Barefoot Innovation Podcast with Jessica Renier
Managing Director of Digital Finance, Institute of International Finance

*Note that transcripts may contain errors.

Jo Ann: I have really been looking forward to today's show because my guest is Jessica Renier, who is the Managing Director of Digital Finance at the IIF, the Institute of International Finance. And Jessica, thanks for joining us today.

Jessica Renier: Thank you, Jo Ann. It's wonderful to be here.

Jo Ann: I have known you for a long time and I had the opportunity to hear you speak the other day. I reached out and said, "I would love it if you could come on the show." Among other things, you're a former senior official at the Treasury Department, and you just bring an incredible perspective to what's going on in the world internationally in the financial arena, so I'm really excited to talk with you today. Let's start by asking you to talk about yourself. Tell us about what your background is and what you're doing.

Jessica Renier: Sure. So where to start? Just a little bit about my background then. I'm an economist by training, originally started my career at the Federal Reserve Bank before, during, and after the financial crisis. So the background of financial stability considerations certainly underpins a lot of my thinking. I also did time at Deloitte as a consultant doing strategy and operations consulting for banks and securities companies and explicitly for blockchain technology issues and really worked to build what's now their global blockchain technology practice and did a fair amount of work on digital identity at the time. What I really took away from that experience that I think I use a lot today is just the sense of how important the business model is. And when we, as policymakers or regulators or just people involved in the policy space, are asking businesses to do something, the question is can they realistically do it? Does it make sense for the economy?

Jessica Renier: Sometimes regulation sounds really good on paper, but it doesn't work quite as well when it's implemented, and being able to grasp that is something I think about a lot. But yeah. After that, I moved to Washington, actually, from San Francisco where I was in Silicon Valley, moved to Washington to spend time at the Treasury Department, both in the Domestic Finance side of growing the economy, as well as the Terrorist Financing side, and making sure that we understood how bad actors could abuse financial technologies, and in particular cryptocurrency. And then, gosh, went to OMB over at the White House to manage the budgets during a very exciting but concerning time, I guess, during COVID where there were a lot of different small businesses and other applications to look out for and keep afloat, but certainly a good perspective on a whole of government approach to think about financial technology today.

Jo Ann: And am I right that you're also a reserve officer, am I remembering right, in the Navy?

Jessica Renier: Yes, I am. I am a lieutenant currently in the Navy Reserve. So still spend some time thinking about the financial sector more on the national security front while continuing to be here in my primary civilian capacity at the IIF leading our digital finance team where we cover a pretty big range of topics where we think about a few different big buckets, I would say digital assets being the biggest bucket of policy in this space right now, whether that be considering unbacked crypto assets or stablecoins, central bank digital currencies, and decentralized finance.

Jessica Renier: Another big bucket, I would say, of priority issues is certainly looking at cross-border payments. Now, you may think about digital assets, certainly, in that sense of being used in a cross-border payment sense, but there's also a much bigger set of issues at play around cross-border payments and the G20's faster payments roadmap and various building blocks. And then data, data being a very large broad bucket of topics to think about whether we think about the impacts of data localization or fragmentation, looking at open finance. That's really turning into and should end up transitioning into more open data questions, not just open banking and then open finance, but broader open data and leading to the need to think about digital economic cooperation at large, so thinking about the way that we interact in the economy and in financial markets today, where all of our information is just increasingly digitized.

Jessica Renier: I see a lot of documents, and even our documents at the IIF, where we say the digital economy, and I think, "Well, that's just the economy at this point. It just is digital." So when we think about data, it's really at the core of every issue that we might think about in the financial space. And then AI and machine learning is another significant bucket of policy issues and an area that we look at. We have a Machine Learning Survey that the IIF does where we talk to our various members and understand how they are using machine learning or hoping to apply machine learning to various aspects of their business model. And then we're able to look at that across the globe since we have over 400 members across more than 60 different countries and get a sense of where are areas of the financial system investing in particular kinds of applications versus others and why, and work with the global standard setters to understand those trends in those areas. So a handful of different things, quantum computing, pretty much everything you can imagine these days. It's a pretty busy place to work.

