

# Opinion

## Digital currencies

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Digital currency is a hugely important topic for the German Banking Industry Committee (GBIC) for a number of reasons. Firstly, a rapidly growing number of companies are looking at the integration of distributed ledger technology (DLT) into their production and business processes. With this comes a growing demand for payment solutions based on smart contracts that banks will need to address on behalf of their customers. Then there are private initiatives, such as the Libra project's stablecoins, where the GBIC wants to ensure a level regulatory playing field. And, finally, policymakers and the Eurosystem are considering the evaluation and possible introduction of a central bank digital currency. These initiatives and ideas should only be pursued if they will bring significant added value for the broad public and if the stability of the financial system and its ability to provide efficient funding can be guaranteed.

### **1. Payments processing in Germany and Europe**

Payments processing is regulated explicitly and in detail by payments processing agreements in Germany and at European level. Fundamentally, it operates without restriction. The German Banking Industry Committee has created a consistent and reliable framework which it continuously evaluates in the interests of all market actors – both national and European. The payments processing infrastructure currently in place is extensive and robust.

In an increasingly digitalized and globalized world, however, there will be radical changes to the ways in which the payments processing systems of banks and savings banks are required to operate. The key question is therefore in what form and for what purpose will new digital currencies be required in the future, for example in the form of cryptocurrency. Clarification is urgently required, especially since there are already a number of efficient (private and statutory) means and methods of payment.

Real-time payments processing already meets the requirements for real-time availability. Within the pan-European payments processing system, the financial institutions are aiming to establish instant payments as the new standard. At a global level, efficient payments processing requires uniform and consistent central bank standards.

Furthermore, banks and savings banks offer a system (Central Authentication Services, CAS) that enables their customers to transmit their personal identification data simply and conveniently. In principle, this makes it possible for customers to transfer their personal identification data to other service providers (e.g. to a cell phone provider in order to enter into a contract) conveniently and securely. The banks and savings banks are therefore already offering customers additional added value on their accounts.

However, new digital payment services are expected to result in automated payment transactions that cannot be carried out adequately via the existing payment formats. Distributed ledger technology (DLT) with the use of so-called smart contracts could provide the technological basis for further developments. These make it possible to capture and review contracts and to execute conditional payments automatically. Automated payment processes (machine-to-machine payments), for example, are fast becoming an integral part of the Internet of Things (IoT). These processes and procedures require a means of payment that is sufficiently easy to integrate technologically, not least for reasons of system and application stability. This is also essential for ensuring that companies in Europe can compete in a global market.

Going forward, banks and savings banks want to continue offering secure payments processing services that meet customer requirements in the best possible way. The current debate surrounding Libra, and the types of application arising in connection with the growing use of digital technologies, mean it is essential that banks and savings banks focus on the development of a smart-contract-enabled 'eEURO'. Banks and savings banks are tackling these challenges by continuously improving the performance of payments processing systems for private individuals and for companies as part of the Single Euro Payments Area. The innovative force of the entrepreneurial activities of credit institutions acting in the private sector should continue to be the central driver for the further development of payments processing systems. The state should only play a supporting role.

## **2. Regulation of stablecoins**

Facebook's announcement last summer of its intention to launch Libra – a new global stablecoin – stoked the debate about new digital currencies. If widely accepted and disseminated, Libra could have a significant impact on payments processing systems and the financial system as a whole, and thus also on society. In particular, the impact of growing dependence on US providers of digital money and digital services is currently difficult to assess.

The German Banking Industry Committee is in no doubt that responsibility for the monetary system must continue to lie with the sovereign states or the EU as a union of states. Any supply of money, be it from banks or other private organizations, must therefore fit into the state-mandated order. Anything else would lead to instability.

The advent of stablecoins demands a new regulatory approach. Current regulation does not cover projects such as Libra that have global reach. An internationally harmonized system of regulation is therefore required, otherwise there is a risk that every jurisdiction will issue its own rules. This necessitates international consultation and coordination of the various national regulatory approaches.

The introduction of stablecoins should only be allowed if the following conditions are met:

- Stablecoin suppliers must be subject to the same supervision as other market actors, under the principle of 'same business, same risk, same rules'.
- State currency sovereignty must be fully maintained.
- Stablecoins must not be allowed to put financial and monetary stability at risk.
- It must be possible to guarantee the stable value of and confidence in the stablecoin in spite of the risks (credit risk, market risk, liquidity risk, operational risk).
- There must be a legally secure right to demand the repayment of stablecoin credit balances.

- The use of stablecoins for money laundering and terrorist financing must be effectively prevented; comprehensive regulation at global level is needed to ensure that all transactions carried out can be associated with the persons involved.

For these reasons, the decision made by the EU finance ministers on December 5, 2019, effectively banning stablecoins such as Libra from the EU until the risks they pose have been identified and assessed as manageable, is to be welcomed.

### **3. Introduction of central bank digital currency**

Central bank digital currency (CBDC) is central bank money (IOUs against the central bank) provided by electronic means. It can be supplied in several forms. It may be based on deposit accounts at the central bank ('account based') or crypto tokens ('token-based'). Central bank digital currency can be made available to the general public ('general purpose') or to narrowly defined user groups ('wholesale settlements').

