

Bank of England response to the Lords Economic Affairs Committee report *Central bank digital currencies: a solution in search of a problem?*

16 March 2022

1. The Bank of England (the Bank) thanks the Committee for its report on Central Bank Digital Currency (CBDC) and welcomes it as a contribution to the debate around this topic. The Committee raises a number of important issues, which the Bank is considering as it explores the case for any eventual UK CBDC. We welcome the opportunity to respond to the Lords Economic Affairs Committee's report.
2. This letter addresses the recommendations made by the Committee to the Bank and the joint Taskforce. The recommendations to HM Government (HMG) will be addressed in a separate response by HMG.

The Nature of the Bank of England's current work

3. The Bank and HM Treasury (HMT) have not yet made a decision on whether a CBDC should be introduced in the UK. We are currently in a "[research and exploration](#)" phase, evaluating the case for CBDC, in order to determine whether one could be needed. As part of our "research and exploration", together with HM Treasury, we will publish a Consultation Paper in 2022. That consultation will set out our assessment of the case for a UK CBDC, evaluate the opportunities, risks and implications, and conclude on the merits of any further work to develop an operational and technology model for a UK CBDC. As part of the consultation, we will explore many issues, including those raised by the Committee, in more detail.
4. Introducing a CBDC is an important decision that will necessarily involve a wide set of stakeholders, including Parliament. The Bank will work with HMG to understand any legislative framework needed for implementing and operating a robust CBDC system in the UK. The Taskforce will continue to engage with Parliament on its CBDC work as it progresses and will ensure open and transparent discussions and appropriate scrutiny of any proposals.

Assessing the case for CBDC

5. The Committee recommends that the HMT – Bank of England CBDC Taskforce should set out in the 2022 Consultation Paper the most significant long-term problem to which it believes a CBDC may be the answer and assess CBDC against other means of achieving the same outcomes. The Bank of England has already identified the need for in depth articulation of the 'use case' as a key theme among responses to the Bank of England's 2020 [Discussion Paper](#) on CBDC (as set out in our 2021 [summary of those responses](#)) and will address this in the Consultation Paper. One of the issues we will explore is whether and how CBDC can provide resilient and responsive public infrastructure with which the private sector can innovate in order to most efficiently and effectively meet user needs in a dynamic payments landscape.
6. Our assessment will be forward-looking, taking account of future payments needs in an economy and society that is increasingly digital, and where the pace of private payments innovation is rapid. Given the pace of innovation in this area, our forward looking assessment will consider CBDC against both current payment options but also to take account of the possible entrance of new forms of digital money such as stablecoins, and the emergence of possible new players in the payments landscape such as so-called 'Big Techs'.
7. The Committee notes that, as cash usage declines, it is not obvious that CBDC could satisfy any residual demand for cash, which is often valued for its tangibility and its privacy features. The Bank has made clear that it does not intend to withdraw cash. Rather, we are considering the case for an alternative form of central bank money alongside cash. The Bank recognises

the importance of central bank money not only for those who want to use it, but also for its unique role in anchoring value and promoting confidence in the monetary system. A CBDC could play an important role in sustaining, and potentially expanding, retail access to central bank money.

8. The Committee also recommends that the Taskforce should lay out the risks and threats to the monetary system posed by privately issued stablecoins and other cryptoassets and explain how both CBDC and wider regulation could offset those threats. The Bank set out its initial views on potential implications of privately issued stablecoins and cryptoassets for the financial and monetary systems in its 2021 Discussion Paper “New forms of Digital Money”. The paper also discussed the current regulatory environment and proposed a set of regulatory models for systemic payment stablecoins. The specific regulatory framework that may apply to stablecoins would be the subject of future Bank of England and other regulators consultations, pending the conclusion of HMT’s consultation process and any subsequent legislative process. The 2022 CBDC Consultation Paper will include discussion of how the case for a CBDC relates to wider developments in the payments landscape, including cryptoassets and stablecoins.
9. The Committee recommends that the Taskforce consults on the use case for a wholesale CBDC alongside the retail CBDC consultation. The Bank already provides wholesale digital central bank money through its real-time gross settlement system and has done so for the last 25 years. Moreover, the Bank is actively exploring the trends emerging in the wholesale settlement landscape as part of its transformational programme to renew the Real Time Gross Settlement (RTGS) service¹ and is due to move RTGS to a new modern platform in 2024. RTGS is the means by which the wholesale sector accesses digital central bank money on a regular basis, with an average of over £700 billion settled each working day. In spring 2022, the Bank will issue a public consultation on the roadmap for further enhancements of this new RTGS platform beyond 2024. This consultation will outline proposals that could further facilitate innovation and support safe and efficient settlement in central bank money. These proposals have been developed in close collaboration with the industry. The Bank will also work with the new BIS Innovation Hub London Centre to prototype and test improved solutions for wholesale settlement, including synchronisation².

