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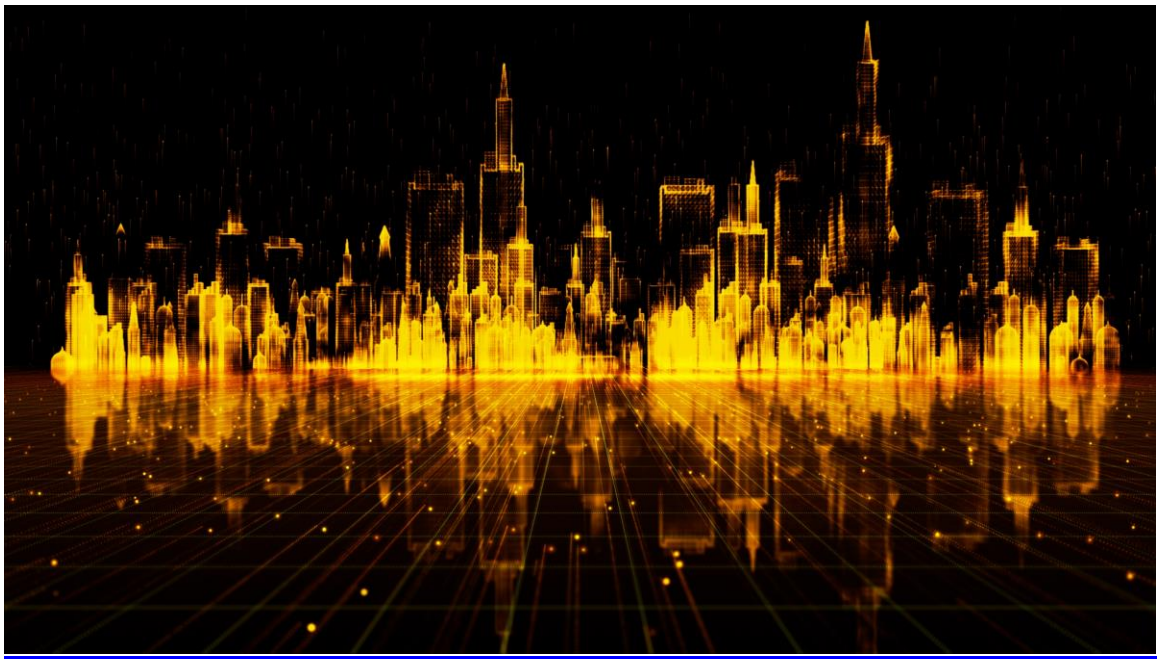


Basel iii News, May 2022

Dear members and friends,

Pablo Hernández de Cos, Chair of the Basel Committee on Banking Supervision and Governor of the Bank of Spain, gave a great presentation at the 36th Annual General Meeting of the International Swaps and Derivatives Association in Madrid.

Computers and money: the work of the Basel Committee on cryptoassets

Introduction

Good morning, and thank you for inviting me to speak at your 36th Annual General Meeting (AGM). On a personal level, let me welcome all of you to Madrid. I hope that you will have the time to visit and enjoy all that it has to offer. It's great to see meetings and events slowly taking place in-person once again.

I understand that the last time ISDA held an in-person AGM was in April 2019. I don't think it's an understatement to say that the world has changed profoundly since then.

A global pandemic, heightened geopolitical tensions and rising stagflationary pressures, to name just a few developments, will continue to shape the risk environment for the banking system over the coming months and years. Vigilance continues to be the watchword for both banks and their supervisors.

But there are also medium-term structural trends and developments that have continued to grow in importance. Most notably, the twin forces of digitalisation and climate-related financial risks will be at the centre of the Basel Committee's priorities over the coming years.

Add to this the growing interconnections between banks and non-bank financial intermediation (NBFI) and rising debt (both public and private), and you have no shortage of vulnerabilities that need careful monitoring and management.

I will focus my remarks today on a subset of these structural trends, namely, the Committee's work on digitalisation, with a particular emphasis on cryptoassets. But before I do so, let me first mention another pivotal element of the Basel Committee's work over the coming years.

As just discussed in the previous session, implementing all aspects of the Basel III framework in a full, timely and consistent manner is an imperative for our member jurisdictions.

Events over the past two years, including the pandemic and the Ukraine conflict, have once again highlighted the importance of having a prudent and robust global regulatory framework in place.

These events have also underlined how we cannot afford to leave unaddressed the remaining fault-lines in the regulatory framework. We may not always have as much fiscal and monetary space available to respond to future crises as was the case over the past two years. Banks' self-resilience will therefore depend even more critically on their own capital and liquidity resources.

A key aspect of the outstanding Basel III reforms is the revised market risk framework. As you know, the revised framework seeks to address a number of shortcomings related to banks' trading books that were painfully exposed during the Great Financial Crisis, including:

A porous boundary between the trading and banking book, resulting in exploitative regulatory arbitrage. The gravity of this behaviour during the GFC made it the textbook example for regulatory arbitrage.

The revised framework introduces more prescriptive requirements when it comes to the scope of instruments that may, or may not, be included in the trading book.

Internal models that lacked robustness and could not account for the magnitude of extreme financial shocks.

More than a decade since the GFC, we continue to see how existing value-at-risk (VaR) models are incapable of capitalising against such events: the number of VaR breaches by major internationally active banks in response to market volatility over the past two years exceeded pre-pandemic breaches by an order of magnitude.

This time is certainly not different. The revised framework replaces VaR with an expected shortfall model that better captures tail risks and limits the discretion available for banks to determine capital requirements.

The lack of an appropriate standardised approach to serve as a credible fallback to internal models, thus increasing the incentives for aggressive modelling behaviour and lowballing modelled capital requirements.

A fundamentally redesigned standardised approach will bring greater risk sensitivity and serve as the basis for calculating market risk requirements for the "output floor". This, in turn, will help ensure that banks' modelled capital requirements do not fall below a certain level. It will also facilitate the comparability of banks' market risk profiles within and across jurisdictions.

It is in our collective interests to see the Basel III reforms implemented in full and consistently. ISDA and its members can contribute to locking in these financial stability benefits by doubling down their efforts and focus towards implementing these standards.

In that regard, allow me to be somewhat blunt: the time for negotiations and lobbying is over. The Committee will in due course evaluate the impact of all of its reforms after they are implemented.

Cryptoassets and DeFi: some progress, but much more work needed

There was a quip about three years ago that described cryptoassets as "everything you don't understand about money combined with everything you don't understand about computers". I think it's fair to say that, since then, our understanding of both the economic and technological dimensions of cryptoassets has deepened.

Despite our better understanding of cryptoassets and DeFi, the jury is still out when it comes to ascertaining how best to harness their oft-cited

promises and benefits, while mitigating their risks and safeguarding financial stability. The shortcomings of the existing financial architecture are well known, including at times high costs, low speed, limited access and insufficient transparency.

The purported aims of DeFi and cryptoassets of a seamless, open, inclusive and transparent financial system are certainly noble. Some might also sympathise with the idea of a robust network characterised by its "unstructured simplicity", as originally envisioned by Satoshi Nakamoto.

To read more: https://www.bis.org/speeches/sp220512.htm

CBDCs for the People

Agustín Carstens, General Manager of the BIS, and H.M. Queen Máxima of the Netherlands, the United Nations Secretary-General's Special Advocate for Inclusive Finance for Development, published by Project Syndicate.

Central banks around the world are considering whether to issue their own digital currencies. While financial inclusion is often cited as a key motivation, this is not automatic. Precisely how can central bank digital currencies (CBDCs) be designed and implemented to ensure that "unbanked" people have access to essential financial services?

According to the World Bank, 1.7 billion adults worldwide are unbanked. With no access to services from the formal financial sector, they are forced to resort to alternatives, often at significant cost or risk. Such financial exclusion entrenches poverty, limits opportunity and prevents people from protecting themselves against hardship. It stifles hope for a better future.

Financial inclusion starts, but does not end, with the ability to make and receive payments. People need a fast, secure, and cheap way to transfer money. To date, central banks have largely met this need by providing the most inclusive form of money we currently have: cash. However, using cash exclusively leaves the unbanked outside the formal financial system and without the data and transaction trail needed to readily access financial services. This can make it much more difficult for small businesses to build savings and gain access to credit.

But due to the widespread adoption of digital and mobile technologies, the payments landscape is changing. Cash transactions are declining, and there is a shift toward digital activity – a trend accelerated by the COVID-19 pandemic, when online transactions surged. Given these broad developments, it is imperative that we work to close the widening digital divide. Central banks and policymakers now have an opportunity to explore reforms, including the issuance of digital central bank money for all.

CDBCs could offer an opportunity to overcome some barriers facing the unbanked. Traditional services have potentially prohibitive costs and requirements such as transaction fees, minimum account balances, or formal proof of identification. Additional obstacles include the low level of trust in digital payments and the lack of smartphones among some groups.

