IRSG

INTERNATIONAL REGULATORY STRATEGY GROUP

Bank of England

CONSULTATION AND CALL FOR EVIDENCE

International Regulatory Strategy Group Response to the Bank of England's Consultation Paper: 'The digital pound: A new form of money for households and businesses?'

SUMMARY

The remit of the International Regulatory Strategy Group (IRSG), a joint venture between the City of London Corporation and TheCityUK, is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services.

The IRSG welcomes the opportunity to respond to the Bank of England's (BoE's) Consultation Paper (CP) on the case for a central bank digital currency (CBDC)[1]. In summary, IRSG is ready to explore together with the BoE and the market what problems retail CBDC aims to solve and (if warranted), through this intermediate step of exploration, clearly articulate the value a digital pound can bring. In this vein, clarity is required, in particular on the continued collaboration with and the role of the private sector. It may also be that there are alternative plans or options which would solve the same issues raised in the CP without necessitating an overhaul of the payments infrastructure.

We also wish to make the following general observations:

- **Prerequisites.** There are numerous prerequisites to a CBDC functioning in a way as described in the CP which need to be considered and for successful adoption including **a clear use case, scope, goals and roadmaps beforehand**. These include the need for more solid digital identities, interactions with New Payments Architecture and Real Time Gross Settlement (RTGS) Renewal, and the security of such a system to emerging technologies such as quantum computing. In addition, **further consideration is required of the regulatory framework underpinning the distribution model of CBDC and the specific role of banks and other financial services providers.**

- **Financial Stability.** The financial stability points in the CP should be further considered. There are potential negative unintended effects that should be evaluated. For example, retail CBDC could disintermediate the banking sector causing a loss of credit creation which will in turn lead to increased costs and reduced availability of credit to consumers and businesses. There could also be an increased reliance on wholesale funding for the banking sector. Retail CBDC also poses a risk of exacerbating a stress situation with a flight to safety. The risks to financial stability run counter to the aim of safeguarding monetary stability given that the two are so closely linked and confidence in financial stability is paramount for monetary stability. Therefore, **we encourage further consideration of the risks to financial stability and how they**

[1] We would encourage BoE to consider UK Finance's submission to the Digital Pound consultation for further views from the banking and finance industry [Policy and Guidance | UK Finance](#).

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might be mitigated, particularly if there is an intention to remove any limits after a transitional period.

- **Other jurisdictions.** The implementation of CBDC projects in other jurisdictions remain to demonstrate clearly the benefits of CBDCs. The Swiss National Bank has examined the option of a digital currency and concluded that instant payments are already efficient, meaning that no real value would be added by a digital central bank currency. Existing CBDC pilots in other jurisdictions (e.g.: China and Nigeria) demonstrate the challenges in getting the wider public to adopt CBDC. Nevertheless, we recognise that CBDC use cases are evolving and given the UK's role as a leader in financial services, we welcome this exploration of what CBDC could mean (both positively and negatively) for the UK without necessarily committing to a retail CBDC. The Financial Stability Board and the Committee on Payments and Market Infrastructures did recognise the cross-border potential of CBDC in their initial roadmap in 2020. One key benefit of CBDCs is the opportunity to start with a "clean slate". **Effective collaboration** (between the private and public sectors, as well as between international central banks) **in the early stages of CBDC development is needed**, particularly if used for cross border purposes. In order to mitigate the challenges inherent in today's banking processes**, CBDCs should be designed with an international dimension in mind, a commitment to interoperability, consistent standards and coordination of CBDC design principles and a harmonization of KYC/AML requirements**.

- **Use Cases**. We support the BoE's approach to beginning exploration of the digital pound now without committing to creating a digital pound given that use cases may become clearer over time.

  The IRSG note that while issuance of a digital pound may deliver the objectives mentioned in the CP there are clear alternatives that could achieve those objectives while attracting lower levels of risks and **the BoE should work with the industry to examine the use cases that are currently being explored**. Also, developments in the broader payments ecosystem (e.g. Open Banking, planning for Open Finance, introducing the New Payments Architecture and updating various other payments rails and RTGS) need to be considered and factored in. **There is a need for a holistic review of what already exists, is planned or is in the process of being delivered and an assessment of the gaps.**

- **Reputational risks and the perception of the UK.** Reputational risks may arise from the UK embarking on a project which, as of now, would benefit from a clearer understanding of positive outcomes. In fact, a **CBDC could significantly alter the role and perception of the BoE**. The distribution of money could also significantly change. All of this needs to be carefully evaluated and factored into a robust cost benefit analysis. In addition, roll out of a digital pound would need to be accompanied by **a public education programme**, aligned with commercial stakeholders.

