

Discussion Paper: New Forms of Digital Money

Bank of England
September 2021

Response from the Emerging Payments Association

Introduction

The Emerging Payments Association (EPA) welcomes the opportunity to contribute to the Bank of England's Discussion Paper (DP), "*New Forms of Digital Money*".

The community's response contained in this paper reflects views expressed by our members and industry experts recommended by them who have been interviewed and who are referenced below. As the EPA's membership includes a wide range of companies from across the payments value chain, and diverse viewpoints across all job roles, this response cannot and does not claim to fully represent the views of all members.

We are grateful to the contributors to this response, which has been drafted by Riccardo Tordera, the EPA's Senior Policy Manager. We would also like to express our thanks to the Bank of England (BoE) for their continuing openness in these discussions. We hope it advances our collective efforts to ensure that the UK's payments industry continues to be progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.

With special thanks to:

- Bob Blower, Clarency
- Daniel Holden, Trust Payments
- Jason Butcher, Coin Payments
- Jonathan Bye, NatWest Group
- Paul Sisnett, PayWithGlass
- Robert Courtneidge, EPA

Tony Craddock
Director General
Emerging Payments Association

High level comment

We believe that whilst regulation is extremely important, to make change happen more swiftly, regulators and policy makers should approach this transformation in the spirit of digital money, which transcends the traditional consolidated operational way which is the status quo today.

Two general considerations arise:

- 1) Digital money allows transfer of value, which is something completely different from the current system of moving funds using traditional payment rails. The current system is under pressure from the driving force of the blockchain, where the value moves with the token. This is yet to be fully acknowledged, despite its potential to make cross border payments more accessible.
- 2) The technological element still lacks a detailed approach. The choice of appropriate technology behind the realisation of new forms of money is crucial to its success. It allows a better exploitation of the final solution which will ultimately benefit consumers. At present, the Bank of England appears to assume that technology will be a neutral element of this transformation as the paper focuses predominantly on the impact that CBDCs and stablecoins will have on consumers, financial stability, monetary policy and macroeconomic issues, overlooking how it will be delivered.

Furthermore, we believe there needs to be a clear distinction between CBDCs and stablecoins which should be reflected in law and regulation. UK laws in this area lag behind other countries, such as the US, where they are in process of updating their laws to give digital asset holders and investors basic protection in order to fulfil domestic demand while overcoming geopolitical challenges. Separately, we should not underestimate the Chinese cashless revolution and the ongoing piloting of the e-yuan.

We appreciate the recent HMT consultation on cryptoassets and the BoE/HMT Taskforce on CBDCs. We believe that it is key for a Global Britain to get the process of the digitalisation of money right, in order to regain the UK's historic role as 'global financial centre'. We firmly believe that the Bank of England could and should lead this process at an international level and we would appreciate them looking into the specific benefits of using a central bank omnibus account as a global settlement account for all CBDCs and potentially other stablecoins. In addition there are other potential use cases, such an account addressing the banking challenges of the global fintech community by offering a level of stability and liquidity that only such a trusted central bank settlement account would provide. To achieve this, we urge UK regulators and policy makers to explore the transformational impact of the multiple use cases flowing from the creation of a new FMI using such an omnibus account at the Bank of England.

Contents

The section numbering below corresponds to the numbering of the “online survey form” in this paper.

1. Type of respondent

- Organisation
- Individual

2. What industry/sector is your organisation part of?

Trade body in payments.

3. Organisation/Individual name

Emerging Payments Association (EPA).

4. Organisation/Individual contact email

Riccardo.Tordera@emergingpayments.org

5. How might new forms of digital money affect money and credit creation? Are there channels beyond those explored in this paper?

Credit is created by banks on the basis of the reserves they hold with their central bank. New forms of digital assets like Bitcoin— despite not being intrinsically linked to credit – can allow credit through decentralised finance (DeFi), which allows the issuing of credit backed on those token-based assets. Some banks are already moving in the direction of the digital token market and the regulators, together with the industry, need to establish appropriate competitive rules to make this happen safely and without risk to consumers, whilst guaranteeing liquidity requirements and financial stability.

The industry already has systems in place in relation to e-money, such as wallet infrastructure and e-wallets which enable their use. This is already a form of digital money, and e-money issuers already have the polices, guidance and directives which apply to the e-money space. This could easily be adapted to CBDCs and stablecoins.