Central bank digital currencies: a new tool in the financial inclusion toolkit?

FSI Insights | No 41 | 12 April 2022

by Raphael Auer, Holti Banka, Nana Yaa Boakye-Adjei, Ahmed Faragallah, Jon Frost, Harish Natarajan and Jermy Prenio

PDF full text (1,709kb) | 39 pages

You may visit: https://www.bis.org/fsi/publ/insights41.htm

While CBDCs are not the only way to overcome these barriers, they could be part of the inclusion toolkit. Central banks are already coordinating further improvements to retail payments by adopting fast payment systems, and CBDCs represent a natural extension of this continuum.

Both fast payment systems and CBDCs can spur competing providers to offer new services, lower costs, and, ultimately, broaden access. A further benefit of CBDCs is that, by their very nature, they will incorporate the unique advantages of central-bank money – safety, finality, liquidity, and integrity.

CBDCs could bypass many of the vested commercial interests that have cropped up around payment systems and contributed to inefficiencies and costs for users. They could also lower costs by removing the credit and liquidity risks inherent in other forms of digital money.

A CBDC has the potential to upgrade and connect payment systems – both domestically and across borders. It could spur countries with limited financial infrastructure to leapfrog directly to a CBDC arrangement, creating an opportunity to connect to an inclusive, safe, and efficient payments system.

There are also benefits for social policies. For example, governments could use CBDCs to channel financial support to low-income households, which would deepen longer-term inclusion and act as another gateway to other financial services.

To realize these benefits, any CBDC rollout must be accompanied by policy reforms and safeguards to address potential difficulties and risks, such as low levels of financial and digital literacy, and operational challenges, including cybersecurity.

Policy reforms also should prevent disintermediation: the danger that money will be held in large amounts in CBDC wallets, rather than as deposits in commercial banks, making it unavailable for lending (such as mortgages) and other productive purposes.

Central banks also should consider designing CBDCs to level the playing field. Give people control over their transaction data and the ability to share it with a wider set of financial service providers. Growing concerns about data privacy could be addressed by hardwiring personal data protections into the structure of a CBDC.

Central banks exploring CBDCs will have many design choices to make to balance privacy protection and transparency, and to ensure both financial inclusion and financial integrity.

They will need to consider whether to grant direct access to consumers or to use a purely intermediated model that offers CBDC digital wallets through banks or nonbank financial service providers. More dialogue, research, and trials will be needed to show how CBDCs can best become engines of financial inclusion.

Central bankers and other public-sector representatives have a duty to ensure the financial system is inclusive, open, competitive, and responsive to the needs and interests of all groups. If designed properly, CBDCs hold great promise to help support a digital financial system that works for everyone.

To read more: https://www.bis.org/speeches/sp220418.htm

BIS Papers No 123

CBDCs in emerging market economies

Monetary and Economic Department, April 2022

CBDCs in emerging market economies

Sally Chen, Tirupam Goel, Han Qiu and Ilhyock Shim

Introduction

In recent years, in both advanced (AEs) and emerging market economies (EMEs), central banks have become increasingly engaged in projects related to central bank digital currencies (CBDCs) – ie digital money that is denominated in the national unit of account and is a liability of the central bank (BIS (2021)).

However, the stage of engagement – research, pilot or launch – varies according to the country.

All 26 central banks participating in this meeting (Annex Table A1) are active in CBDC research. Several have progressed to the pilot or proof-of-concept stage (eg Hong Kong SAR, Saudi Arabia, Thailand, the United Arab Emiratis (UAE)).

A few are close to launching (eg China's eCNY), while some do not see a pressing need for a CBDC in the near future (eg Poland, Singapore).

This paper begins by discussing the main motivations of EME central banks for CBDC engagement, focusing primarily on the rationale for retail CBDCs.

A second section reviews central banks' main concerns regarding retail CBDCs, including data privacy and data governance.

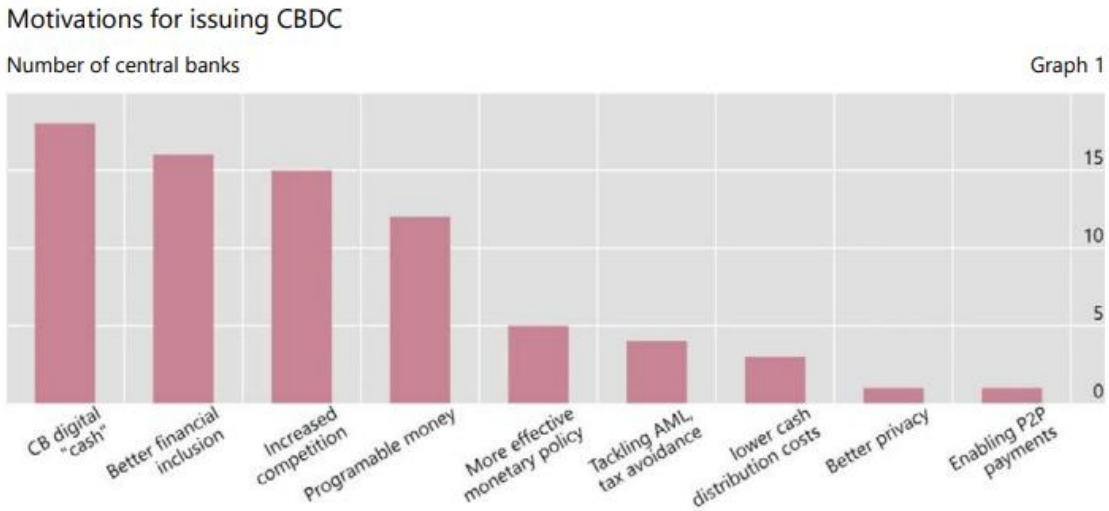
The third section discusses design choices for retail CBDCs that promote central bank objectives while addressing possible concerns.

The fourth section discusses the implications of cross-border use of CBDCs and related design considerations.

The paper concludes with high-level takeaways. Throughout, the paper draws on survey responses and background papers from the central banks participating in the meeting.

Motivations for CBDC issuance

The top motivations for CBDC issuance vary across EMEs, with no single factor dominating, as the survey shows (Graph 1).



Each bar indicates the number of central banks that choose a given motivation as one of its top three motivations.

Source: BIS EMDG survey 2022.

Providing a cash-like digital means of payment, in light of reduced cash usage and an increase in private digital payment services, is the most common consideration.

Boosting financial inclusion also ranks high. Other significant considerations include strengthening competition among payments service providers (PSPs), increasing efficiency and reducing the costs of financial services.

Background papers suggest that these motivations are not mutually exclusive. Indeed, a majority of central banks consider many of these motivations as jointly important (Annex Table A2 on central bank survey responses).

Provide cash in digital form

The digital revolution is changing the payments landscape. As big techs and fintech firms move into financial services, payments are no longer a commercial bank monopoly.

New forms of digital asset such as cryptocurrencies and stablecoins are also emerging as a potential means of payment.

In many EMEs – including India, Pakistan, Kenya and Tanzania – digital payments via mobile phone have gained ground.

Meanwhile, the cash-to-GDP ratio – a proxy for the use of cash in payments – has declined in a number of EMEs (CPMI (2021)). In China, for example, cash could lose its central role in the not-too-distant future.

Against this backdrop, a CBDC could serve as a tangible marker of the trust in money, just as cash does today (BIS (2021)).

In the same vein, central banks in Chile and Indonesia noted that CBDCs could also help central banks maintain their role as the issuer of the unit of account and as the anchor of the monetary system.

The Reserve Bank of India noted another possible motivation for issuing a CBDC – potential savings from reducing cash in circulation.

Savings could stem from lower costs related to printing, transporting and storing banknotes and coins.

The potential for savings is greater in economies where cash circulation remains high.

To read more: https://www.bis.org/publ/bppdf/bispap123.pdf

Statistical release: BIS international banking statistics and global liquidity indicators at end-December 2021

• Banks' outstanding cross-border claims changed little overall in the fourth quarter of 2021. Their year-on-year growth rate slowed to 1.6%.

