



Economic Affairs Committee

Corrected oral evidence: Central bank digital currencies

Tuesday 19 October 2021

3.55 pm

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Members present: Lord Forsyth of Drumlean (The Chair); Lord Bridges of Headley; Lord Fox; Lord Monks; Lord Stern of Brentford.

Evidence Session No. 4

Heard in Public

Questions 38 - 46

Witness

I: Andrew Cregan, Head of Finance Policy, British Retail Consortium.

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Examination of witness

Andrew Cregan.

Q38 **The Chair:** Mr Cregan, welcome to this second session of the committee. Perhaps I could begin by asking you the first question. Do you agree with Sir Jon Cunliffe that digital currencies could trigger financial instability and should be regulated as a matter of urgency?

Andrew Cregan: Sir Jon is the deputy governor of the Bank of England with responsibility for financial stability. If that is what he thinks, who am I to argue?

Seriously, yes, I do. People see cryptocurrency as a promising investment, a panacea for world ills, in some countries across the world as a more stable currency than their own national currency, or maybe it is a channel selected to pay a ransom in a hostage crisis, who knows, but for whatever reason people do use digital currencies. They are used widely and they continue to grow. There are millions of people using cryptocurrencies in the UK and across the world, and the total market value for cryptocurrencies rose above \$2 trillion again this summer.

It is substantial enough, certainly, for financial instability. There are certainly risks involved and substantial harm. The *Times* reported in 2019 on a cryptocurrency Ponzi scheme, OneCoin, which duped ordinary people out of billions before its chief went missing. The *Times* described it as one of the biggest scams in history.

Essentially, this is really a matter of prudential regulation and financial stability, and Sir Jon is in a far better place to judge the need for regulation of digital currencies than the BRC.

The Chair: One place where you are in a good place to judge is: is there a trend towards accepting alternative means of payments? For example, do many large or small retailers currently accept privately issued digital currencies as payment?

Andrew Cregan: Yes and no, I think, with this one. I will take it in two parts. Yes, there is a trend towards using alternative means of payment. The BRC has been engaged with the open banking implementation entity and a range of new and innovative payment providers for years to help develop open API infrastructures that will work for consumers and the retail industry and I hope will some day achieve a critical mass that could pose a serious threat to the absolute dominance of the anti-competitive card payments industry in UK retail payments, with all the excessive costs and charges and abuse of market dominance that comes with that.

As it stands, open banking payments reached a high of one million transactions per month earlier this year. Twelve million transactions a year is good. It is a drop in the ocean in the context of 17 billion retail transactions per year, but it is growing. According to our annual payment survey, published last month, alternative payments doubled its share in retail sales from 2% in 2019 to 4% last year, accounting for £16 billion of retail sales. The New Payments Architecture, too, is supposedly being

designed with retail payments in mind, and it remains to be seen what impact solutions such as requests to pay could have on the market.

To the second part of the question on how much of these alternative payments are currently constituted by digital currencies, by and large it is none. I am sure you could find a retailer somewhere to tell you that they do accept a digital currency but, as I have said to the handful of fintech journalists who have approached the BRC over the years when they have been poised to write about the rise of digital payments, "When is the last time that you paid for your weekly shop with Bitcoin?" These developments are exciting for some people but, for the majority of customers, there is no demand to use it and, therefore, hardly any retailers offer it as a payment channel today.

Q39 Lord Monks: This is a question about the motivation for introducing digital currencies. Do you think the motivation is about benefits to consumers and customers in the retail sector or could it be an initiative basically to try to protect the banking system from all the things that are going on around the edges, including bitcoin-type developments? Or is it simply that others are doing it, we had better do it, too, or we will lose a significant part of the transactions that already take place in this country?

Andrew Cregan: Those are good questions. In terms of what the Bank's intentions are, it remains to be seen. I think we are in an exploratory phase. If a central bank digital currency is pursued, then for many the devil will be in the detail. The Bank of England appears to indicate that it sees the greatest benefit of a central bank digital currency in providing enhanced resilience and trust in the financial system, but innovation, particularly in payment applications, is another of the major potential benefits. Some are calling for this CBDC to be available, initially at least, as a wholesale proposition only, but in the BRC's view this would be a missed opportunity for increased payment diversity, encouraging financial inclusion, and improving cross-border payment.

