the payments association

connecting the future

The digital pound: a new form of money for households and businesses?

Consultation Paper

Bank of England & HM Treasury
February 2023

Response from
The Payments Association
June 2023

Introduction

The Payments Association welcomes the opportunity to contribute to the BoE and HMT Consultation Paper "*The digital pound: a new form of money for households and businesses?".*

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 Payment Association'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, our Head of Policy & Government Relations and Robert Courtneidge, Board Advisor. We would also like to express our thanks to the BoE and HMT 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.

Tony Craddock
Director General
The Payments Association

Members' "responses to the questions" set out in the consultation:

The section numbering below corresponds to the numbering of the 'questions for respondents' in this paper.

1. ***Do you have comments on how trends in payments may evolve and the opportunities and risks that they may entail?***

We agree with the views expressed in the Consultation Paper outlining how trends in payments are leading us towards a digital economy where the digital pound could play an important role. Opportunities arising out of the creation of a digital pound include enabling faster and more transparent transactions in a fully interoperable global infrastructure thereby creating cheaper and near instant 24/7 transactions. The implementation of a digital pound could address and solve the risks related to data security, privacy and cyber threats whilst, at the same time, working alongside existing payments architecture in an interoperable way. However, our members believe it is key that the Bank works with international standards setting bodies to deliver a solution that is harmonised, so far as is reasonable and practicable, on a global basis to enable the best cross border solutions alongside national ones.

2. ***Do you have comments on our proposition for the roles and responsibilities of private sector digital wallets as set out in the platform model? Do you agree that private sector digital wallet providers should not hold end users' funds directly on their balance sheets?***

At a high level, we agree with the platform model and the principle that a digital pound should be a collaboration between the public and private sectors. We also agree with the delineation between the two – the public sector should do those things that only the public sector can do, including providing the central infrastructure, the rules and standards, while the private sector should be given freedom to innovate and compete for customers. That combination is most likely to achieve the most user-friendly products, while maintaining the highest levels of security and resilience at a reasonable cost to society.

We concur that to create a "deep public trust in this new form of money – trust that their money would remain safe, accessible, and private", the Bank needs to create a system where the digital pound remains a liability of the central bank to the holder of digital pounds, like a bank note is today: wallets providers should be treated as technology providers, not financial institutions.

Nonetheless, some members have pointed out that in cases where a private sector digital wallet provider is allowed to hold end users' funds directly on their balance sheets, they should be considered as custodians and, as a consequence, be subjected to greater levels of compliance and regulatory capital requirements than non-custodial purely technical service providers.

Others have outlined the necessity of alignment with the current HMT proposal for the regulatory regime of cryptoassets, with particular attention to the role foreseen for Payment Interface Providers (PIPs) and External Service Interface Providers (ESIPs) which will require significant obligations that only a regulated firm could effectively meet. Our members felt that the Bank's design phase should be holistic in thinking about private providers of:

CBDC services, regulated stablecoins, cryptoassets, tokenised bank deposits, and existing payment services.

It is the opinion of some of our members that the entry of non-regulated PIPs and ESIPs could result in a more fragmented payment experience for consumers and businesses and could create increased complexity. A more seamless experience could be achieved through, for example, requiring regulatory authorisation as a custodian under the Payment Services Regulations 2017. This would enable a PIP to provide both a fiat and CBDC wallet (e.g. payment account).

The cost of compliance for onboarding, managing financial crime and other ongoing customer obligations is significant and is today deferred by Bank interest. It is a commercial reality that PIPs need to cover their operating costs. In designing a system which depends solely on use cases to defer operational costs, this would result in a bias toward commercial use cases with high revenue models to defer costs, and not necessarily use cases that provide the most value (e.g. peer to peer payments). The caps on holdings could provide a natural limit on consumers transferring too much of their savings and undermining credit creation in the wider market but the Bank needs to continue with detailed analysis of impacts caused by different holding limits and adapt as necessary.

Market scale – for PIPs to effectively create the right volume environments to build effective business models, the Bank needs to ensure that enough UK consumers adopt a digital pound. Our members expect that both card payment volumes and interbank payment volumes could migrate significantly to a digital pound and see this as a key opportunity for innovation within the payments industry.

Finally, there is a risk of consumers holding many different CBDC wallets, which could be confusing for the consumer and make it difficult to monitor holding limits.

3. **Do you agree that the Bank should not have access to users' personal data, but instead see anonymised transaction data and aggregated system-wide data for the running of the core ledger? What views do you have on a privacy-enhancing digital pound?**

Firstly, the Bank and the Treasury should be applauded for tackling the issue of privacy head on, as societal debate on the issue is critically important to the success of the initiative.

All our members strongly agree that the Bank should not have access to users' personal data. Some have raised the point that the Bank should be granted access only in relation to AML/CTF purposes. Overall, there is consensus around the proposed central structure where the central bank holds the currency and the risk, and the private banks hold the KYC and the details of the individuals. It is therefore key that suitable anonymising tools should be used to reduce risk of data being de-anonymised etc. However, some members are not comfortable with the central bank being able to view even anonymised transactions/wallet balances. Those that are sceptical of the motives of the central bank and the government might argue that advances in data analysis will allow such data to be interpreted and abused, perhaps through combining with other data sources, including geolocation or tax and benefits data. However, restricting the Bank's access to aggregated, system-wide data is likely to engender greater trust in the system.

