

# NEW FORMS OF DIGITAL MONEY - DISCUSSION PAPER

## *POSITIVE MONEY RESPONSE*

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The following text was submitted by Positive Money in response to the Bank of England's "New Forms of Digital Money" discussion paper, published on 07 June 2021. The original paper and questions for discussion can be found at the Bank of England website at: <https://www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money>

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

As the Bank highlights, a significant outflow of deposits from the banking sector into stablecoins or CBDC could reduce the level of credit provision by the banking sector. Since the vast majority of bank lending currently goes towards unproductive assets such as mortgages, with only a small proportion going towards productive investment, any impact on credit provision to the real economy will likely be muted. Meanwhile, a reduction in bank credit provision for the housing market would likely bring a number of benefits, such as increasing housing affordability and dampening a significant driver of inequality.

In the case that banks do reduce their credit provision to the real economy by a significant amount, it is not certain that market-based finance will step in to fill the gap. In addition, smaller firms which are unable to issue bonds or shares could find it even more difficult to obtain affordable funding under a shift to market-based finance. The Working Group on Productive Finance — which the Bank of England co-convenes — should therefore consider how productive investment could be supported through other lending channels, such as community banks, publicly-owned lenders or stakeholder banks. For example, public banks could be established with the ability to issue bonds eligible for purchase by the Bank of England. In this way, public money creation to finance real economy lending could make up for shortfalls in credit provision from commercial banks and market-based finance.

If there is a wider shortage of credit, the Bank of England should be equipped to use monetary policy tools which could help meet the funding needs of the real economy. The Bank, with the support of HM Treasury, should consider a range of policy options which could meet its primary and secondary objectives more effectively than the Bank's current toolkit. This could include the Bank crediting the government with new funds to invest directly (through the Ways and Means facility, for instance). Alternatively, the Bank could capitalise public infrastructure or development banks with newly created central bank reserves, or provide 'helicopter drops' of CBDC directly to households.

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

Very important

Somewhat important  
Not important

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

Publicly available central bank money should continue to play a central and foundational role across the money and banking system. In accordance with this overarching principle, the Financial Policy Committee's (FPC) expectations for stablecoins require that stablecoin issuers guarantee prompt redemption of their deposits for fiat currency: this implies the existence of a form of central bank money that the stablecoin provider initially holds, the public can access, and which remains widely accepted as a means of payment; it seems unlikely that stablecoin providers will seek to hold substantial physical cash reserves or operate facilities that support in-person withdrawals, as commercial banks do.

As a result, we believe a CBDC would be the only practical means for a stablecoin issuer to provide redemption in fiat currency. The only feasible alternative would be for redemption with bank deposits, but this would increase the 'tiering' in the financial system — increasing financial stability risks — and would not fully meet the FPC's expectations. We recommend that the Bank of England require any stablecoins that promise stable value against fiat currency to be fully backed by funds held in the form of CBDC with on-demand redemption.

Positive Money remains concerned about the decline in both access to cash and cash acceptance. We recommend the Bank determine how a CBDC could be designed to best meet the needs of particularly cash-dependent groups by consulting directly with relevant stakeholder groups and civil society organisations. Possible features could include a pathway to opening a CBDC account with meaningfully lower barriers to entry than a commercial bank account (for example, a pathway for opening a CBDC account without an address could also be made available to those without a fixed address).

To maximise the accessibility and inclusivity of a CBDC, we recommend that a trusted public organisation, such as the Post Office, be supported to provide front-end account services for CBDC (alongside private sector payment providers). The Post Office would be especially well placed to deliver this, given that it already provides banking services to a high standard, is widely trusted by the public, and maintains a large network of branches that continue to operate across the UK.

Positive Money has long advocated for the Bank of England to consider alternative monetary policy tools that would support the real economy directly — such as helicopter money — and recommends the Bank stand ready to use such tools in future. Our assessment is that a general loss of access to public money would complicate and limit their use, while issuing a CBDC would improve the feasibility of such tools.

