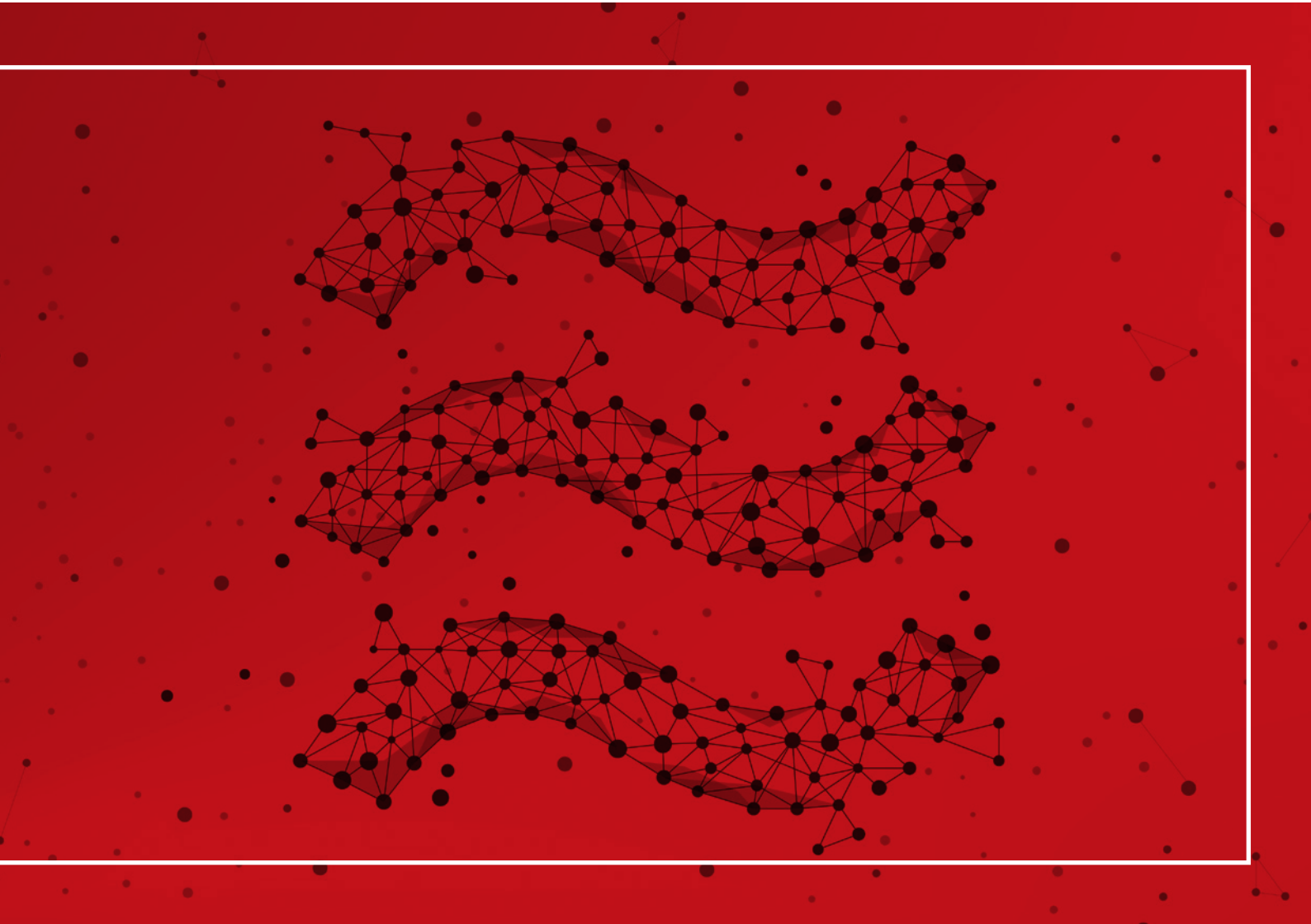


LIBRA: A QUICK TAKE ON FACEBOOK'S CRYPTO PLANS



WHAT IS LIBRA?

Libra is a forthcoming digital, blockchain based cryptocurrency that the Facebook-led consortium 'Libra Association' proposes to launch in 2020. Facebook outlined the vision for the currency through a whitepaper¹ released in June 2019. The underlying framework behind the introduction of Libra is to build a distributed network that can scale to serve billions of people with a stable global digital currency.

The independent Libra Association headquartered in Geneva will govern the initiative. The association already has 28 founding members² and plans to onboard approximately 100 geographically distributed and diverse organizations with each contributing at least \$10 million to the network. Together, these founding members will articulate the vision of making the financial ecosystem more accessible, decentralized and financially inclusive.



HOW WILL LIBRA WORK?

The plan is to form Libra as a consortium of 100 nodes along with Facebook's node, with the authority to validate and add transactions to the blockchain. The transactions will be inherently managed through pseudonyms and will not be anonymous, ensuring that Libra provides regulators with

the ability to trace transactions. It will also allow anyone to offer a custodian wallet (equivalent to a digital bank account). Facebook's subsidiary Calibra³ is building one such digital wallet service for Libra.

KEY FEATURES

Libra plans to differentiate itself from traditional banking through geographically distributed asset-backed currency, lower transaction costs, a smart contract platform, permissioned blockchain and pseudo-anonymous identity.