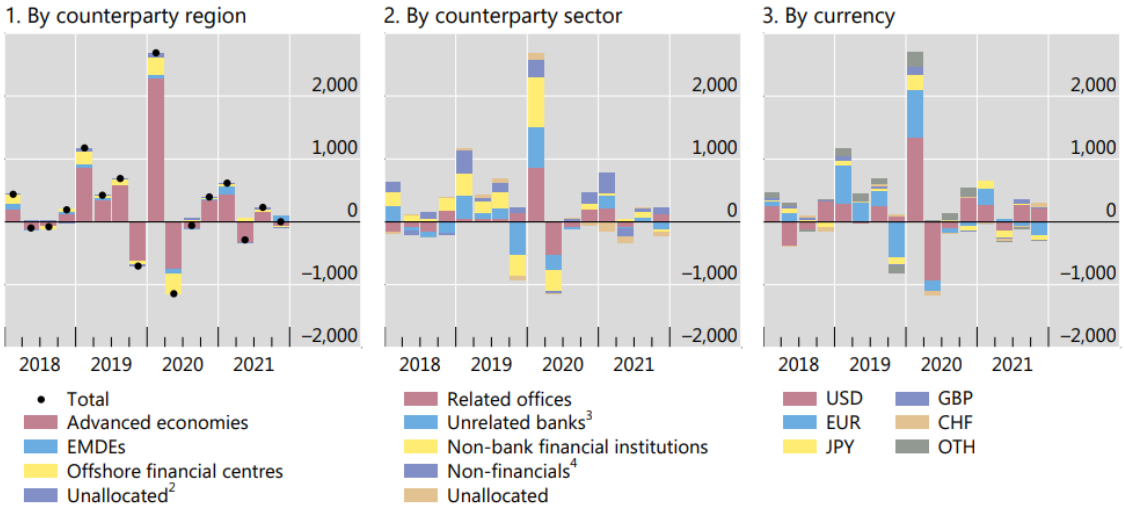
• Cross-border claims on emerging market and developing economies (EMDEs) increased by $103 billion, mainly vis-à-vis Latin America and Africa and the Middle East.

• Cross-border claims on Russia were about $90 billion at end-2021, down markedly from 2014. Banks in Europe account for most of the outstanding claims.

• Issuance of international debt securities continued to drive growth in global foreign currency credit to non-bank borrowers.

Global cross-border claims

Value-adjusted[1] quarterly changes, in billions of US dollars — Graph 1



[1] Adjusted for breaks in series and changes in exchange rates. [2] Includes international organisations. [3] Includes central banks and banks unallocated by subsector between related offices and unrelated banks. [4] Includes non-banks unallocated by subsector.

Source: BIS locational banking statistics.

Global cross-border claims changed little in Q4 2021

The BIS locational banking statistics (LBS) show that internationally active banks' outstanding claims amounted to $35 trillion at end-Q4 2021, virtually unchanged from the previous quarter on an exchange rate-adjusted basis (Graph 1.1).

Their year-on-year (yoy) growth from end-2020 was 1.6%. This compares with prepandemic yoy growth rates of more than 5%.

The overall stability during the quarter concealed large changes in claims on particular regions and sectors, and across currencies (Graph 1).

Claims on EMDEs rose substantially ($103 billion) during the quarter while those on advanced economies (AEs) and offshore financial centres (OFCs) declined (Graph 1.1).

By sector, claims on unrelated banks (-$129 billion) were lower, but claims on related offices rose ($115 billion) as did claims on non-financial borrowers ($106 billion) (Graph 1.2).

As for currencies, as in the previous quarter, US dollar-denominated claims expanded while euro claims contracted (Graph 1.3).

Within the overall decline in claims on AEs and OFCs were large differences across countries and jurisdictions.

Banks' claims on the United States grew (+$182 billion) during the quarter while those on Japan and Europe shrank (–$95 and –$254 billion), notably vis-à-vis borrowers in France, Finland, Germany and the United Kingdom.

Among OFCs, the declines in claims on the Cayman Islands and Hong Kong SAR (–$49 and –$29 billion) were larger than the increases in claims on Macao SAR and Singapore.

To read more: https://www.bis.org/statistics/rppb2204.pdf

Green Swan 2022

A virtual conference co-organised by the Bank for International Settlements, the European Central Bank, the Network for Greening the Financial System and the People's Bank of China.

Building on the foundation of the inaugural Green Swan Conference in 2021, which brought together a wide range of high-calibre policymakers, experts and practitioners from different sectors, Green Swan 2022 offers a deeper dive into the topics of:

(i) monetary policy setting and operations in the context of climate change, and

(ii) the role of finance in the climate transition, including transparency and disclosures, transition plans and financing green innovation.

The conference will be fully livestreamed. Join the conversation on social media using #GreenSwanConference

Opening event

09:30 - 09:35 **Welcome remarks**

Luiz PEREIRA DA SILVA
(Bank for International Settlements)

09:35 - 10:05 **Opening address**

Ravi MENON
(Monetary Authority of Singapore; NGFS)

Session 1: The role of finance in climate transition

11:20–11:35 **Keynote speech**

ZHOU Xiaochuan
(China Society for Finance and Banking; former Governor of the People's Bank of China)

11:00–12:30 **Roundtable: What can the public and private sectors do to turn transition finance framework to actions?**

Chair: MA Jun
(G20 Sustainable Finance Working Group; China Green Finance Committee)

Masyita CRYSTALLIN
(Indonesia Ministry of Finance)

Paulina DEJMEK HACK
(European Commission)

Emmanuel FABER
(International Sustainability Standards Board)

Daniel HANNA
(Standard Chartered Bank)

Kamran KHAN
(Deutsche Bank)

Vivek PATHAK
(IFC - International Finance Corporation)

Nicolas STERN
(London School of Economics)

To read more:
https://www.bis.org/events/green_swan_2022/overview.htm

Agenda:
https://www.bis.org/events/green_swan/green_swan_2022_agenda.pdf

The impact of digitalisation on the financial system

Burkhard Balz, Member of the Executive Board of the Deutsche Bundesbank, speech delivered at the FGV-Ebape in Rio de Janeiro

1 Introduction

Ladies and gentlemen, FGV students and faculty members, Professor Norden,

Thank you very much for inviting me here today. It is a great pleasure for me to be at the FGV-Ebape in Rio de Janeiro. Given the restrictions imposed by the coronavirus pandemic over the last two years, I do not take this opportunity for granted and am very thankful for the chance to exchange views with you today.

One thing is for sure; you can`t go to Brazil and not go to Rio de Janeiro. When you think about Brazil, it is Rio that first comes to mind. Rio is one of the most sought-after destinations in Brazil and has more citizens than some European countries in total.

However, Rio de Janeiro is not just known for its carnival and sunny beaches, but also for its unique fintech climate and its role as an economic powerhouse. The city of Rio de Janeiro is home to the headquarters of many private, national, multinational, and state corporations. Needless to say, the rise of digitalisation in society and business will also affect the future of this city.

I am not only delighted to be in Rio de Janeiro, but, more importantly, to be able to discuss the impact of digitalisation on the financial system with you here at the FGV-Ebape today. Digitalisation is picking up speed.

This affects universities, as well as you as students. Not just as consumers, but also as future employees and managers in business, digitalisation will accompany you throughout your lives. Digitalisation is pertinent to the entire financial sector.

As my colleague Roberto Campos Neto, President of the Banco Central do Brasil, once so aptly put it: “There can be no more difference between a large bank or a fintech. All financial institutions must be digital.”

Digitalisation is also very evident in payments: it fundamentally changes the way we pay. This brings me straight to the subject of my speech. As the

Deutsche Bundesbank Executive Board member responsible for the area of payments, I have been monitoring changes in this sector since September 2018.

It is clear to me that the pick-up in the pace of digitalisation is caused by demand as well as supply factors. So I'll begin my remarks by discussing changes in user and payment behaviour. Afterwards, I'll address the challenge posed by new players in the payments space.

I would then like to outline my thoughts on how we should react to the new challenges. These thoughts can be summarised under one key heading: updating existing payment systems, for example via instant payments, and also central bank digital currency (CBDC). In the context of the latter, I will also give a brief overview of the ongoing project on a digital euro.

2 Challenge 1: Changes in user and payment behaviours

When it comes to payment habits, cash remains the number one means of payment at the point of sale in Germany. The general public still delve into their wallets for coins and notes to settle around 60% of payments when they're out shopping.

That is one of the key findings from the payment behaviour study which the Bundesbank conducts regularly, most recently in 2020. As a means of payment in the German retail sector, cash still has a high standing.

However, it is losing significance – the share of cash was 74% in the preceding study from 2017, thus decreasing by an impressive 14 percentage points within only three years. Certainly, the coronavirus pandemic gave non-cash payments an extra boost here.

In my view, Brazil and Germany are not that different from each other in this respect – in Brazil, too, cash still is the preferred means of payment for many people, but non-cash payments are experiencing strong growth, helped along by the coronavirus pandemic: to my knowledge, between 2019 and 2020, cash use at the point-of-sale fell by almost 25% in Brazil.

However, the Brazilian market differs from that of Germany in one major aspect: while there are more than 110 million bank accounts in Germany (for 83 million inhabitants), a significant proportion of the Brazilian population has no access to banking services in a traditional sense.

Digital technologies could therefore present an opportunity to further bridge the financial inclusion gap. We can observe this evolution here in Brazil already, as the pandemic produced strong growth in the number of digital bank accounts and significantly increased the access of citizens to banking services.

At this juncture, I would like to praise the Brazilian central bank for being an active driver of developments in the booming fintech market and for fostering competition and innovation in the banking sector. The most prominent example might be the new – and already very successful – instant payment system Pix.

The central bank's efforts have resulted in a considerable increase in competition – according to one study, more than 100 Brazilian fintech companies are now active in the field of payments.

