



THE INFLUENCERS: DIGITAL TRANSFORMATION

TRANSCRIPT COMMISSIONER HESTER PEIRCE

John Salmon	<p>Commissioner Peirce, thank you so much for taking time to join us and be a part of our Digital Transformation <i>The Influencers</i> podcast series. We really appreciate it. You certainly don't need any introduction. You know you've been a leading voice in the crypto assets space and definitely a leader in progressive policy in this space for a long time. So we're really very grateful for you taking your time to join us on the podcast today. As you know, one of the reasons that we're very keen to get you on the podcast was the letter that you wrote to the UK Regulator, the Financial Conduct Authority, with regard to the Digital Securities Sandbox. So just as a kind of open question to begin with, what sparked you to put your response in on this paper in the first place?</p>
Commissioner Peirce	<p>Well, thanks, John and it's great to be with you. I appreciate the chance to speak with you. I do want to give you my disclaimer, which is that my views are my own views as a Commissioner of the US Securities and Exchange Commission and not necessarily those of the SEC or my fellow commissioners.</p> <p>You know, I was drawn to the request for comment from the UK because I think the UK Government has been quite forward thinking and trying to find ways to work with people who are innovating in the financial space. So when I saw the Digital Sandbox and I know this has been something that's been underway for some time, but when I saw this latest request for comment, it struck me that this really would be an opportunity for us to do something cross-border, for us to expand the reach of a Sandbox so that it included multiple jurisdictions, which would then give both regulators the ability to see how the project worked in different jurisdictions, and so that really was what drew me to respond to this particular request for comment.</p>
John Salmon	<p>What would you see as the current U.S. approach to digital security is and is this something that presents itself, you know, as a real opportunity, given the leadership of the U.S. in capital markets and the UK's position in capital markets, what sort of opportunity do you see here?</p>

<p>Commissioner Peirce</p>	<p>Well, I think you're putting your finger on something, which is that I think the UK can maybe help push the U.S. a little bit. The US has been a little bit less willing to certainly work with people in the digital security space on experiments with how digital securities might transform our traditional financial world. I think part of this has been just a conflation of everything. Crypto was something that the U.S. doesn't really want to see happen here and as a result, even pretty tame traditional financial experiments have been pretty slow to get off the ground here. There have been some, but I think we could be much more active in really thinking about how this technology could be transformational. And again, it's not really the regulator's job to plot the path of technology, but it is the regulator's job to work with people so that when they're trying new things, they can try them in a way that is commercially feasible and also consistent with the basic regulatory principles.</p>
<p>John Salmon</p>	<p>Yeah, it's very interesting and it definitely reflects the discussions that we've had with the UK, you know, the Bank of England and the FCA; they said it's not our job to create innovation for the industry, but it is our job to try and help facilitate that within our regulatory environment and ensure that we're enabling it, basically enabling that innovation. So, I completely agree with your comment there.</p> <p>In your letter, you mentioned that you're more of a “beach than a sandbox type regulator” but you can see the benefits of a sandbox in this instance. What is it about the Digital Security Sandbox that draws out these benefits for you and attracts you to it?</p>
<p>Commissioner Peirce</p>	<p>Well, I think that the Digital Security Sandbox is really meant to allow some iteration along the way and growth in scale as the project moves along and as the regulator sees what happens. Again, when I say I'm more a beach type regulator, I do think that the technological development that happens if the regulator is sitting there next to the innovator, watching every step and sort of commenting on every step the innovator makes, I think there's a real danger that the type of trial and error that happens can be very different than if you have a regulator that sort of sits back and, you know, sits in the lifeguard stands, watches to make sure no one's drowning and puts up the red flag when the sharks come by, but really, other than that is not sitting there building the sand castles with the people on the beach. So, I think there's a danger with any kind of sandbox that it turns into something like that.</p> <p>As you said, the UK and FCA have been quite thoughtful in looking at their role as a distinct role from that of the innovator and being willing to have conversations, but also being willing to leave things open enough that people can try different things and can iterate. So, that's what drew me to it.</p>