Further, we believe that it would be beneficial to launch a privacy-enhancing digital pound, for the purposes of minimizing risks of data breaches and data exploits, and also to give consumers a greater sense of security.

4. **What are your views on the provision and utility of tiered access to the digital pound that is linked to user identity information?**

On balance, we understand the rationale for having tiered access as a design choice, but we need to understand what kind of complexity this introduces and whether this could stifle adoption. More exploration is needed on the impact justification.

From a general perspective we think that it could be great from a consumer point of view as it would provide the benefits of the current cryptocurrency versatility of payments, whilst maintaining AML standards.

But, we would recommend caution as this is public money, and there is a risk that tiering of any kind could lead to fragmentation and financial exclusion. We can see the utility in general terms but it would be prudent not to unintentionally discriminate without conducting a comprehensive impact analysis.

One member has outlined that user identity information should remain at the wallet/payment account level. This would be essential for public trust. They endorse the Delegated Model over the currently proposed platform model as, in their opinion, Tiered Access to market infrastructure is the model used for securities and derivative exchange membership, securities and derivatives clearing house membership, and participation in regulated payment systems. This model reflects the realities of the high degree of system capabilities, scalability and risk management required to have direct participation. It also relieves the market infrastructure operator of managing compliance, IT and policy changes amongst market participants.

A tiered model could be a more inclusive option by providing a low-priced wallet option. But Big Tech cookies and terms and conditions could make consumer choices inauthentic, giving individuals little choice but to accept the prejudicial terms offered by dominant firms. That said, a tiered system is an excellent ideal, but is likely to require careful regulation by the FCA to protect consumers.

5. **What views do you have on the embedding of privacy-enhancing techniques to give users more control of the level of privacy that they can ascribe to their personal transactions data?**

It is our opinion that different use cases require different levels of privacy. Some members have also suggested that some spending limits should be linked to the various levels of privacy. Overall, we would like to remember that one of the main benefits of introducing CBDCs is to give the possibility of such options, which cannot happen with our present payment systems. In addition, there is generally a high degree of concern around giving the central bank authority to control access to customer funds.

6. **Do you have comments on our proposal that in-store, online and person-to-person payments should be highest priority payments in scope? Are any other payments in scope which need further work?**

These types of payments clearly remain a high priority, as the consumer use of cards and online transfers is widely adopted, and enabling a digital pound for those types of payments could be beneficial for both users and merchants. To this point, we require more clarity on how the Bank would consider the onboarding of merchants and commercial entities of all sizes to participate. Much work is needed to understand, for example, the impact on existing in-store infrastructure to be updated (POS terminals etc).

Nonetheless, some of our members believe that the highest priority in scope should be cross-border payments, an area where the introduction of CBDCs could deliver a higher economic output provided always that international interoperability is delivered with common accepted standards. It is our opinion that, in this space, the main issue will be to ensure seamless interoperability with the existing payment rails.

7. Considering our proposal for limits on individual holdings, what views do you have on how corporates' use of digital pounds should be managed in transition? Should all corporates be able to hold digital pounds, or should some corporates be restricted?

With some distinctions, most of our members do not see any reason in restrictions, favouring the view that all corporates should be able to hold digital pounds. However, on the question of limits, it is difficult to see how they could be applied to merchants; otherwise, people could not spend their digital pounds once the merchant hit their limit. This is an area that needs a lot more deliberation and impact assessment studies.

9. Do you have comments on our proposal that non-UK residents should have access to the digital pound, on the same basis as UK residents?

There is good reason to offer the digital pound to non-UK residents only but, impact assessment is needed in the design phase to identify all risks and explain how they should be mitigated. Any digital pound should be enabled for use globally, just as the physical version of the UK pound is used, in order to be adopted easily and to deliver benefits. A digital pound could also strengthen the usage of the pound globally. It could be used by non-UK residents who transact within the UK or with UK merchants, and also be enabled for use by any third countries (or indeed a smaller category such as, Commonwealth countries) who do not have a CBDC but may want to use a digital pound rather than a digital currency issued by other jurisdictions e.g. the digital Yuan. However, the concept of anonymous low-limit wallets being created for visitors to the UK to hold digital pounds would make sense.

10. Given our primary motivations, does our proposed design for the digital pound meet its objectives?

On balance, whilst we believe that the proposed design is positive and look forward to continue working with the Bank to make sure it does meet its objectives, with all transactions carried out by the central infrastructure, it naturally leads to an API-enabled, account-based CBDC model. This is no more than a modernised database, and mentions of a distributed ledger are largely irrelevant because only the Bank would have access. Such a model undervalues the innovative leaps that have been made in the digital asset industry in the last 3-4 years, specifically related to token-based systems built on blockchains.