This means that usage patterns are evolving. Digital financial and payment services are gaining ground. Just a year and a half after Pix was launched, more than half of the Brazilian population have already used it, underlining just how quickly the adoption of digital payments can spread.

The situation is changing in Germany, too, where contactless payments based on NFC technology are particularly popular. For instance, at the end of 2021, three out of four (73%) payments of the debit card[6] common in Germany were contactless.

In Germany, there are more than 100 million cards in circulation. The system is operated by the German banking sector and is independent of international credit card companies like Visa and Mastercard.

In Germany, more and more customers are reaching for their smartphone instead of cash or card when paying for goods. Here, mobile payments are gaining more momentum by the day.

Something similar is happening in Brazil. The average citizen here owns 1.6 smartphones and payments with digital and mobile wallet are growing. Brazil's instant payment system Pix contributes to this, offering various overlaying services including QR code and NFC payments.

In Germany, savings banks and cooperative banks also run a successful peer-to-peer (P2P) mobile payment service. Thus, in Germany, the topic of smartphone payments is being pushed by both bigtech firms and banks.

3 Challenge 2: New actors in the payments markets

This brings us to an important driver of digitalisation in the financial industry in both Brazil and Germany: New players, namely fintech and bigtech firms.

Fintech players – that is, fledgling start-ups offering innovative technology-enabled financial services – also feel very much at home in the payments market. These newcomers are starting out on greenfield sites and are able to build their systems from the ground up in a way that lets them

leverage the opportunities offered by the platform economy and digitalisation. One example of this is smartphone banks such as Revolut in the United Kingdom or N26 in Germany and also here in Brazil.

A key element of the new digital banking world are the much-discussed application programming interfaces – APIs. So-called open interfaces that allow for the seamless interlinking of different services – like bank account management and payments. Many fintech firms are basing their business models on these interfaces.

And yet even the traditional banking industry in Europe recognises the importance and urgency of refining its own business model in times of open banking and open interfaces.

More and more credit institutions are therefore deliberately positioning themselves as platform providers. The idea is to create one's own API ecosystem which allows bridges to service providers across Europe to easily be built. This development is also covered and supported by European law and a corresponding legal framework – most prominently the revised Payment Services Directive (PSD2).

In Brazil, too, new players are stirring up the financial industry. Nubank, for example, reminds me of Germany's N26 since it also focuses on smartphone banking: account and payment services as well as all communications take place via the customer's mobile device.

After being publicly listed at the New York Stock Exchange, Nubank is one of the largest and most valuable digital banks worldwide. Interestingly, Nubank also runs an office in Berlin so as to benefit from the German IT developer scene.

From Germany, I can report that fintech firms definitely have a big impact, because we are seeing more and more cooperative ventures between credit institutions and fintech players. These allow the former – the banks – to provide their customers with convenient, innovative services within a short space of time.

The latter – the fintech businesses – get to tap into a large customer base and benefit from the confidence shown in them and from regulatory expertise, amongst other things. Between them, fintech players and traditional banks are often forming quite a symbiosis.

By contrast, bigtech players are transforming the European financial sector and particularly the world of payments far more radically than the up-and-coming fintech firms ever could. Bigtech firms are the heavyweight global tech businesses and platforms such as Apple, Amazon, Google and

Meta, formerly known as Facebook from the United States, Alibaba and Tencent from China or MercadoLibre in Latin America.

Bigtech players can leverage a large, existing customer base, technological expertise and sizeable financial resources to conquer new markets. For instance, the dominant force in e-commerce in Germany has, for a long time now, been the US group Amazon – which also offers a payment service of its own. Google Pay and Apple Pay are two other bigtech players that offer their payment services in a wide range of countries, including, of course, Germany and Brazil.

China offers a very vivid example of how far bigtech services can penetrate people's day-to-day lives: there, WeChat and Alipay, which is affiliated with the e-commerce giant Alibaba, can be used not only as a payment method, but also to directly order food, buy cinema tickets or call taxis – all services united on a single platform.

This development is, however, not without its problems from the point of view of the consumer, nor from the perspective of regulators and established banks.

If bigtech firms expand into an increasing number of business areas, there is a risk that monopolies will be formed. Moreover, if the data generated are analysed and consumers are offered matching products and services, they will lose sight of the alternatives. In the marketplace of the internet economy, the winner usually takes it all.

From the consumer's perspective, we should remind ourselves of the business logic of many bigtech firms: many of the services they offer – such as payments – might be provided as a way of obtaining data, the key raw material for their business model.

Hence, many services are only ostensibly free for consumers, since they are paying for them with their personal data – and an increasing dependency on the services offered by one big commercial supplier.

For established banks, meanwhile, there is the danger of losing the battle for the customer in payments, which would leave the banks merely as interchangeable settlement agents in the background.

For now, the bigtech firms still rely on cooperation with banks for the settlement of payments in Europe. There, a payment made using Apple Pay or Google Pay is mostly settled via the credit card stored in the account, which is issued by a bank.

The next step could be to create closed payment systems that no longer are based on established payment instruments. The most prominent example

of such a concept was probably the Diem initiative (formerly known as Libra) launched by Facebook – or nowadays Meta, to be precise. Diem was intended to be a "stablecoin".

These often peg their value to an existing currency or a currency basket. Furthermore, their value is backed by suitable collateral. However, Meta will not pursue this project – at least not in this form and as things stand today.

Nevertheless, the idea of bigtech stablecoins remains relevant. Meta recently launched a pilot project with Paxos to enable payments with stablecoins in its dedicated Novi app in the context of remittances. For the purpose of money transfers between the United States and Guatemala, various design options are to be tested on a small scale.

PayPal is also planning to issue its own stablecoin. Thus, discussions on the handling and regulation of these new means of payment will continue. In this context Europe is currently being working at full speed, by creating the Markets in Crypto Assets Regulation – MiCA. With MiCA, the European Union would create a single European regulatory framework for crypto assets. This would be an important contribution to the stability of the markets for crypto assets in particular, but also of the financial markets in Europe in general.

4 Possible answers and conclusions

How should we be responding to the challenges posed by digitalisation in payments?

Despite having lost momentum, initiatives like Diem reveal that there is room for improvement in payments, and that this also applies to cross-border payments, or, in short, global payments. With this in mind, I would like to take a closer look at two key concepts: updating existing payment systems, for example via instant payments and also central bank digital currency (CBDC).

4.1 Updating existing payment systems / Instant payments

I believe that it is vital to think about how we can further develop our traditional payment systems in order to correct deficits in global payments and master new requirements.

European law stipulates that transfers must be credited to the recipient's account within one working day. However, if we think about the availability of information, communications and media content, then "real time" is now already the norm.

Against this backdrop, central banks in the euro area launched TARGET Instant Payment Settlement system – or TIPS for short – at the end of 2018. TIPS is able to ensure the availability of almost all institutions active in payments throughout Europe.

The goal must be for instant payments to become the new normal in the long term. We are still a fair number of steps away from reaching that point in Europe. Therefore, the European Commission is evaluating potential regulatory interventions to push the market further in that direction.

Here in Brazil, the Banco Central do Brasil is further improving real-time payments. With the BCB's instant payments system Pix, which is available around the clock, instant payments in Brazil are becoming more attractive and are already in broad use nationwide. Brazil can surely be counted among the pioneers of instant payments in Latin America.

In my view, instant payments can also help to improve the deficits in traditional payment systems that have been made increasingly clear by offerings from bigtech companies. In order to achieve this, real-time processing has to be combined with attractive and customer-friendly products for end users.

If we look at global payments systems, the most important aspect is to make transactions faster, cheaper and more transparent. There are already plenty of initiatives, such as SWIFT's global payment initiative. However, it is also crucial to better link traditional interbank payment systems, especially in industrialised countries, with the smartphone-based payment systems in emerging economies.

An interesting approach could be, for example, the linkage and interoperability of different instant payment systems. Given that new and innovative instant payment systems are already being set up in many parts of the world, we should think about linking them up or using them for cross-border payments.

4.2 Central bank digitial currencies (CBDC) and the digital euro

In the last couple of years, there have been increased calls for central bank digital currency, or CBDC. This means that CBDC is currently one of the hottest topics in the world of central banking. A stocktaking by the Bank of International Settlements (BIS) in mid-2021 counted at least 56 initiatives on CBDC around the globe. More than ten have either completed the initial pilot phases or, like Sweden's for example, are in the midst of doing so.

More initiatives are constantly being added, and existing ones continue to mature into fully fledged concepts or pilots. One example would certainly be the Chinese central bank – the People's Bank of China – which has

already decided to introduce a digital alternative to cash. Or the Bahamas, where the Sand Dollar was launched in October 2020.

With digitalisation changing our payment habits and the accelerating decline of cash usage, it is possible that banknotes could lose their role as reference value, undermining the integrity of the monetary system. In this new age, CBDCs would ensure that citizens have free access to a simple, universally accepted, secure and reliable means of payment.

