Box 3.2

THE LIBRA PROJECT: KEY CHARACTERISTICS AND RISKS

The Libra White Paper, published on 18 June, formalised the project to create a new cryptocurrency sponsored and promoted by Facebook. The initiative is still at the definition stage, with 28 strategic partners from various origins – tech companies, some key financial industry players, representatives of non-profit organisations and academics, among others – having expressed interest so far.

According to its promoters, Libra's fundamental goal is to help raise global financial inclusion levels. Specifically, it seeks to combine the characteristics of virtual currencies (global reach and low volatility) with those of an infrastructure that will allow transactions to be completed quickly and efficiently, using blockchain technology, digital wallets and smart contracts.

Compared with other cryptocurrencies,[1] Libra presents a series of notable differences. First, the idea is that it will be backed by a basket of deposits and other low-risk high-liquidity assets. The Libra Reserve, as it is called, will be denominated in the main global currencies and administered by a network of custodians worldwide. The returns obtained on these investments will be used to cover the costs of the system and to pay dividends to the partners. Naturally, any change in price in the underlying assets will affect the price of each unit of Libra in any national currency at any given time.

Second, the initial governance model of Libra will not be decentralised. Rather, a non-profit foundation has been set up – the Libra Association – based in Switzerland, which will be responsible for coordinating the founding members when it comes to making the necessary technical, business and management decisions. The aim is to ensure the orderly development and correct functioning of Libra. The Association will also have the exclusive right to create and destroy the cryptocurrency monetary units and to determine the Libra Reserve's management policy.

Lastly, turning to the more technical aspects, Libra is based on open-code software. A new programming language has been developed to simplify the writing of the code and safeguard the integrity of the blockchain. In addition, the network will be administered by a small number of validator nodes, to be confined initially to the founding members.

From the regulatory standpoint, discussions are still ongoing as to the regulations – current or new – that will govern the new cryptocurrency. If it were considered a deposit, it would have to be subject to banking regulation, as this is a regulated activity. However, in the Libra proposal there appears to be no explicit obligation to refund the amount deposited in full. It is also unclear if it can be considered electronic money; if it were, it would be subject to the Electronic Money Directive, but for that to be the case, any holder of Libras would be entitled to be reimbursed by the issuer at any time and for the nominal amount. If it were considered a financial product it would come under the investor protection umbrella, but that does not square with the fact that the main intention is for it to be used as a means of payment. In any event, there must be assurance that Libra customers will receive all the necessary information on the product and that they understand how it works.

Turning to the data protection aspect, the lack of international harmonisation may be an impediment for a proposal with such a global reach. What does seem much clearer, according to the published information, is that Libra would come under the scope both of the anti-money laundering regulations, in its capacity as a platform for exchange of a fiat currency for a virtual currency, and the counter terrorist financing regulations, as a provider of custodial services for electronic wallets.

Given that Libra has the three functions of money – a means of payment, a unit of account and a store of value – it is essential that it be correctly regulated, considering the possible implications for macroeconomic and financial stability if it were to fully evolve as a cross-border retail means of payment. And more so, if it were to cross over from retail payments and gain acceptance in the world of wholesale payments.

Firstly, it may have a significant impact on the effectiveness of monetary policy and the role of central banks. Given its multilateral nature, it could reduce monetary authorities' ability to influence domestic

---

1   The analysis in this box is confined to privately issued cryptocurrencies. For a detailed analysis of the advantages and disadvantages of central bank-issued digital currency, see "Central bank digital currencies", BIS, the Committee on Payments and Market Infrastructures (CPMI) and the Markets Committee, March 2018.

Box 3.2

THE LIBRA PROJECT: KEY CHARACTERISTICS AND RISKS (cont'd)

interest rates if it tries to hold the exchange rate steady, as it would encourage capital flows. Moreover, to the extent that a crypto-asset of this kind may become a generally accepted means of payment, in its capacity as a private money issuer it could affect the money creation process. This could also have fiscal implications as it would reduce seigniorage income.

Regarding financial stability risks, Libra may make the aggregate money supply procyclical, as it will allow assets that are not easily convertible (emerging market domestic currencies) to be transformed into much more liquid assets (Libra). It is important to remember that when a unit of Libra is created, the money used does not disappear, but is invested in other financial assets. Besides, it may have a significant impact on the business of financial institutions, becoming a strong competitor and weakening both their income (fees) and their source of funding (deposits and other finantial instruments).

Lastly, as it is a global currency, with access to the data of more than 2.4 billion potential users and with scarcely no transaction costs, it may contribute significantly to the international transmission of local shocks as it encourages capital inflows and outflows, with major implications for exchange rate shifts and volatility.