European Financial Services Round Table

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EFR POSITION PAPER ON CONSIDERATIONS FOR THE DESIGN OF A DIGITAL EURO

Introduction

In recent years, the emergence and spreading of new forms of digital money and reduced uses of cash have spurred central banks worldwide to consider issuing their own digital currencies (CBDC). In Europe, the ECB has decided to move ahead with a formal investigation phase of a retail digital euro as an electronic form of central bank money that would complement cash. A final decision about whether or not to issue a digital euro would be taken by end-2023, and, in case of a positive decision, development work would take around three more years.

Given that commercial banks are the main issuers of commercial money – approximately 80% of the money in circulation is issued by commercial banks – and that they hold the primary relationship with retail customers by providing financial services (potentially including those for the digital euro), and that the issuance of a retail digital euro could have huge impacts on the whole financial ecosystem and its stability, it is essential that they are closely involved on a continuous basis in the development of the digital euro.

Opportunities

In the ECB's view, the issuance of a digital euro could be a feasible response to the emergence of new digital assets and payment methods, including stablecoins or foreign CBDCs, as well as the decreasing use of cash, all of which can have an impact on key public policy challenges, including monetary sovereignty, financial stability and financial inclusion.

In particular, the **threat to monetary sovereignty** posed by foreign CBDCs or crypto assets (especially global stablecoins) becoming widely used in Europe is a plausible reason within the context of the mandate of the ECB to issue a digital euro that is made available to the general public complementary to cash. This would be most feasible and better achieved in combination with initiatives of the private financial sector within the context of the two-tiered monetary system of the EU.

Depending on its design, a CBDC has the potential to contribute to **efficiency and innovation in retail payment systems**, including cross-border payments. Whilst similar results could also be achieved with existing payment system infrastructures, (e.g. instant payments) the opportunities should be assessed to take conscious decisions on the future EU payment ecosystem. Moreover, the issuance of isolated domestic CBDCs does not seem to be the optimal way for improving cross-border payments efficiency.

A retail CBDC could furthermore contribute to improved **access to and use of central bank money in a future cashless society**. In the EU, however, cash still plays an important role and it is not certain whether customers make a real difference between commercial and central bank money. Similarly, the opportunity for a retail CBDC to facilitate **financial inclusion** in certain contexts, is not as relevant in Europe as in other jurisdictions because more than 90% of the population already has a bank account, and exclusion risks are more generally related to the access to digital technologies.

In the context of cross-border payments a CBDC has the opportunity to introduce more efficient cross border transfer processing of payments if central banks worldwide agree on and adhere to a set of standard principles.

In light of these opportunities, the **private sector's focus** is to provide a variety of digital and innovative payment solutions to consumers and corporates as well as merchants and retailers. The financial industry is overall committed to improving existing payment systems, to developing new solutions (e.g. based on instant payments or programmable money), as well as to exploring the options of tokenizing commercial bank money.

Moreover, in the context of **capital markets**, a wholesale CBDC for the usage in the interbank context could facilitate more **efficient issuance, trading and settlement as well as processing** of subsequent corporate actions like dividend or interest payments.

From a **supervisory point of view**, new forms of digital money could also contribute to improving the efficiency and effectiveness of existing AML/CFT processes, embedding regulatory supervision within the system and thus reducing the need for firms to actively collect, verify and deliver data[1]. Legitimate needs for privacy from customers should however be taken into consideration.

Risks

The implications of a retail digital euro for the financial system can be profound and require a thorough assessment and adequate design solutions in order to help mitigate the risks:

Potential deposit substitution and its impact on banks funding and lending:

- The ECB has identified the risk that the digital euro may be used as a store of value (not only as a means of payment), which could cause a shift of commercial banks' deposits into its digital euro and intends to avoid this undesirable situation.
- The ECB's emphasis on its guarantee for its digital euro could undermine the confidence in commercial money, or even the solidity of commercial banks. The digital euro **could be easily understood as a safer store of value than deposits and commercial banks money**. In times of crisis the digital euro would clearly facilitate bank runs, but in normal times it could also impact bank funding if customers think that their savings could be safer in digital euros than in banks deposits or if the privacy of the digital euro is preferred.
- To mitigate this risk and limit its use as a store of value, one of the most commented options would be to install a limit of digital euro holding per individual.
- Another mitigating option would be a two-tiered remuneration structure, in which an initial amount below a certain threshold may enjoy a remuneration close to market rates, while quantities exceeding that threshold would be disincentivised with a lower rate. Still, this tool may not be effective in crisis periods or low interest environments. The first estimates show that even in a "normal" period, the volume of resources that would switch to the ECB couldn't be replaced by market resources due to the volume of issuance that would be needed.
- Depending on the remuneration of the digital euro, this would influence the rates paid to depositors and savers, and therefore on the cost of funding and the cost of credit. Provision of fixed rates loans would be also endangered.
- In case of bank disintermediation, more expensive and less stable market resources would have to compensate the decrease in commercial money deposits. This would imply a higher interest rate risk for the banking sector, and therefore a higher cost for customers.

Today commercial banks create money as a counterpart of loans financing the real economy. With CBDCs, central banks could become a main financier of the economy, although central banks are not ready to fulfil that function for which they have neither capability nor mandate.