The central bank would issue it and, depending on the actual design, private individuals as well as retailers and other companies could pay with it. Speaking for the euro area, it would under no circumstances replace cash, but rather supplement it.

A CBDC would expand the existing choice of payment methods. It could contribute to financial inclusion and ensure that less digitally savvy groups of the population also have access to digital payments. In addition, depending on the design choices, it could offer the opportunity to exploit technical innovations like DLT and thus enable, for example, payments embedded into programmable applications.

In Europe, when it comes to CBDC we aim to be “ahead of the curve” as ECB president Christine Lagarde put it, while, at the same time, taking the utmost care to evaluate the design options for a digital euro. Its development is a balancing act between two key risks.

The first risk is that being too ambitious could lead to a crowding out of private payment solutions and a potential disintermediation of the banking sector.

The second is the risk of creating an unattractive product that would not be accepted by consumers and enterprises.

In October 2021, the ECB launched what it refers to as the investigation phase of the project. This is designed to ensure that the Eurosystem stands ready to offer a functioning digital euro, should the decision be made to introduce it. Until then, we will carefully investigate the risks, the functional and technical design options, monetary policy independencies as well as financial stability implications.

Last but not least, we are holding lively discussions with all relevant stakeholders to identify key features that would add value for the potential users of a digital euro. The primary goal is to maintain the accessibility of central bank money in a digitalised economy. To fulfil this function, the digital euro must be accepted throughout the European Union and adopted by its citizens.

We are therefore fostering a dialogue with European businesses and citizens. The EBC recently published the findings of the responses by focus groups. These give us additional insights on the payment needs of consumers and merchants and specific use cases of a potential digital euro.

Most importantly, participants in the focus groups preferred payment methods with pan-European reach, speed, high convenience and universal acceptance in physical shops and online.

In addition, privacy protection is of high importance. Participants also valued the possibility of instant and contactless person-to-person payments. Here, Brazil's instant payment system Pix can serve as an example, showing that consumers have a demand for such services and quickly adopt them.

As you can see, there is a great deal to do and central banks, governments and other public institutions play a major role here, because the past has shown that without their input no major and sustainable improvements can be achieved.

Let me draw to a close here. Payments and payment systems, although often remaining unnoticed, inevitably affect everyone. They will always be driven by innovation and despite huge geographical distance, we face similar challenges when it comes to digitalisation in the financial sector. Ultimately, the same holds true for both Brazil and Germany: a digital economy needs efficient, quick and competitive digital payment methods.

Thank you for your attention.

To read more:
https://www.bundesbank.de/en/press/speeches/the-impact-of-digitalisation-on-the-financial-system-889922

EBA proposes to simplify and improve the macroprudential framework

The European Banking Authority (EBA) published its response to the European Commission's Call for Advice on the review of the macroprudential framework, proposing a set of recommendations to simplify the procedures around some of the existing macroprudential tools and to increase harmonisation for others.

The EU banking system proved resilient during the COVID pandemic and banks continued to provide credit to the real economy. This was partly due to the extraordinary fiscal, monetary and prudential measures, that were put in place and that included a release of macroprudential buffers.

The lessons learnt since the inception of the macroprudential framework, including those gained during the COVID pandemic highlighted the need for some targeted changes to make the macroprudential framework more effective and to improve the functioning of the Single Market.

The EBA's advice includes the following recommendations:

- to rebuild regulatory capital buffers to sufficient levels so that they can be released when needed again in the future;

- to undertake a comprehensive evaluation of the interaction of macroprudential measures with other capital requirements, such as leverage ratio, own funds and eligible liabilities (MREL) requirements;

- to maintain clear roles and responsibilities of the different authorities involved in microprudential and macroprudential policy as well as close coordination between them;

- to include a legal mandate in the Capital Requirements Directive (CRD) to develop methodologies covering both the identification of other systemically important institutions (O-SIIs) and the setting of buffer rates;

- to simplify the text of the CRD and the Capital Requirements Regulation (CRR) around governance procedures for some macroprudential measures;

- to perform further assessments on the ability of current macroprudential tools to address environmental, crypto assets and cyber security risks;

- to establish an oversight and monitoring system for non-bank lenders and enlarge the scope of the macroprudential framework to cover non-bank lenders.

To read more:
https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Other%20publications/2022/1031866/EBA%20advice%20on%20the%20review%20of%20the%20macroprudential%20framework.pdf

Macropru – fit for the future?

Sarah Breeden, Executive Director for Financial Stability Strategy and Risk and a member of the Financial Policy Committee (FPC), the United Kingdom's macroprudential authority.

When the financial system is in poor condition – when there is financial instability – it can be damaging to us all.

I like to compare the importance of financial stability to our collective prosperity with the importance of health to an individual. Good health may not be the only thing that matters for an individual's happiness. But it is essential. Because poor health comes with undesirable consequences.

We need only remind ourselves of the global financial crisis, more than a decade ago, to appreciate the undesirable consequences of financial instability.

UK GDP shrank by more than 6% during the first five quarters of the crisis, staying below its pre-recession size for a further five years. Unemployment increased, with an additional 1 million jobs lost by its peak at the end of 2011. And labour productivity, the best way to measure living standards in the long-run, fell sharply in 2008 and has barely recovered since.

The poor health of the global financial system was exposed in the most dramatic of fashions. We might liken it to a heart attack. And in response the authorities co-operated across borders and across institutions to design a radical 'healthcare plan' – to improve resilience, both at the micro-prudential individual institution and the economy-wide macro-prudential levels.

It is this macro-prudential perspective that I want to discuss today – specifically, to consider how macro-prudential policy will need to adapt, just as our health-care plans adapt, to be fit for the challenges of the future.

Since the global financial crisis, the financial system has not been a cause of sustained economic instability. But this is no reason for complacency. The financial system is ever changing. And experience suggests our job may not yet be complete.

So today, I will begin by setting out why financial stability is important and the role of macro-prudential policy in delivering it. In so doing I hope to set

out why it's as important for the financial system to observe macro-prudential policies as it is for patients to stick to their health-care plans.

I will then briefly set out some principles on which good macro-prudential policymaking is based. The rules of thumb that underlie our prescriptions if you like.

And I will conclude by raising some challenges that macro-prudential policy is facing now, including my thoughts on the road ahead. Through that, I hope to set out how we need constantly to adapt macro-prudential policies, as we do with our health-care plans as lifestyles evolve.

Interactions between financial stability and sustainable growth and the role for macro-prudential policy

Why is financial stability important?

To understand why we place so much emphasis on a well-grounded macro-prudential framework, it's important to understand why we care about financial stability in the first place. In brief, it is because we believe that financial stability is a precondition for sustainable economic growth.

A stable and well-functioning financial system exists to serve us all. It enables the efficient allocation of resources, so that businesses can exploit productive opportunities and households can meet their needs. And it allows the risks incurred in the course of generating economic growth to be shared.

The banking system supplies credit to households, to buy homes or spend more than they currently earn; and to businesses, so that they can hire more workers, invest in capital, and innovate and expand.

Non-bank financial firms further transform long-term savings into new investments via bond and stock purchases; and they enable both households and businesses to insure themselves against risks that could prove costly were they to crystallise.

The financial system also facilitates payments, so that households and businesses can pay safely for the goods and services they choose to receive.

A stable financial system is one that is resilient to shocks and so is able reliably to support households and businesses through the consistent supply of the vital services that they demand. Financial stability thus supports growth and prosperity, just as good health supports us in our daily lives.

The role of macro-prudential policy

Historically, there was a view among policymakers that as long as monetary policy guaranteed low and stable inflation, and micro-prudential regulation was successful in ensuring the balance sheets of individual institutions were robust to shocks, the financial system could take care of itself, and financial stability would follow.

However, the global financial crisis revealed the flaws in this view: while monetary policy sets the benchmark interest rate for financial transactions and "gets into all the cracks" in the financial system, it isn't sufficient to ensure that those transactions are undertaken efficiently and effectively.

Similarly, micro-prudential policy ensures the safety and soundness of individual institutions, but does not take a sufficiently bird's eye view to identify possible risks affecting the financial system as a whole.

The financial crisis highlighted quite how much the whole is greater than the sum of its parts. And that ensuring the parts are healthy does not guarantee that the whole is.

Macro-prudential interventions typically fill two gaps:

1. Individual agents don't necessarily take into account the bigger picture. Individual financial institutions and borrowers face private incentives which do not take into account the wider social impact of their actions. In such cases, macro-prudential policymakers can seek to better align private costs and benefits with social costs and benefits.

One example is the Financial Policy Committee's (FPC) mortgage tools, which seek to limit the number of mortgages banks can extend for loans that are high relative to income.

Individual borrowers may be keen to stretch themselves financially to buy a bigger house, expecting their earnings to grow or house prices to rise. And individual lenders may be happy to provide a larger loan to receive more income. But should a recession hit, not only will we see defaults, but overstretched borrowers will reduce their spending as they struggle to pay their mortgages. And this reduction would ultimately spillover to the rest of the economy, making the downturn worse.