Jo Ann: And the IIF is such an important organization. And I must say, whenever I'm doing something really interesting, it seems like the IIF is always there. So we're going to actually drill down on a lot of the topics that you've just touched on. It's really fascinating. Before we do that, as you said, you're an economist by training, let me just invite you to talk a little bit about where you see our economic moment right now and how you think developments in digital finance are being impacted by that or are likely to impact it.

Jessica Renier: Sure, Jo Ann. So I would certainly first acknowledge the challenge of inflation that the economy, that the global economy, is really looking at right now. I want to acknowledge that but not focus on that, because from a digital front, from the particular aspects of digital policy that I'm looking at and that my team is looking at in particular, I wouldn't say that they're so driven by that or that they drove inflation. Those are larger macroprudential issues that have been long in the making for a little while. So what I would point to or draw out from the digital front specifically is more looking at the trends in geopolitics and the relationship to financial innovation. And one of the things that I think is really important to see and quite concerning is just a march towards localization and protectionism globally.

Jessica Renier: And I know there's a lot of discussion about that being deglobalization, and you can think about it like that, but clearly a desire to be protectionist in a lot of ways, and that's what's causing the deglobalization. And if you look at other phrases that are certainly related, but perhaps don't carry quite as negative of a connotation, you have talk about strategic autonomy, and then specifically technological autonomy. It's not even just a strategic question as much as actually looking at technology, and can any given nation operate and exist onto itself just with its own technology? And not that a country shouldn't look to be able to be self-sufficient in various ways, that's a question of national security that's certainly worth asking, but it's just the trend that one sees in this, just marching away from cooperation and towards protectionist tendencies, which is not good for the economy. It is not good for the free flow of data across borders.

Jessica Renier: And that free flow is what enables cooperation, and it fundamentally enables financial transactions to take place, and I think we have often gotten very used to taking for granted that if I just use a credit card in a different country, but I'm back here in the US and I use a credit card somewhere else, and I want my payment to go through and it just goes through instantly and all of my data is transferred, and we're used to that just working, and what concerns me is that we are making those kinds of operations harder and harder and more challenging, which would cause institutions to begin to ask whether it is worth serving various areas and potentially pulling out of those.

Jo Ann: Yeah, which could have profound implications for underserved markets that have less robust systems that are attracting all the players into them as well.

Jessica Renier: Yes, certainly.

Jo Ann: So you mentioned CBDC, central bank digital currencies. Let's talk a little bit about what you see as the important developments in that space. I know the IIF has commented on the Federal Reserve questions on that as well as the consultations in the European community. Tell us what you think is happening and where the IIF is hoping things are going to go.

Jessica Renier: Sure. Yeah. So the IFF did respond to both the Federal Reserve's consultation or discussion paper on a potential US CBDC, as well as the European Commission's targeted consultation on a digital euro. We responded to those two in part largely because of the global roles of both the dollar and the digital euro, and certainly interested in CBDC development around the world, not to just single those out, but clearly when you're looking up potentially arguably changing the nature of the world's reserve currency, that's a pretty big question that deserves some serious thought. So with that, the IIF wanted to be very constructive in its feedback and thoughtful about these questions and submitted fairly lengthy responses. I would summarize them by saying that we absolutely support the Fed, the European Commission, the ECB, other central banks, and looking into these questions and doing research around potential central bank digital currency, asking these questions. They should be being asked.

Jessica Renier: As technology moves ahead and advances, then we look to how might our daily operations and other pieces including just the fundamental nature of money evolve as well. So it makes sense that they would be researching them, particularly when you look at globally, across the world, so many countries that are doing the same. So certainly supportive of their efforts and look forward to working with them, to continue to provide iterative and constructive feedback. The IIF does see many challenges, however, with a retail CBDC in particular. When I say challenges, though, I'm not saying that they're insurmountable, necessarily, challenges, but challenges for sure. And these challenges range across a number of things, including risk to financial stability around potential runs away from commercial bank deposits to retail CBDC. In the case of a run towards something that's clearly backed by the government, if a direct liability of the central bank, as it sounds like a CBDC likely would be, again, still a lot of things, questions around that and in ways in which one might be able to mitigate those risks.

