the payments association

connecting the future

The Bank of England's approach to innovation in money and payments

Discussion Paper

Bank of England
July 2024

Response from
The Payments Association
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Introduction

The Payments Association welcomes the opportunity to contribute to the BoE Discussion Paper "*The Bank of England's approach to innovation in money and payments*".

The community's response contained in this paper reflects views expressed by our members and industry experts recommended by them who have been interviewed. 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 Director of Policy and Government Relations and Robert Courtneidge, Advisor to the Board. We would also like to express our thanks to the 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.

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. **Are there areas in which programmable platforms, including those enabled by DLT might bring significant benefits and risks in payments and settlement?**

We believe these platforms (inc. DLT ones), could bring significant benefits such as reducing inefficiencies, bringing in new financial products (conditional payments, programmable loans, targeted subsidies etc.) and enhancing transparency in payments and settlements.

A good example of the use of smart contracts on DLT was when, during COVID-19, the Indian government used it to distribute health-related benefits, ensuring funds were used for their intended purpose. Indeed, the use of smart contracts could automate complex transaction workflows and reduce transaction times and costs in payment settlements. In addition, using DLT can enhance traceability of transactions across the financial ecosystem, providing a single source of truth that can reduce disputes and fraud.

However, smart contracts also carry the risk that funds could be locked for specific purposes and may not be redirected quickly when priorities change if required. As such, we feel that intended use cases should be fully thought through to ensure such unintended consequences are avoided where possible.

2. **How likely are programmable platforms, including those enabled by DLT, to be taken up at scale by wholesale financial markets?**

We think that large-scale adoption could occur, but it may be limited by saleability issues as DLT was not originally built to work in the high volume, fast-paced environment of wholesale payments. Hence, whilst DLT does have potential benefits over conventional payment rails, consensus is that payment solutions should remain technology-agnostic. We also note that programmability can be achieved without DLT and, indeed, it may not always be the most efficient solution in every scenario. As such, wholesale markets are likely to adopt technologies that are the most cost-effective and interoperable with their existing systems which may not be DLT-based.

3. **What are respondents' views on the pace of innovation in private money – in particular, commercial bank money – used in retail payments?**

We believe that the pace of innovation in private money is slower than needed and that regulatory delays are the main issue here. A snap election, coupled with wars in the Ukraine and Middle East, has meant that payments have not been the top priority of the Government or regulators. We note that the key delays have been in regulations for stablecoins and related crypto and digital tokens to cover similar areas as MiCA in the EU. This has prevented the UK leading the way in this digital revolution. Other issues include the delay in publishing the 'National Payments Vision', the lack of visibility on the updating of the UK's Payment Services Regulations, the slowness in getting the Data Protection and Digital Information Bill that was revised and renamed post-election through Parliament into law and the need to review and deliver the currently suspended New Payments Architecture.

The UK, as a result of Brexit, has the opportunity to rapidly create and implement best of breed laws and regulations which could provide fintech with blueprints for the rest of the world to follow (with our renowned global leadership in this space) but the window of opportunity is closing as other countries move forward faster.

4. **What are respondents' views on the wholesale infrastructure that might support retail payments innovations, including to ensure that singleness of money can be maintained across stablecoins and tokenised deposits?**

Our members would like to see a unified payment system that can handle various payment methods, ensuring that all forms of money (cash, commercial bank money, stablecoins, tokenised deposits) are interchangeable at par value. This requires a robust API-driven architecture that supports interoperability between the different payment platforms. An interoperable wholesale infrastructure is seen as crucial for supporting future retail payment innovations. One thought is that inter-ledger protocols could be used to facilitate transactions across different payment networks. Another is the development of a form of orchestration layer to manage transfers between all forms of payment rails.

5. **What are the risks and benefits from the use of: a) tokenised deposits; and b) stablecoins for wholesale transactions?**

In relation to tokenised commercial bank deposits, our members looked at the Regulated Liability Network (RLN) Experimental Phase under the supervision of UK Finance. The core components of its technical platform are a multi-issuer tokenised platform to facilitate the issuance of the tokenised deposits enabling programmability, privacy and security together with an API and orchestration layer to enable interoperability across all forms of money and several new and existing ledgers. This delivers functional consistency, programmability and access to a rich set of innovative features. In addition to the above, its key benefit is having synchronised, or 'atomic', settlement which could reduce counterparty risk due to immediate transaction finality. The challenge faced by industry is that true public/private partnership is needed to take forward retail interbank innovation. Whilst it shows great promise, the ability to deliver it is not known and it has legal and regulatory hurdles to overcome as well as technical ones.