**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

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

Recent polling data from Redfield & Wilton Strategies (August 24, 2021) suggests that 70% of the UK public are concerned that a CBDC could threaten payment privacy. Such fears could provide an obstacle to building trust in new digital forms of money. The Bank should design a CBDC to ensure that any personal data it collects is used purely for operational purposes. However, if private sector Payment Service Providers (PSP) offer CBDC services, it is likely that they will seek to collect and monetise personal data as part of their funding models, which could fuel concerns over privacy and misuse of data.

To mitigate such concerns, there should be a free 'public option' for CBDC access, which does not rely on personal data collection as a means of funding. Such a service could be state-funded and provided by the Post Office, which currently plays a strong role in providing banking services to communities, and would be well placed to offer free account services for CBDC while ensuring personal data is used purely for operational purposes and regulatory compliance.

The existence of such a public option would provide a strong 'competitive floor' which would encourage private PSPs to improve their services, as well as a means for users to access CBDC while 'opting out' of their data being monetised for commercial purposes. Private sector PSPs would then be free to offer alternative services in exchange for access to user data or other fees.

Alongside the issuance of digital public money designed to protect privacy to the greatest extent possible, the Bank should redouble its efforts to protect access to physical cash — and promote cash acceptance — across the economy. For now, cash is the only systemic payment method that circulates without personal data collection, and we expect all digital payment methods (whether publicly or privately provided) to fall short of the level of privacy protection cash already provides.

Recreating all the privacy benefits of physical cash with a digital currency would be a greater technical and regulatory challenge than issuing an account-based CBDC, but this alone should not rule out digital cash. Some technically complex proposals have been put forward for a CBDC that is compatible with existing regulatory requirements while claiming a high standard of privacy protection, and even compatibility with anonymous transactions. We encourage the Bank to review and consider such design proposals, and to remain open to the possibility of fully-fledged 'digital cash' that would support transactions with digital fiat currency that do not collect users' personal data.

Another risk is that a larger role for technology companies in the payments system will result in more elaborate profiling of users through monitoring their payments activity, and a greater reliance on automated systems to allocate credit. We are concerned that exploitative and discriminatory lending practices will be rendered less visible: there is a common tendency to

assume that automated processes are naturally unbiased, but they frequently reflect the biases (conscious or unconscious) of the designer, or historical biases contained in datasets used to train AI systems. All automated lending processes should be required to meet a reasonable standard of transparency and explainability, especially to regulators. This risk has some relevance to the Bank of England's regulatory framework, but primarily falls within the scope of the Financial Conduct Authority (FCA).

**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?**

The Bank should prioritise interoperability between regulated payment services over interoperability with unregulated forms of money and cryptocurrencies. PayPal's recent announcement that it will provide account services for cryptocurrency is one recent example (among many) of the blurring of the boundary between regulated and unregulated payment systems. The challenger bank Revolut also offers a range of financial services that blur the customer's perception of the boundary between conventional payments and unregulated money.

Greater interoperability between new forms of digital money and conventional digital payments can only be provided safely if all new forms of digital money they interoperate with fall within the regulatory perimeter, and meet a high enough regulatory standard (as the Bank's stablecoin expectations have identified). In addition to establishing a regulatory perimeter, the Bank should establish a 'regulatory firewall' to preserve the distinction between regulated and unregulated money, and prevent financial stability risks arising in the unregulated money ecosystem (for example, from volatile cryptoassets) and 'spilling over' into regulated money and payment services. The FCA should provide public guidance on the distinction between different forms of money, and could work with PSPs to ensure similar guidance is available across all regulated payment platforms.

A firewall would address a variety of risks relevant to the Bank's objectives, including: the risk of the creation of financial derivatives that are subject to regulation, but sensitive to market volatility outside the regulatory perimeter; the risk of users not understanding the differences between regulated and unregulated money, and taking greater risks than they are prepared for; and the risk of legitimising the widespread use and acceptance of unregulated cryptoassets with negative impacts (such as enabling criminal activity, or unsustainable energy costs).

As a first step, the FCA should set clear expectations for regulated PSPs that offer services for unregulated forms of money (the Bank could do the same in cases where the PSP is a licensed credit institution). The Bank should also consider restricting regulated providers from providing services for unregulated forms — this could include enforcing limits on the quantity or frequency of transactions, or completely prohibiting the provision of such services.