Jessica Renier: So that's why I say not insurmountable, but challenging and complex for sure, very complex questions that we haven't yet dealt with. I also think about, though, getting back to where I always go back to the business model. Is this possible for the financial institutions that are involved? Who are the intermediaries here? And if you think about the intermediaries being the banks, being the holders, in our response, we talked about the intermediaries, at least in respect to a potential US CBDC being those who hold a Fed Master Account. And if we're talking about those, then we need to think about what is their business model and ensure that we cannot only create something that technologically works, but also works for the business model of the institutions that you need to operate in the space, because you have to have both sides, or else just the economy doesn't work.

Jessica Renier: You potentially risk taking away or cannibalizing deposits, which those banks actually use to then turn around and lend to the economy. That wouldn't be good. So it's a question of when would that become problematic? At what magnitude, or immediately? All of those questions are things that are quite complex and have yet to really have an answer. Having spoken to a lot of different financial institutions, central banks around the world, I think this question of how that business model works seems to be the outstanding question that everybody understands is the issue that needs attention and resolving. I'd say another aspect that the BIS actually recently, rightfully so, acknowledged, and I'm glad to see them focus on, is interoperability of various systems around the world.

Jessica Renier: You have countries, as could be expected, working on potential CBDCs at very differing rates from each other. And when they work on them at different rates and with different design decisions, then there may be critical points in design or infrastructure that get reached at different points. And if they're not made in a way that's coordinated or talks to each other, you are potentially losing out on the opportunity for a more globally cooperative integrated system that I think the BIS hopes would come of a lot of this development. So there's some question about how does one cause this coordination point through mechanisms if these systems do go forward to occur, whether at the same time or in some kind of coordinated way. And then I have to wonder, what countries or regions of the world realistically end up being those that drive what those decisions end up being made?

Jessica Renier: Is it because they started sooner or because they had a more sound process to developing it that took them a little bit longer? One thing, to that end, that I think is so important in this space is I've heard a lot of people comment about certain countries being ahead of or behind other countries in the research and development of a central bank digital currency. And I think something that is the nature of the space of innovation is just the mantra of innovating fast and fail fast. And entrepreneurs like to move fast, and you innovate fast and then you fail fast, and then if you're going to fail, then you pick up and you try again. And that only works in certain circumstances, and maybe in most entrepreneurial circumstances.

Jessica Renier: But when dealing with sovereign currencies, they can't afford to fail. So you can't just run out of the gate and say, "Innovate fast and fail fast." You need to not fail. So it doesn't concern me as much to see various countries, including the US to date, having taken time to be fully asking all of the questions and doing the research because they need to get it right if they're going to do it at all, and it's a pretty complex project to think about.

Jo Ann: That is so well taken. And even in the private sector, there is such a thing as second-mover advantage and being a fast follower. So before we leave this topic before, do you have a sense of, as we look at the countries around the world that are exploring CBDC, how many of them are thinking about a retail version versus a wholesale version that'll be focused on working with the banking system?

Jessica Renier: That's a great question. I actually probably couldn't give you a number per se, just more of a sense that I think the wholesale version is easier right off the bat for a lot of economies to imagine and less disruptive. Some people might argue that we effectively have a wholesale central bank digital currency in a number of ways already, just slightly different technology. So I think in the fact that it is less disruptive in some ways perhaps more have thought about it, but then we haven't talked as much about it because the focus, and particularly the focus in a lot of discussions in media and conferences seems to be much more on the retail side, I think, one, because it is very different. It's not the obvious case, and there's a particular focus around the world on access and inclusion. And not that there isn't usually, but there seems to be really an increased focus on that as of late, which I think a lot of people are looking at could a retail CBDC help in that area?

Jessica Renier: I would say at the IIF, we're a bit skeptical that that would be the case. It would be great if it would be, however, I'm still skeptical in terms of actually seeing where, if you look at what the actual pain points are that cause lack of inclusion or challenges to inclusion and access a digital currency on its own, I am not sure actually addresses those as opposed to questions like solving digital identity, for instance. I do think that it is quite possible in that case, for instance, that a retail CBDC may carry enough geopolitical interest in pushing it forward that it then, as a consequence, causes us to solve for other issues that we haven't otherwise had enough support or willingness or just focus to go solve, like aspects of tiered digital identity. And if that's the case, then it will be as a consequence of, but not necessarily just because on its own, it was the answer, but it certainly remains to be seen.

