatory or legislative authorities.

The third challenge is the need for cross-border cooperation and coordination. Because Libra will be used across borders, it is a matter of international interest. Its global nature would also call for a global regulatory and supervisory response to avoid regulatory arbitrage, ensure consistency of outcomes and guarantee the efficiency of public policy responses to Libra. There are welcome signs that the global community is already working together to mitigate Libra's risks. Both the G7 and the Committee on Payments and Market Infrastructures have evaluated Libra, with an emphasis on its potential use in money laundering and terrorist financing. Further work is expected by the G20, the Financial Stability Board and other fora with a stake in the stability of the global monetary and financial system.

Finally, I would like to say a few words about the ECB's general stance towards financial innovations such as Libra.

The ECB's Treaty-based tasks include defining and implementing the single monetary policy and promoting the smooth operation of payment systems. In the context of monetary policy, the ECB takes a close interest in market innovations that could directly or indirectly affect the Eurosystem's control over the euro or shift some of its monetary policy to third parties. Depending on Libra's level of acceptance and on the referencing of the euro in its reserve basket, it could reduce the ECB's control over the euro, impair the monetary policy transmission mechanism by affecting the liquidity position of euro area banks, and undermine the single currency's international role, for instance by reducing demand for it.

In the context of the smooth operation of payment systems, the ECB takes a close interest in market innovations that seek to replace the euro with alternative settlement currencies or create new and autonomous payment channels. Although some of Libra's aims are legitimate, reductions in cross-border fund transfer costs and other efficiency gains can also be obtained through established instant payment solutions. The Eurosystem recently launched the TARGET Instant Payment Settlement service, or TIPS – a pan-European, 24/7 settlement service for instant payments. By operating in central bank money, and by being embedded in TARGET2, TIPS provides a high-performance payment solution that is safer and more economical than questionable, market-based retail payment innovations.

Let me conclude here.

In the field of money, history bears testament to two basic truths. The first is that, because money is a public good, money and state sovereignty are inexorably linked. So the notion of stateless money is an aberration with no solid foundation in human experience. The second truth is that money can only inspire trust and fulfil its key socioeconomic functions if it is backed by an independent but accountable public institution which itself enjoys public trust and is not faced with the inevitable conflicts of interest of private institutions.

Of the various forms that money has taken throughout history, those that have best fulfilled their purpose and proven the most credible have invariably benefited from strong institutional backing. This backing guarantees that they are reliably available, that their value is stable and that they are widely accepted. Only an independent central bank with a strong mandate can provide the institutional backing necessary to issue reliable forms of money and rigorously preserve public trust in them. So private currencies have little or no prospect of establishing themselves as viable alternatives to centrally issued money that is accepted as legal tender.

The stance of central banks towards modern forms of money is bound to evolve with time, and central bankers have embraced technological developments in the field of money and will continue to explore helpful new innovations. But the rise of cryptocurrencies and other forms of privately issued instruments that can only fulfil some, but not all, of the functions of money is unlikely to fundamentally upset the two truths I just described. If anything, it will serve as a useful reminder of central banks' pivotal role as responsible stewards of public trust in money, and stress the need for vigilance towards phenomena capable of undermining public trust in the financial system.

I sincerely hope that the people of Europe will not be tempted to leave behind the safety and soundness of established payment solutions and channels in favour of the beguiling but treacherous promises of Facebook's siren call.

[1] See Mersch, Y. (2018), "Virtual or virtueless? The evolution of money in the digital age", lecture at the Official Monetary and Financial Institutions Forum, London, 8 February.

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