- **Cryptocurrency backed by real assets to maintain price stability:** Libra will be fully backed by a reserve of assets designed to give it an 'intrinsic' value and mitigate volatility as experienced by legacy cryptocurrencies. Libra reserve will consist of bank deposits and short-term government securities in the form of currencies from stable and reputed central banks, and a geographically distributed network of custodians will hold the reserve.
- **Permissioned blockchain that can scale to a permission-less blockchain:** During the initial phase, only the members of the Libra Association will be able to validate

and add transactions (i.e. a permissioned model) and will have the ability to mint and destroy Libra coins. While this permissioned model doesn't give full decentralization like permission-less model, it provides higher transaction performance (1000 transactions/sec vs. 15 transactions/sec for current blockchain offerings. Compared to current payments services like Visa⁴, which can process 65,000 plus transactions/sec, this is still limited) and lower fees. However, the association aims to become a permission-less chain over the next five years.

- **Financial inclusion with financial disruption:** The vision and objective of Facebook's foray into the world of payments are to disrupt the financial industry and provide access to money to millions of unbanked people who are currently outside the system, predominantly in developing countries in Asia and Africa.

IMPLICATIONS FOR FINANCIAL SERVICES INSTITUTIONS

A stable digital currency will set a stage for the unbundling of financial services which currently have high fees and high friction. Libra could bring disruption in some of those services, such as:

Remittances

Calibra's integration with WhatsApp and Messenger, coupled with a strong customer base of 2.7 billion people and 90 million small businesses could offer a great wallet experience and

disrupt the money transfer service, especially cross-border payments by making them faster, cheaper and frictionless relative to the existing bank processes. In Canada, remittances offer a vast market opportunity for Libra thanks to the country's diverse population. According to World Bank reports⁵, the total remittances from Canada to other countries in 2017 was approximately \$24.5 billion. The average cost of remittances from Canada is around 7 percent⁶ of the value of remittances (approx. \$1.7 billion) then when you include transfer fees

and forex (FX) spread that constitutes a significant revenue contributor to financial institutions/payment services. Adoption of Libra would put this revenue at-risk for banks and other payment services (e.g., western union, etc.), which is a very profitable part of their overall business.

In the cross-border payments space, Coinbase⁷, though not appropriately regulated, currently offers a similar capability that allows users to transfer money from one currency to another within 3-20 seconds. MasterCard Send⁸, is another service launched in May 2019, that aims to reduce friction in cross-border payments by leveraging Interac e-Transfer platform for international money transfer from Canada, starting with European bank accounts.

RISKS AND CONCERNS

Risk to monetary policy

Sovereign nations may consider it a high risk for an externally managed medium of exchange based in Switzerland, to engage in its monetary policy or capital markets. If Libra usage becomes wide enough to offer global citizens an alternative to local currencies, it could threaten the ability of developing economies to control monetary supply, impose capital controls and in turn affect reserves of stable currencies such as US Dollars.

Other financial products

If the Libra network is successful, Facebook could offer other financial services, such as loans to customers/small businesses in the long-term leveraging the vast amount of data it has been collecting. The use case could be similar to Uber's, where Uber in collaboration with Mexico's BBVA bank is providing its unbanked drivers with access to a digital account from BBVA within Uber's mobile app in Mexico. They can access Uber Driver's income via the Uber app and make targeted offers for loan products, etc.

Investment vehicle

Libra mentioned no interest payment until now. However, in the long-term, it can be expected to offer services like Weibo, which offers money market funds and holds the largest portfolio in China today.

Regulatory and privacy concerns

Facebook's subsidiary Calibra is proposed to be kept separate from Facebook's advertising businesses. While Calibra will be regulated, it will not be restricted off Facebook like other payment service providers. However, there is growing skepticism, as a result of recent events (e.g., Cambridge Analytica) and other user privacy issues. Additionally, there are concerns regarding the proposal for developing universal digital identities for billions of people to be used across countries that will be controlled by a private consortium.

WHAT SHOULD BANKS DO?

Many players are entering the market with similar offerings such as JP Morgan which will also be launching its virtual currency (JPM Coin⁹) to speed up institutional payment processing. A consortium of banks, led by UBS and Santander, are also working on a “utility settlement coin” that would expedite the processing of international inter-bank transactions. While banks are responding, they do not have the global customer base and scale that Facebook can bring in. However, with current technology and governance, it will be imperative for banks to look at testing the water in ways like Facebook is doing. Interestingly, there is no bank in the initial list of founding members of Libra.

Banks can opt for some of the following measures:

- Create separate entities that provide on-loading and off-loading services and enable custodian digital wallet services
- Expand the current model of money movement to meet customer demand for multiple digital channels
- Become consortium driven, reduce friction and enable digital currency capability to their customers.



INDUSTRY REACTIONS

Central banks and regulators have already warned that any new currency will be subject to the highest standard of regulatory oversight. Some of the initial reactions are:

- **Jerome H. Powell, chairman of the Federal Reserve**

“the central bank would be looking at Libra very carefully given its potential scale. I think that our expectations from a consumer protection standpoint, from a regulatory standpoint, are going to be very, very high.”¹⁰

- **Mark Carney, Bank of England (BOE) Governor**

“The Bank of England approaches Libra with an open mind but not an open door. Unlike social media . . . the terms of engagement for innovations such as Libra must be adopted

in advance of any launch. To remain a dominant player, we in the U.K. must do what London’s markets have always done: evolve.”¹¹

- **The Bank of Canada** will review Facebook’s whitepaper on its proposed global cryptocurrency Libra very carefully but would not comment on whether the social media giant has been in touch about its ambitious plans.¹²

CAPCO’S TAKE

Libra has the potential to have a significant impact to the way financial transactions are performed; however, given the lack of trust with tech companies in the current environment, it is yet to be proven if the industry and the regulators will adopt Libra.

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