Macro-prudential policy takes these spillovers into account. By ensuring borrowers in aggregate are not overstretching themselves and financial institutions in general are lending responsibly, macro-prudential regulators can ensure that the whole system is more resilient to shocks.

2. Markets are not necessarily efficient or complete. Market prices may not reflect the real value of assets, not every market is perfectly liquid and risks may not be as well-dispersed as they might seem. These imperfections can lead to two types of risk to financial stability: cyclical and structural.

Cyclical risks arise because financial conditions can suddenly reverse. The simplest example is of financial institutions taking on too much risk in booms, in the expectation that the assets they purchase will always be in demand. When the cycle turns, asset prices can fall rapidly, leaving institutions with losses. This is why we have countercyclical tools - to ensure the system can build up resilience in good times, and use it in bad times.

Structural risks refer to fault-lines within the financial system, such as high concentrations of risk, complex interconnections, promises made that cannot necessarily be honoured, and uninsurable – or tail – risks. These risks can trigger sharp reversals in financial conditions, or amplify cyclical risks when they crystallise. As with cyclical risks, macro-prudential policy looks to build resilience to these risks, as well as eliminating fault-lines where appropriate.

The cost-benefit calculus

In seeking to fill these two gaps, it is important to acknowledge that there are two sides to the ledger – that a build-up in financial stability risk is often accompanied by higher growth.

When the financial system under-prices risks, households, companies and the economy at large may appear to benefit. As asset prices rise, perceptions of wealth become inflated and risks appear smaller. Households and companies feel more comfortable taking on debt, banks and investors feel more comfortable lending to them. We can consume more, invest more, grow the economy more and feel more prosperous.

The problem is that it cannot last. We cannot continue consuming more than we ever hope to earn; we cannot invest more than we ever intend to save; risks cannot be under-priced forever. This time it probably isn't different.

And when it all goes into reverse, when risks are found to be under-priced and not well-dispersed, when shocks arise and are amplified by the financial system, the cost in terms of lost growth can far outweigh the benefit of higher growth enjoyed while the risks were building.

It is this cost-benefit calculus that both motivates a role for macro-prudential policy, and helps us define precisely what we mean by it.

In short, macro-prudential policy aims to improve the trade-off between the financial system's contribution to the rewards expected in a growing economy and the degree of risk that we will face in the bad times.

To return to my analogy, we might liken it to the NHS and to health insurance where we pay a bit in the good times to protect ourselves should our health take a turn for the worse.

Principles of good policy making

Macro-prudential authorities, like the UK's FPC, work to ensure that financial systems are resilient to, and prepared for, the wide range of possible shocks they could face. Their aim is to ensure that when shocks occur, the financial system is able to absorb those shocks, rather than to amplify their impact on the economy.

We ground what we do in two elements of good macro-prudential policymaking:

- Macro-prudential policy should be targeted to provide a net benefit to the overall economy. Where interventions incur costs, these should only be imposed when they are outweighed by the benefits over the full cycle. This is perhaps equivalent to starting a course of new medication, where a good doctor must be aware of potential side effects as well as intended benefits.

  We must also recognise that there will be occasions when interventions are not yet needed, as emerging risks are not yet systemic in nature. To return to our analogy, a good doctor might decide not to start medication, but instead simply monitor a patient's general health to judge better how to improve it.

- Macro-prudential policy should be ready to adapt to change, allowing the economy to expand and innovate safely. Change always brings with it opportunities and risks and so our macro-prudential framework will need to evolve. To overuse the health analogy once more, doctors need to adapt. A doctor in the 1960s, for example, would never have had to think about the health effects of vaping.

Challenges that lie ahead

Ten years after establishing the FPC, we have reached the point where we have both made the case for macro-prudential policy, and built a macro-prudential framework designed to ensure the sector is resilient to stress. In other words, we have pulled together the skeleton for a healthcare plan and convinced the patient that they need it and that it needs to be updated regularly.

These are important achievements. Indeed we need to make sure we hang on to them even as memories of the global financial crisis fade.

But we need to decide the plan for the coming months and years too. Recent shocks – the Covid pandemic, and more recently, Russia's invasion of Ukraine – and structural changes to the financial system have reaffirmed that our work is not yet done.

Let me briefly mention a few of the lessons from our experience in Covid-19.

First the capital framework does not in practice support use of bank capital buffers in a stress as we intended. And that would have mattered a lot in the absence of the substantial government support for the corporate sector.

Second, we need to change our approach to stress testing in a stress if we are to avoid those stress tests further amplifying any downturn.

And third, in a shock of roughly half the size of the global financial crisis, it was only large-scale use of central bank balance sheets that calmed dysfunction in the system of market-based finance.

We are continuing to learn through the Russia-Ukraine crisis too. We are exploring concentrations in, and interconnections across, energy and other commodity markets, the financial system, and the real economy, as well as the potential for feedback loops between them. And we have observed too that commodity markets are relatively opaque.

We must now develop the macro-prudential framework to reflect the lessons from these recent stresses.

Looking beyond recent events, neither the financial system nor the economy stands still: there are clear structural changes that macro-prudential policy must confront.

1.The rise of market-based finance: vulnerabilities that are as much global as domestic

One key challenge is that many vulnerabilities are as much global as they are domestic. That includes non-bank, or market-based, finance.

Non-bank financial institutions currently represent around 50% of global (and UK) financial sector assets. They are increasingly a source of finance for UK businesses. However, the 'dash for cash' in March 2020 led to a rapid deterioration in the functioning even of advanced-economies' government bond markets and created market dynamics significant enough

to raise the cost of lending. The episode clearly demonstrated the need to build resilience in market-based finance.

Given the global nature of market-based finance, the effectiveness of any policies in the UK will depend in part on policies implemented in other major jurisdictions. We are therefore working with international counterparts in the Financial Stability Board to take coordinated action to address these issues - including on open-ended funds, margins, the liquidity structure and resilience of core markets, to name a few. In the meantime, the FPC (and other UK authorities) need to continue monitoring them, starting by ensuring there is reliable data to do so.

2.The growth of cryptoassets and decentralised finance: regulatory frameworks need to evolve

Another important challenge is seen in cryptoassets and decentralised finance (DeFi) which in recent years have grown to represent around 1% of global financial assets.

Cryptoasset technology is creating new financial assets, and new means of intermediation. Many services now facilitated by this technology mirror those available in the traditional financial sector, including lending, trading and exchange, investment management and insurance.

While that activity is currently small, if the pace of growth seen in recent years continues, interlinkages with the traditional financial sector are likely to increase. In addition, the new technology has the potential to reshape activity currently taking place in the traditional financial sector, either through the migration of that activity or the widespread adoption of the technology.

Crypto technology has the potential to bring significant benefits, for example by reducing the cost and increasing the speed of cross-border transactions, and encouraging competition in the financial system. But those benefits can only be realised and innovation be sustainable if it is undertaken safely and accompanied by effective public policy frameworks that mitigate risks and maintain broader trust and integrity in the financial system.

In this way, the growth of cryptoassets and DeFi has highlighted another of the key challenges for policymakers: the need for regulatory frameworks to adapt.

3.The transition to net zero: structural change requires coordinated action from all sectors

And finally, we face the continued need to support the orderly transition to a net zero economy. Climate change creates risks to financial stability through two channels: physical risks and transition risks. And the financial system will play a key role in financing the significant structural economic changes needed to deliver the transition to a net zero economy.

The unique challenge here is that the orderly transition to net zero will require coordinated action across private and public sector institutions, and across all sectors of finance and the real economy. The Bank's role is focussed on tackling the consequences (not the causes) of climate change. Indeed the transition to net zero is likely to be a bumpy one, particularly in light of recent events, and macro-prudential regulators have an important role to play in helping manage those bumps.

In support of this work, we are running a stress test of the UK's largest banks and insurers that will extend the time horizons over which we, and they, view climate risks. This is a good start in understanding the implications of climate change and transition for the financial system. But more work is needed to build the green market infrastructure that will support an orderly transition to net zero, and this will be an important area of focus for macro-prudential regulation over the coming years.

Conclusion: The road ahead

Where does all this leave us?

It's clear that we macro-prudential policymakers need to look forwards as well as backwards as we do our risk assessment. And we must also ground our analysis in the impact of shocks to the financial system on businesses, households and so the economy, and not just their impact on financial players.

The source of shocks and the mechanisms through which the financial system could amplify those shocks is wide – covering climate, Covid, crypto, cyber, and conflict as well as the credit cycle and the core banking system. But our understanding of many of these is still developing, reflecting differences in the maturity across our framework.

The consequence is that like any health check the list of what we need to review is long. And so the key is how we prioritise our work and what prescriptions we write on the back of it. That's a daunting task. But helpfully while for some issues only the macro-prudential policymaker can do the job, for other issues just like a GP we can call on the help of specialists.

