Discussing the impact of cryptocurrency on international financial stability.

The Economic and Financial Affairs Council (Second Committee)

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I. Introduction

Cryptocurrency represents a digital currency produced by a public network, rather than any government, that uses cryptography to make sure payments are sent and received safely[1]. It poses an undeniable challenge to international stability due to its high volatility, lack of regulation, and potential use in illicit activities. Its unique traits have drastically influenced the trajectory of numerous lives in the past fifteen years and more. It didn't only draw the attention of the entire world and quickly become a primary method of digital payment, investing and trading, but also segmented the world into different groups based on their perspectives on cryptocurrency and the actions they choose to take in response to it. While many people still use it today as intended, a convenient, fast and secure form of payment, there are plenty who believe that they have fully understood the algorithm and discovered the equations needed to predict whether a currency's worth is going to spike or take a dip and that it is mathematically impossible for them to not make a profit utilizing cryptocurrency. Over the years, numerous companies have faced accusations of scamming individuals through the use of cryptocurrency, employing a range of deceptive and exploitative schemes. Among the most notorious of these is the Ponzi scheme, with known scams like BitConnect[2] and OneCoin[3], both of which lured naive investors by promising high returns with minimal risk. Another well-known scam is the Rug Pull, where developers suddenly vanish with investors's funds, as seen in massive crypto coins such as the Squid Game Token[4] and AnubisDAO[5].

[1] https://dictionary.cambridge.org/dictionary/english/cryptocurrency

[2] https://www.justice.gov/usao-sdny/pr/co-founder-multibillion-dollar-cryptocurrency-scheme-onecoin-sentenced-20-years-prison

[3] https://www.justice.gov/archives/opa/pr/bitconnect-founder-indicted-global-24-billion-cryptocurrency-scheme

[4] https://en.wikipedia.org/wiki/2021_Squid_Game_cryptocurrency_scam

[5] https://www.bbc.com/news/world-europe-66752785

II. Definition of key terms

Blockchain

A blockchain is a system that contains a high number of transactions made using various cryptocurrencies. It is maintained on all computers that are linked in the network created by that certain cryptocurrency.

Crypto Exchange

A cryptocurrency exchange, or a digital currency exchange, is a business that allows customers to trade cryptocurrencies, being able to acquire various elements, such as other cryptocurrencies, money or items bought through websites that allow crypto payment.

Digital Wallet

A digital wallet is an app used to make payments electronically or to store different types of cryptocurrency.

Fiat money

Fiat money is a type of currency issued by the government that is not backed by a precious metal, such as gold or silver, nor by any other similar form of commodity.

Non-fungible token (NFT)

A non-fungible token (NFT) is a unique digital form of payment popularized in 2021 that is recorded on a blockchain and is used to prove the ownership and authenticity of a certain photo.

III. Background Information

Disruption in traditional banking and finance

In many parts of the world, access to traditional banking services is limited due to various factors, such as geographical reasons, lack of the needed budget or just the government's decision that having banking services is not a primary objective. Cryptocurrencies and the entire blockchain technology represent a solution to the challenges that are met when attempting to transport a larger sum of money in an easier way. This can be done without the need for centralized intermediaries like banks.

One well-known and clear example takes place in Sub-Saharan Africa. Despite its strong economies, a significant portion of the population in this region has limited or no access to traditional financial services. People from this region have started using cryptocurrency increasingly often due to how efficiently it can meet their needs created by these lacks. The platforms have become conduits for millions of dollars in transactions each week, bypassing the traditional financial system and its barriers.

This disruption is multi-faceted:

- **Financial inclusion:** Cryptocurrencies are a very efficient and easy way in order to promote financial inclusion by providing individuals with access to digital wallets. This way, they are able to actively participate in the global economy, save money securely, and access financial services like loans and money transfers.
- **Reduced costs and increased efficiency:** It is known that cryptocurrency transactions can reduce transaction fees and processing times. This efficiency has the most benefits for cross-border transactions, which are notoriously slow and expensive through traditional banking systems.