Therefore, we call authorities for a thorough analysis of the different adoption scenarios and of the measures to mitigate possible negative effects. In this analysis it will be essential for each central bank to consider the specificities of each financial system, as explained in the recommendations.

[1] https://www.bis.org/publ/work811.pdf

Potential impacts on payments and payments data:

- Data privacy is the highest-ranking concern of EU citizens in the context of a digital euro, according to an ECB survey conducted in 2021. Payments are a part of everyday lives and reveal huge amounts of data about individuals. Hence, data protection measures and levels of privacy are key areas where a CBDC design should be focused on to avoid any uncertainty which risk trust and acceptance.
- At the same time, data plays an essential role in the provision of financial services and the relationship between clients and financial institutions: less data from customer transactions may weaken banks' ability to prevent fraud, develop more accurate credit risk models, self-learning transaction surveillance processes and personalized financial services.

Other issues:

- The cross-border dimension of CBDCs poses particularly difficult issues. If they are accessible to non-residents, spillover effects are difficult to avoid, but limiting the cross-border use would be difficult in practice and could require some modality of capital controls.

Central banks should also consider these other side effects when designing CBDCs.

Conclusions & Recommendations

Overall, **CBDCs should have a clear purpose and offer tangible benefits**. Taking into account that many of these opportunities could also be achieved through the implementation of private money solutions, with appropriate regulation and supervision, **central banks will therefore need to assess the merits and risks of issuing CBDCs, and whether retail or wholesale solutions would be needed**.

If central banks take the decision to issue a CBDC, an efficient and future-oriented **partnership approach between central banks and the private sector** will enable customers to hold CBDC with commercial banks or other regulated payment service providers that serve as user-facing intermediaries, managing accounts, customer service, compliance and other requirements. Value-added services and interoperability of the CBDC with tokenized commercial bank money and other payment solutions will add further value to customers. In relation to new forms of digital money and to demands from different industry sectors, the financial industry investigates use cases for CBDCs and the role it could play

It is important that any game-changing policy measure, such as the issuance of a digital euro, is carefully analysed following a cautious approach, as the ECB has done so far. Therefore the EFR suggests:

- When analysing the reasons to offer a CBDC, central banks should take into account the **idiosyncrasies and specific characteristics of each jurisdiction and each financial system and the needs** that a CBDC would help to fulfil. While in some regions for example there are huge opportunities to advance financial inclusion, in Europe this is not a problem. The issuance of a CBDC must be made conditional on the materialization of a series of scenarios where it could be needed, identifying (ex-ante) the problems that need to be addressed.
- CBDCs should be used **for payments and not become a new form of investment or store of value**. Moreover, the tools that central banks adopt to avoid the use of a CBDC as store of value (e.g. limits on individuals' holdings or transactions) must be effective under all different circumstances (including periods of low interest rates, or contexts of economic or financial stress, where bank runs are more likely to happen and central bank money becomes more attractive). Central banks should also consider providing **alternative sources of funding to banks** should clients decide to transform their commercial bank deposits into central bank liabilities.
- **Interoperability with other payment solutions** would facilitate the deployment of the CBDC while contributing at the same time to the overall adoption of digital money and payments. CBDCs should be integrated into broader services enabling intermediaries to offer new value-added services. Access to CBDCs should be provided through **supervised intermediaries** that are best suited for providing end user services and adapting to evolving user needs. It is important to ensure that the central banks develop a robust and flexible core **infrastructure that leaves enough room for the private sector to deploy profitable business models** that encourage further innovation and investment in the development of value-added services for citizens and consumers.

- **Interoperability with other jurisdictions** with a set of aligned standards, e.g. as defined in the G7 Public Policy Principles for retail CBDC, would avoid fragmentation and friction in cross-border and cross-currency processes as experienced today for cross-border payments. Achieving a level of global harmonization for CBDC would greatly contribute to the G20 roadmap of enhancing global cross-border payments.
- Central banks and legislators should provide **legal certainty and a policy framework** for the CBDC ecosystem:
  - CBDC design should ensure that **data** is used **in a responsible way, ensuring both security and privacy**. This should not be incompatible with allowing customers to decide to share their payments data on a voluntary basis to be able to benefit from value-added services. Payments data is a core element for banks e.g. to provide credit and also to offer improved personalized solutions. Many potential value-added services will rely on access to and use of data. Therefore, it is essential that the sharing of data from CBDC transactions respects existing regulations.
  - The **level of anonymity and privacy** should be carefully considered, not only in comparison to cash but also in comparison to other digital payment solutions facilitated by the private sector. A regulatory level-playing field for all types of digital payment solutions (i.e. CBDC and private sector solutions) in terms of AML controls and traceability is equally important.
  - We encourage Central Banks also to explore the opportunities offered by different design options such as the potential addition of **programmability** features to CBDCs that could provide the private sector new ways to innovate, as well as the implementation of **embedded supervision**, which could improve the efficiency, and effectiveness of existing supervisory processes.
- It is crucial that the **private sector – banks and non-banks - takes part from the beginning in the development of concrete features and design options**. The financial industry should contribute to the central banks' work with their experience and knowledge of the retail payments market, as well as with their own experimentation with digital forms of money.

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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