In relation to stablecoins, we believe that they could offer significant benefits in terms of cross-border transactions and enabling faster, cheaper settlements, but the regulatory challenges under the initial consultations mean that it would be difficult to create commercially viable stablecoins. Further industry consultation is needed to create a working model for stablecoins in the UK – the risks of stablecoins depend entirely on their form and the regulation behind it, and the benefits follow those of RLN above.

One opportunity explored by the RLN project was the introduction of an 'orchestration layer' to provide functional equivalence between different forms of money. This could be enabled through extensions to the Open Banking standards. Given the large number of firms invested in Open Banking services, exploiting this synergy could catapult the UK's delivery of new features far beyond our global comparators.

6. **Are there innovations that could support central bank money being equipped with the requisite functionality to ensure safe settlement in light of technological advances in financial markets?**

We believe that the use of innovations like programmability could enable central bank money to be more flexible and responsive to market needs. This may involve smart contracts that execute automatically based on predefined conditions. In addition, the expansion of the operating hours of existing payment systems, such as CHAPS, could also support safer and faster settlement.

Embracing newer technologies, such as enhanced cybersecurity measures, could ensure central bank money is safeguarded in a rapidly evolving financial landscape. In this way it would be able to meet the levels of safety and efficiency required for payment transactions.

7. **What are respondents' views on potential functionalities of a wCBDC and how might these inform wCBDC design?**

A wCBDC could facilitate real-time settlements, enhancing liquidity management for financial institutions and potentially reducing the need for intermediary processes. The potential for programmable money features within a wCBDC could enable custom rules for transactions, allowing for greater flexibility in how central bank money is utilised in various applications.

Our members stressed that the design of a wCBDC should focus on the user experience for financial institutions, ensuring that it can integrate smoothly with existing systems and processes. This might include ensuring that the technology is not only functional but also intuitive for users.

Finally, there was a general consensus that a wCBDC could be useful, particularly in expanding operating hours for settlement systems and enabling more efficient cross-border payments.

8. **Will the proposed programme of experiments help to assess these potential functionalities for central bank money?**

We feel that the experiments proposed by the Bank of England can serve as an important mechanism for assessing the functionalities of central bank money under real-world conditions, allowing stakeholders to gauge performance, security, and usability.

It was felt that the establishment of a feedback loop during these experiments could provide valuable insights, allowing for iterative design improvements based on practical outcomes and user experiences. Continuous engagement with industry stakeholders during the design process will be crucial to ensure the wCBDC meets the practical needs of the market while adhering to regulatory frameworks.

Finally, some of our members had concerns regarding the timelines set for these experiments, fearing that rushed timelines may overlook critical testing phases needed to ensure the robustness and safety of the technologies being developed.

9. **What are respondents' views on the outcomes that the Bank seeks in retail payments and how can they be reflected in practical questions currently facing policymakers and industry?**

Our members align with the Bank's objectives to improve the efficiency, accessibility and security of retail payments and acknowledge the importance of outcomes such as faster transactions, reduced transaction costs and enhanced user experience.

We believe that the Bank's focus on resolving current operational challenges, such as improving the framework for open banking and ensuring a smooth transition to new payment methodologies, will help lay a strong foundation for future advancements in retail payments.

However, there is a pressing need for regulatory clarity to enable innovation without compromising consumer protection or financial stability. Many members expressed that, without clear regulatory support, potential advancements in retail payment methods will continue to stall, causing the UK to fall behind global competitors.

We also believe that the government's National Payments Vision and Strategy (NPVS), due to be published later in 2024, reflects its recognition of the systemic importance of payments to the UK authorities. We encourage the Bank of England to follow the publication of the NPVS to create a public-private partnership and commission a review that leads to the production of a National Payments Plan (NPP) that will:

- Reinforce the four outcomes identified in the Bank of England's recent paper on the Bank's approach to innovation in money and payments: the singleness of money; innovation; resilience of infrastructure and the wider ecosystem; and effective governance and funding.
- Prioritise initiatives and decide on investment programmes.
- Address institutional changes that may include the rationalisation of current institutions and changes to governance to underpin a resilient, modern, efficient and inclusive payment ecosystem that meets the evolving needs of businesses and consumers.
- Include strategic change programmes aligned with key priorities, including independent oversight, regulatory effectiveness, innovation, and risk management.
- Initiate requirements for regulatory changes to support the implementation of the NPP.

The payments community is now committed to supporting the government and its authorities to produce a compelling, whole-ecosystem NPP by engaging with members from across the payments value chain, from retail stablecoin issuers to cash schemes, in this critical work.

About The Payments Association

The Payments Association 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.

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