- **Wholesale CBDC.** We strongly **encourage the BoE to continue to consider wholesale CBDC** and welcome the fact that BoE is looking at ways of delivering wholesale CBDC, including through the revamp of the RTGS side. The IRSG has produced a report in association with Clifford Chance outlining the potential benefits of wholesale CBDCs.[2]

- **Legality.** While it is understood that the consultation paper is focused on the objectives of a digital pound without going into the specific legal mechanism by which a digital pound would be created, it is difficult to have a meaningful discussion in respect of the digital pound without considering the legal and regulatory framework that would be created enabling it. This would include consideration of any new powers (and obligations) that the BoE would have and what the regulatory framework for the distribution of CBDC would be. **Focus and clarity on the prudential treatment and specific points of law (including on ownership and possession to enable participation by the private sector) would be beneficial**.

- **Economic considerations.** There are issues surrounding the proposed holding and transaction limits, the impacts on credit creation and the risk of lending / deposit flight from commercial banks. The most recent Office for Budget Responsibility figures suggest that UK consumers are £2 trillion in debt, and this is supported by the current account model which the proposed CBDC threatens. There could be large economic shocks caused by suddenly making debt more expensive due to uncertainty on deposits.

  This point is also mirrored in Diagram D.6 of the CP. Multiple types of entity may participate in the distribution of a digital pound (for example, Payment Interface Providers (PIPs)) so it is imperative that each participant upholds the same principles. For example**, the principles of same activity, same risk and same regulation should be applied consistently in order to mitigate any negative effects on the systemic payments market infrastructure**. As more non-banks participate in the distribution of a digital pound, new standards or roles may need to be defined around the movement of digital money and the protection of the data collected when doing so in a way that ensures privacy but also allows participants to comply with existing rules and prevents or mitigates the risk of fraud.

- **Privacy.** We welcome the inclusion of a chapter on privacy in the CP and we are broadly supportive of the approach taken. We agree that it is important to start this journey now so that the digital pound can evolve with innovation and a global CBDC policy.

  As set out in the CP, a digital pound would not indeed be anonymous. The provision of and processing of personal data in the context of preventing, identifying, and addressing financial crime is essential to safeguard digital currency holders, the overall system and other participants. However, **we highlight that levels of security and confidentiality can be 'built into' the CBDC and should be considered further**.

[2] The Use of Central Bank Digital Currencies (CBDCs) in Wholesale Markets (irsg.co.uk).

Further guidance would be helpful as to **how BoE anticipates addressing the privacy challenges around data retention/immutability; amending data in the blockchain; the role of controller/processor and attendant responsibilities and liabilities; data transfers, etc.**

Further guidance would be beneficial **as to whether the data obtained from the digital pound can be shared, accessed, or used by other government departments** such as HMRC, Social Services etc. as part of a joint digital government strategy, and also transferred between intermediaries to assist in discharge of obligations related to KYC/AML and fraud detection and prevention.

We recommend the early consideration of a framework for the protection of data and privacy. We note that the CP states that there should exist the same or stronger protections than bank accounts, however, given the tiered approach described in the CP, we consider it unlikely that security standards among intermediaries will be as high as for bank accounts. The intermediary wallet providers would also need to be identity holders and verifiers making them potential targets for cyber and fraud attacks. Furthermore, supplying intermediary wallet providers with data on consumer preferences based on internet traffic, and consumer preferences based on spending would allow them to have access to potentially significantly disproportionate amount and types of data. We note that the CP proposals to prohibit data uses not required for compliance, unless specifically consented to by the consumer, would reduce the chances of intermediaries becoming influential data brokers but – as outlined later in our response – data protection measures need careful design to avoid undue limitation and unintended consequences. Achieving the right balance will require further careful consideration.

- **Net Zero:** we welcome the Government's commitment to reaching net zero greenhouse gas emissions by 2050, as part of a wider strategy of managing, and mitigating, the impacts of climate change. **We encourage the Government and the BoE to continue to explore the design of the digital pound in a way that supports and maintains momentum around this commitment.** While the digital pound would be a new form of digital money, it would be fundamentally different to a cryptoasset and should therefore not make use of the same energy-intensive technologies that underpin some cryptoassets.

  See also our comments on questions 3 -7 below.