**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?**

Strongly agree  
Agree  
**Neutral** ✓  
Disagree  
Strongly disagree

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

A shift to stablecoins (and thus market-based finance) could cause greater financial volatility and threaten economic stability. The Bank of England may be forced to play an even greater role in providing liquidity to capital markets and increasingly act as a 'market maker of last resort', with significant consequences for macro-financial policymaking. To ensure a commensurate increase in accountability, we recommend the Bank adopt a more formal and transparent framework to guide future liquidity support for financial markets, particularly the market for government bonds.

**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?**

As discussed in our answer to question 5, a shift to market-based financing is unlikely to meet the needs of SMEs, who already struggle to obtain credit from banks, and may find it even more difficult to secure affordable funding from non-banks. This is particularly the case if SMEs were expected to issue bonds or equity rather than accepting loans.

Consequently, we recommend that policymakers introduce new mechanisms to improve the provision of funding to SMEs and the real economy. As Andy Haldane has suggested, a UK Development Bank operating on a decentralised basis may be the optimal means of delivering productive finance.

One concern is that the Bank of England's Working Group on Productive Finance only features a narrow membership, and appears to be lacking mechanisms for public accountability. We encourage the Bank of England to expand this discussion, convening a wider range of stakeholders to discuss possible policy solutions, including decentralised development banks.

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

Positive Money welcomes the Bank's concern about the risk of 'walled gardens' forming in payment services. Especially concerning is the possibility of stablecoins being closely integrated with large social media platforms, with other digital payment methods being excluded from popular online marketplaces controlled by the stablecoin issuer.

The Current Account Switch Service (CASS) allows users to transfer current accounts between commercial banks quickly and easily and without facing exit fees or other negative repercussions. Companies that issue systemic stablecoins and are licensed to operate as PSPs should be required to accommodate an equivalent service, allowing the user to

transfer their funds to another service easily without facing exit fees. This should be operated in the same manner as the CASS: by a not-for-profit subsidiary of Pay.UK. Behind the scenes, this would consist of a transfer of a central bank backing liability between the institutions.

While a new account switch service for stablecoins could be made interoperable with the existing CASS to some extent, we would expect a direct transfer of account to be impossible, as a stablecoin would differ substantially in technical structure and legal form to a commercial bank current account. Even if a workable transfer mechanism could be established, enabling the direct transfer of current accounts to stablecoin issuers would blur the regulatory boundary between bank deposits and stablecoins, and is likely to be inadvisable.

With a fully risk-free digital currency in the form of a CBDC, it may no longer be necessary for the government to provide implicit subsidies to commercial banks in the form of deposit insurance. This could mean a true separation between risk-free CBDC transaction accounts as a means of payment, and bank deposits acting as remunerated stores of value. Separating payments in this way from banks' riskier credit-provision activities could have significant benefits. As well as decreasing financial fragility, it would address the issues of relying on profit-maximising private banks to also provide the public good of the payments system, and the moral hazard of 'too big to fail' banks receiving bailouts to prevent wider economic collapse. Without deposit guarantees, banks would also likely have to pass on higher interest rates to depositors. We recommend that the Bank continue to explore this option in detail.

We recommend the Bank take the opportunities presented by new forms of digital money to set equal and high standards for large financial firms across the board, in line with the Bank's financial stability objective and the principle of 'same risk, same regulatory outcome'. The current banking regime favours incumbent large banks over fintechs and challenger banks, but also inhibits the potential of stakeholder banks to achieve positive social outcomes. The Bank — acting in concert with other key financial regulators, such as the FCA — should pursue a comprehensive regulatory model for digital money that acts as a foundation for a more diverse money and banking ecosystem.

**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

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

If a distinct regulatory model for stablecoins is pursued, the central bank liability (CBL) reserve backing model (section 5.3.3) would best meet the FPC's stablecoin expectations.