Jo Ann: That is a really interesting analysis. I hadn't thought about that sort of circular potential to drive these issues forward with the multiple potential solutions bundling together. So that was a great segue to talking about stablecoins. So talk about how you're looking at stablecoins, what you're seeing in terms of developments from different jurisdictions, what you think are the future of stablecoins and how do you see them if you see them coexisting happily with CBDC as well?

Jessica Renier: Sure. I think stablecoins are fascinating. So at the IFF we've been a bit worried, honestly, from earlier on that stablecoin regulation had seemed a bit poised to be perhaps fragmented from the start between the EU using a stored value or e-money framework in MiCA, the UK looking at more of a money market approach, and the President's Working Group Report last fall in the US favoring more of a deposit-taking licensing approach. Just looking at those three, obviously, there are more jurisdictions to look at across the world, but just amongst those three, there are clearly differences in the initial approaches. However, I would say that there's some convergence that it appears that just more recently, potential convergence on approach. And Under Secretary Liang at US Treasury just recently gave a talk where she potentially signaled some openness to a more harmonized approach to stablecoin regulation with the UK and EU where there might be potential for a non-bank issuer of stablecoin, how the US would think about that regulation.

Jessica Renier: She didn't explicitly say, "Hey, we're thinking about regulating it differently, or this is what we might do," but did speak to that potential existence of such a non-bank issuer, which shows, I think, some openness and some pivot, maybe, from the original PWG Report that moves a little bit more towards Europe and the UK. I'd note that Japan's parliament also recently passed a legal framework for stablecoins that had been proposed by the JFSA in late last year with the legislation taking effect, I think, around perhaps mid-next year. And that law clarifies the definition of stablecoins, which will now be considered as digital money and must be linked to the yen or another legal tender.

Jessica Renier: Japan's position is really congruent with growing thought that coins, or stablecoins, if you want to call them that, that rely on algorithms or algorithmic stablecoins to peg their value, really shouldn't be treated as if they're stable, because they're not. They're not the same animal. They're a very different animal than a stablecoin that is perhaps backed either wholly by fiat currency or largely by fiat and by their fairly stable, highly liquid things like short-term treasuries or things like that. Even those, though, carry risk. They're not one for one. So unless it's truly one for one, there is some risk, but you do see some convergence of recognition that perhaps in this area, there are at a minimum two different types of, quote, "stablecoins," one that is potentially significantly more stable and likely to be, and I think will continue to exist going into the future and have value for the economy potentially. More research is needed certainly around them, but algorithmic stablecoins being... I wouldn't use the word stable. I'd say perhaps they got out of the lab with the word stable and maybe shouldn't have.

Jo Ann: Certainly the experience with the Terra LUNA failure, whatever we should call it, debacle, recently has, I think, got a lot of people thinking about this issue. By the way, I should say for our listeners, we will link in the show notes to some of the other shows we've done on related topics, including one with Michael Hsu recently, the acting Controller of the Currency, focusing heavily on stablecoins, and we'll also link to... I think we have two shows with Chris Giancarlo, the former chair of the CFTC talking about CBDC.

Jessica Renier: And Jo Ann, actually, I would say just another quick thing on stablecoins is that I think a lot of people question can they coexist with a CBDC? And I don't see any reason that they can't or that they wouldn't. I think that the government today has its fully backed form of money and other kinds of financial instruments, and the private sector does as well. And we operate much the same in these ways with a private sector solution and a government solution, and so I don't see why that wouldn't continue to be the case. And certainly, at least for the short... Well, not even just the short-term. For quite a while, a fully functional global system of CBDC, should such a thing come to fruition, which is still a very large if, it will take a while. It will take years for many economies to get there. And stablecoins, global stablecoins, are operational today and filling a definite need and economic function, and so I see them continuing in that way.

Jo Ann: That's so well taken. And one of the things that I've been hearing more and more is some hope that if we have major CBDCs, they may become platforms on which other innovators can build something in the vein of how the Ethereum ecosystem drives interoperability with blockchain solutions. And going back to your earlier point on interoperability, we may be able to get some tech foundations and framework that can make it easier for people to create ecosystems that will interact with each other, both public and private.

