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Financial Regulation, Monetary Policy and the Metaverse

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The metaverse is an emerging, digital environment that will allow users to do almost everything they do in real life, e.g., run businesses, buy real estate, enter into contracts, and socialize, albeit in a virtual setting. It is often described as the next, natural iteration of the current internet. As an ideal, it is a seamless convergence of our physical and digital lives.

Metaverse Markets, Transactions, and Tokens

Though the metaverse is in its infancy, it is growing rapidly, and a dynamic economic ecosystem is forming and evolving. At the center of this ecosystem is blockchain technology: decentralized, tamper-proof public ledgers that record the ownership and sale of cryptographic assets, including fungible tokens like cryptocurrencies, which are identical to each other and, therefore, can serve as a medium for commercial transactions, and non-fungible tokens (NFTs), which have unique identification codes and metadata that cannot be replicated, thus distinguishing them from one other. Because each NFT is uniquely identifiable, NFTs can act as a digital representation of real-world, tangible assets like artwork, real estate, identities, and more; "tokenizing" real-world assets makes buying, selling, and trading them more efficient, while reducing the probability of fraud.

As the metaverse matures, there will be increased convergence between the online and offline worlds and the further development of physical-to-virtual payments and financing, with the potential for new ownership and asset classes, for example, virtual mortgages on metaverse real estate.

With these characteristics, there are opportunities in every market area to develop and build the industries, marketplaces, and products that are consumed in the virtual world. It should come as no surprise, then, that ArentFox Schiff has already advised several household brands on developing a presence in the metaverse before becoming the first major law firm in the country to join as well by acquiring a site in Decentraland, a purely digital world in which users can buy digital plots of land.

Central Bank Digital Currencies

With the evolution of "metanomics" and a corresponding increase in the number of people utilizing digital assets within the metaverse, discussions around regulation and stabilization of this digital world have also increased. The US Federal Reserve recently announced that it is seeking public input as part of a discussion on the potential benefits and risks of central bank digital currencies (CBDC), including one issued and backed by the US central bank. While Americans have long held money in digital form—for example, in a commercial bank account recorded as entries on digital bank ledgers—a CBDC would differ, because as central bank money, it would be a liability of the Federal Reserve, not of a commercial bank. Central bank money serves as the foundation of the financial system and the overall economy. It carries neither credit nor liquidity risk, and is therefore considered the safest form of money.

As the Federal Reserve discusses in its recent digital currencies whitepaper[1], a CBDC could potentially offer a range of benefits: expanded access to a convenient form of central bank money with its attendant features of safety, liquidity, and access; new platforms on which to create innovative financial products and services; and faster and cheaper payments, including across borders.

A CBDC could also pose certain risks and would raise a variety of important policy questions, including how it might affect financial-sector market structure, the cost and availability of credit, the safety and stability of the financial system, and the efficacy of monetary policy.

The Federal Reserve does not plan to take any imminent decisions on a CBDC. Per its whitepaper, it would only consider developing a CBDC if it finds (i) a CBDC is the best way to provide the aforementioned benefits to households, businesses, and the overall economy, (ii) such benefits will exceed the potential risks, and (iii) the existence of broad public and cross-governmental support. As a part of that consideration, the Federal Reserve is seeking public feedback on a range of topics related to CBDC and welcomes comments from all stakeholders here.

Though the Federal Reserve’s endorsement of a CBDC would exponentially broaden the adoption of metanomics, financial services are wasting no time in exploring opportunities in the metaverse. For example, JPMorgan Chase has set up a virtual lounge in Decentraland to much publicity. Other large asset managers such as American Express, Mastercard, and US Bank are also beginning to dip their toes into digital currencies and virtual platforms.

As these large financial institutions increase their presence in these new worlds, regional and mid-market financial players should also begin to think about how best to reach and serve these virtual markets.

ArentFox Schiff will continue to monitor, evaluate and explore opportunities and challenges across the metaverse ecosystem, bringing to bear our combined capabilities in emerging technologies, finance, government regulation, and oversight to provide our clients with crisp insight into these cutting-edge markets.

ENDNOTES

[1] Available here.

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