CBDC can, in principle, enhance the stability and competitiveness of the payments processing system, especially if less cash is used and private electronic payment systems are not efficient and competitive. It can also ensure state sovereignty in an environment where private payment service providers operating at a global level increasingly dominate.

On the other hand, CBDC may also have serious implications for the banking system. For example, the flexibility of banks to lend during the economic cycle could be significantly restricted if CBDC replaces all or some of the credit balances held at commercial banks. If the stability of the financial system is not to be jeopardized by the introduction of CBDCs, CBDC variants must be chosen that avoid such effects.

CBDC may also enable central banks to push key interest rates even further into negative territory if, at the same time, the use of cash is not possible or is possible only to a very limited extent. By supplying additional CBDC, the central bank can also provide monetary stimulus in a new way in the form of 'helicopter money'.

In a working paper published in January 2020, the ECB's Director General of Market Infrastructure and Payments, Ulrich Bindseil, proposed a CBDC model with a two-tier interest rate. Bindseil's model is based on issuance of CBDC to the general public. It envisages a two-tier interest rate which is intended to discourage the holding of large quantities of CBDC. A higher rate of interest is paid up to a certain cap, above which a lower rate is paid. The amount below the cap corresponds to the payment functionality of the CBDC, while amounts in excess of this threshold serve the 'store of value' function. Appropriate interest rates can be used to limit the transfer of funds from demand accounts in commercial banks to CBDC and thus protect the intermediation function of the credit institutions. This should also help to contain the risk of runs on banks in crisis situations (large-scale transfers of customer deposits at banks and savings banks to CBDC in times of crisis). It is still too early to determine the practicability of this particular model. However, the approach shows that the ECB is aware of the risk that full convertibility of deposit money into CBDC poses to the stability of the financial system.

The German Banking Industry Committee does not currently regard the introduction of CBDCs in the euro area as a priority. The threats to financial stability and possible restrictions on the credit supply of banks and savings

banks have not been sufficiently researched, nor is there sufficient added value for citizens, given the still widespread use of cash.

In the future, however, central bank digital currencies could play a significant role in the monetary and currency order. The GBIC therefore welcomes the efforts of the ECB and the G7 to find solutions to the technological challenges that will maintain the stability of the current financial system. Europe is a global competitor and is in a position to set benchmarks once it has carefully weighed up all the advantages and disadvantages.

According to the GBIC, CBDC will be critical in the medium to long term to strengthen the reserve currency, secure the competitiveness of companies in Europe as a whole, and to maintain the ability to take economic policy action. This requires policymakers and business to work together to define precise goals and find appropriate solutions based on a thorough assessment of the benefits and risks of CBDC.

Should CBDC be introduced in the future, the German Banking Industry Committee sees it functioning exclusively as a means of payment. It must not be designed in such a way that it fundamentally changes the role of the banking industry as an intermediary in the economy, nor must it be used as a vehicle to significantly expand the scope of monetary policy. If the introduction of CBDC were to lead to far-reaching effects on the financial sector that conflict with basic elements of the social market economy, the ECB would have exceeded its narrowly defined mandate. This would be the case, for example, in the event of a transition to a monetary system in which the creation of money by banks and savings banks is massively restricted and the supply of credit can therefore no longer be sufficiently adjusted to fluctuating levels of demand within the economic cycle. Independent banks are part of Europe's DNA. In addition, there are questions to be asked about some of the monetary policy instruments that have already been discussed, such as helicopter money or an even more extreme negative interest rate policy. In summary, overreaching by the ECB would damage public confidence in the central banks and lead to further actions in the constitutional courts..

Nor must the introduction of CBDC be allowed to increase the risk of runs on banks in the event of a crisis as this could create significantly higher risks for financial stability with corresponding effects on the economy as a whole. The design of the CBDC must therefore exclude the possibility of large-scale transfers of funds from bank deposits to CBDC in the short term.

Retail access to CBDC should be provided through the existing banking system. This will avoid inflation of the central bank's balance sheet and direct competition with the banking sector. CBDC should be seen as a third form of central bank money alongside cash and the balances held by banks with the central bank. It should complement these existing forms, but not replace them. Secure access to CBDC-based value units and their use in banking business can be based on GBIC's existing and yet to be created infrastructures. The intermediation function of the banking industry would thus continue to be of fundamental importance in the future.

The German Banking Industry Committee believes that the introduction of CBDC requires the creation of a uniform legal and regulatory framework. Legal certainty and appropriate regulatory standards are essential to ensure public confidence in CBDC and its acceptance by all market actors. If CBDC is to be introduced as a means of payment, it is important to clarify whether it should have the status of legal tender (compulsory

acceptance) and whether and to what extent payments can be made anonymously (combating money laundering and terrorist financing versus privacy considerations).

The German Banking Industry Committee is willing to participate in the discourse with policymakers and central banks. At the same time, GBIC is working on adapting payments processing systems to keep pace with the growing use of digital technologies and changing customer needs.