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Facebook's Libra: Watershed Moment for Digital Currencies?

Facebook's Libra, a new global digital currency built on an open-source blockchain, with a payment system embedded into its messaging services, may have wide-reaching implications for finance, in particular cross-border payments. This article addresses the benefits of decentralisation in financial services through blockchain technology. It concludes that, the challenges of regulation and adoption to scale aside, digital currencies have the potential to become the predominate medium of exchange, which could transform not only the financial services industry but also alter the way companies and individuals interact and do business.

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1. Introduction

[1] Facebook's plan to launch Libra, a new global digital currency built on an open-source blockchain, with a payment system embedded into its messaging services, poses a significant and immediate question: how deeply will Libra, and other digital currencies like it, transform the traditional financial services and payments industry?

[2] If realised, Facebook's vision could mean the disintermediation of banks and other payment providers by Libra, by enabling instant, near-free international money transfers for Facebook's 2.4 billion users from their mobile phones.¹ Aside from cross-border payments, the widespread use of e-money like Libra could have broader implications for online commerce. The creation of Calibra, the payment service which Facebook aims to integrate into its messaging service, could be used for micropayments between customers, potentially bringing a new way for users to interact with digital content and make digital purchases.

[3] Libra is currently being backed by over 27 partners including payments companies, e-commerce groups and venture capital companies, including Visa, MasterCard, PayPal, eBay, Lyft and Spotify that have said they will integrate the technology into their services. These companies together will form the independent Libra Association that will govern the network and also provide the financial capital to kick-start the project. Libra will be backed by a pool of currencies and assets around the world with a view to providing a stable and safe store of value, effectively setting it apart from other cryptocurrencies like Bitcoin, Ripple or Ethereum, known for their price volatility.

[4] The main challenges for Facebook and any other company entering this space are seen as twofold: regulation and adoption.² Libra has already caused a storm of inquiries and warnings by regulators in the US, as well as UK and Europe. Aside from the regulatory and procedural issues faced by Facebook in setting up a network to move money around the world, including anti-money laundering checks, Libra may have wide-reaching implications for the structure of the financial system, financial stability and governance.³ This has led to an immediate response, most recently from regulators in the G7 nations, who have created a working group to examine the risks of such currencies to the financial system and consider how to ensure proper controls against money-laundering. In the US, there also have been hearings by the US Senate Banking Committee to understand how the currency works. It is expected that Facebook and the Libra Association will need to work closely with regulators if they wish to overcome the many regulatory concerns. In various circles, the viability of the Libra project itself is being questioned, particularly given

¹ <https://libra.org/en-US/white-paper/?noredirect=en-US> (all websites last accessed on 20 August 2019).

² <https://www.ft.com/content/5c0dbb2c-91eb-11e9-b7ea-60e35ef678d2>.

³ <https://www.fsb.org/2019/06/decentralised-financial-technologies-report-on-financial-stability-regulatory-and-governance-implications/>.

Facebook's recent quarterly report to the US Securities and Exchange Commission (SEC) in which it noted the significant regulatory barriers it faces.⁴

[5] In addition, Libra faces the perpetual challenge that other cryptocurrencies face: namely, the adoption of blockchain and cryptocurrencies at scale to make a practical business case for their mainstream use. In particular, the difficulty in convincing merchants to agree to accept the payment in the form of a digital coin whose value would fluctuate against the local currency of the assets used to back the coin. If achieved, this could potentially signal a new era in which digital currencies become the predominate medium of exchange.

2. Cross-Border Payments and Remittances

[6] Decentralisation in financial services through technology-enabled innovation is not a new phenomenon, nor is the idea that distributed ledger technology is capable of transforming many facets of finance, such as retail and wholesale payments, trade finance, capital markets, lending and insurance.

[7] The impact on financial services is likely to be particularly hard-felt in the payments industry, however, given the potential application of blockchain technology on the settlement of interbank payments and remittances. This is particularly so given the inefficiencies, slow speed and high cost of the current banking system. The consultancy McKinsey estimates that fees are commonly 2 to 3 percent of transaction value and can be as much as 10 percent, while settlement of cross-border payments can take several days to clear.⁵

[8] If counterparties were to exchange digital currencies rather than fiat currencies, that is, without having to go through a central regulating body like a bank, payments could be made and settled in a matter of minutes via blockchain, if not seconds. Moreover, the distributed nature of blockchains would mean that a digital record of payments would exist that is both transparent and immutable. It is estimated by McKinsey that the application of blockchain to cross-border payments could save about \$4 billion a year.⁶ In a market that is estimated to be around \$600 billion annually, that is no insignificant amount.

