European Parliamentary Financial Services Forum

EPFSF Briefing on

"The Digital Euro – a digital currency for Europe?"

Introduction

Central banks around the world are exploring the possibility of issuing retail Central Bank Digital Currencies (CBDCs): a new form of central bank money that is accessible to the general public in an electronic form. The ECB is not an exception to this trend and is working on the design of a retail digital euro that would complement cash and be an alternative to existing electronic payment solutions. Although no issuance decision has yet been taken, the ECB aims to be ready for such a move in the future, and the European Commission will propose in the coming months an enabling legal framework.

The reasons put forward for issuing a digital euro are varied: from responding to the threat of foreign CBDCs or other private payment solutions like stablecoins, and promoting the strategic autonomy of European payments, to preserving access to central bank money in a future where less cash is used and supporting innovation in the digital economy.

Notwithstanding, there are many open questions around consumers' understanding of and demand for a digital euro and the concrete needs it would satisfy. Furthermore, the issuance of a retail CBDC comes with considerable risks, as making electronic central bank money accessible to the general public risks reducing retail bank deposits and leading to undesirable effects on financial intermediation and stability. Furthermore, the interaction between the digital euro and instant payments, which the new legislative proposal aims to make the new normal across the EU, needs to be considered. As recently highlighted by the International Monetary Fund[1], similarities between instant payments and CBDC are too strong to be ignored.

Against this background, this session will discuss the benefits and risks of a digital euro for European consumers and the European economy, as well as the key design choices that the ECB and EU policymakers are confronting.

ECB's work on a digital euro

Following an initial report in 2020, in which the ECB outlined a number of scenarios in which a digital euro could be needed, the ECB started in October 2021 a 2-year investigation phase on the impacts of a possible digital euro and how it could be designed and distributed. The investigation will come to an end this year, with the publication of a bring-it-all-together report and the decision of the ECB Governing Council on the launch of a 3-year realisation phase. Issuance of a digital euro could then take place in 2026, at the earliest.

As part of the ongoing investigation, the ECB has prioritized peer-to-peer, in-store, e-commerce and government payments as the use cases for a digital euro. The use as a store of value would be limited, most likely through a cap on individual users' holdings (which could be set around 3,000-4,000€), although a tiered remuneration mechanism is also being considered. A "waterfall" functionality (i.e. an automatic connection between a digital euro wallet and a bank account) would allow users to make or receive payments that would otherwise exceed the holding limit. In the medium term the wholesale application of the digital Euro will offer even higher benefits.

[1] International Monetary Fund study, November 2022: https://www.imf.org/en/Publications/WP/Issues/2022/11/18/Instant-Payments-Regulatory-Innovation-and-Payment-Substitution-Across-Countries-524032

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It is envisaged that the ECB would be in charge of the issuance of the digital euro , the settlement of transactions and the digital euro scheme rulebook, while the distribution and all front-end services, including onboarding, management of accounts/wallets and provision of payment instruments, would be tasked to supervised intermediaries ((i.e., payment service providers), under an ECB scheme with common rules to ensure a homogeneous end-user experience.

Data from digital euro holdings and transactions would be transparent to intermediaries for AML/CFT purposes (an opt-in system for other data-use purposes has not been discussed yet). The ECB would not be able to infer individual users' holdings nor payment patterns. The ECB will also explore the possibility of a higher degree of privacy for low-value payments and for offline proximity transactions.

Intermediaries would integrate the digital euro into their end-user interfaces/wallets, where they could also offer value-added services, including e.g. programmable payments. In addition to the intermediaries' interfaces, the ECB is considering that it could be mandatory for intermediaries to provide a stand-alone 'digital euro app' as a homogeneous gateway to digital euro services (but which would still need to be linked to an intermediary). The ECB intends the digital euro to be free of charge for basic use by citizens, but contemplates a compensation model for intermediaries, yet to be discussed.

Legal framework for a digital euro

The European Commission will issue a legislative proposal in Q2 2023 to serve as the legal basis for the possible issuance of a digital euro by the ECB. This legal framework is expected to establish the legal tender status of the digital euro and the associated acceptance obligations for merchants, as well as addressing issues related to the distribution, the provision of basic digital euro services =the interaction with payment regulations such as PSD2 and the balance between data privacy and Anti-Money Laundering rules.