SPECIFIC RESPONSES

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 view taken in the CP that use cases may become clearer over time given the extent of potential payment infrastructure changes associated with a digital pound. Therefore, we support beginning exploration and building capabilities from now without committing to following through with retail CBDC.

We recommend that BoE and His Majesty's Treasury (HMT) comprehensively examine the challenges and opportunities in the UK market, the initiatives that are being developed to address some of the issues already identified and determine what the outstanding problems and issues are in this context. This involves looking beyond the digital currency landscape and considering alternatives to solving existing issues in the first instance. For example, a reduction in real time payment volumes may have unintended consequences on modernisation program objectives in place (e.g., Pay.UK strategy).

When creating a new system there are also new opportunities which may arise and should be considered such as improving fraud detection and creating preventative controls, depending on infrastructure design. There is also the ability to tie a real world person or entity to their on-chain identity which will allow a third party to verify their assets, examine their cash flows and, potentially, use those as an input for initial and ongoing assessment of their creditworthiness.

We also recommend that funding considerations of multiple and competing projects should be explored. This will include considering questions such as:

- How will a digital pound be funded alongside other investments and initiatives being carried out by the central bank and industry, and who will do the upfront funding? We recommend that a cost allocation model should be agreed upfront.
- Are there conflicts or overlaps between the objectives of existing initiatives and those of a digital pound?
- How will other initiatives now be prioritised? Resources in the private sector working on existing initiatives are already limited, and the digital pound would compete for those already scarce resources (such as technology developers).

The above considerations reinforce the need to spend the necessary time to think carefully about infrastructure design holistically and take this as an opportunity to consider how to mitigate/eliminate some of the existing problems, as well as coming up with a realistic prioritisation of initiatives and resources. Tremendous efforts are already in place to modernise the UK’s payment infrastructures, namely the RTGS Renewal and the New Payment Architecture (NPA). Both programs seek to enhance the efficiency and functionality of the infrastructures (i.e. via ISO20022 and enhanced API), whilst lowering the barrier to entry to increase competition, innovation and consumer choices.

The interoperability between retail CBDC and other forms of money (e.g.: cash, bank money or other digital currencies) as well as between different PIPs is key. We would welcome greater clarity on how interoperability is proposed to be achieved in practice. We also would welcome further clarity on the process by which the digital pound will be onboarded and integrated into existing financial structures.

We also re-emphasise that there are alternative methods of resolving the issues raised in the CP and support the BoE's exploration of wholesale CBDC as a more effective alternative. Wholesale CBDC is a key use case and offers great potential for wholesale financial transactions to take place at a lower cost, higher speed and with greater resilience. Wholesale CBDC's potential is recognised in the CP, and we encourage BoE to explore this further and consider how a wholesale CBDC, separate from retail CBDC, can be delivered at a faster pace. We support BoE's exploration of RTGS and synchronisation as a method of implementation, but further exploration would be beneficial to determine how existing and/ or new infrastructure can be used to deliver wholesale CBDC in a manner which will not disintermediate banks and allow for lending to continue within the economy.

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?**

This is an important decision that would have significant wider effects and therefore should be carefully evaluated. Both the distribution model and where funds reside are two key questions in any CBDC structuring decision.

IRSG are of the view that banks could hold digital pound deposits on their balance sheet as this would make no real difference for end users in terms of counterparty risk. Given the individual limits considered for a digital pound and given that this would be well below the amounts that any individual is covered for under the deposit guarantee scheme in the UK, further consideration should be given to what the benefit would be for end consumers of holding that risk free form of digital money.

Consumers may not readily adapt to what may appear to be increased complexity – specifically, they will have to handle different wallets for different assets, which they are not used to. The differentiation of public vs private money is not obvious even for the most sophisticated users. We query the extent to which the benefit to users is sufficiently off-set against this added complexity.

If banks were to have their functions limited to being transaction providers, consideration should be given to the economic model and business case for participation on this new network. Consideration should also be given to the effect this would have on disintermediation and potential financial stability risks. In this particular case, any limits or controls related to volumes and scale would be of significant importance and would have significant effects on the banking system. The availability and cost of credit for end users should also be studied in more detail.

Related to this is the potential use of a digital pound as a bridge asset to facilitate money flows between different stablecoins. If stablecoin providers were to be allowed to deposit their reserves at the BoE, this would create a pseudo CBDC and could amplify the use and attractiveness of stablecoins, particularly if those have no limits. This could put further pressure on money leaving the banking system, compounding the potential financial stability risks created by a digital pound, and the consequent impacts to the availability and cost of credit for the economy.