Jessica Renier: Yeah. Certainly. And simply because something continues to exist, it doesn't mean that the use case for it stays the same. So perhaps the way in which consumers or financial institutions then use the instrument going forward fundamentally changes, but it provides different kinds of functionality or perhaps programmability or many different things, a rainbow of possibilities right now that we simply don't know and requires more research.

Jo Ann: Yeah. Absolutely. So let's push the boundary out even a little further, not that we're not already pretty well toward the edge, and talk about decentralized finance, DeFi. How are you looking at that space? Where might it be taking us? What should we be hoping for? What should we be worrying about in DeFi?

Jessica Renier: So what I think about DeFi that is unique versus a lot of the other topics that we've covered in the rest of the digital asset space is that DeFi is the creation of markets, not just the creation of a single coin or token that's going to operate a particular way, but the creation of markets. And that is a notable thing, and certainly something when we think of markets, then we think about how to put parameters around those markets to appropriately regulate or provide guardrails. That is a natural thing for the global financial system to do and for global standard centers to do, certainly reasons why IOSCO is looking further into DeFi and what those questions are, because if you're looking at the regulation of markets, and this is the creation of markets, then those are questions that need to be asked.

Jessica Renier: In the current volatility of the market, and I would say a clear cleansing of some significant irrational speculation that was clearly going on in the crypto market and in DeFi, that is to be expected. What is happening right now is the natural evolution of innovation is a new technology. A lot of people jump on it, it gets really exciting, and there's irrational speculation. You can look at the dot-com bubble much the same. And then you see a correction because one of the things that I always take with me after the financial crisis, being at the Fed during that time, is that the math just doesn't lie. Math is math. That which cannot continue will, in fact, not continue.

Jessica Renier: There will be a point that irrational behavior and speculation will come crumbling down. And it's necessary to cleanse the market of the actors that don't have the staying power, that aren't built for the long-term and don't actually present the long-term value that is beneficial as a new technology or a new financial instrument or a new market. And I think there are benefits to be realized by aspects of DeFi, and it's a question of getting to what that slice is that has that long-term value and where it should be applied and how within the system in a safe way, in a way that when there are financial stress points in the market or in the globe, that it allows failure to happen, but failure to happen safely without going through the rest of the financial market.

Jessica Renier: And in this case, I think, I'm actually so glad that what is happening right now is happening because it shows us exactly why it is so important that we test new technologies and test new instruments and test them for stress and understand fully what the impact will be when certain things happen, and that we don't integrate them too quickly to the rest of the financial system, but that we also ensure that we create a regulatory framework that is responsible around them to both protect the financial system, but to help them mature and grow the piece of it that will be beneficial. And I think that it is just so important for all the players in the market today to see this, to experience the current situation, both of a purging of speculation and a cleansing to focus on those that will absolutely survive this period of volatility and will turn, potentially, into very, very significant operations going forward that will be beneficial to the world.

Jessica Renier: I think there have been a couple of times earlier on where I did think back to the financial crisis. Shortly thereafter, when I was leaving the Fed, before I was going off to business school, my boss at the time told me that everything else that I would do after having been at the Fed during that time might seem boring, or not crisis-focused, and that I would need to find the interesting piece of it because the world doesn't live in crisis like that every single day.

Jessica Renier: But what was really important was as my first job that I had seen a whole lot of things that I couldn't fully appreciate at that time. And at some point in the future, I would look at something, look at a situation or be presented by it, and think, "I've seen this movie before, and I know how it ends. I can't even fully tell you why, but I know how it ends." And this is the kind of thing that if you don't test this and allow this level of failure before it's connected to the rest of the financial system, then you end up with a movie that ends very poorly.

Jo Ann: That's a great story, and your refrain has been weaving through the whole conversation about the need to do testing. Do you have in mind the best ways for things of this nature to be tested? Is it sandboxes? Is it running... How do we go about that?

Jessica Renier: That is a fantastic question, Jo Ann, and I think something that all the global regulators are thinking through and are challenged by today, particularly DeFi, because it involves so many different activities that are covered by or where other differing bodies have oversight over those activities, and not all under one roof, or even under a couple of roofs, connection points that typically all of these bodies don't have to work together, and it is something that is challenging and a question that I think nobody has managed to put their hands around, and I don't imagine that we will. And in that sense, that piece of it does make me nervous. It does give me concern, because no matter what, we're forging into a new area that we don't know how to test.