Our members note the distinction between CBDCs and stablecoins. What remains to be considered is what happens with stablecoins outside the CBDC space. Stablecoins will help solve the process of the digitalisation of traditional finance collaterals, being attached to – potentially – a CBDC. And to this purpose, a pure CBDC would be the ideal form of stablecoin collateral, as a proper digital form of cash, with the same targets that central bank money currently has.

Considering the cash perspective, a historical analogy could provide a precedent for the coexistence of CBDCs and stablecoins, which could be pegged to a basket containing CBDCs. The UK could look at

Hong Kong as a pilot (referencing the national experience of Scottish banks and Northern Irish banks being allowed for a certain amount of time to issue their own notes and coins by maintaining reserves with the central bank).

6. How important is direct access for the general public to central bank money in a digital world?

- Very important
- Somewhat important
- Not important

7. Explain your reasoning for your answer to question 6, and your thoughts on the question more generally

There is risk associated with enabling public access to central bank funds but there is also the need for some protection for commercial banks, as this would disintermediate commercial banks from the users' 100% deposit guarantees. Central banks, therefore, could offer higher rates of interest, which would be cheaper than borrowing on the open market.

8. Do you agree with the Bank's view on protection and privacy? What would you regard as a minimum set of protections?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

9. Explain your reasoning for your answer to question 8, and your thoughts on the question more generally

The real challenge is how to protect information, with a proper focus on privacy beyond the concept of anonymity. Information should not be protected passively but actively, by preventing the information being shared without consent and holding it in an appropriate place.

10. What steps could be taken, and by whom, to help promote interoperability of new forms of digital money with other payment systems, and thereby foster a competitive environment?

Reducing the cost of value transfer is an important goal and interoperability is essential to achieve it. Interoperability is critical for efficiency, reliability and compliance, and technology is essential to make it run smoothly. The real issues, however, will be in international cross border interoperability rather than domestic. International standards are key and the UK should actively contribute to the development of standards (such as the new ISO 20022 for payments), and should also offer the international community practical solutions piloted and successfully implemented in the United Kingdom.

We appreciate the recent HMT Consultation on stablecoins and cryptoassets, and the BoE's establishment of the HMT Taskforce on CBDCs because we believe that a significant step in the construction of a 'Global Britain' will be the digitalisation of money. In this way we will be able to regain the UK's historic role as the world's most progressive and leading financial centre. We firmly believe that the Bank of England could and should lead this process at an international level. We are looking into the specific benefits of the newly created Bank of England Omnibus Account being used as a global settlement account for all CBDCs and potentially other stablecoins. In addition, such an account has the potential to offer solutions to the banking challenges of the global fintech community by offering a level of stability and liquidity that only such a trusted central bank settlement account would provide. To achieve this, we urge the UK regulators and policy makers to explore the transformational impact of the multiple use cases flowing from the creation of such an account. We will be publishing an in-depth paper about how such an approach can address a range of use cases by the end of 2021.

11. Does the illustrative scenario have the right components and responses with which to assess the impact of demand for new forms of digital money on the macroeconomy?

- Yes
- Partially
- No

12. Explain your reasoning for your answer to question 11, and your thoughts on the question more generally

The scenario illustrates the risks coming from the introduction of a CBDC which could result in deposits moving away from banks and thereby inducing banks to seek alternative forms of lending. We can foresee this possible migration, but it could be mitigated by managing how CBDCs are used by the general public. At present, a CBDC would be a replacement of cash, which is already declining. Thus, the introduction of CBDCs could alter the status quo and cause the disintermediation of commercial banks. However, DeFi models (already used by some banks) could be a solution, by implementing those models which allow existing commercial banks and bank deposit models to coexist. This would promote innovation and competition.

Moreover, a significant benefit of digitisation will be reflected in a more inclusive ecosystem. The adoption of digital currency in combination with more granular personal financial management tools will help consumers to better manage their finances. Depending on how digital currencies are deployed they may also provide currently unbanked citizens with access to financial services.

13. Can respondents identify any other significant risks to economic stability from new forms of digital money even when stablecoins are adequately regulated?

One of the biggest problems from new forms of digital money is currency substitution and how this would work with CBDCs and stablecoins. International cooperation is certainly the only way forward to tackle this problem.

14. Do respondents see any other impediments to, or benefits from, a shift to market-based financing in the event of a tightening in bank credit conditions?