With this approach, stablecoin issuers would operate similarly to PSPs offering CBDC services. The stablecoin issuer could then reliably provide redemption in fiat currency. We also recommend that the central bank liability take the form of a CBDC. This would best meet the FPC's expectations: redemption in cash would imply a commercial bank branch, post office branch, ATM operator or other cash services provider acting as an intermediary for the withdrawal, complicating the redemption process. 'Withdrawals' from stablecoins in CBDC could be conducted quickly online, with low operational costs, making a CBDC a strong candidate for the backing liability. A mixed central bank liability model, consisting partly of CBDC and partly of central bank reserves, could also be worth consideration, as it would enable monetary policy levers alongside CBDC withdrawals.

Choosing the bank model (section 5.3.1) raises a much broader set of questions and challenges for the Bank than it currently faces. In such a scenario, how would a stablecoin be functionally distinct from a bank deposit? Stablecoins are — both in popular understanding, and in their proposed designs — intended to be a distinct form of money, not denominated in pound sterling. Trust in large technology companies to provide money has been shown to be significantly lower than both banks and central banks in recent public polling (conducted in 13 countries for the Official Monetary and Financial Institutions Forum), and we are concerned that allowing companies to effectively operate as banks but advertise their services as a distinct form of money could mislead the public on the nature of the services they are providing. Firms that intend to provide banking services (especially money and credit issuance) should be required to take on the same regulatory responsibilities expected of banks, operate under the existing banking regime, and denominate liabilities in pound sterling.

We are also concerned that licensing large technology companies as banks — giving them the ability to create money and credit in addition to their existing powers (which are considerable, and could include control over large social networks and online marketplaces with millions or billions of active users) — would constitute an unprecedented concentration of power in a small number of private institutions. In the extreme, this could pose risks beyond the regulatory scope of the Bank of England and the FCA: antitrust measures may need to be enforced by other regulators, such as the Competition and Markets Authority and the Information Commissioner's Office, to protect users.

The HQLA model (section 5.3.2) would raise similar concerns as the bank model, though to a lesser extent. One key benefit is the preservation of a clear regulatory boundary between banks and stablecoin issuers, and a clear distinction of the legal form of the stablecoin. The HQLA model is also comparatively flexible, suggesting the possibility of tightening the requirements on the quality of the backing assets for stablecoins as necessary: smaller stablecoin projects could have looser restrictions on backing assets (providing they remain high quality and liquid), but systemically crucial stablecoins could require full backing with central bank liabilities.

Within the deposit-backed model (section 5.3.4), the underlying value backing the stablecoins would depend on the financial health of the commercial banks providing the deposits. Along with increasing the 'tiering' in the payments system, this would render the risks of holding stablecoins less visible, both to users of the stablecoin and regulators. If stablecoins were able to be backed by deposits from multiple banks, these problems would

be compounded. Permitting stablecoins operating in one jurisdiction to be backed by banks in other jurisdictions would introduce further risks and complications. Another possibility within the deposit-backed model is existing banks operating their own stablecoins (if not directly, then through a subsidiary or partner company) in order to compete more effectively with stablecoin providers. This would complicate the distinction between deposits and stablecoins, and could pose challenges for developing a coherent regulatory framework. Given the wide array of downsides, we advise the Bank not to pursue this model.

**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?**

Positive Money welcomes the proposed use of limits to restrict the rapid expansion of stablecoins and mitigate the risk posed to financial stability by their introduction. If the same limits are imposed across stablecoin issuers regardless of the company's operational scale — for example, a maximum total of funds held across all accounts — a more level playing field for smaller stablecoin providers would result, as they will be able to compete effectively with the largest technology companies for an equal share of the market during the 'takeoff' phase. Incumbent technology companies with large pre-existing networks of users, such as Facebook, would be less able to capture the market for stablecoins.

We would expect a more diverse ecosystem of stablecoin issuers to form under these conditions, resulting in a more competitive payments sector with more space for small firms to innovate and grow. This would provide greater financial stability (with a higher chance for variety in firms' profit models, management styles, and operational structures), and result in less concentration of market power, further mitigating against the unprecedented regulatory challenges that could arise from allowing large technology companies to operate as banks (as discussed in our responses above).



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