The disruption of traditional banking and finance by cryptocurrencies signals a broader movement towards a more inclusive, efficient, and democratized financial system. However, this global change inevitably brings challenges to international financial stability, regulatory issues, the need for technological infrastructure, and concerns about security and fraud. As the use of cryptocurrencies continues to expand, it will be crucial to address these challenges to fully realize the potential benefits of this financial revolution.

Negative impact of cryptocurrency on international financial stability

While cryptocurrencies have introduced numerous innovative financial solutions, their special characteristics have significant risks to international financial stability. The decentralized nature of digital currencies and the challenges they present for their monetization can negatively affect traditional financial systems:

- **Volatility**: The value of cryptocurrencies is constantly changing and being very difficult to tell how and in which way it will modify, it will lead to unpredictable market conditions. This volatility can destabilize economies, especially in places where currencies are at a higher risk of quickly losing value.
- **Regulatory challenges**: Cryptocurrencies can be used outside traditional financial systems, making it difficult for governments and central banks to regulate them and to detect suspicious transactions with possibly illicit reasons. This can only result in illegal activities like money laundering, tax evasion, fraud and many more.
- **Systemic risk**: The rise of decentralized finance (DeFi) platforms related to cryptocurrencies creates systemic risks. If one major platform collapsed, it would then trigger a domino effect across the global financial system, threatening the broader economy.

IV. Major Countries and Organizations Involved

Switzerland

Under Swiss law, issuing cryptocurrencies and trading tokens may be subject to anti-money laundering (AML) regulations. The starting point is determining whether a person/company engages in "financial intermediation" and is thus considered a financial intermediary under AMLA.

There are two main groups of financial intermediaries. First, regulated financial intermediaries in the "banking sector," subject to comprehensive regulation under special legislation. Examples include banks and securities firms. Second, financial intermediaries in the "non-banking sector," such as those who: (i) accept or hold deposit assets of third parties; (ii) assist in the investment of such assets; or (iii) assist in the transfer of such assets. This definition includes those providing services related to payment transactions, holding securities, or managing securities. Before engaging in financial intermediation, such persons/companies must join a Swiss self-regulatory organisation.

AMLA and implementing regulations require financial intermediaries to verify the identity of customers and beneficial owners.

Regarding cryptocurrencies, the following is important for AML regulations:

- **Primary market/ICOs**: According to FINMA, issuing cryptocurrencies (e.g., payment tokens or stablecoins) constitutes financial intermediation.
- **Secondary market/sales and trading**: Selling cryptocurrencies or using them as payment does not constitute financial intermediation. The revised Swiss AML Ordinance clarifies that services related to the transfer of virtual currencies are subject to AMLA if provided in a permanent business relationship.

United Arab Emirates

The United Arab Emirates is known to not only allow, but also promote cryptocurrency use. The Dubai Financial Services Authority (DFSA) now accepts cryptocurrency payments, such as Bitcoin (BTC), Ethereum (ETH), and Tether (USDT), to pay for various trade licenses and visas through the government-owned company KIKLABB in Mina Rashid, Dubai. Besides that, the DFSA declared in January 2021 that as part of its 2021–2022 Business Plan, it would bring numerous benefits to the users while not affecting the country's financial stability.

The United Arab Emirates created the Emirates Blockchain Strategy 2021 in April 2018. This means that their goal was to make the United Arab Emirates the first government powered by blockchain by moving at least 50% of its transactions onto the platform by the end of 2021.

Singapore

Out of all the countries in the Asia-Pacific region, Singapore is by far the one that has taken the most action regarding it and also the one that allows it's use, securing approximately $627 million in funding for crypto companies across 88 deals in 2023.
The Monetary Authority of Singapore (MAS) has shown their open stance, authorizing 19 cryptocurrency service providers as of January 2024. This includes major players like Crypto.com and Coinhako.
Singapore has a system for regulating crypto firms, known as "digital payment token (DPT) providers" in the country.

