Excerpts from Keynote
The Rising Strategic Importance of Capital Meeting Policy: Investor and Enterprise Perspective, US and Global

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Capital Meets Policy Dialogue
Singapore Fintech Festival
Nov. 1, 2022

This year's spectacular implosion of crypto markets and the resulting failure of many prominent crypto firms have made regulators even more wary of crypto and the distributed ledger technology that underpins it. Those regulators who have taken a hard line against crypto are feeling vindicated. Those who have tried to accommodate it are feeling some remorse. This intensifying regulatory skepticism could threaten the future of crypto and the success of those who have invested in it.

Regulators and policy makers continue to acknowledge the potential of distributed ledger technology to achieve socially desirable outcomes, including lowering consumer costs and making the financial system less risky and more inclusive. But scalable use cases just haven't materialized. Increasingly I hear from regulators, where's the beef?

To win over regulators, the industry will need to show that their innovations have some value to society —that they will actually make the incumbent system better. And there is plenty of room for improvement. It is important to remember that the incumbent system also failed spectacularly during the Great Financial Crisis of 2008/2009. And while reforms have strengthened the system we have today, many parts of it still suffer from inefficiency, excessive leverage, lack of transparency, and rent seeking.

While crypto firms will face a high bar in convincing skeptical regulators of their worth, other types of fintech have undeniably made the current system better. For the most part, these success stories have been achieved by working with regulated banks and building upon- not disrupting - the current financial infrastructure.

Fintech firms have led the way in making domestic payments cheaper and faster, developing online platforms that have made financial services more accessible to low-income households and rural areas, and pioneering new ways to understand credit risk that are more inclusive and less susceptible to cultural bias. When there have been problems, regulators have worked with innovators to find answers. For instance, prodded by regulators, AI is becoming more transparent and less susceptible to racial and gender bias. I am hopeful that with appropriate regulatory oversight, BNPL could transform into a simpler, less costly alternative to credit cards.

Unfortunately, examples of socially beneficial innovations in the crypto space are hard to find. Part of the reason may be regulatory resistance, but the bigger problem is that it's just been too easy to make money using crypto for speculation. It's much harder work to build use cases that will actually achieve some social good. But any asset whose only use is reckless speculation will quickly lose value when market conditions tighten. The good news is that with interest rates rising, we should see more discipline around capital allocation in crypto. If investors want regulatory acceptance and sustainable returns, then they need to back innovators who are trying to apply this technology to solve real world problems, with uses that have true, intrinsic worth.

What might these be? In 2015, I became interested in DLT, hoping that a more decentralized financial system could address many of the fragilities we saw during the GFC, as well as reduce rent seeking and lower consumer costs. I actually wrote a chapter on the subject for a book edited by the late Paul Volcker, *Public Service and Good Governance for the Twenty-First Century*. In preparing these remarks, I decided to go back and review that piece to see how my aspirations for DLT have fared.

At the top of my list was lowering the cost of payments, particularly international transfers which are expensive, slow, and obscenely burdensome for lower income immigrant households trying to send money home.

Also high on my list was using distributed ledgers to achieve near simultaneous clearing and settlement of securities transactions. Multi-day settlement times impede market liquidity and expose participants to counter-party failure and steep margin calls. The need to post margin until trades settle traps capital in unproductive uses. Settlement delays were a major factor in the breakdown of repo markets during the GFC, and have repeatedly contributed to disruptions in financial markets.

My list also included credit reporting (giving consumers access and control over the distributed database where their credit records are stored); real estate titles (dis-intermediating title insurers by creating a distributed ledger for tracking title transfers); reputation management in the sharing economy (for instance, allowing AirB&B to address safety issues by creating a tamper proof ledger for managing credentials of guests and providers); energy grids (empowering individuals with excess capacity to be their own power providers); “know your customer” requirements for financial institutions (creating a highly secure, shared database of customer information and transaction data); and philanthropic uses such as creating and tracking digital identities for refugees.

This is by no means an exhaustive list, but does represent examples of where DLT could actually do some good. These are the kinds of use cases I would encourage investors to seek out. Unfortunately, none of these ideas have achieved scale, though I note real progress in exploring the use of distributed ledgers to facilitate international payments, led by innovative central banks like the MAS.

A threshold question regulators will be asking crypto innovators going forward is how they intend to make the world a better place. They’ve seen the damage crypto can do with heartbreaking stories of crypto investors, young and old, suffering significant losses. Before they take the risk of approving new uses of crypto, they will want to know what good will be achieved.

If you are seeking their approval for your innovations, they will want to know if you really understand what regulation means. Are you just interested in the imprimatur of regulation, or are you really prepared to meet rigorous, regulatory expectations in areas like AML/CFT, liquidity and capital, operational integrity, and non-discrimination?

If your plan is to dis-intermediate the current system, they will also want to know what the transition will look like. The job of regulators is NOT to protect incumbent, centrally intermediated systems if distributed ledgers can provide better alternatives. But they do have a right to know how you plan to get there without disrupting the services provided by those incumbent systems upon which the public relies.

Hopefully, recent events will not let fear drive regulatory decision-making. In particular, I hope regulators will be more open to sandbox approaches that give innovators leeway to experiment on a limited basis. Sandboxes can also help inform what the regulatory regime should look like. I fear regulators, particularly in the US, are trying too hard to figure everything out at once, when I don’t think they can get it right without some experimentation.

Finally, regulators may be wondering if they could be disrupted too. The current system is primarily focused on oversight of large, centralized intermediaries. That may or may not be a good system, but it is probably easier to understand and control than a system where decision-making and power are broadly distributed.

I am confident that whatever the future financial system looks like, it will always require government oversight. Even legendary free-market economist Milton

Friedman acknowledged this reality. The key challenge for regulators is to identify and secure the tech talent they need to provide effective oversight, and to understand that distributed ledgers may require a shift in focus, perhaps to one less focused on credit risk, and more on governance, consumer protection, and operational integrity. Whatever the technology and correct supervisory approach, the goals will be the same: to protect the public, particularly against fraud, manipulation, and instability.

Technology may disrupt financial services but it will never disrupt the need for financial oversight. Fintech innovators must embrace the need for regulation to have a constructive dialogue with regulators. Working collaboratively, not combatively, with financial regulators will help society realize the promise of distributed ledgers and in the process, help investors achieve durable, lasting returns.