



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Lord Forsyth of Drumlean  
Chairman, Economic Affairs Committee  
House of Lords  
London  
SW1A 0PW

9 March 2022

Dear Lord Forsyth,

I am writing to respond to the Lords Economic Affairs Committee's report into central bank digital currency (CBDC). I would like to thank the Committee for its inquiry and report, and for the opportunity to give evidence about the government's work in this important area.

Last year, the Chancellor of the Exchequer announced a Taskforce jointly chaired by HM Treasury and the Bank of England to lead the UK's exploration of a UK CBDC, along with forums to engage a broad range of stakeholders from across our economy and society, including consumer groups, think tanks, businesses, academics, financial institutions and technology experts. The Taskforce is ensuring that UK authorities adopt a strategic and coordinated approach as they explore a CBDC, in line with their statutory objectives.

No decision has been taken by the government and the Bank of England as to whether to issue a UK CBDC, which would be a major infrastructure project. A decision will be based on a rigorous assessment of the overall case for a UK CBDC and will be informed by extensive stakeholder engagement and consultation. Exploring and delivering a UK CBDC, if there were a decision to proceed, would require carefully sequenced phases of work, which will span several years.

As part of those explorations, HM Treasury and the Bank of England will publish a consultation in 2022 setting out their assessment of the case for a UK CBDC, including the merits of further work to develop an operational and technology model for a UK CBDC.

This letter summarises the government's response to each of the recommendations of the report.

### Central bank digital currencies

Chapter 1 of your report considered the role of Parliament, and policy objectives of a CBDC. It noted that a UK CBDC would have far-reaching consequences and the

## **Government and Bank of England should set out how a CBDC will deliver its objectives versus other solutions.**

The government agrees that CBDCs pose a broad range of opportunities and risks, which require careful evaluation. The government has established a Taskforce to consider these questions in depth and welcomes the Committee's scrutiny of the Taskforce's work as we work towards a consultation later this year. The government expects to fully engage Parliament – including through any possible legislation – in an open and transparent manner to ensure that there is a full and proper scrutiny of any proposals over the coming years.

An estimated 86% of central banks globally are actively researching domestic CBDCs. Different jurisdictions will have their own unique reasons for issuing or not issuing a CBDC. A core responsibility of the Taskforce in the coming months is to establish and evaluate use cases for a UK CBDC, which may be different to those of other countries. For example, the exploration of a CBDC in some countries is motivated by rapidly declining cash usage, whereas in other countries it is driven by a desire to address challenges in the provision of public money.

While no decision has been taken on issuance in the UK, against the backdrop of accelerating international work, it is important that the UK develops an understanding of the desirability and viability of a domestic CBDC to ensure we are in a position to take an informed decision on how to proceed. This exploratory work has an important role to play in ensuring the UK remains at the forefront of global payments innovation and can shape the international debate.

### **Households and businesses**

**Chapter 2 of your report noted that a CBDC system has the potential to spur innovation and greater competition in payments, in addition to those already taking place. The Committee did not see significant other advantages for consumers in a UK CBDC. The Committee commented on the relationship between a CBDC and cash, as well as CBDC's potential to improve cross-border payments.**

#### **Domestic payments**

Through the CBDC Taskforce, the government and the Bank of England are working closely with the Financial Conduct Authority (FCA) and the Payments Systems Regulator (PSR) to evaluate the potential benefits of a CBDC for consumers and businesses making and receiving payments, amongst other potential drivers for a CBDC. Furthermore, through the CBDC Engagement Forum and Technology Forum, we are regularly engaging with industry stakeholders, including consumer groups, on the question of how a CBDC might impact domestic payments.

The UK has long been regarded as being a leader in payments. The UK is already home to a diverse, evolving payments landscape, where technology, innovation and reliability combine to drive consumer choice and business confidence, all underpinned by an effective regulatory regime.

It is possible that a CBDC system could have the potential to spur innovation and greater competition in domestic payments. A CBDC could improve the efficiency and cost of domestic transactions, providing a parallel payment method alongside retail payments systems, offering wider choice. However, the extent to which these benefits could be achieved by other means is being evaluated by the Taskforce. For instance, the New Payments Architecture (NPA) offers the opportunity to provide a modernised core clearing

and settlement infrastructure in a way that will catalyse innovation in payment services and support global payment system interoperability.

#### Cross-border payments

Today, cross-border payments are often slow and expensive. As your report highlights, CBDC could be one of several possible solutions to these inefficiencies, provided that CBDC ecosystems internationally are designed in an interoperable way.

The G7 Public Policy Principles for CBDC, which were published under the UK's G7 Presidency in 2021, highlighted that cross-border functionality will be crucial to the success and uptake of any CBDC.

It noted that jurisdictions considering issuing CBDCs should explore how they might enhance cross-border payments, including through central banks and other organisations working openly and collaboratively to consider the international dimensions of CBDC design. These principles will guide the UK's consideration of cross-border payments relating to CBDC.

