



**While some CBDC pilots are advancing globally, the US will undergo extensive policy and design research before moving forward with its own CBDC**

The theoretical concept of CBDCs emerged several years ago,<sup>vii</sup> and CBDC pilots are now underway at several central banks including the central banks of China, the European Union, England, Sweden, Canada, and the Bahamas.<sup>viii</sup> According to a January 2021 Bank for International Settlements (BIS) report, 86% of central banks surveyed by the BIS said they were engaging in research, experiments, or other work related to the development and use of CBDCs.<sup>x</sup> However, 60% of respondents replied that they were unlikely to issue a CBDC in the next six years.<sup>x</sup>

In the US, there is a growing narrative that a CBDC could or would potentially crowd out all other private digital assets, such as stablecoins<sup>xi</sup> or Bitcoin.<sup>xii</sup> Other observers, however, suggest that both stablecoins and cryptoassets are not in competition with CBDCs or each other but, rather, are complementary components in the future of money.<sup>xiii</sup>

With research being in its early days, there is understandably no consensus view in the US, with some prominent financial authorities even likening a CBDC to “a solution in search of a problem.”<sup>xiv</sup> Federal Reserve Board Chair Jerome Powell has said it is more important for the US “to get it right than be first” when contemplating any development of a CBDC.<sup>xv</sup> Powell has also said that the Federal Reserve would seek “very broad support in society and in Congress, and, ideally, that would take the form of authorized legislation, as opposed to a very careful reading of ambiguous law to support [creating a CBDC].”<sup>xvi</sup>

In the first part of this Point-of-View (POV) series, we focus on several policy objectives that will guide the potential introduction of a CBDC

in the US and consider some of the unresolved policy and regulatory matters.<sup>xvii</sup> The policy and regulatory framework development will inform the public and financial institutions on what CBDCs might be most beneficial for, such as a policy tool or as a complement to them.

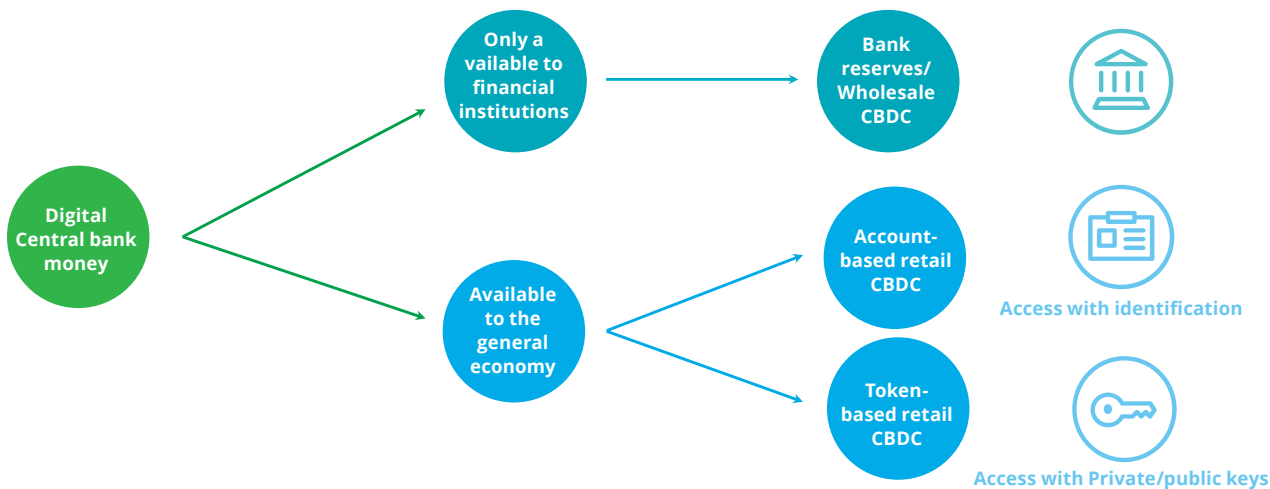
**Background on CBDCs**

The BIS defines a CBDC as “a digital payment instrument, denominated in the national unit of account, that is a direct liability of the central bank.”<sup>xviii</sup> CBDCs can be designed for use by regulated financial institutions (e.g., wholesale CBDCs) or by the broader consumer economy (e.g., retail CBDCs).<sup>xix</sup> They can offer settlement finality, liquidity, payments integrity, and other unique advantages of central bank money. CBDCs have been characterized as “an advanced representation of money for the digital economy,” and much commentary has focused on the need for digital money to “be designed with the public interest in mind.”<sup>xx</sup>

Electronic central bank money exists in the US today. The key difference between it and a CBDC is that, whereas existing central bank digital money is available only to depository institutions with access to Federal Reserve accounts, a CBDC could be made available to the public.