It is clear that the market is moving, and the crypto currencies and assets are in increasing demand by consumers. The demand for CBDCs and stable coins is only likely to grow. To expand on that, for many, or for most, stable coins are a half-way house between fiat money and cryptocurrencies. If cryptocurrencies are the relatively wild west of global finance and payments, it makes sense to at least regulate and police the border. A CBDC could be considered as an ultimate stable coin.

The early rollout of a central bank digital currency could bring other major benefits to the UK economy. China's new digital yuan is expected to be used primarily for retail payments in China, and for whatever reason other countries are likely to follow suit with their own CBDCs. These developments themselves will make it more likely that people will use digital currencies in the future and that their influence will grow and, along with it, the use cases for digital currencies. The UK has hitherto seen itself as a pioneer in payments, so there is a question for the UK Government and regulatory authorities as to whether we could, without a central bank digital currency, be left behind other markets as fintech players move elsewhere to experiment with and develop products and

propositions for retail payment services that are based on central bank digital currencies and new digital money.

If the work to date in the UK in developing the New Payments Architecture, open banking and open API infrastructures puts the UK at a competitive advantage, surely it makes sense for the UK to leverage that fintech expertise in this brave new world of digital currencies. I have recently joined the Bank of England's central bank digital currency engagement forum; I assume that is one of the reasons I am here. I am encouraged by the work that the Bank of England has already done in this space. The BRC is supportive of these core principles identified by the Bank that will guide its future exploration of CBDC: first, financial inclusion—it should have a high degree of accessibility; secondly, a competitive CBDC ecosystem, with the Bank providing a minimum level of infrastructure and the private sector taking the leading role in responding to the needs of end users; thirdly, protecting users' privacy, notwithstanding measures to tackle fraud and money laundering; and, fourthly, as the retail industry has no interest in monetary or financial instability, we are fully supportive of the Bank's primary focus for CBDCs on the benefits that those could bring to payments.

Lord Monks: You represent the retail industry. Can you envisage a situation developing where, for example, I am responsible in a company for purchasing a fleet of vehicles and I want to pay in digital dollars or digital euros? What would the response be there? One thing that is worrying me more and more about this particular exercise is the competitive nature of it between central banks making their currency the important one for international trade. I want to pay in dollars. What would you say?

Andrew Cregan: We are looking at solutions that will not be here and delivered tomorrow. We are looking at some time before the delivery of a central bank digital currency and the overlay services that sit on top of that. Something else that is already significantly in train and being led by the G20 is the greater facilitation of cross-border payments, and there are a number of initiatives that are taking place there. There is significant scope for the reduction in friction of cross-border payments through new digital money and central bank digital currencies, and the overlaid payment services that are based on those.

The answer to your question remains to be seen, because this is still a very exploratory area. As I say, the devil will be in the detail in terms of what the Bank of England and the Treasury decide for the design of a UK CBDC. If there is the scope for those innovative overlay payment services and things that can be used for foreign purchases, and there is progress in that G20 work for cross-border payments, there is a significant opportunity to be able to reduce the friction in the kinds of transactions that you were talking about. I am not sure whether that is the point you were trying to address.

Lord Monks: If we have competitive central bank currencies, and people are talking about choice and so on, people will look around for the best

currency to do their deals in; in some cases the ones that are least regulated, in other cases the Canada-type example that has already been cited to us today, which is very well regulated.

Andrew Cregan: In some ways, does that not happen today? Do businesses not sign cross-border contracts that hedge in foreign currencies?

Lord Monks: Yes. There is an exchange rate issue and how that is dealt with. The central bank at least has control of its currency to a very high degree. I do not see that it would have very much influence in this competitive world of digital currencies.

Andrew Cregan: I am missing the question.

Lord Monks: If France has a euro central currency, and others in the eurozone, if America has a dollar digital currency, and us with a pound, just take those three, if you are an international business buying a fleet of trucks you might choose which one you will do it in and which one will give you the best deal. Obviously, people already worry about the varying values of currencies, but it seems to me this is a whole new dimension that is being opened up by the digital currency.

