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In Depth: Regulatory Hurdles Loom As Facebook Announces Launch Of Libra Coin

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Facebook has finally pulled back the curtain on the worst-kept secret in Silicon Valley: a global peer-to-peer and retail payment system that seeks to plant the use of cryptocurrencies firmly in the payments mainstream.

Soaring ambitions to revolutionise cross-border payments and boost financial inclusion in the developing world through Libra, described as a “stablecoin”, were revealed in a flood of white papers, technical notes and memoranda released by the social media giant on Tuesday.

The effort will leverage the expertise and geographic reach of a club of some of the world’s biggest financial services companies, including Visa and Mastercard, which will throw in $10m apiece to back a reserve fund that underpins the currency and keeps its value steady.

However, questions have already arisen over how the vast payment scheme will grapple with the demands of a milieu of regulators around the world, many of which look upon cryptocurrencies with deep scepticism.

Calibra — the entity being spun off by Facebook to handle the development of the project — has said it “is committed to keeping illicit activity off the platform and working with law enforcement globally” and promised a robust anti-money laundering (AML) and counter-terrorist financing (CTF) programme.

In the United States, it has received authorisation to operate as a money service business by the Financial Crimes Enforcement Network (FinCEN) and said it would comply with the 5th Anti-Money Laundering Directive in the European Union.

But it has not canvassed licensing or compliance structures in other jurisdictions, including the biggest underbanked markets in Asia and Africa it plans to target. A Facebook spokesperson said that discussions with regulators are already underway but did not respond to specific questions about whether it will set up regulated entities in each jurisdiction.

“While the network is open and accessible to everyone with internet access, the network's main endpoints, in the form of exchanges and wallets, will need to follow applicable laws and regulations and collaborate with law enforcement,” Facebook said in a press release.

“In addition, like many other blockchains, the ledger of transactions on the Libra blockchain will be publicly accessible so that it is possible for third parties to do analysis to detect and penalise fraud.”

> “We should not curb innovation while we wait for regulators to catch up,” said David Murray of the Financial Integrity Network. “The onus should be on governments to redesign their counter-illicit finance regimes to deal with the reality that non-banks are playing an ever-increasing role in consumer payments.”

Like cryptocurrenceis such as Bitcoin and Ethereum, Libra “does not link accounts to a real-world identity”. That provides a degree of anonymity for users and means they are “free to create multiple accounts”, Facebook said in a technical paper.

However, Calibra said it would be responsible for carrying out know your customer (KYC) checks on users opening digital wallets that will hold Libra, acting as a choke point that would prevent funds from being purchased and spent anonymously.

It said that it will require “documentary and non-documentary” identity verification, conduct due diligence on customers “commensurate with their risk profile”, report suspicious transactions and apply “the latest technologies and techniques, such as machine learning, to enhance our KYC and AML/CFT program”.

Other participants, including payment processors and cryptocurrency exchanges that will make up the cogs of the global machine, will be responsible for fulfilling their own compliance obligations, a Facebook spokesperson told PaymentsCompliance.

The design of the blockchain, which was also published on Tuesday, appears to allow enforcement authorities to monitor public keys — effectively wallet addresses that investigators can monitor for suspicious activity — said a European lawyer with expertise in application of blockchain and cryptocurrencies to financial services.

“That means from a law enforcement perspective it should be a pretty transparent system,” the lawyer said, speaking on condition of anonymity due to commercial sensitivities.

Livia Benisty, head of financial crime at UK-based firm ComplyAdvantage, said the application of laws and attitudes of regulators across jurisdictions would likely hinge on how users switch between Libra and fiat currencies.

“It will depend very much on what is touching down in the country, to what extent people are paying in and paying out,” she said. “Unless there’s a clear declaration that they can’t do it, then are local banks prohibited from allowing people to cash in and out of the system?”

But the first sign that the regulatory battle will be an uphill one came from closer to home. Maxine Waters, chairwoman of the powerful United States House Financial Services Committee, said the company must stop work on the project “until Congress and regulators have the opportunity to examine these issues and take action”.

