Yves Mersch: Interview with Bloomberg

BIS General Manager Augustine Carstens said in his speech in Frankfurt the other day that there is a “strong case” for authorities to rein in digital currencies because of their links to the established financial system. How would you respond?

The General Manager of the BIS is usually also reflecting the views that are expressed around the table when central bankers come together. You won’t be surprised to know that we at the ECB are fully in line with his views and we have similar worries, or similar endeavours we are working on.

The question is not so much that these virtual currencies (VCs) are already at a level that would cause huge disruption in the real economy, but we are currently more concerned about the social and psychological effect they seem to have. In this respect money has to do with confidence and that’s why we, central bankers, feel that we have a certain role to play to preserve confidence of the public in our legal tender. There is so much money flowing in that it’s like a gold rush – but there is no gold.

What specific role can the ECB as a banking supervisor play in reining in digital currencies?

It’s important to stress that we are a supervisor and not regulator. But supervisors can also impose certain requirements in terms of risk mitigation and prudent behaviour. But by and large, many banks out of their own initiative have already taken clear positions that they will not venture into this gold rush. But that being said, it’s not only the question of the bank supervisor. Also from the monetary policy perspective, the central bank has a mandate to promote sound and efficient payment systems. From that point of view, it remains appropriate that we keep a clear distinction between virtual private initiatives, not backed by anyone, and trusted public currencies that are legal tender and backed by whole economies.

Are you coordinating your efforts with other authorities?

We are obviously in a constant dialogue with other authorities, whose mandate is to maintain the integrity of the markets, protection of investors and of consumers. Therefore we should have a deeper reflection on where the action is needed. There is an area of investor protection, then there is oversight of the financial market infrastructure. If you increasingly have bridges between the virtual world and the real world and then there is a collapse in this virtual world, it could drain liquidity from the real world. This then becomes a concern for the central bank.

Take the example of CCPs: if one were to offer future contracts on such VCs these would then have to be cleared. But CCPs have a single fund of default and if that fund were not sufficient then that would engage the responsibility of other clearers. That would mutualize risks that are emanating from those virtual currencies. The question then arises whether we shouldn’t have a clearer segregation between the real and the virtual world. The same goes for the imported credit risk that could come along and the question of collateral. These are the areas where we have direct responsibility as a central bank.

What is relevant to us is that we protect the functioning of our open market economy. At the same time, if someone wants to play Casino, let him do it, but then we shouldn’t mutualize losses with the rest of the society.

What tools do you have to keep this virtual world at bay and do they need reinforcement?

Our existing frameworks for monetary policy clearly don’t accept these assets as collateral and we will also not accept them to enter our existing platforms like Target-2 – these rules are already in place. The question is: should we go beyond?

If banks were to start leveraging, i.e. giving loans to finance such activities, then it would obviously be of concern for us, not only from the point of view of the risk management as a supervisor, but also in the view of our role to support financial stability and in view of our functioning, because we conduct monetary policy through banking system so we need a sound banking system.

Would it help if also in the market infrastructure we would have the obligation to segregate accounts or to have higher capital retention? Those ideas are typical tools that are at disposal of either the central bank or the supervisor or macroprudential authorities and we might have to take a look whether they are also applicable to those virtual currencies and whether the time has come to go that way. But since some of those VCs have no national base, but rather define themselves as being globalized it would be best to have a globalized response and that’s why the G20 is looking into the matter.

In what areas do you foresee the need for more forceful global response?

Since I have heard from different locations of similar concerns, we are all working at home, looking at what could be done. But it’s at a very premature stage because we don’t want to overdo it. We are in an open society, where people are free to lose money as they like.

It’s a phenomenon that affects central banking, payment systems, banks and financial market infrastructure. By definition those activities become cross-border so a cross-border response is always preferable to a fragmented national one. In many jurisdictions there is a very high concern about money-laundering and terrorism financing. What needs to be decided here as a super-priority has to do with the level of political responsibility rather than the level of individual agencies. Therefore the G20 where you also have the government side coming is a welcome forum.

The second in the list of priorities is to have more information because it’s very difficult to have access to what is happening and where it’s happening.

We need more information and that’s why for me one obligation would already be to force the unregulated platforms to report transactions in a harmonized way to repositories so that we would have access to information also in order to create a better response. I hear often that there are concerns of criminal activity and the amount of hoaxes in this virtual world is rather high. So the main concern is the absence of proper information and the absence of traces so you could track the transactions. So this is certainly something that specialized staff in different member states will also look into.

Your colleague Benoit Coeuré said recently that the ECB expects G-20 meeting in March to focus on coordinated response to the growth of digital currencies and urged leaders to come up with a regulatory answer. What are you expectations about this meeting in Buenos Aires?

You should not think of a meeting as being a switch. It will launch a certain amount of studies, it will probably task a certain number of existing institutions to dig deeper and then we will start the work. But in the meantime we already prepare in-house. Whatever happens, we want to be prepared.

What can you do until this coordinated response is ready?

We have on the one hand our existing toolbox. It always is useful if you look at the toolbox again in terms of what is possible from the point of view of a new application. Then you can see that a lot can be done already. Some measures might also be taken without huge or difficult legal changes.

Could you give us an example?

Our collateral framework, our platform where we are an operator, we have our payment systems, we are in the midst of discussing European framework for CCPs – these are all areas where there is still time and where a certain amount of legislation is still under review, so we could add it.

Would you be ready to abandon your TIPS initiative in favor of a blockchain/DLT based solution? The conclusion to your Stella project with BOJ says “DLT-based solution could meet the performance needs of current large value payment systems”?

TIPS is 10 seconds, 0.2 cents. DLT transactions are at best 30 euros and take at least one hour. Why would we abandon TIPS? We have a mandate for efficient payment systems, and we go for efficiency. We are not bound to a technology, we are bound to results, and I think it’s the result that counts.

As to the technology of DLT, we are testing it but there are so many unsolved questions in terms of governance and legal certainty in DLT. We are looking to what extent we could overcome these legal barriers, but we are at a very early stage.

There seems to be a certain change of tone in how you and your colleagues now speak about digital currencies. In the past some of your colleagues largely dismissed it as, for example, Tulip mania with no immediate consequences for the central bank. What prompted this bigger sense of urgency that something

needs to be done right now?

As long as it was negligible it was not considered a priority, but since this hype accelerated at the end of last year it has moved higher up on the agenda. If you see how fast something can develop, it can very quickly reach dimensions of past bubbles that also had negative effects on the economy. That we cannot ignore. The valuations are not at a level where you would now jump from your chair and say “you need to forbid this thing”. We are not there. But what I do not like is the public hype driving this thing. Also the amount in ICOs is rather small. But this is market integrity, this is protecting the consumer. Here you can’t say it’s also affecting monetary policy. One thing to remember is also that we target asset bubbles if they are a risk for financial stability, and are debt-financed.

If we could fast-forward a bit – can you imagine a situation where there is going to be one day a digital euro? Do you completely rule out such development – a digital fiat currency?

I’m not a science fiction writer so in my official imagination I would restrain myself at best to look at certain circumstances if citizens were to desert cash, which is not the case right now. I could imagine a digital representation of cash, meaning a digital issuance that would replicate the features of cash, not a new digital currency disrupting bank intermediation, in order not to rock the boat of our whole economy and put into question the functioning of a two-tier banking system. So why would we do it? For the sake of disruption? We have made so much effort to make our banking system safer and sounder again, and we are still not fully finished. Why would we then discontinue with that? I think there would be a price – and maybe not a small price – in doing away with the banking system from one day to the next.