To: Members of the EMA

From: EMA

Subject: Response to Bank of England discussion paper on new forms of digital money

Date: 7 September 2021

General comments

The issues raised in the paper helpfully frame the discussion in relation to both CBDCs and stable coins. We welcome the discussion of both products in a single context, and look forward to a more comprehensive discussion of the manner in which CBDCs are likely to operate in the competitive landscape.

We note the present focus on the impact of a successful CBDC or stable coin initiative on commercial banks, addressing the possible reduction in the volume of deposits and in turn impacting lending activities and the cost of lending in particular.

We would welcome further discussion of the impact of CBDCs in particular on existing payment service providers, on their existing business as well as any potential role that may be envisaged for such a entities. This is not yet explored to any significant extent, and may ultimately have a considerable impact on the wider industry. The impact may be positive, giving rise to new opportunities, or it may raise costs with limited rewards, and it may vary for different participants. It does however merit a broad discussion, and engagement with the payment sector, including the non-bank payment sector.

This issue could be further elaborated by exploring the role of the private sector in bringing about a successful CBDC offering, and the likely inter-dependency that will follow from engagement, for both the Bank and payment service providers.

Responses to questions:

The role of money in the economy

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

Requirements for success

We agree that new forms of payment and forms of digital money have the potential to improve the manner in which users transact, and potentially to enable innovative payment solutions, including ‘programmable money’. We would go further however and suggest that these are not only benefits, but are in fact requirements for the success of any new means of payment.

The experience of the e-money and non-bank payments' industry has been that new means of payment are only adopted when there is a significant improvement in the user experience, or where the product solves a problem that is not addressed by exiting products. E-money succeeded when the Internet laid bare (i) the limitations of card acquiring in the early noughties, failing to provide a means for small merchants and individuals to receive payments, and (ii) the slow speed at which banking clearing and settlement took place at that time. Indeed, this was another factor that resulted in the adoption of Faster Payments by the banking industry. The rapid growth of non-bank payment products that enabled instant payments over the Internet at that time, revealed the shortcoming of BACS and interbank payments at that time.

Other areas of success in the e-money and payments' sector have invariably involved the offering of significant advantages to users, over existing products and services. Any potential CBDC or Stable Coin would have to reach a threshold of significance to have succeed. Growing to reach systemic importance will involve greater challenges.

CBDCs may have an immediate USP of being issued by a central bank, but their success will depend significantly on the manner in which they are implemented and the functionalities that they offer. The Bank's thinking in this regard would benefit from elaboration.

Stable Coins on the other hand do not have this benefit. Those that could be regulated under the CBL (funds held with the Central Bank) model may approach this benefit, but as the discussion paper states in section 5.3.3, such stable coins will not be central bank liabilities. Stable coin issuers are required therefore to meet a similar business challenge to that facing all other payment service providers.

One possible consequence of this challenge is that a successful stable coin product will invariably be accompanied by significant benefits to the sector in which it operates, and ultimately to the economy. Commercial bank deposit outflows could therefore be balanced against increased business activities for banks and potential inflows of deposits.

Account balances

In our experience, users very clearly distinguish products that are intended as a store of value, or that are intended as a means of managing their income, from those whose function is mostly to facilitate payments.

The EMA conducted a survey of the balances held in e-money accounts during 2020, as part of a submission it made to the OECD – hence the thresholds were denominated in USD.

The data captured the number of user accounts held by Electronic Money Institutions ("EMI") in the UK and the EU, having an end of day balance above a given threshold. The data is presented as a percentage of the total number of accounts held, and relates to the balance held on any day for the year ending on 31 December 2020. The balance thresholds chosen were USD 5000, 2000 and 1000.

Number of e-money accounts in the UK & EU	Total number of accounts assessed	Percentage having a balance in the previous 12 months in excess of USD:		
		5,000 (£3500)	2,000 (£1400)	1,000 (£700)
Data for year 2020	314,000,000	0.15%	0.30%	0.50%

The data suggests that the number of accounts that are used to store value on an ongoing basis, is a very small fraction of the e-money account population. Only 0.5% of accounts were found to have a balance of £700 or more on any given day.

This is consistent with users distinguishing products that are primarily intended to facilitate payments, from those that are intended to manage income more generally.

This of course does not mean that in the future, some greater migration of deposits to e-money or stable coins or CBDC products will not take place, but it does suggest that the impact on deposits and lending may only be one of a number of issues that merit consideration at this time. It also impacts the assumptions made in the illustrative scenario.

Public policy objectives

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

We concur that access to central bank money is important, and that making this available in a digital context is a benefit to users in general and to the UK economy.

Taking into consideration the issues raised in our response to the previous question, we note that the bank describes its approach as seeking "to ensure that financial innovations, including new forms of digital money, do not impair its ability to maintain monetary and financial stability. Ideally, they would enhance it." This approach suggests that the bank would not be seeking to innovate, but rather to respond to market needs.

Our concern in this context is that the bank may need a broader remit if it is to drive through the offering and implementation of a successful CBDC product. This may be achieved in partnership with the private sector, but is likely to go beyo0nd the remit as described above.