As for PIPs and External Service Interface Providers (ESIPs), it is unclear at the moment if there is a proposal for a PIP to be regulated as a Payment Service Provider (PSP), similar to the EU. If it is not possible to be both a PIP and a PSP in the model proposed, this would add another step to the critical payments flow.

There is also a risk of arbitrage between different PIPs as there is potential for individual PIPs to offer incentives to consumers e.g.: loyalty bonuses or gifts. We recommend that this risk is considered in detail and appropriate mitigants are created.

In addition, any new entrants, and in particular those non-financial intermediaries considered in the proposal, would need to adhere to very clear minimum standards to not increase risk for system participants and the overall system.

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?**

We consider the model proposed regarding privacy to be appropriate. However, personal information would need to be accessible to the PIPs if they are undertaking compliance reporting obligations and adherence to Financial Action Task Force (FATF) requirements.

Aggregated data would enable the BoE to get insightful information for fraud prevention measures, and to better understand consumer behaviours so we think it is appropriate for the BoE to have access to this information on an anonymised basis. We highlight, however, that there is legal and technical uncertainty about when aggregated data is truly 'anonymised'. Given that technology allowing for the reverse engineering of personal data from aggregated datasets is likely to improve over time, thought will need to be given to future-proofing.

In terms of PIP and EISP access to personal data and their ability to use it for different processing purposes, we note that the BoE draft proposal is stricter than the UK GDPR and Data Protection Act. The BoE only seems to anticipate firms processing personal data in order to execute a transaction and maintain a wallet, to comply with legal obligations, or where the customer has proactively opted into additional processing. This excludes other 'legal bases' available under the GDPR, notably the potential to process personal data where the firm has a 'legitimate interest' in the processing, on the condition that there are not overriding negative impacts on the rights and interests of the individual.

This approach by the BoE would seem to prevent firms from using data for a range of purposes that have a low privacy impact and/or are beneficial to society, for example:

- Training models, including for AML and other compliance purposes.
- Market analysis and product improvements.
- Protecting vulnerable customers.
- Compliance processing, where there is a high-level regulatory requirement, for example processing activities to protect customers from fraud.

In the context of model training, market analysis and similar processing, firms could in theory seek the consent of the customer for the processing. However, given that most consumers do not change their default settings, this would likely imply a great reduction in the data available. This could impact accuracy and – in the context training models ultimately used to make decisions about customers – could give rise to unfair or discriminatory outcomes, if certain demographics turn out to be less likely to consent, leading to unrepresentative training data.

We would encourage BoE to consider alternative means to providing strong privacy protections, such as:

- Giving more tools for customers to 'opt out' of certain processing (ie: provide choice, but have processing 'on' by default). Consideration is required as to how easily firms should allow opting out of activities like fraud prevention, however, given the risk of negative outcomes for the customer.
- Working with the ICO and industry on specific CBDC guidance, potentially in the form of a Statutory Code under the Data Protection Act 2018.

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

Tiered access linked to identity information seems reasonable.

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?

Embedding privacy-enhancing techniques to allow users to control the level of privacy, properly designed, seems appropriate. The default should be to the maximum level of privacy, with users able to opt to reduce their privacy levels, rather than vice versa.

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?

We do not recommend starting with Point-of-Sale (POS) payments given its complexity and dependencies.

We support a staggered rollout approach with implementation in the order below:

1. **P2P** (Peer-to-Peer) - we recommend P2P as the initial use case as it is the lowest impact scenario to the industry whilst adding value to the consumer, ensuring infrastructure is tried and tested and has a realistic chance of hitting dates.

2. **G2X** (Government-to-person or business payment) would be a better phase one use case than e-commerce in terms of effort; however, we think there is likely to be less appetite for this.

3. **E-Commerce** is where complexities arise, and whilst we understand that for the digital pound to have value it must be able to be utilised, we think realistically this should be a phase 1b. The e-commerce scenarios will involve multiple new flows in both the retail/wholesale markets to support. It therefore becomes more challenging to ensure readiness at a level to support a positive consumer experience.

4. **POS** (Point-of-Sale) or in store makes sense in a later phase given the uplift for merchants and additional testing etc. that would be required.

   Note that there could be further roll out stages that would likely result in at least one additional phase.

The design of the digital pound as a payments instrument could create high levels of transfer volumes and liquidity moving throughout the system. Whatever technology is used, its end design needs to be able to support large amounts of liquidity and transaction volumes. These volumes may peak in a crisis period and the BoE would need to be comfortable that its infrastructure is able to withstand high volumes – otherwise such a scenario may trigger a crisis of confidence in public infrastructure, the BoE and ultimately the pound itself.