I'm not proposing to write any prescriptions in this speech today. But the Bank and FPC are working hard on their diagnoses and will aim to

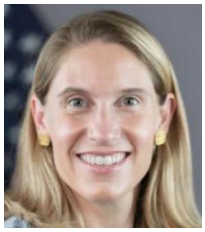
communicate further on issues that they wish to prioritise later this year, through the Bank's Financial Stability Strategy and the FPC's medium-term priorities.

And I hope that today has given you a flavour of the importance of building a macro-prudential framework that's as fit for the risks and opportunities of the future as it is for those we have faced in the past.

The views expressed here are not necessarily those of the Financial Policy Committee. I am grateful to Nicola Anderson, Kristina Bluwstein, Giovanni Covi, Tom Daniels, Emma Moriarty, Nicholas Vause, Danny Walker and Gabija Zemaityte for their assistance in drafting these remarks. I would like to thank Jon Cunliffe, Alina Barnett, Geoff Coppins, Lee Foulger, Grellan McGrath, Jon Relleen and Matt Waldron for their helpful comments.

Remarks at Virtual Roundtable on the Future of Going Public and Expanding Investor Opportunities: A Comparative Discussion on IPOs and the Rise of SPACs

SEC Commissioner Caroline A. Crenshaw



Thank you Hal [Scott] for that kind introduction and for inviting me to speak today. I am honored to precede such an esteemed panel of practitioners and academics. As always, I must give my standard disclaimer that my remarks are my own and do not necessarily represent the views of the Commission or its staff.

I cannot emphasize enough how important discussions such as today's are – thinking through some of the most pressing questions in our markets. And, one of those areas is Special Purpose Acquisition Companies, or SPACs.

Now, of course, this was an issue that we were paying attention to well before the notice and comment period for the SPAC rulemaking proposal. But nothing takes place in a vacuum, and the meteoric rise in SPACs and the Commission's proposed rulemaking must be considered in the context of changes in both the public and private markets.

So today's topic is particularly apt. I hope the roundtable will be one of many, and that such discussions will lead to academic work, public input, and engagement from all stakeholders and interested parties.

As you are all aware, the U.S. public markets provide many benefits, including disclosures and safeguards at the offering stage followed by periodic reporting, public trading venues that offer high degrees of liquidity, and an ecosystem of laws and regulations that provide investors with protections and remedies when needed. In 2020, 165 operating companies went public via a traditional initial public offering (IPO).

There were a total of 248 SPAC IPOs that same year, meaning roughly 60% of all IPOs were conducted through SPACs. While that level of SPAC activity may not be sustained over the long-term, it is clear SPACs provide an alternative to the traditional IPO model, and may offer some competitive challenges.

That's a good thing. But, perhaps, we need to be careful not facilitate a race to the bottom in terms of public market protections. And since the boom,

the Commission and its staff identified several areas of concern with SPACs.

Such concerns include misaligned incentives, several points of dilution that may disproportionately impact retail investors, and a lack of liability that may be creating an unjustified advantage in this path to the public markets over the traditional IPO.

The questions and challenges of how to adequately address these concerns in a balanced way remain. And I, of course, look forward to your thoughts and engagement on the SPACs proposed rulemaking.

I noted this a couple of weeks ago during prior remarks, but I think it is a point that bears repeating: there is an ongoing debate about what the right balance is between the public and private markets, and what that means for retail investors. For today's symposium, we are focused on the balance within the public markets, between the two primary paths to becoming a publicly traded company – SPACs and traditional IPOs.

However, these questions of balance within the public markets are really a part of a broader debate about the balance between public and private markets. The private markets are growing, with more companies remaining private for longer, while enjoying more access to private capital than at any time in recent memory.

I look forward to the panel, and to the future discussions and research that the panel may generate. But I would encourage the panel to contextualize their discussion about SPACs in light of the growing divide between public and private markets. I will try to do the same, as I highlight some additional observations about SPACs.

Shareholder Voting

In elections for political office, the ideal has been "one person, one vote." In corporate governance, the ideal that some cite is "one share, one vote."

The shareholder vote is meant to be a key check on management, on whom investors rely to generate returns and manage risks.

Shareholders exchange their capital for ownership shares, and depend on a board of directors and management to represent their interests in the operation and decision-making of a corporation.

Shareholders generally only vote on a few fundamental events in a corporation's life, including certain proposed mergers and acquisitions. However, shareholder ownership is often dispersed, which may diffuse the

incentives for individual investors to meaningfully participate in corporate governance, and diligence proposed mergers and acquisitions.

In SPACs, that lack of incentive to meaningfully participate in governance of the shell company and the selection of a target for de-SPAC may be especially acute.

As you know, early investors in a SPAC IPO are issued "units," which typically include redeemable shares and a fraction of a warrant. Such units are nominally priced at $10, and a full warrant entitles the shareholder to buy a share at an exercise price at a future date.

The shares and warrants usually begin trading separately after a certain period and, typically, investors may only exercise whole warrants, not fractions of warrants.

Once the SPAC sponsors identify a target for de-SPAC, there is a shareholder vote.

If a de-SPAC is approved by the requisite majority vote, shareholders have the option to hold onto their shares and become shareholders of the de-SPAC'd entity – or, they can redeem their shares.

Interestingly, the choice to redeem one's shares does not impact the ability to vote in favor of completing the de-SPAC.

So a shareholder can vote to approve the de-SPAC transaction and redeem their shares to recoup their initial investment plus any interest earned while funds were in the SPAC's trust, and retain their warrant.

In effect, a redemption but vote to approve insulates from downsides, but retains some exposure to upsides through warrants.

This seemingly eliminates the incentive for shareholders to consider whether the proposed de-SPAC is actually worthwhile, and perhaps erodes incentives for sponsors to make a thorough, well-reasoned, well-supported case for the transaction to the shareholders.

Data collected indicates that an average of 58% of SPAC IPO shareholders redeemed in 2020-2021, and reporting indicates that redemptions from the first quarter of 2022 are higher.

So what is the problem here? SPACs involve sophisticated sponsors, underwriters, shareholders, PIPE investors, and private operating companies.

Some may argue that, even if the voting mechanism is a rubber stamp, diligence of the proposed transaction still occurs at a couple of levels.

First by the sponsors and other SPAC related advisors, and then by the PIPE investors who come in at a later-stage. And the SEC has a proposal out that seeks to address these concerns.

So why am I talking about SPAC voting today? One reason is that SPACs were not always structured to allow for unlimited redemptions, and observers have noted that allowing SPACs to consummate a de-SPAC even when a substantial majority of shareholders redeems its shares creates and contributes to poor incentives, increases potential for dilution, and raises investor protection concerns.

Stock exchanges are self-regulatory organizations and gatekeepers that provide investor and corporate governance protections. As part of that gatekeeping function, the exchanges establish listing standards designed to protect financial markets and the investing public.

With regard to SPACs, one exchange formerly had listing standards that required certain redemption thresholds, or really non-redemption thresholds, to be met in order for a de-SPAC'd company to be publicly listed.

In other words, a certain amount of shareholders had to stay in order for the de-SPAC'd company to be listed as a public company.

At that time, this was industry practice, and it was codified as a listing standard.

However, that industry practice, and the listing standard that enshrined it, has changed.

While there may have been valid reasons for allowing the redemption threshold requirement to lapse, it may be appropriate to reconsider the balance of equities in light of the recent experience with SPACs, the high-rates of redemption, and a de-SPAC merger approval vote that increasingly seems pro-forma rather than an actual check that helps ensure only well-considered acquisitions proceed.

To be clear, the option to redeem is an important investor safeguard, it is one safety valve against potential misaligned incentives between sponsors and shareholders; and illiquidity in shell company shares.

The right to redeem should likely be protected. However, it is another question as to whether redeeming shareholders should retain the ability to vote to approve the de-SPAC after recouping their capital.

As the Commission's proposal notes, "cases where…the shareholders are able to vote in favor of a merger but also redeem their shares…could present a moral hazard problem, in economic terms, because these redeeming shareholders would not bear the full cost of a less than optimal choice of target."

Further, in a scenario of high redemptions, the SPAC affiliates,[21] may still be incentivized to consummate a merger and may rely upon new PIPE investors to offer later-stage funding, potentially at the cost to those shareholders that did not redeem.

As the SEC's Office of the Investor Advocate recently noted in public recommendations, current listing standards contribute to "an inherent conflict of interest in the consummation of the SPAC's proposed business combination…permit[ing] these [de-SPACs] to occur even when assets are depleted by significant exercise of conversion rights, and early investors have economic incentives to allow deals of questionable quality to occur."

Importantly, the Investor Advocate has urged all exchanges that list SPACs to implement a conversion threshold of at least 50 percent, similar to a previous listing standard, to "ensure at least half of the outstanding shares of the SPAC" keep skin in the game.

This would help protect against a redemption of the majority of shares depleting the SPAC trust and raising the potential for dilution for those investors that do not redeem.