The structure of the current system is based on central banks being the lenders of last resort. Theoretically, in a properly distributed world there wouldn't be a lender of last resort. However, in a well-constructed world of CBDCs and stablecoins, DeFi can become the lender of last resort. The difference sits in the approach to tackling economic stress and encouraging innovative solutions to come forward and develop safely.

15. Do respondents have any other concerns over the ability of banks and markets to adjust to the introduction of new forms of digital money in addition to those identified?

Technology is critical to resolving this issue. The choice of appropriate technology behind the realisation of new forms of money is crucial to its success. If the technology isn't fit for purpose, it will have a detrimental effect on the system and ultimately harm the consumer. At present the Bank of England offers a technology-neutral position and focuses more on the impact that CBDCs and stablecoins will have on consumers, financial stability, monetary policy and macroeconomic issues.

16. Do respondents think there are any other features of the banking regime that need to be reflected in the regulatory model for stablecoins?

A clear distinction between CBDCs and stablecoins must be reflected in law and regulation. Our laws need to be updated – as indicated in the recent HMT discussion paper – not only to deal with new forms of digital money but also to consider giving digital asset holders and investors basic protection and fulfilling domestic demand whilst at the same time overcoming geopolitical challenges.

We believe that while regulation is extremely important to make change happen more swiftly, regulators and policy makers should approach this transformation in the spirit of digital money, which transcends the consolidated operational way we are used to observe. Digital money allows the transfer of value, which differs fundamentally from the current system of moving funds using payment rails. We believe that the old system will progressively disappear under the driving force of the blockchain, where the value moves with the token.

Overall, some unique features and benefits of stablecoins versus CBDCs arise. For instance, stablecoins backed by a basket of currencies might have widespread international acceptance. This could make it suitable for both cross-border commercial payments and for remittances. This could

avoid foreign exchange exposure and help recycle stablecoins without having to cash out to fiat currencies.

17. Do respondents agree with the Bank's assessment of the four possible regulatory models for stablecoins? Are there other models the Bank should consider?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

18. Explain your reasoning for your answer to question 17, and your thoughts on the question more generally

Whilst the Bank does cover four kinds of stablecoin, there are others which were not included for consideration and comment, such as algorithmic stablecoins.

19. Given the large uncertainty around a new steady state and risks identified during any transition, are there any other reasons for imposing limits? How should such potential limits be structured?

This again goes back to how CBDCs are implemented and how technology is used. As mentioned above, e-money issuer rules might help to solve current issues, but in the long term there is the need to recognise the creation of a more decentralised market. The coexistence of CBDCs and stablecoins will ultimately drive competition, benefit innovation, and offer cheaper, faster and more secure products and services to consumers.

Further, we would like to focus on the benefits coming from the enhanced consumer protection that building the appropriate digital money framework will provide: it is important that all customers but in particular consumers understand and have confidence in digital currencies, be they CBDC or privately issued stablecoins. In part, protection against purchase scams will be an important factor but beyond this, consumers will require confidence in the use of digital currency. For instance when making purchases clarity over the kind of protection available (e.g. in cases of insolvency if the merchant or chargeback type situations) will facilitate consumer confidence in using digital currencies to make transactions.

About the EPA

The Emerging Payments Association (EPA), established in 2008, sets out to make payments work for everyone. To achieve this, it runs a comprehensive programme of activities for members with guidance from an independent Advisory Board of 16 payments CEOs.

These activities include a programme of digital and (when possible) face-to-face events including an online annual conference and broadcast awards dinner, numerous briefings and webinars, CEO Round Tables, and networking and training activities. The EPA also runs six stakeholder working groups. More than 100 volunteers collaborate on the important challenges facing our industry today, such as financial inclusion, recovering from Covid-19, financial crime, regulation, access to banking and promoting the UK globally. The EPA also produces research papers and reports to shed light on the big issues of the day and works closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

The EPA has over 150 members that employ over 300,000 staff and process more than £7tn annually. Its members come from across the payments value chain including payments schemes, banks and issuers, merchant acquirers, PSPs, retailers, TPPs and more. These companies have come together to join our community, collaborate, and speak with a unified voice.

The EPA collaborates with its licensees at EPA EU and EPA Asia to create an interconnected global network of people passionate about making payments work for all.

See www.emergingpayments.org for more information. Contact malik.smith@emergingpayments.org for assistance.