AT A GLANCE

Scientific Foresight: What if?

European Parliament

What if Libra disrupted the financial system?

As of 2020, Facebook's cryptocurrency project Libra promises to connect everybody to the global, digital world of banking. The introduction of a privately governed currency could fundamentally challenge the current EU financial framework, conflict with EU law and tax requirements, and violate consumer rights.

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Could we abandon the euro and do financial transactions – receiving, transferring and paying money – in Libra? Libra, once launched, would operate as a global digital currency, meaning that users could access, pay and manage their accounts online. Facebook announced its project in June 2019 with a white paper, and envisages launching the cryptocurrency in early 2020. Libra's ecosystem consists of three parts:

1. The cryptocurrency itself (hereafter called Libra);
2. Individual banking with Libra via Calibra, a digital wallet;
3. The Libra Association governing Libra.

The Libra Association would be responsible for ensuring price stability as well as for managing the assets and investments of the Libra Reserve. It currently comprises 29 members, such as payment operators (e.g. MasterCard, Visa, PayPal) and e-commerce businesses (e.g. booking.com, eBay, Spotify, Uber), as well as venture capital and non-profit organisations. Facebook expects this to rise to 100 members ahead of the launch. While two thirds of members are companies and commercial interest groups, notably no banks are part of the Libra Association. Indeed, its private governance structure has been compared to a de facto central bank. Facebook's co-founder Chris Hughes confirmed this argument, stating that Libra will shift power from central banks to corporations. Put differently: its large-scale adoption could threaten the existence of national currencies.

The United States Securities and Exchange Commission is currently debating whether to allow trade in Libra on stock exchanges. If permitted, this would be subject to authorisation ahead of the launch. Jerome Powell, Chair of the Federal Reserve, expressed doubts about data privacy, money laundering, consumer protection and financial stability. President Donald Trump said Libra would have to comply with banking regulation and seek a new bank charter. Internationally, central banks and parts of the financial services industry are assessing potential impacts on the stability of financial markets. Due to EU-specific tax regulations, unforeseen issues for European consumers, and, particularly EU-based SMEs, may arise. The European Central Bank and Japanese, UK, French and German politicians have also announced closer investigation. Legal experts have even advocated calling a halt to the cryptocurrency project. Because of these challenges, it is unclear whether Libra will indeed launch as planned.

Potential impacts and developments

Libra's stated mission is to create a fairer society by empowering unbanked people (adults without a bank account) in developing countries. However, e-commerce and online shopping for European consumers could also change significantly. In the digital ecosystem, users appear to prioritise convenient services over safeguarding individual privacy rights. Libra's payment ecosystem is likely to gain popularity over time. Prominent Libra Association board members would be early adopters, allowing users to familiarise themselves with the Libra currency itself in a first phase. Low entry barriers and minimal costs appeal to convenience-oriented consumers, who would use Libra from time to time in a second step. The Calibra app would integrate payments with WhatsApp, Instagram and Messenger, probably exploiting personal network effects. Should both e-commerce operators and consumers become accustomed to Libra, intervening in the ecosystem would become increasingly difficult. In short, the cryptocurrency could become the largest bank and investment broker worldwide – without a single physical branch.

Widespread Libra use could pave the way towards a cashless society. Nevertheless, when around half of all adult Europeans did not use internet banking in 2017, it is likely that digitally illiterate, poor and elderly citizens would be particularly disadvantaged. Moreover, a cash-free economy depends on a stable electricity supply, an extensive

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communication infrastructure and robust security networks. However, Libra's technical infrastructure is dependent on multiple nodes, such as mobile networks, devices, information technology infrastructure and data flows, operated by numerous stakeholders. These systems are vulnerable to malicious actors and cyber-threats. Pseudonymous transfers could favour money-laundering systems and trade in illegal goods. This poses questions as to what would happen if an account was blocked without prior notification, and which independent instances would help users to enforce their rights. In addition to requiring robust cybersecurity and oversight systems, the necessary increase in data centres and extended technical infrastructure would result in higher energy consumption and environmental contamination with e-waste.

Each member of the Libra Association contributes at least US$10 million to the reserve, backing financial assets and values to avoid price volatility. The incentives for investors include the revenues generated through transaction fees as well as savings as soon as users start exchanging money. Once the Libra Association members' initial investments are reimbursed, the revenues would be invested in low-risk assets that generate dividends over time. In a hypothetical scenario, Libra would make around US$7 billion profits annually after five years. However, Facebook states that 'Users of Libra do not receive a return from the reserve'.

The exchange of transaction and personal data with Libra Association members gives these businesses unprecedented insight about consumers. This would not only conflict with the EU's General Data Protection Regulation (GDPR), but could also result in price-maximising algorithms or possible anti-competitive conduct, since board members could oversee the financial transaction data of smaller businesses. The pseudonymous – not anonymous – transaction process may enable data sharing between Facebook and third parties. This somewhat contradicts the 'strong commitment to protecting customer privacy' stated in the white paper. Although it said it would not do so, Facebook has already sold user data, as seen with the Cambridge Analytica scandal.

The Facebook-owned Calibra application would integrate payments and transfers into Messenger, WhatsApp and Instagram. This would not only facilitate transfers but also automatically merge information about purchases with social media profiles. These demographic, behavioural and psychographic data combinations are highly attractive for businesses to anticipate consumer behaviour and enhance targeted advertising. Given that Facebook makes most of its revenue through advertising, the Calibra wallet would gather profitable data for the company. Finally, the introduction of Libra would fuel a new ecosystem, characterised by an unprecedented close relationship between private banking and commerce.

Anticipatory policy-making

The introduction of Libra raises a range of regulatory, legal and policy challenges, already extensively debated worldwide in the context of the optimal use of cryptocurrencies. Libra is an asset-backed cryptocurrency powered by a permissioned blockchain, to which only a specific group of organisations have access. Should Libra customers be affected by a technical mistake, fraud, or face data privacy problems, the lack of legal recourse and/or of a redeemer of last resort, and uncertainty about the responsibility of jurisdictions raises issues of forum shopping. Consequently, low-regulation extraterritorial jurisdictions, that do not have adequate money-laundering controls in place for example, may develop a significant advantage as service providers by hosting Libra operations. Additionally, Libra's decentralised nature and its private-sector-led character trigger questions about their compliance with standard customer due diligence and financial reporting requirements at supranational level.

To set the legal status of the Libra coin/token and its classification, an international agreement is needed on harmonising existing rules for crypto tokens. This should acknowledge the changing nature of the concepts of money and liquidity, as well as the technological potential of such cryptographic currencies to be encoded in smart contracts. At the same time, data privacy, consumer protection and the security of transaction processes, including strict verification and capital requirements, will also have to be ensured. Co-regulatory oversight of the Libra operation scheme by both state-operators and stakeholders would be needed to prevent money laundering, illicit transactions and consumer fraud. Furthermore, any regulatory initiative in this field needs to focus on strengthening investor protection in view of the increased tokenisation of assets, as well as on substantially improving transparency in the global financial system. The European Banking Authority opinion on 'virtual currencies' puts forward a series of regulatory approaches, and cautions against drawing similarities between existing payment and payment-related services and some virtual currency-based services. As the first case study of blockchain banking, Libra's adoption and use – if Facebook's plans go ahead – would need to be closely monitored from a legal and institutional perspective, as it could have a serious impact on the integrity of existing financial governance schemes, and undermine the orderly functioning of financial markets.

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