So as you discuss these issues today, I am curious about your thoughts. What impact do redeemable shares without limitations on conversion thresholds have on the different investors in the SPAC? And what impact does this have on the integrity of the public markets and investors' confidence in those markets?

When PIPE investors step-in to replace the financing that exits when there are high-redemptions – how does that shape the negotiations, and to what extent are remaining investors harmed by dilution because PIPE investors demand better terms? Do these combined circumstances contribute to momentum for sub-optimal or inefficient de-SPAC transactions? Further, I'm interested in understanding who the shareholders who choose not to redeem and convert their investment into the de-SPAC'd operating company are.

Do those shareholders represent a minority view that the proxy disclosures represent an outlook that outweighs the risk of non-redemption? Or are those investors remaining for other reasons?

SPACs – The Equity "Complex Product"

Investing in a SPAC IPO share is fundamentally different from investing in equity shares of publicly listed operating companies.

The optionality of the redemption, second layer of diligence about the private company that the shell company targets, and potential for dilution, among other factors, add complexities.

Calculating the potential for dilution is not straightforward and may be impacted by multiple considerations, including the amount of redemptions, the sponsor's promote, the equity overhang from warrants, and the negotiating dynamics of the PIPE investors.

As one of today's panelists recently stated, it initially took his colleagues and him eight hours to calculate dilution, which indicates the opaqueness of the dilutive effect and how difficult it may be for investors who choose not to redeem their shares to understand the extent of dilution.

A SPAC shareholder must decide whether or not to redeem, in part, given the potential for dilution and the prospects of the future de-SPAC'd company.

The Commission's proposal seeks to address concerns around dilution through enhanced disclosures, including a table showing the potential for dilution based upon percent of redemption, a requirement to disclose each material potential source of additional dilution that non-redeeming shareholders may experience, and greater information about financing arrangements.

Simply stated, SPACs are complex, and some of the purported benefits, such as a cheaper and more efficient path to the public markets for private companies, have been questioned.

Studies have found that the cost of going public via SPAC costs may actually be higher than a traditional IPO.

Indicating that a detailed understanding of the costs and benefits of this avenue to the public markets is not widely agreed upon. Hopefully, the SEC's proposal, if approved, will provide certainty and disclosure where it is needed most, but I'd be interested to hear further input on how the SEC could ameliorate these concerns. And I will continue to follow the work being done on all these questions.

SPACs & Other Paths

Practitioners, academics, and policy-makers should continue to think holistically about the public markets. As many have pointed-out, an increasing trend is that fewer companies are going public, small- and mid-sized IPOs are less frequent, and companies are staying private for longer.

Ensuring that companies, particularly small- and medium-sized companies, have adequate access to the public markets is an important policy objective. It provides investors more opportunities to diversify, more entrepreneurs access to the capital they need, and promotes market integrity and investor protections.

The recent SPAC boom raised concerns about the rigor of forward-looking statement disclosures, potential conflicts of interests, and whether adequate liability attached to the key second-phase of a SPAC, the de-SPAC. In some cases, SPACs may have elevated companies to the public markets sub-optimally.

One question I will be thinking through is whether this alternative path to the public markets provides unjustified opportunities for legal or regulatory arbitrage when compared to the traditional IPO. In other words, whether the form, an IPO through merger rather than offering, has been elevated over substance.

All of this being said, the traditional IPO process is not free from critique. While there are certain safeguards built into that process, it is well-documented that there are areas of friction and inefficiency with a traditional IPO, including high fees imposed on issuers.

As counsel to former Commissioner Robert Jackson, I worked with him on a speech about the middle-market IPO "tax," describing fees for middle-market companies to go public, which have remained stagnant at 7% for decades. We worked with one of the panelists today to revisit whether the middle-market IPO 7% fee was still observable, and found that from 2001-2016, over 96% of mid-sized IPOs had a spread of 7%.

Another area of friction in the traditional IPO is the pricing of the stock. Recent academic work has noted that "IPOs tend to be underpriced, relative to aftermarket prices, and that the underpricing phenomenon is persistent over time and across countries."

So I am also interested in understanding how we can provide competitive pressure to reduce such frictions. Whether that is through improvements to the traditional IPO or ensuring well-calibrated disclosures and investor protection safeguards are incorporated into alternative avenues such as SPACs and primary direct listings.

Finally, I encourage everyone at this symposium to think about the ever-growing divide between the public and private markets and how the paths to public markets can be improved and made more efficient while preserving key investor and market integrity protections.

Part of the underlying problem in many, if not all, discussions about public market paths such as SPACs, is that the public securities markets are declining in terms of overall market share. Increased exemptions to public offering registration requirements have put into place strong incentives to remain private for longer than ever before, and more capital is raised in the private markets than in the public markets.

But at what cost? As I noted a couple of weeks ago, the unicorn is no longer a unique or novel creature found in the woods of the private market. Rather, they have become larger and more common, with the largest unicorn valuation exceeding $400 billion.

I think we cannot have a conversation about integrity of the public markets, without acknowledging that more capital is raised in the private markets every day, and there are fewer public companies than in recent memory.

I know all of these are difficult, big, questions with no easy answers. But I also know that today's panelists, and the symposium attendees, are among the individuals that can help us answer these questions. Thank you.

To read more:
https://www.sec.gov/news/speech/crenshaw-remarks-spac-symposium-042822

Fake WhatsApp 'voice message' emails are spreading malware

A phishing campaign which impersonates WhatsApp's voice message feature has been spreading information-stealing malware.

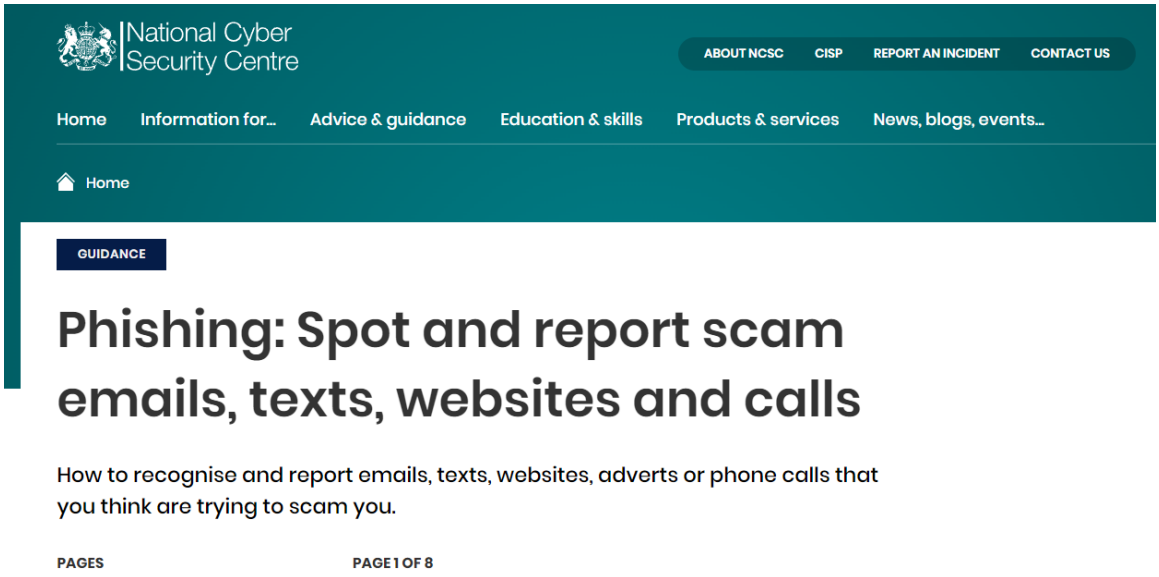
The attack starts with an email claiming to be a notification from WhatsApp of a new private voice message. The email contains a creation date and clip duration for the supposed message, and a 'Play' button.

The identity 'Whatsapp Notifier' masks a real email address belonging to a Russian road safety organisation. As the address and organisation are real, the messages aren't flagged as spam or blocked by email security tools. Armorblox, who discovered the scam, believe the Russian organisation is playing a role without realising.

The 'Play' button will take the email recipient to a website which then asks them to click 'Allow' in an allow/block prompt to 'confirm you are not a robot'. Once 'allow' is clicked, the browser will prompt to install software that turns out to be information-stealing malware.

While there are numerous 'tells' that this is a scam, these attacks rely on people missing the signs – perhaps because they are waiting for urgent or exciting news that could well be delivered by a voice message.

The NCSC has published guidance on how to spot and report scams, including those delivered by email and messaging. You may visit: https://www.ncsc.gov.uk/collection/phishing-scams



Our top tips for staying secure online will help you keep your devices and information secure even if you do click on a scam, and you can also learn how to recover a hacked account.

You may visit:
https://www.ncsc.gov.uk/collection/top-tips-for-staying-secure-online

https://www.ncsc.gov.uk/guidance/recovering-a-hacked-account

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