There are numerous design choices, technical dimensions, and potential economic features of CBDCs that have been examined and well-explained by the BIS, central banks, and many other financial industry commentators.<sup>xxi</sup> Assessing the merits of each architecture and approach is an area of ongoing research for many stakeholders, including the US Congress. While it is widely recognized that retail and wholesale CBDCs have the potential to bring efficiency and benefits to the global economy, CBDCs are still a new concept with significant technologies, policy, privacy, and risk considerations.<sup>xxiii</sup>

**Two often discussed potential forms (retail and wholesale) of a CBDC in the US**



In today's financial system, digital fast money is available only to regulate financial institutions in the form of reserves accounts held by commercial banks at the central bank. Wholesale CBDCs would, in theory, be similarly restricted to financial institutions. Retail CBDCs, in contrast, are available to the general consumer economy.

With the retail CBDC, there are two prominent options. Account-based retail CBDCs would be linked to an identification scheme, and all users would need to identify themselves. Token-based retail CBDCs would be accessed via password-like digital signatures and could be accessed anonymously.

## CBDCs and the public trust

Interest in CBDCs comes at a critical time for financial markets. The rapid migration to digital payments spurred on by the pandemic, plans for the use of foreign CBDCs in cross-border payments, and concerns about financial exclusion in the economy have raised awareness of a quickly evolving payments ecosystem.<sup>xxiv</sup> Additionally, there are growing expectations for safeguarding privacy and identity as well as the responsible use of data in payments and protection from cyberattacks. Research has shown that US consumers trust traditional financial institutions and the government itself to protect their personal information significantly more than they do big tech companies.<sup>xxv</sup>

Central bankers are aware that they cannot ignore the advent of new forms of digital money and realize they may individually need to play a central role in the system rather than remaining an observer.<sup>xxvi</sup> In the US, these policy areas will undergo extensive research before any final decisions are made.

## What policy objectives will be key in guiding the design of a CBDC in the US?

### Consumer privacy and data governance

The vast amount of consumer information needed to operate a CBDC makes governance over data a key issue. Operating a CBDC through a central bank assures that there is no competitive advantage given to a commercial provider. However, regardless of the operator responsible for safeguarding, consumer privacy through good data governance and internal controls (and supporting consumer confidence) is critical for an effective CBDC in the US.

### Monetary policy and financial stability

One of the biggest issues with advancing CBDCs is the potential for disintermediating the role of commercial banks. US policy discussions often highlight that a CBDC should not disrupt the role that banks play in capital creation and liquidity. Regulators are aware of concerns about the potential for unintended consequences of any CBDC design and its impact on the financial sector, especially given the nature of the fractional banking system today. Clarity around the role that the Federal Reserve wants or does not want to play relative to performing Bank Secrecy Act (BSA), anti-money laundering (AML), and know your customer (KYC) requirements -- and whether transaction records will be accessible by the central bank -- will be critical to a CBDC's policy design.

CBDCs can support design features that enhance the transmission of monetary policy, such as attaching interest payments or directly distributing currency to the public (in lieu of checks such as those distributed through the recent COVID-19 relief packages in the US). CBDCs could also create other implications for trade facilitation, foreign exchange stability, reduction of counterparty credit risk, and currency control.

CBDCs could have the ability to act during financial market stresses which are not or may not be necessarily associated with or driven by the risks associated with other digital assets (such as cryptocurrencies and some stablecoins). At the same time, there is some concern that a CBDC could lead to significant declines in

reserves at banks during periods of stress, potentially pushing rates higher.

With monetary policy currently effected through the banking system, any shift in this approach would be carefully considered. A CBDC could provide a monetary policy tool that policymakers are giving serious attention to whether being deployed or not.

### Financial inclusion

While there are several underlying causes for the large number of "unbanked consumers," a CBDC may lower transaction costs making digital assets more affordable to the unbanked. The potential for the average consumer to hold CBDC in a digital wallet on their cell phones could enable more unbanked consumers in the U.S. to have access to services now only provided through a traditional account at a bank. Among several of the CBDC pilots underway, there are some concerns that financial inclusion is not being as prioritized as it should be. Some financial authorities have raised the question if the unbanked population in the US would be interested in a Federal Reserve CBDC or whether there is a more efficient way to promote financial inclusion.<sup>xxix</sup>

### Illicit finance

CBDC models will need to mirror or improve on current controls and reporting standards, requiring CBDC systems, platforms, exchanges, and other services to have appropriate protections built into their technological and legal foundations.