The G20 has made enhancing cross-border payments a priority and endorsed a programme to address key challenges, including targets for faster, cheaper, more transparent and inclusive cross-border payments. The G20's cross-border payments roadmap includes a programme of work for the Committee on Payments and Markets Infrastructures (CPMI), the BIS, the IMF and the World Bank to explore collectively whether and how CBDCs could enhance cross-border payments. The government is committed to driving forward the goals of the G20 cross-border payments roadmap domestically, and within international fora.

#### Cash

As your report notes, whilst the use of cash is declining in the UK, it remains important for the daily lives of millions of people. Analysis by the FCA found that around 5.4 million people relied on cash in their day-to-day lives as of February 2020.

A CBDC would be a new form of money that would exist alongside cash and bank deposits, rather than replacing them. The government is committed to legislating to protect access to cash. The government's proposals seek to support the continued use of cash in people's daily lives, including by enabling local businesses to continue accepting cash through access to deposit facilities.

#### Financial inclusion

The government wants to ensure that everyone has access to useful and affordable financial products and services whatever their background and income. As your report suggests, we will be carefully considering the role which CBDCs could play in increasing access to digital payments; given the digital nature of CBDC, it will be critical to consider how it can support financial inclusion. The G7 Principles reiterated how important it is for governments to consider financial inclusion elements of a CBDC. The G7 Principles noted that a CBDC should not impede, and where possible should enhance access to payment services for those excluded from or underserved by the existing financial system.

#### CBDCs and the monetary system

Chapter 3 of your report considered how a CBDC would exist in the broader monetary system, including how a CBDC might exist alongside other forms of innovation in money. The report also made recommendations relating to: the relation between CBDC and cryptoassets; CBDC design with regard to monetary policy and financial stability considerations; and privacy and digital ID.

### Cryptoassets and CBDC

Your report highlighted the risks posed by new innovations in payments, particularly from stablecoins, and called for the Taskforce to set out the role of regulation.

Certain cryptoassets and stablecoins, offering new ways to transact and invest, are part of a trend of rapid innovation in financial technology; it is likely that any future CBDC will exist alongside cryptoassets and stablecoins, as part of a competitive and innovative payments landscape.

The government established a Cryptoassets Taskforce (convening HM Treasury, the Bank of England, the FCA) to consider the UK's regulatory response to cryptoassets. The government and UK authorities have taken a series of actions to support innovation and mitigate risks:

- The government has set out its intention to legislate later this year to bring certain cryptoassets into financial promotion regulation. The FCA has also publicly consulted on its detailed rules for the regime. This would ensure that relevant cryptoasset promotions are held to the same high standards for fairness, clarity and accuracy that pertain in the financial services industry.
- To further protect consumers, the FCA has banned the sale of cryptoasset derivatives to retail consumers. The government also launched a new anti-money laundering and counter-terrorist financing regime for cryptoassets in 2020.
- The government has also consulted on proposals to ensure certain cryptoassets, known as stablecoins, meet the same standards we expect of other payment methods. It also included a call for evidence on the use of Distributed Ledger Technology (DLT) in financial markets. The government is considering responses and will outline next steps in due course.

### Monetary policy

The Bank of England has responsibility for setting monetary policy and will consider how that interacts with CBDC. The government fully endorses the G7 principles, which stated that any CBDC should be designed such that it 'does no harm' to monetary and financial stability.

### Financial stability considerations

Alongside cash, a CBDC could help maintain general confidence that people can access public money easily, and at all times. Such confidence is key to financial stability, particularly in periods of economic stress. However, as noted by the Committee, a CBDC could also introduce challenges and risks to the financial system. If significant deposits moved to CBDC, this could have implications for commercial banks' funding models. In turn, this could affect the amount and cost of credit provided by banks to the wider economy.

In considering the case for a CBDC, the Taskforce is assessing potential risks, including to financial stability, and considering how they could be managed.

### Privacy and digital ID

As your report noted, protecting users and their privacy is a crucial part of any CBDC.

HM Treasury is engaging widely with stakeholders, including with the Information Commissioner's Office (ICO), to ensure that protecting the privacy of UK consumers is a central factor both in the decision on whether to implement a CBDC, and any design choices about a CBDC if introduced. Furthermore, the G7 principles outlined the UK's commitment to upholding standards of privacy in any potential CBDC ecosystem. The G7 principles state that "rigorous standards of privacy, accountability for the protection of users' data, and transparency on how information will be secured and used are essential for any CBDC to command trust and confidence. The rule of law in each jurisdiction establishes and underpins such considerations." This principle will underpin the UK's approach to CBDC privacy concerns going forward.

The government, led by the Department for Digital, Media, Culture and Sport (DCMS), is committed to realising the benefits of digital identity, without creating ID cards. In 2021, DCMS published a draft of the UK digital identity and attributes trust framework. It sets out what rules and standards are needed to protect people's sensitive identity data when used digitally. The government has recently closed a consultation on the legislation and governance that will be required to enable the use of digital identity across the UK economy, for a wide range of use cases including CBDC, and we expect a response to be issued shortly. The CBDC Taskforce is considering the role of digital identity in any CBDC.