Japan

Under Japanese law, only licensed banks or fund transfer business operators are permitted to provide a "fund transfer service". Provision of a "fund transfer service" means, according to a Supreme Court precedent, "undertaking the task of transferring funds requested by customers, utilising a system of fund transfer without transporting cash between distant parties, and/or carrying out such a task". Technically speaking, Crypto Assets do not constitute "funds". However, it is possible to interpret a remittance transaction in respect of a Crypto Asset as constituting part of a "system of fund transfer", in which case the service provider will likely be deemed to be providing a fund transfer service by way of remitting Crypto Assets. Moreover, the issuance of EPIs (i.e., stablecoins), which are pegged to fiat currency, would also be deemed engagement in money remittance transactions.

Under the Act on Prevention of Transfer of Criminal Proceeds, CAESPs and EPIESPs are required to: (i) conduct KYC (know your customer) checks on customers and persons with substantial control over customers' businesses for the purpose of conducting transactions and businesses; (ii) prepare KYC records and transaction records; (iii) maintain the records for seven years; and (iv) report suspicious transactions to the relevant authority, among other requirements.

[6] https://www.finma.ch/en

V. Timeline of events

Date	Event
December 2013	China bans banks from handling bitcoin transactions
April 2017	Japan recognizes bitcoin as legal payment
September 2017	China bans ICOs and crypto exchanges
July 2020	U.S. OCC allows banks to hold crypto assets
September 7 2021	El Salvador adopts bitcoin as legal tender
September 2021	China declares all crypto transactions illegal
April 2023	EU passes mica (markets in crypto-assets) regulation

VI. Relevant UN treaties and events

- **Financial Action Task Force (FATF) Guidelines**

  In 2019, FATF created a clear set of regulations for crypto exchanges and the companies that handle them, setting global standards for these transactions.

- **Basel Committee on Banking Supervision reports**

  Recommendations for the risks that come with not banning crypto exchanges and allowing them to integrate into the global financial system

- **IMF & World Bank Reports on crypto and financial stability**

  Many studies addressing cryptocurrency's effects on monetary policies, inflation risks, and financial stability have been made in order to accurately predict the possible result.

VII. Previous attempts to solve the issue

- Regulation of cryptocurrencies

In 2017, the EU came up with an anti-money laundering directive, which created laws to prevent money laundering and other dire actions, such as terrorist financing using crypto coins. Besides that, heavily involved countries like Japan and South Korea have noticed this problem and their governments have agreed on a clear set of regulations that make crypto exchanges more easily trackable. That gave authorities an increasing oversight on cryptocurrency transactions.

- Cryptocurrency bans and restrictions

Numerous countries, such as China and India, have attempted to tackle the risks posed by cryptocurrencies by banning or constantly regulating crypto exchanges. For instance, China's authorities often measure these transactions and mining operations. The Chinese government has expressed concerns over financial instability and capital outflows caused by cryptocurrency use. India's government has debated cryptocurrency regulations, seeming to prefer banning these types of transactions due to their possible consequences, but faced challenges due to pushback from both cryptocurrency investors and the tech community.

VIII. Possible solutions

- **Stronger Regulatory Frameworks**
  Governments can enforce stricter AML and KYC requirements for people that exchange cryptocurrency periodically, making sure that users are properly verified and illicit transactions are more easily detected and reported.

- **Blockchain Analytics**
  Tools like Chainalysis and Elliptic can help track cryptocurrency transactions, making it easier for authorities to trace illegal activities, identify criminal networks, and prevent money laundering.

- **International Cooperation**
  International regulatory bodies, such as the FATF, can work together to create strict and well-defined cryptocurrency laws across countries, sharing information to combat cross-border illicit crypto activities and any other types of activities that can affect a country's financial stability.

Questions delegates should consider during research:

What are the regulations and policies regarding the use of cryptocurrency in my delegation's country?
How much does my delegation's country benefit from the use of cryptocurrency?
What has my delegation's country done so far regarding cryptocurrency?
Which other countries share a similar stance on cryptocurrency regulation as my country?

IX. Sources

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