Andrew Cregan: Yes. I suppose, yes. I do not think I am the best-placed person to address some of these points. The rise of digital currencies should bring with it a great deal of interoperability between the different new stable coins or central bank digital currencies.

The Chair: Are you saying you are in favour of competition in money?

Andrew Cregan: The BRC does not have a position on whether or not we are in favour of competition in money. That is something I would have to go away and consult with colleagues and members about and come back to you.

The Chair: It is central to Lord Monks's question.

Q40 **Lord Fox:** I will reverse it and look at it from the other side. Rather than looking at it from the consumer point of view, let us look at it from the retailer point of view. If I am selling something in the United Kingdom that is a long lead time commodity or product that I am importing from the United States, the perfect hedge is for me to charge dollars for that. I imagine you would support your members who wanted to do that kind of perfect hedge, given that you represent retailers. That sort of flexibility, the sort of thing that the Lord Chair was talking about there, the ability for retailers to, in a sense, hedge or protect themselves against currency fluctuation by having competitive currencies within the United Kingdom, would be an advantage, would it not?

Andrew Cregan: Yes, it would.

The Chair: Okay. You did not need to consult.

Andrew Cregan: Thank you, Lord Fox, for making that clear.

Q41 **Lord Stern of Brentford:** Given the understandable remarks you made about the cost to retailers of the credit card system and how it works, I take it you would see benefits to a central bank digital currency to retailers. Tell me if I am mistaken. Could you describe how those benefits would work? Do you see different kinds of competition developing as a result?

Andrew Cregan: Yes, definitely. We see that it is an attractive proposition in terms of competition, innovation and transparency in payments, which is ultimately what the British Retail Consortium is looking for in the public policy space, given that retailers conduct over 50 million retail transactions a day and turn over £400 billion in a year. Yes, we want those outcomes, and I believe that a CBDC could be helpful in achieving those outcomes. If it were just a matter of utility and functionality, essentially credit cards and debit cards today function extremely well, but cost is one of the major concerns about these payment solutions for retailers, and has been for 30 years. In the early 1990s the BRC first logged a complaint with the European Commission, and later in the 1990s with the OFT here. That is one of the things that led to the introduction across Europe of the interchange fee regulation, although unfortunately that has been sidestepped by the card payment industry.

Other areas have been looked at. We need to see effective regulation of card payments, but there are other areas that the Government and regulator have been considering in terms of developing interbank payments and overlay services, whether that is open banking or whether that is in the New Payments Architecture. I talked earlier about how the adoption of these novel interbank payment solutions will be driven by consumer demand and what is cheaper for the merchant to use. The pricing of that will be a driving factor. Here I think it is important to talk about the rails, and that is where the CBDC comes in.

The BRC had objected to Mastercard's acquisition of Vocalink several years ago, and it has since queried whether the PSR—Payment Systems Regulator—would consider mandating a divestment of Mastercard over Vocalink. The PSR has not proposed that structural separation but is bringing forward some measures to impose operational separation to mitigate the risks associated with that provider's dominant position. If all these new interbank payment solutions operate on faster-payment Vocalink rails, it puts a major organisation that is a big player in cards—but also now a big player in the interbank payment system—in a potentially anticompetitive position.

The rails that the Bank of England is proposing to develop for a central bank digital currency could deliver exactly the same benefits Pay.UK and the Payment Systems Regulator generate with the New Payments Architecture, where those competitive overlay payment services are provided by a range of private sector operators. That is also something we can get with CBDCs, and, certainly from my understanding, is envisaged by the Bank of England, for the development of competitive payment services with CBDCs. Sorry for the long way there, but yes,

there is potential for CBDCs to substantially support competition, innovation and transparency in retail payments in the UK.

Q42 Lord Stern of Brentford: In principle, it should bring down costs and increase demand. Would it to a substantial extent put the credit cards business not out of business but down very substantially?

Andrew Cregan: It could create the pressures to do that. The driver for whether or not these theoretical future overlay services for a central bank digital currency will be successful are the same factors that decide the success of interbank payments today, in meeting the objectives of the Government and regulator here, as well as in the European Union, where those competition objectives have been set.