The Eurogroup issued a statement in January 2023 arguing "that the introduction of a digital euro as well as its main features and design choices requires political decisions that should be discussed and taken at the political level".

Conclusion and Issues for discussion

The digital euro envisaged by the ECB would offer an alternative for European citizens to make retail payments and for merchants to receive them. The main difference vis-à-vis existing payment solutions (e.g. cards, instant payment solutions) would be the underlying form of money (central bank vs commercial bank-issued) and the associated legal tender status. The conceptual nature of this differential feature is a challenge for the general public's understanding of and demand for a digital euro as it does not change the client experience in an obvious way. Other possible differences with respect to existing payment solutions, such as the possibility to make offline payments and the degree of data privacy, are still under consideration and involve a policy trade-off with respect to AML and fraud prevention objectives, as well as the level playing field between all payment service providers.

From a more strategic perspective, the digital euro could be the foundation of a pan-European payment solution independent from non-European providers, a policy objective of EU authorities that has not yet been delivered by the market. However, the digital euro will only achieve this objective for the Euro-area.

In terms of an alternative to the emerging digital assets economy comparable to those of global stablecoins or even other CBDCs that may opt for a more innovative design, the type of digital euro envisaged by the ECB does not seem to offer innovation features for these novel payment needs.

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In any case, the digital euro is a large-scale project that will involve significant investments and running costs for both the ECB and the distributing intermediaries. The magnitude of these costs will vary depending e.g. on the degree to which the digital euro leverages on existing payment infrastructures and solutions. This comes at a time where the EU payment industry is still digesting the large-scale investments into the migration of the ECB's TARGET services and the implementation of ISO20022 standards as well as anticipating the upcoming similarly significant investments into instant payment infrastructures.

In order to retain the competitiveness and innovation potential of the EU in the global context, conscious prisonisation and targeted definition of the next chapter of payment-related initiatives are needed. After all, payment services are a systemically important and must be based on a robust and reliable framework. Intermediaries will need to be enabled to be compensated for their role in providing digital euro services.

Finally but very importantly, although the risks to financial intermediation and stability can in principle be mitigated by imposing limits on digital euro holdings, there will always be a fundamental tension in limiting access to a publicly provided form of money, and this tension may turn into political pressure in situations of financial crisis, with a possibility to cause bank runs. Also, the level of the holding limit – and the processes and tools used to enforce it - would need to be carefully calculated in order to prevent negative consequences on the intermediaries' deposit base and therefore on their capability of financing the economy.

While the main focus of the debate at this stage remains on retail markets, policymakers should also continue to explore, in collaboration with the private sector, the role that the digital Euro and CBDCs in general can play in driving innovation and efficiencies in wholesale markets.

Questions for discussion:

1. What are the strongest reasons for the issuance of a digital euro? Are there other alternatives to achieve some of the intended policy objectives?
2. What are the benefits for consumers and how will they perceive a digital euro vis-à-vis other payment solutions?
3. Is there a risk of the digital euro crowding out private payment solutions or, conversely, a risk of the digital euro not being used?
4. Should the digital euro also cover more innovative payment use cases such as those in the digital assets space? Is there a risk of it not being future-proof with respect to stablecoins or other CBDCs?
5. What are the key design choices for the digital euro to add value for Europe while mitigating the risks for e.g. financial stability? What choices should be made at the political level and which ones should be left to the ECB?
6. Is there a need for a higher level of privacy in digital euro payments? How could it be balanced against AML/CFT objectives? Is it wise to issue a public means of payment with less demanding AML requirements than existing private solutions?
7. How could the digital euro be developed and deployed in a cost-efficient way? To what extent can existing payment infrastructures and solutions be leveraged for the digital euro?
8. How should intermediaries be compensated for their role in distributing the digital euro to end-users and providing all the associated services? Could existing payment business models be applied to the digital euro?
9. How does the digital euro fit together with the instant payments legislation that is currently proposed by the Commission?

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