CBDC and central bank mandates

10. Given the Bank’s statutory objective to protect monetary stability, an assessment of how CBDC would affect monetary policy is an essential component of the wider judgement on the case for or against CBDC. CBDC can, in principle, expand central banks’ monetary policy toolkits, and the Committee recommends that the Bank assess the possible use of CBDC for monetary policy purposes. The Consultation Paper will consider whether there is a public policy case for CBDC, which will include assessing the impact of introducing a CBDC on the Bank’s ability to conduct monetary policy. At the current time, we do not consider expanding the monetary policy toolkit to be a motivation for the introduction of a CBDC. We note the monetary policy opportunities are largely conceptual, and would face a number of practical constraints. In particular, for CBDC to significantly reduce the effective lower bound to interest rates, cash use might need to be substantially reduced or even eliminated. This is something

¹ As part of this work, the Bank has allowed the private sector to open omnibus accounts to develop new innovative payment systems, underpinned by the security of central bank money settlement.

² Synchronisation would enable conditional settlement between RTGS and other platforms for digital assets, e.g. securities or housing. See <https://www.bankofengland.co.uk/paper/2019/synchronisation-engagement-and-next-steps>

that would be contrary to the Bank and UK authorities' clear commitment to sustain access to cash.

11. Similarly, given the Bank's statutory objective to protect financial stability, we continue to analyse the implications of CBDC for bank disintermediation, which we will cover in the Consultation Paper. The Committee recommends that the Bank further assesses the effect on the banking system if more than 20% of deposits converted to CBDC. In its 2021 Discussion Paper "New Forms of Digital Money" the Bank modelled, using a set of assumptions, an illustrative scenario of the demand for new forms of digital money, where around 20% of household and non-financial corporate deposits transferred to new forms of digital money owing to non-financial factors. This assumption allowed for an analysis of the impact of a large outflow of deposits on the banking system. It was an illustrative scenario rather than a forecast given any future demand is inherently uncertain and would depend on design features including any remuneration. In a scenario where the deposit outflow was greater than 20%, banks could be more reliant on long-term wholesale funding and more lending might also migrate to non-banks. The impact on loan rates would depend on any increase in the premium that investors might want for holding more wholesale debt funded lending and the competition for lending in that environment.

Other considerations

12. Working with consumers and businesses to understand their needs is critical to the design of any UK CBDC. The Committee points out the need to ensure consumer groups are engaged throughout the exploration phase. HMT and the Bank have established a CBDC Engagement Forum, which has an important role in helping to understand the practical challenges of designing, implementing and operating a CBDC. The Engagement Forum includes senior stakeholders representing the interests of consumers, namely a spokesperson for Citizens Advice Scotland and a member of the Financial Services Consumer Panel. The membership of the Forum will be kept under periodical review and the Bank will continue looking for opportunities to add other consumer groups to them. The Bank is also using additional mechanisms to understand consumers' preferences, needs and concerns, including consumer research.
13. The Committee cites privacy and identity as key considerations related to CBDC and points out potential reputational risk to the Bank of being drawn into controversial debates on these issues. The Bank recognises that these are important topics for the design of any CBDC system and that appropriate safeguards must be ensured if CBDC is to command users' trust and confidence. These matters are being looked at as part of the Taskforce's exploratory work and will be taken forward in the Consultation Paper. The Bank also recognises that these issues extend beyond the remit of the central bank. As such the Bank will closely support the work being undertaken by, and take its lead from, HMG.
14. The potential security risks that a CBDC system could be subject to highlighted by the EAC will need to be carefully considered, and if CBDC were to be developed, comprehensively addressed. In the 2020 Discussion Paper, the Bank noted these risks and identified resilience as a core design principle of any CBDC system. Any CBDC system must be resilient against hardware, software, or telecom network failures, and must be capable of sustaining continuity of operations at all times. CBDC should also follow the highest standards of cyber security and resilient to fraud and other threats. The Bank and HMG are undertaking substantial analysis of such issues as part of the Consultation Paper.