Lord Stern of Brentford: Do you think it will bring down prices and stimulate demand as a result of lowering the cost of the transaction?

Andrew Cregan: There is definitely substantial opportunity to do that. It really depends on how these overlay services work. Sorry, the factors—that is what I was getting to. I lost my train of thought. The factors of success will be driven first and foremost by consumer demand. Is there consumer demand for these overlay services of CBDCs, of interbank payment services like open banking, or New Payments Architecture services like Request to Pay, or for any of these new payment initiatives that are out there? What is the consumer demand for it? That will be driven by functionality and utility. Does it offer something that is in excess of what I already experience as utility, what we all experience as utility, from more traditional payment methods such as cards?

Also, what are my consumer protections there? We have a very limited regime in terms of consumer protections for these new novel payment methods, as it stands today. Also, incentives, because if you have all those things in place, why, as a consumer, will I ditch what I am very used to? Some 81% of retail transactions in the UK are made by a credit card or debit card. People are comfortable using that. I have grown up using that. I have no inclination to move away from using that. People would need to be incentivised to move away from that, either by providers or by retailers themselves. The only way a retailer could incentivise that is if it is more cost effective. As well as the driver having to come from consumer demand, it needs to come from it being a viable business alternative for retailers to offer.

Q43 Lord Bridges of Headley: To try to wrap this up, can I please have a yes or a no? In your mind, the main motive for the BRC to adopt CBDCs is to get more competition in payments, yes?

Andrew Cregan: Yes.

Lord Bridges of Headley: Great. Therefore, under the system you are looking at, coming back to this rails point, you are saying that the dominant players in payments will be what, in competition with more players on a platform provided by the CBDC, is that right?

Andrew Cregan: Yes.

Lord Bridges of Headley: They will still be there. You are thinking that more people will come in and function. I am just trying to understand how this will happen. The reason I am asking is that it is not as if, as you were saying, the payment system is not undergoing enormous disruption. We know it is. As you know better than anyone, people now use their phones and smart watches to pay through different tech platforms, and so on. I want to understand why we need to go through all this to get to the disruption you are looking for. You yourself have said there are various initiatives under way. Why are we going through all this?

Andrew Cregan: When it comes to using things such as wearable devices and mobile phones to pay for goods and services, in many cases those are card-based payments. It is simply your card details uploaded on to your phone or watch.

Lord Bridges of Headley: But they are still being disintermediated in the banks.

Andrew Cregan: Yes, but the card costs that are levied on the retail industry and in train the consumer, are still substantial and growing all the time.

Lord Bridges of Headley: Why will we get more competition?

Andrew Cregan: Why more competition? It is not really about that. It is about why we are having a conversation about central bank digital currencies and payment overlay services that could come with that. We have been talking about enhancing competition in the payments industry for years, with those interbank payment initiatives that I have probably talked about enough. The difference is that those things had to be designed, partly in response to a Competition & Markets Authority ruling and partly due to the revised payments services directive—PSD2. They have facilitated the development of these interbank measures. The reason we are talking about CBDCs is different. That is more organic. That is because there is already \$2 trillion worth of virtual currencies being used across the world. People are using stable coins as a platform in and out of fiat currencies and the cryptocurrency world. There are dangers there. It is something that should be regulated as much as possible to protect people from harm.

New digital money is well-used and a growing area of the financial and payments system, and it is likely to move more and more in future years into retail spaces, and move into more use-cases. The question is not whether or not CBDCs or new digital money is desired, or whether or not it has a future. We already know it does; that is why we are talking about it. The other things, the interbank things, are things that have been crafted out of regulatory or government competitive initiatives. The thrust behind how we got to where we are with new digital money is very different.

Q44 **Lord Bridges of Headley:** In terms of the disruption that this will cause retailers, can you talk us through, in practical terms, what it would mean for one of your members if we introduced the CBDC?

Andrew Cregan: Going back to what I said before about the devil being in the detail, it is possible that a CBDC could be introduced for purely wholesale use with no possibility for an individual to have a CBDC account with overlay payment services that they could use as an alternative to commercial bank accounts. In that case there would be no substantial benefit to the retail industry at all. The only way there is, and the only reason I am here, is if it does move into that more retail space, if consumers can use it, and if we see the development of those capabilities and the benefits that they could bring. As I say, the adoption of it will be based on consumer demand.