Waters warned: “With the announcement that it plans to create a cryptocurrency, Facebook is continuing its unchecked expansion and extending its reach into the lives of its users.

“The cryptocurrency market currently lacks a clear regulatory framework to provide strong protections for investors, consumers, and the economy.”

Patrick McHenry, Republican leader of the House Financial Services Committee, issued a statement shortly afterwards calling on Waters to arrange a hearing on the subject.

“It is incumbent upon us as policymakers to understand Project Libra,” he wrote. “We need to go beyond the rumors and speculations and provide a forum to assess this project and its potential unprecedented impact on the global financial system.”

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Calibra will also pick at Facebook’s deep wells of user data for compliance purposes, but vowed to keep an otherwise strictly policed distance between users’ social media data and their payment activity.

Among the “limited exceptions” to the data separation principle will be “to keep people safe, comply with the law and provide basic functionality to the people who use Calibra”, Facebook’s launch statement said. “Calibra will use Facebook data to … secure customers’ accounts, mitigate risk and prevent criminal activity.”

User data from Calibra will be shared with payment processors, a compliance and privacy statement said, but only that which “is necessary for completing the defined activity or service”.

Over time, Facebook plans to slowly loosen its grip on the network, it explained, placing control in the hands of the Libra Association, which will be situated in Switzerland. Founding members already announced, in addition to the two biggest card schemes, include PayPal, Uber, Stripe and Booking Holdings.

They will also act as “validator nodes” for transactions taking place on the Libra blockchain, which will initially start life as a “permissioned” system among a select group of participants, but is intended to become a “permissionless” open ledger in future.

In terms of the reserve fund, the company said that resellers will be able to move fiat and Libra in and out as necessary.

“These authorised resellers will integrate with exchanges and other institutions that buy and sell cryptocurrencies to users, and will provide these entities with liquidity for users who wish to convert from cash to Libra and back again,” Facebook explained.

> “If you’re putting an entire means of payment on a platform that has been used for such nefarious purposes such far, there are concerns there with what that means,” said Livia Benisty, head of financial crime at ComplyAdvantage.

The structure of the currency and its governing association suggests a level of flexibility that will allow it to bend itself to competing regulatory demands in different jurisdictions, the lawyer said.

“It seems that the plan is to have local players interacting with local users and not having something set up at a global level,” the lawyer said, adding that the explanation of the system seemed akin to the set up of a card scheme.

“The design is open enough to find ways to deal with the different regulatory environments. It doesn’t necessarily matter if one regulator in India concludes that this is electronic money and another regulator in Brazil concludes that this is a financial instrument, and a third regulator concludes that this is an investment fund,” they said.

“It is open enough that they may be able to address all these issues and get the necessary approvals, licences, etc., that are needed in the different jurisdictions.”

Facebook said it wants customers to begin making payments from early 2020, but that is an ambitious target given the regulatory uncertainty surrounding the project, according to Benisty of ComplyAdvantage.

“If anyone is pretending that they’re going to have this nailed down [by early 2020] — they’re not. It’s just not possible,” Benisty said. Even in jurisdictions that have incorporated crypto-assets into existing legislation, there are still gaps and bumps, she said.

But David Murray, a vice president of the Financial Integrity Network in Washington, D.C., said that questions marks over regulation should not be allowed to spoil the project.

“We should not curb innovation while we wait for regulators to catch up,” he said. “The onus should be on governments to redesign their counter-illicit finance regimes to deal with the reality that non-banks are playing an ever-increasing role in consumer payments.”

If Facebook and its launch partners manage to grasp the reins of the regulatory demands placed on them, few are doubtful that it would mark a dramatic turnaround in the troubled reputation of virtual currencies.

“Once this is on the Facebook infrastructure I would imagine that mass adoption is more likely than it would have ever have been,” noted Benisty.

But, she warned: “If you’re putting an entire means of payment on a platform that has been used for such nefarious purposes such far, there are concerns there with what that means.”

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