In our view, a better setup would be to use non-custodial wallets, provided by a regulated intermediary, holding tokens issued by the Bank. That would eliminate financial risk to the intermediary, whilst providing a clear and robust claim on the central bank. It would enable the intermediary to offer wallet services related to both the digital pound and other digital assets, enabling the customer to easily interact with a broader digital asset ecosystem. That interoperability would cut costs for the industry and support the stated aim to catalyse innovation in the private sector.

The new digital pound should be targeted at areas of the market where it can improve and increase economic output, particularly in the area of cross-border payments, and, according to some of our members, this should be done ahead of domestic payment solutions. All our members want the Bank to focus on commercial benefits, customers use cases, and the ability for the digital pound to interoperate seamlessly with the current payments' infrastructure.

We believe the digital pound is likely to have significant impact, albeit this has yet to be fully analysed. We remain supportive of engagement and will appreciate more extensive engagement throughout the Phase 2 (design phase). Ultimately, we are yet to fully grasp the Bank's vision on which type of money the digital pound will be modelled: is it going to be a cash, payment or bank account substitute? Clarity of vision will lead to further thinking and clarity on design choices to be taken. Also, we would appreciate the Bank sharing more of its vision on how CBDCs will work in a complex ecosystem with stablecoins and tokenised deposits and how they will be able to interoperate seamlessly. Indeed, without a deeper understanding of the overall target payments architecture it will be hard for the design of the digital pound to be optimised.

11. **Which design choices should we consider in order to support financial inclusion?**

Financial inclusion must take into account digital inclusion, and the focus should be on all categories of people, from the elderly (many of whom struggle with advanced technology), vulnerable people, people with disabilities, and of course those who live in remote areas with poor technological infrastructure. Enabling private sector innovation should be a priority as this will bring in "thinking outside the box" and engage stakeholders whilst also making sure the discussion is not anchored in the "past" and avoids the problems of "legacy systems". Many organisations are already looking at creating off-chain solutions which would work in remote area and education is key to enabling solutions across all excluded persons. Clearly, solutions such as the ones we already see in Africa, India and China should be reviewed as they could contribute immensely to supporting digital inclusivity.

12. **The Bank and HM Treasury will have due regard to the Public Sector Equality Duty, including considering the impact of proposals for the design of the digital pound on those who share protected characteristics, as provided by the Equality Act 2010.**

    Please indicate if you believe any of the proposals in this Consultation Paper are likely to impact persons who share such protected characteristics and, if so, please explain which groups of persons, what the impact on such groups might be and if you have any views on how impact could be mitigated.

We are supportive of the Bank and HMT having due regard to the Public Sector Equality Duty. We would like to comment that our response to this question depends on the various protected characteristics we focus on: age and disability need further analysis, whilst there is no obvious reason to imagine how a digital pound could differently affect ethnic minorities or people with different sexual orientation. We welcome design solutions that meet those criteria that will work to protect different kind of vulnerabilities.

Members “further comments” beyond the consultation questions:

We would appreciate more research about the following areas which may not have been fully covered in the consultation questions:

- Evaluation research of the successes and shortcomings of the public adoption of existing CBDCs
- Systems design research on the technical trade-offs of key digital pound design decisions, such as transaction speed with reversibility and programmability, and offline access with security
- Privacy research on the management of user data, with the goal of striking a safe and effective balance between operational issues, security concerns, and data ethics
- Research from a technical perspective about how specific innovations from decentralized cryptocurrency intermediaries might be deployed in relation to a digital pound
- Policy research on the role(s) of public, private, and civil society entities in the digital pound ecosystem, operations, and governance
- User experience research on cross-border CBDC payments—an important use case that is fraught with problems for the most vulnerable
- Public opinion research on trust, misinformation, and communication related to the digital pound considering levels of distrust worldwide in existing institutions

About The Payments Association

The Payments Association (previously the Emerging Payments Association or EPA) is for payments institutions, big & small. We help our members navigate a complex regulatory environment and facilitate profitable business partnerships.

Our purpose is to empower the most influential community in payments, where the connections, collaboration and learning shape an industry that works for all.

We operate as an independent representative for the industry and its interests, and drive collaboration within the payments sector in order to bring about meaningful change and innovation. We work 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.

Through our comprehensive programme of activities for members and with guidance from an independent Advisory Board of leading payments CEOs, we facilitate the connections and build the bridges that join the ecosystem together and make it stronger.

These activities include a programme of monthly digital and face-to-face events including our annual conference PAY360 and PAY360 Awards dinner, CEO round tables and training activities.

We run seven stakeholder working Project groups: Inclusion, Regulator, Financial Crime, Cross-Border, Digital Currencies, ESG and Open Banking. The volunteers within these groups represent the collective view of The Payments Association members at industry-critical moments and work together to drive innovation in these areas.

We also conduct exclusive industry research which is made available to our members through our Insights knowledge base. These include monthly whitepapers, insightful interviews and tips from the industry's most successful CEOs. We also undertake policy development and government relations activities aiming at informing and influencing important stakeholders to enable a prosperous, impactful and secure payments ecosystem.

See www.thepaymentsassociation.org for more information.

Contact malik.smith@thepaymentsassociation.org for assistance.