Lord Bridges of Headley: What practical steps would I as a retailer down at the corner shop have to take to accept this new CBDC?

Andrew Cregan: That will depend on how the payment service provider designs its overlay service. Could it be QR codes? Is it something I do on my phone? Does it need a card reader? Probably not. It is not a question that I can answer. That is a question for a payment service provider that will go away and develop the proposition.

Lord Bridges of Headley: Given you are on the Bank of England advisory committee, what are you advising? Are you pointing to best practice—the Bahamas or somewhere else? Is there somewhere we should look at where this is all operating well or do you literally have a blank sheet of paper?

Andrew Cregan: It is exploratory for the Bank of England, and I think it is exploratory for a number of the other markets and countries around the world that are looking at this. It is probably the Chinese that have taken a lead in deciding to move ahead with it.

Lord Bridges of Headley: The players here are Visa, Mastercard, and those who have the terminals and the systems already. I keep coming back to the prime objective, as you said, to get more competition in payments. I am trying to see how you can achieve and deliver this, given where we are now and given our place in the market.

Andrew Cregan: New digital money is very much a long-term competitive proposition, but then so are the existing initiatives that are being developed by Pay.UK, and the PSR, and open banking. They will take time to reach a critical mass, for retail payments to migrate from their more traditional solutions towards these new solutions. As I say, one of the big drivers behind CBDCs is not created, it is organic. It is already there, and there are millions of users across the world who already do this and use these solutions. The question is: are they likely to grow and expand, and are there benefits for the UK to act early in this area for business, for consumers and for retailers—or do we sit on the sidelines, watch others do it and follow later?

Lord Monks: That last point seems to be central to the future. Do we watch others gain the lead, in which case we may have to take some risks with some of the things we have been talking about, or are we extremely cautious in terms of protecting our systems? I would have thought, from what you have been saying, that a major advantage in the mind of the British Retail Consortium is to get rid of the charges of Mastercard and Visa—to put it rather crudely—and get rid of that intermediary that you have to pay at the moment. Is it right for me to take that conclusion from what you have said?

Andrew Cregan: Yes, that would be a successful outcome. It is something that would provide a significant saving for UK retailers and consumers. That money could be reinvested into UK businesses. It is almost £50 per household that could be spent on goods and services. It is a net export from—or a prevented net import to—the UK economy. The £1 billion that is spent on card fees by UK retailers is something that, with more competitive domestic solutions in place, could be reduced significantly, and that money could be used more effectively within the UK.

Q45 **Lord Monks:** Do you see the digital currency idea foreshadowing the end of cash, with retailers at some stage saying, “No, we only accept digital currency”?

Andrew Cregan: I do not see in any way that it substitutes for cash. The competitors to CBDCs are the interbank initiatives and card payments. They are other digital payments. I do not envisage that individuals who have been so reticent over using card payments over the years, or any other forms of new payment that have become more readily available in more recent years, will jump on the CBDC bandwagon and abandon cash. People use cash either for budgetary purposes or for concerns around security or fraud. They use cash for other reasons that will not be affected by the creation of a CBDC.

Q46 **Lord Stern of Brentford:** You have touched on a number of these issues already, so I am asking you to step back and briefly speculate as to where market forces might drive the payment system. You have already referred to a number of innovations that are out there being prepared. Where do you think those market forces will take us on a payment system, and would a CBDC add much to those forces that are in play already? I do not want great detail; step back and just speculate briefly.

Andrew Cregan: I can speak only in very broad terms on this anyway. As I say, the available payments architecture for the UK will provide an alternative and additional rail to those that currently exist—those that are regulated by the PSR: the interbank and card rails. Those rails have existed for some time, but more and more is being delivered on top of those interbank rails in terms of the New Payments Architecture and open banking solutions. Those same innovative solutions could be emulated on top of a central bank digital currency. Because of the wider use cases for central bank digital currencies, I guess they potentially have an even

greater chance of success, and a greater chance for international interoperability and cross-border payments.

The Chair: Mr Cregan, thank you so much for answering our questions and coming today. That concludes this session of the committee.