### International implications

Chapter 4 of the Committee's report considered the international dimensions of CBDC development, including the challenge of making global CBDC projects interoperable, and how this work could be expedited. The committee requested that the Office of Financial Sanctions Implementation assess the impact of other countries' CBDCs on UK sanctions, and took stock of security and resilience risks to CBDC. The report recommended further collaboration on CBDC, work on international CBDC standards, and further work to consider the case for a UK wholesale CBDC.

#### Sanctions and security

To come within the Office of Financial Sanctions Implementation's enforcement of sanctions, a transaction must have a connection to the UK (a UK nexus). A UK nexus might be created by such things as a UK person or company working overseas, transactions using clearing services in the UK, actions by a local subsidiary of a UK company (depending on the governance), action taking place overseas but directed from within the UK, or financial products or insurance bought on UK markets but held or used overseas. While these examples are not exhaustive or definitive, the use of Sterling in any transaction does not of itself constitute a UK nexus. The use of a CBDC to evade sanctions would be enforceable if it had a UK nexus.

The Foreign, Commonwealth and Development Office (FCDO) is responsible for the majority of sanctions designations under the Sanctions and Anti Money Laundering Act (2018). HM Treasury and FCDO work closely to ensure that ahead of any individual or entity being targeted with financial sanctions, considerations such as national security, regime effectiveness and impacts are taken into account.

The government agrees with the Committee's view that any CBDC would need to be designed so that it is adaptable and able to be updated rapidly in response to technological change and emerging security threats. All entities in any CBDC ecosystem (both at central bank and private sector level) will have operational resilience, data security, and cybersecurity at their heart.

### International co-operation

The government is already undertaking considerable international co-operation in relation to CBDCs. We are nonetheless committed to deepening this co-operation as global CBDC development progresses, in line with the report's recommendation.

The cornerstone of our international co-ordination is the G7 Principles. These reflect G7 shared values in design aspects including governance, privacy, security and interoperability. The G7 is also collectively calling on the world's international financial institutions and standard-setting bodies to continue to analyse the potential cross-border use of CBDCs. We want to see collaborative work between national authorities and international organisations to make sure that countries are able to effectively – and responsibly – safeguard themselves against spillovers from foreign CBDC.

The UK is progressing our international co-operation through other organisations too. The Bank of England and six other international central banks are collaborating with the BIS Innovation Hub to take forward work on CBDC policy options and practical implementation issues. Through our UK membership of the G20, we are shaping work on a global cross-border payments roadmap and the role that CBDCs play within that.

The government recognises that CBDCs issued by other governments present opportunities and risks for the UK. The government will ensure our continued ability to maintain the stability and the integrity of the UK's monetary system. The UK is engaging with international partners on responsible CBDC policy choices, specifically that global CBDCs should avoid risks of harm to the international monetary and financial system, including the monetary sovereignty and financial stability of other countries. Every G7 member has agreed to that principle.

### Wholesale CBDC

As your report noted, retail CBDC has been the focus of the government's work so far, including of the two Bank of England discussion papers on this topic, and it will be the focus of HM Treasury and the Bank of England's consultation later this year.

With regard to wholesale CBDC, banks already have access to electronic central bank money, in the form of reserves. This has long been available, and the Bank of England has recently broadened the scope of institutions that can make use of reserves.

However, the UK is open to exploring innovative ways in which wholesale firms can use central bank money. HM Treasury and the Bank of England are working together to continue exploring the case for new and improved ways of facilitating wholesale settlement. There are currently a number of ongoing initiatives that are considered likely to provide improved outcomes, though the effectiveness of these measures at delivering relevant benefits will be continually assessed.

In particular, the Bank of England is already renewing its wholesale payments system – the Real Time Gross Settlement system, or RTGS, which was first introduced in 1996. This will improve the efficiency and resilience of domestic wholesale payments being made, as well as offering increased interoperability. Further, the Bank of England earlier this year introduced a new 'omnibus' account model to enable private sector innovation in

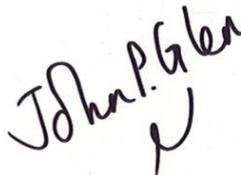
wholesale payments. Finally, HM Treasury's proposed Financial Market Infrastructure Sandbox will support firms wanting to use new technology, in particular distributed ledger technology (DLT), to provide the infrastructure services that underpin financial markets, such as the settlement of securities. This regime will be inspired by the FCA's sandbox and HM Treasury is working together with the Bank of England and the FCA to deliver this.

### Concluding recommendations

Your report set out concluding recommendations, establishing important questions that the joint CBDC Taskforce should answer before deciding whether to issue a CBDC. These are vital questions that ongoing work and the joint HM Treasury and Bank of England consultation later this year will address.

Finally, your report made a recommendation that whilst the committee does not consider the UK should implement a CBDC as a matter of urgency, long lead times and other factors mean that joint work on a potential UK CBDC should continue.

I would like to once again thank the Committee for the recommendations contained in their report, which the government will carefully consider and use to inform our work.

A handwritten signature in black ink that reads "John P. Glen". The signature is written in a cursive style with a large initial 'J' and a flourish at the end.

JOHN GLEN