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

Data protection and more broadly, privacy concerns are likely to be an important consideration when it comes to user take-up. A recent ECB survey of user concerns in relation to a possible digital Euro found that privacy was the most important consideration across all user groups, whether professionals or consumers.

When considering privacy, the comparator will be cash and not bank account. The amounts, the uses, and the potential prevalence means that a different approach is required. Privacy considerations will need to be given appropriate weighting when assessed against issues of risk management or even financial crime.

Records of payment transactions offer a means of surveillance, and if cash were to be substituted with CBDCs, and the opportunity of anonymity or pseudonymity was excluded, then an erosion of individuals' privacy would likely ensue.

If this is the path that is preferred, then a full and transparent discussion should be initiated with different stakeholders in civil society, and with the merits of different choices considered in turn, in order to arrive at some consensus.

It is not accurate to suggest that anonymity is expressly excluded by AML legislation, as set out at Box E. When addressing cash transactions, AML legislation allows for significant thresholds before customer due diligence is undertaken (£15,000). The more appropriate comparator for CBDCs is cash, it matches more closely the intended utility.

4. **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?**

Interoperability is a desirable outcome, although the manner in which it could be achieved can vary significantly. In the crypto asset space, exchanges can be said to facilitate interoperability, while conversely in the card payments space, card schemes are separate but do use bank funds to facilitate payments and access the same bank accounts of payers and payees for settlement.

It would be helpful to elaborate the nature of interoperability that is envisaged, and the level at which this can operate. There will continue to be a need for an incentive for businesses to invest in developing their customer base and their product propositions in competition with others.

An illustrative scenario

5. **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?**

The illustrative scenario is helpful in setting out the impact of CBDCs and stable coins on the banking sector.

When considering the demand for new forms of digital money, we believe significant price differentiation and unique functionality are likely to be the biggest drivers for take-up. Added convenience would need to be significant and perhaps have additional advantages: contactless payments offered for example savings in time and convenience and later the benefit of hygiene accelerated take-up.

The assumption made in relation to the amount that is likely to be held being equivalent to that in cash – see paragraph 1 on page 37; is not borne in practice in the e-money industry. The ability to withdraw or convert bank deposits into payment products on the fly means that users also have the option of only purchasing a CBDC or stable coin when it is needed.

There are exceptions to this behaviour, stable coins that are used as a convenient means to intermediate the purchase of crypto assets for example may involve users holding larger balances to enable faster trading.

It would be additionally helpful for a future discussion paper to address the impact of CBDCs on the payments sector, including the non-bank payment sector. Issues that could be elaborated include the role of payment service providers in contemplated CBDC offerings, the impact of a CBDC product on PSPs current businesses, the likely need for investment, the opportunities that might arise as well as any potential negative impact and competition.

We believe, as set out in our response to the previous question that the impact on deposit taking and lending is likely to be more limited in the short term and perhaps the medium term.

Implications for macroeconomic stability

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

Our concern is that the focus on the possible impact on flows of deposits, the impact on lending and on monetary policy may result in a regulatory regime that seeks to mitigate risks that are yet to materialise, and may result in products that are burdened by excessive regulation.

There are suggestions in the paper that the e-money regime is too light, and could fail to adequately address prudential risks that arise. We are not aware of evidence for this assessment, and would welcome a discussion on this issue.

7. **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?**

No response

8. **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?**

No response

The regulatory environment

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

The current electronic money and payment institution regime provide a good starting point for regulating stable coin issuers; with the additional payment system element addressing the ecosystem as a whole.

Depending on the choice of regulatory model that will be available or that is adopted by issuers, different elements of banking or prudential regulation will be appropriate. There are no additional components that come to mind, but the challenges of distributed architectures will require a fit for purpose approach that responds to the specific roles played by different participants, on a proportionate basis.

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

The models offer a range of alternatives that will require further consideration and assessment of the impact on the business case for stable coins.

There is likely to be a reluctance to have commercial banks intermediate stable coin issuers' engagement with the Bank under the DB model. This will likely subject issuers to the risk policies and management practices of the commercial banks, which are likely to diverge from those of the issuer. If this model were to be extended to non systemic products, then it is likely to be a significant challenge to find any banks with the appetite to support smaller stable coin issuers.

There is some concern that stable coins that are not systemic in their impact have not been considered in this paper, and that consequently the transition from a small to a significant offering is unclear in regulatory terms. It is unclear in terms of the models that would be available, the scope of regulation, and the role of the different competent authorities.

11. **Given the large uncertainty around a new steady state and risks identified during any transition to new forms of digital money, are there any other reasons for imposing limits? How should such potential limits be structured?**

The approach is reasonable, It will however need to take account of the business uses of the specific stable coins. Those that are predominantly used for small value retail payments will be characterised by frequent low value transactions, whilst those used for international remittances will have another, and will be predicated on international transfers. Products that are used to enable online trading will be different again. Any transitional approach will need to take account of the needs of the different products and to impose limits that do not disrupt the business proposition.