Jessica Renier: We can try to slowly analyze and put guardrails around pieces and pick these aspects apart, see what the interaction is. So like right now, see what happens when something goes badly and sets in a negative downward spiral in the market and try to learn from that. I mean, DeFi, certainly it is susceptible to many of the same risks, all of the same risks, pretty much, that a lot of traditional finance is susceptible too. You talk about leverage and liquidity issues and just a different version of counterparty risk, if you will, and the fundamentals of economics don't change simply because you call it something else or the technology allows it to be something else. Economics are still economics are still economics and are always going to be economics, and those are the economics that market.

Jessica Renier: So I don't know. I wish that I knew, but that is the one thing that I can feel fairly confident saying, "We will miss something, for sure," as this develops. We absolutely will miss some way in which these new technologies or new instruments are connected to other parts of each other or the financial system or things that we never could have imagined, interactions that we just never saw coming as much as FSOC or FSB or others might try, it will happen, and it's all the more important that we take it slowly in terms of exposure to the broader system.

Jo Ann: That's one of the things as a former bank regulator, myself, that I worry about, because as you say, something will go wrong and our system is set up to make the policymakers just naturally risk-averse. If we don't do anything and something goes wrong, it seems like you're less likely to be condemned for your actions than if you do something new and it goes wrong. And yet I feel that the risk of inaction is rising by the day in this whole space of innovation, where if we can't keep the government and regulatory machinery up to pace with the private sector change, then things will go wrong there as well.

Jessica Renier: Yeah. Absolutely. There is a definite risk of inaction and definite risk of moving too slowly. And I also think the nature of regulation and regulators is to be very risk-averse, to constantly protect for the risks, as is their job. And oftentimes, if you have a lever or a screw that you can screw in tighter, then you use that one and screw it in tighter, even if it's not quite the right one to be using just because it's there, then regulators tend to use it and turn it, and perhaps they should leave that alone. I think a perfect example of that is actually the ability of more of the traditional system and banks to participate to a greater degree in the digital asset space. I know that the Basel Committee is still thinking about capital requirements and other aspects of exposure to crypto assets.

Jessica Renier: But I think this is one of those things where banks have, for a long time, managed risk. It's what they do. They know their customers. Their customers, many of them trust them and have had a long relationship with them, and they're highly regulated institutions. So while we need to be very careful and thoughtful about the degree of exposure of new instruments to the broader system, we also can't make it so punitive that it's impossible for that system to operate within it and experiment at a responsible scale. And I think thus far, it's pretty darn punitive.

Jo Ann: Jess, you are so interesting to listen to. I have a million questions, but I know our time is pretty much up. Is there anything you want to say either in summary, or do you have advice for the audience to be thinking about final words of wisdom for us?

Jessica Renier: Sure, Jo Ann. I know that we only talked about or really focused on digital asset issues today, and it's certainly just a part of the portfolio and all of the different activities that are going on and very important questions in digital finance. But I think the biggest thing I'd leave folks with right now, particularly given the state of the markets and activity that we see going on, because I think there have been more speeches, legislative actions, regulation, et cetera, in the last week to 10 days than we've seen at any other time in the digital asset space. And I would just say what we're experiencing right now is the natural curve of innovation. What's happening in markets right now is normal, and we fully expected would happen. There needed to be a correction, and that's exactly why appropriate regulatory structures are going to be so important going forward, and I'm glad that we're seeing this now so that we can usher it forward in a more mature, safe fashion.

Jo Ann: Fantastic. I couldn't agree more. Totally agree. Where can people get more information about the IIF?

Jessica Renier: Sure. Certainly at iif.com. We publish any of our open public responses to consultative reports are on our website. So if you wanted to look at the responses, for instance, that we submitted to the Fed or to the European Commission, they're there regarding CBDC as many others as well. And we also host our own podcast called Finance Regulation Technology, FRT, that comes out roughly every other week, and you can find that on our website as well.

Jo Ann: I have been honored to be a guest on that show. It's a terrific show, so that's fantastic. Jessica Renier, thank you so much for being with us today. It's been absolutely fascinating.

Jessica Renier: Thanks, Jo Ann.