7. **What do you consider to be the appropriate level of limits on individual's holdings in transition? Do you agree with our proposed limits within the £10,000–£20,000 range? Do you have views on the benefits and risks of a lower limit, such as £5,000?**

This needs careful evaluation as the higher the limit, the higher the potential disintermediation and potential systemic risk. More detailed analysis would be helpful from the BoE on their rationale to downplay this effect, especially given the initial proposal from the European Central Bank for a much lower holding limit of 3000 euros for the digital euro, which is still being debated.

We respectfully disagree with the proposed limits and support a lower limit. The exact amount would need to be further evaluated taking into consideration average deposit values, intended use cases, and where those digital pounds are ultimately held (central bank or commercial banks).

The suggestion that limits could be removed after the introductory/transition period is very concerning, particularly given the magnitude of recent bank runs in other jurisdictions.

As noted in our comments on Q2, further consideration should also be given to the coexistence of the digital pound with stablecoins. The digital pound may be perceived as safer than bank deposits, resulting in the rapid transfer of deposits to the digital pound in times of stress. If the limit is £20,000, or even £10,000, the magnitude of the impact of multiple users moving their money could be significant. Stablecoins may compound these impacts if they are used as a bridge asset between commercial bank deposits and the digital pound. Furthermore, if stablecoins are backed by central bank liabilities then they too may be perceived as another risk-free asset which customers may move their deposits to in addition to the digital pound, in times of stress. More thought and evaluation is needed on the proper calibration of limits for businesses.

The BoE should also consider what happens when the limit threshold is breached and how it will manage the off ramp for digital pounds in excess of the threshold. Again, the end design of the technology will need to be able to manage this on a large scale. Any disruptions may create reputational issues and a crisis of confidence in BoE infrastructure.

Depositing payroll on a digital pound wallet may raise other concerns related to personal identifiable information and privacy.

We also seek greater clarity on how institutions will be able to accept the digital pound as a means of payment and be able to hold them if there is a limit on individual holdings.

8. **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?**

Similar considerations regarding disintermediation, effect on cost and availability of credit and effect on financial stability should be taken into account in the case of corporates. This is particularly relevant in this case given the weight of corporates' balances on the overall deposit volumes, the overall bank funding composition and also the risk of rapid flight.

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?**

We consider it prudent to start with UK residents. Making GBP available to non-residents would also raise other issues that could have effects on other monetary systems, particularly in emerging markets.

However, close coordination with other international jurisdictions is encouraged to agree on common standards and be able to contribute to the FSB's objectives regarding cross border payments[3].

[3] The Financial Stability Board has set out a roadmap for enhancing cross-border payments in order to achieve the G20 targets. This roadmap can be found here: https://www.fsb.org/wp-content/uploads/P230223.pdf.

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

We are of the view that further thinking should be developed to solve the problems outlined in this response and deeper consideration of the available alternatives is required. From the recent showcase of project Rosalind[4], it appeared that everything shown could also be achieved with existing systems or private sector solutions using digital forms of commercial bank money.[5]

The need and value proposition of a digital pound needs to be further evaluated by the BoE considering the whole ecosystem including end users, corporates, merchants, payment providers, banks, etc.

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

It is important to be aware that one of the reasons of financial exclusion is strict onboarding requirements, which are in turn linked to AML/KYC regulations. There is a risk of a two-tiered system with lower requirements which could have significant implications in the traditional financial system. We would argue for the need to implement the principles of same risk, same activity, same regulation across the board to protect both users and the financial system as a whole.

Offline functionalities should be evaluated in light of fraud and risk implications.

On a practical level, a wide-ranging public education campaign would be required in order to enhance consumer understanding, facilitate access to the digital pound across society and minimise the risk of financial exclusion.

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[4] Project Rosalind was a joint experimentation between BoE and the Bank for International Settlements aiming to develop prototypes for an application programming interface for a consumer focused CBDC. Further information can be found here: https://www.bis.org/about/bisih/topics/cbdc/rosalind.htm.

[5] In conjunction to these findings, Project Rosalind results published by BIS show that CBDCs can be rolled out for public use with relative ease and are adaptable to technologies used in the payments sector. The experiments focused on digital portals, known as application programming interfaces (API), that allow companies to communicate with each other online. These technologies included contactless payments, smart phones and QR codes, allowing CBDCs to flow from payer to receiver.