<p>John Salmon</p>	<p>I love the sandbox versus beach analogy, actually, I think it's very interesting and it's, again, I think with a lot of these proposals, it is about how the regulator achieves the right balance and I think it's really hard in this space, in particular, to get to that, which leads me to, I guess my next question. One thing that you note is the effectiveness that sandboxes have on facilitating innovation. Is there scope for something similar to take place in the U.S.?</p> <p>Typically, you know we've not seen the approach taken to sandboxes and I've certainly heard a number of U.S. commentators being quite negative about sandboxes. But having seen what's been happening in the U.S. and the UK and given the kind of new business models coming up, do you think the U.S. will start to look at sandboxes or even beach boxes or whatever?</p>
<p>Commissioner Peirce</p>	<p>There has been some experimentation on the state level with sandboxes, which is encouraging, and then I would argue that even some of the things that the SEC has done for many years are akin to sandboxes. If you think of something like a no action letter where you set conditions, in negotiation with the regulator, you set conditions and you can do something. Now, a no action letter in many ways takes it outside of the regulatory jurisdiction. What a no action letter is, it's typically staff, sometimes Commission, says if you do things in this way pursuant to these conditions, we're not going to recommend an enforcement action. And so, it does give room for some experimentation.</p> <p>And then we also do a lot of exemptive orders, which allow people to tailor conditions so that they make sense. We saw that, for example, with the growth of exchange traded funds, which you know are one of the big innovations of the last quarter century and they grew out of mutual fund regulation but needed some exemptive relief and that exemptive relief went on for a number of years and then finally turned into a rule. So, in some ways that's a little bit like a sandbox.</p> <p>What I've proposed is a much more clear embrace of a sandbox. In a way it's a beach-like sandbox because you, the innovator, get to decide what the conditions are. You do notice filing with the SEC and then you can start. And of course, you're subject to anti-fraud rules but other than that, you're pretty free. Now, the goal presumably for you would be to get to a point where you have permanent relief, and so if you really want permanent relief, you're probably not going to start off with conditions that don't make sense if the project were to scale. So, I think that we could do something like this. This obviously was just a proposal from me, one commissioner, so it's not out for official comment, but I think that we certainly do have the latitude from Congress to set something like this up.</p>

<p>John Salmon</p>	<p>Coming back to the balance point that we were talking about and the difference between a beach regulator and a sandbox one, while discussing the DSS in the UK and the feedback that we've heard from clients and others in the industry and discussing with the regulator, a lot of the conversation has been around the lessons learned from the EU approach with the DLT pilot regime. So, the EU pilot regime initially had a lot of interest, but there's been quite low pick up and one of the reasons that it's been given has been the low thresholds that have been put in place and as such there's been a lot of commentary from the industry that when the UK comes back with its response to the consultation, which is likely to be in the next month, the right balance is struck between guarding against systemic risk on the one hand, but also presenting enough of an opportunity to encourage meaningful participation, particularly with regulated entities, because the feedback that we've had has been that if you are a big bank, you're not going to want to put the resource into doing this unless the thresholds are pretty high and something meaningful can come out. How, in your view, would you go ahead addressing this and your comment around the beach regulator because I think what you'd mentioned in your previous comment was let the participant decide what the thresholds are almost or what the parameters are. Is that how you would approach it?</p>
<p>Commissioner Peirce</p>	<p>Well, I think this is actually a concern that I've heard with respect to what I put out there as well, because I did suggest that there would be thresholds, right? You'd have to set some thresholds because otherwise someone could just start a whole nationwide large business, you know, using the sandbox and there might be concerns about that because you mentioned systemic risk, but even the investor harm could be pretty extensive if something went awry. So that is the balance. It's a difficult balance. And I think what people have said to me is Hester, the problem is that you can say keep under this threshold but if something is successful, it can take off very quickly and it's not clear how that could happen if you have that threshold in place. What are you going to do shut down? Start telling new clients they can't come in? It's very awkward and so I have to do some more thinking about how do you try to have some release valves that you could come in and get those thresholds moved up if you're bumping up against them. What I like to think is happening is that the experiment is going on. People are at the same time coming in and talking to the SEC about what they're doing and working toward more permanent relief, which would then allow you to move beyond those thresholds but that, you know, in practice could be quite difficult. And so I'd like to underscore that I welcome people coming in and working with me to think about how do we make this work in practice. I'm really focused on this idea of ensuring that we can allow experimentation that's commercially viable also, and that's something that we haven't been very good at doing at the SEC and so, I don't want to put in a program</p>