[9] Some initiatives that leverage distributed ledger technology already exist. Ripple, for instance, connects financial institutions and payment providers via their own global payments network, and enable transactions using fiat currency or Ripple's own XRP cryptocurrency. Similarly, Wyre has built a cross-border payments platform and settlement infrastructure. Meanwhile, SWIFT is collaborating with financial technology companies to experiment with distributed ledger technology for cross-border payments. Finally, central banks and other financial institutions that had previously lagged behind the curve are showing signs of increasing blockchain adoption and readiness to engage with the new era of digital currencies. For example, thirteen of the world's biggest banks are preparing to launch digital versions of major global currencies in 2020.⁷ Even

⁴ <https://investor.fb.com/financials/sec-filings-details/default.aspx?FilingId=13550646>.

⁵ <https://www.mckinsey.com/industries/financial-services/our-insights/blockchain-and-retail-banking-making-the-connection>.

⁶ <https://www.mckinsey.com/industries/financial-services/our-insights/blockchain-and-retail-banking-making-the-connection>.

⁷ <https://www.ft.com/content/9fd8e8ea-83e5-11e9-b592-5fe435b57a3b>.

the International Monetary Fund (IMF) has acknowledged that it could release its own digital asset or central bank digital currency (CBDC)⁸ in the future for which the IMF could propose a hybrid public-private blockchain similar to Facebook's Libra or JP Morgan's Quorum.

[10] Despite the upsurge of blockchain-based payments solutions, there remain significant barriers to adoption at scale. One issue is that the transparent nature of blockchain means there are limitations to anonymity in scenarios where sensitive or private data is involved. In response, several companies are exploring the «tokenization» of sensitive data to preserve anonymity.⁹ Another challenge is the inevitable friction caused by the conversion of crypto assets and fiat currencies, particular given the inherent volatility of cryptocurrencies. Enter Libra, a digital currency that is fully backed by a reserve of real-world assets that would effectively minimise volatility, although would not entirely eliminate it, given that the value of Libra would inevitably fluctuate as the value of the underlying assets moves.

3. What Lies Ahead?

[11] Beyond cross-border payments, and the challenges to adoption at scale aside, in an age where online shopping and small mobile payments are rapidly growing, the widespread use of e-money and adoption of digital wallets that enable contactless payments and speed up transaction time and reduce cost could have far-reaching implications.

[12] Libra, or any other digital currency for that matter, could be used to facilitate micropayments, which would allow users to pay for digital content as they read, stream or watch it. With the advent of «smart contracts» on to the blockchain network, agreements expressed in code that enable the automatic transfer of money when certain real-world conditions are met, this could mean the wholesale disintermediation of payments. We discuss in greater detail the key characteristics and advantages of smart contracts in our previous publication.¹⁰

[13] While it is difficult to see how other decentralised financial technologies, like AI or big data, might further impact a future connected world, given the current rise of the «sharing economy» based on peer-to-peer services, it is easy to see how the application of blockchain and smart contracts to cross-border payments could benefit a range of companies and stakeholders. This includes companies like Uber, Airbnb and Spotify, which essentially act as platforms for micropayments, as well as the actual content publishers, creators or owners of digital property who would be able to receive instant payment upon the viewing, use or conversion, by other users, of their respective content or digital property.

[14] We must wait to see if Libra becomes the global currency and de facto money transfer standard that it aspires to be. Given the current resistance that it has been met with by regulators, there is no assurance that it will be able to launch next year as planned, or at all. Notwithstanding, Libra has already succeeded in sparking up a long-awaited conversation and may well serve as a watershed moment for digital currencies. It is clear that digital currencies have the potential

⁸ <https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2018/11/13/Casting-Light-on-Central-Bank-Digital-Currencies-46233>.

⁹ <https://www.mckinsey.com/industries/financial-services/our-insights/blockchain-and-retail-banking-making-the-connection>.

¹⁰ <https://www.clydeco.com/insight/article/smart-contracts-the-next-big-battleground>.

not only to transform financial services but also alter the way companies and individuals interact and do business.

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