Anti-money laundering and combating the financing of terrorism (AML/CFT) requirements are core policy considerations that may drive support for a CBDC. This will require an identification system for which options have been developed and actively discussed internationally.

Anonymity akin to cash is one of the major considerations of a CBDC in the US: it is not a preferred policy outcome for most US policymakers, but for users, it may be the desired outcome. Striking a balance between privacy and preventing illicit activity will be a critical design component for a successful CBDC.

### Implications for the US on cross-border payments

According to the BIS, CBDCs have the potential to enhance the efficiency of cross-border payments as long as countries work together "through different degrees of integration and cooperation, ranging from basic compatibility with common standards to the establishment of international payment infrastructures."<sup>xxx</sup> One example of cross-border central bank collaboration began in February 2021 when the People's Bank of China had joined central banks from Thailand, the United Arab Emirates, and Hong Kong to conduct a digital currency cross-border wholesale (i.e., bank-to-bank) payment project.<sup>xxxi</sup>

Depending on factors such as the level and nature of international adoption, however, CBDCs face several unresolved macro-prudential questions in terms of cross-border payments. The macro-financial implications of cross-border CBDC include a potential increase in cross-border flows, potential financial stability risks and currency substitution, and potential impact to reserve currency configurations and backstops.<sup>xxxii</sup>

### Key unresolved regulatory issues and policy linkages

By design, the FRB as the nation's central bank would be the issuer of a CBDC. The main difference between CBDCs and other digital assets (such as stablecoins or Bitcoin) is that a CBDC is a direct claim on the Federal Reserve, and the others are not. Bitcoin (and other cryptocurrencies like Ethereum) is effectively a digital asset and is usually bought and sold as such. Stablecoins, while pegged to a central bank currency and backed by holdings denominated in that currency, are not a direct claim on the Federal Reserve and would still require an intermediary to support.

In recent Congressional hearings and other public forums, FRB officials have said they may seek legislative authority before formally developing a CBDC.<sup>xxxiv</sup> Over the past few months, US policymakers have ramped up their focus on digital innovation and convened several discussions with bipartisan interest as they explore the potential benefits, costs, and logistics of creating a CBDC. Indeed, lawmakers from both parties said that maintaining the US dollar as the global reserve currency is critical reason to consider developing a CBDC in the US, and many cited China's digital yuan pilot as a potential geopolitical concern. In June 2021, the Senate Banking Committee held a hearing on "Building A Stronger Financial System: Opportunities of a Central Bank Digital Currency."<sup>xxxv</sup>

However, FRB officials are clear that research and policy considerations will be cautious and deliberate, and no decisions have yet been made.

In June 2021, the House Financial Services Committee task force on financial technology held its first hearing on CBDCs, "Digitizing the Dollar: Investigating the Technological Infrastructure, Privacy, and

Financial Inclusion Implications of Central Bank Digital Currencies."<sup>xxxvi</sup>

At the hearing, House Financial Services Chair Maxine Waters announced that her Committee's hearing would be "the first in a series of hearings on an especially important topic of digital assets and cryptocurrency."<sup>xxxvii</sup> She also announced the launch of a Digital Assets Working Group of Democratic Members "to engage with regulators and experts on this poorly understood and minimally regulated industry."<sup>xxxviii</sup>

In July 2021, the House Financial Services Committee hosted its second CBDC-related hearing, "The Promises and Perils of Central Bank Digital Currencies."<sup>xxxix</sup> Chair Waters noted that as Congress continues to explore the policy, law, and regulation surrounding digital assets, "it is important for the Federal Reserve to have powerful tools to achieve its mandate," including adopting a CBDC "as one potential tool."<sup>xi</sup>

### A look ahead

The evolution of a CBDC could have profound ripple effects for the entire financial system, including the growing digital asset ecosystem. Evaluating the policy, legal and regulatory dimensions, and unresolved questions of CBDCs is an important part of understanding a quickly moving discussion that has attracted considerable attention.

This POV is the first part in a series by the Deloitte Center for Regulatory Strategy. Future pieces will explore other technology, risk, and policy considerations of CBDCs, provide a global comparison of selected CBDC pilots, and assess their impact to financial institutions and their operations.

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## Central Bank Digital Currencies (CBDC): Regulatory and Policy Considerations in the US

### Endnotes

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