	that will prevent people from using it for the reason that you just suggested. And part of it is going to be at the front end figuring out what those right thresholds should be. But part of it is also just making sure that the process, once you get into the process, you really are working diligently and the staff is working diligently with you to try to get to more permanent relief.
John Salmon	It is really interesting, isn't it? And it's a very tricky balance because if you are a global bank that is used to doing this in the old world, if you like, and you want to do this as part of the sandbox or the beach experiment, then you're probably going to want to do it in quite a significant way and you could, I suppose, do it through some sort of gating process where you kind of got bigger over time when you together with the appropriate regulator got confidence, but that might be a different approach from say a fintech that hasn't done this before, right? And doesn't have any regulatory permissions and hasn't got that operational experience.
Commissioner Peirce	One thing I want to guard against is, I don't want it to be a sandbox that works just for established players.
John Salmon	I agree.
Commissioner Peirce	Because the regulators are comfortable with established players, that's sometimes where they're most comfortable seeing the regulatory innovation happen. And based on my experience with the crypto world, I mean I've seen a lot of people who come from nontraditional finance, from a non-finance background, and I think it's really important to allow those people to be able to try their hand at innovation. So again, it is tricky in practice.
John Salmon	Yes. And it's just working out the thresholds, it might work depending on what, the background of the party and what they're trying to do and with whom, I suppose.
Commissioner Peirce	And the activity, right? What activity is it, I think, matters too.
John Salmon	Yes, absolutely, and the effect it has on the market, etcetera, etcetera. Yeah, it's hard to figure out a rule that works in in all ways.
Commissioner Peirce	But one of the benefits I think of doing this cross-border is the ability to see how the thing works in different settings and with different types of clients potentially, right. Different countries have different jurisdictions, have different needs and different types of products that would be competing with it, so, you know, I think it could be very interesting and it's a way to maybe get a little more scale, but also kind of keep it contained by doing it in two jurisdictions simultaneously.
John Salmon	One of the points that really struck us when we saw your letter was the idea of a joint sandbox. I mean, it seems to be a really exciting

	<p>opportunity. The U.S. and the UK are pretty well aligned around their views on capital markets. They are two of the leading jurisdictions obviously. And the legislation that enables this in the UK gives HM Treasury a very broad power to set up as many sandboxes as it sees necessary, and for as long as it sees it necessary. So, while it's not possible to form some form of collaboration for the sandbox, there is real merit for a future collaboration. So, this could address some of the points around scale that we've obviously talked about and, you know, the parameters, etcetera. What would you see as the barriers to making this happen? If we could persuade the UK that this is a good idea, what do you think could make this happen from your side?</p>
<p>Commissioner Peirce</p>	<p>Well, I think we would have to put in some sort of information sharing agreement to make sure that we can get information back and forth and that can be a little difficult these days because there are all these, new regulations around privacy protection and so that can make these kinds of things more difficult. But I think also what I wouldn't want to see happen is, I wouldn't want to see the UK worrying that it's just going to be used by U.S. firms to do things in the UK. I think really the goal is to have our two economies, as you pointed out, we have a common commitment to strong capital markets. And so, I would want it to work in a way that really allows entrepreneurs in each jurisdiction to work in the other jurisdiction, and I think that kind of mutual recognition can be very valuable in lots of areas but in this area as well.</p>
<p>John Salmon</p>	<p>Shifting gears slightly, when we talk about Digital Security Sandbox, the other area that comes up is around digital money and when we've had discussions around the DSS, there's been a lot of mention on stablecoins, wholesale CBDCs, tokenised deposits. How important do you see the regulation of digital money and in what form would you see it taking place around digital securities?</p>
<p>Commissioner Peirce</p>	<p>Yeah, well, a lot of the digital money stuff probably is outside my purview, and I think that points to an important issue, which is that, you know, you see that in the UK, the FCA and the Bank of England are working together. In the U.S., we could have a multi-regulator consortium involved in this too, so that if people wanted to try things in the payment space and that could work as well. I mean I think CBDCs raised a whole set of issues because that's basically the government trying to experiment. I'm really interested in seeing sort of the private sector stablecoin type experiments. Though again, I think many of those fall outside of the purview of the SEC, and that's one of the challenges too. You know, we're trying to figure out which regulator you actually go to and whose sandbox you get in. That can be very challenging, especially for someone who's just walking into the financial regulatory thicket for the first time and realizing how very complicated it is.</p>

John Salmon	Any other thoughts on DSS and how the U.S. might be able to work with the UK on this?
Commissioner Peirce	We can watch what is happening with the DSS and I think can draw lessons from that. And as you say, I mean, even if this isn't going to be the time that we do a joint project through the DSS, let's think about getting to a place where we can try something together and so maybe as we watch what happens with DSS, we'll get some ideas of what the next iteration of the sandbox might look like and how that could work cross-border.
John Salmon	I really appreciate you taking the time to do this, Commissioner Peirce. It's been a really interesting conversation from our perspective. We're very grateful and very interesting to hear your thoughts on how the UK and the U.S. might work together in this really exciting space.
Commissioner Peirce	Well, John, I really appreciate it and I do encourage people if they have thoughts about what we can be doing here in the U.S. to set the groundwork for future cooperation with the UK, or, you know, even just domestically what we can do to build a sandbox here, I'm all ears, happy to hear from people, so please knock on my door .