

DIGITAL EURO BUSINESS CASE



HARALD WAIGLEIN

Director General - Federal Ministry of Finance, Austria

Digital Euro - Europe's way forward in a digital age, isn't it?

As we are in the midst of the highly anticipated autumn 2023 waiting for the European Central Bank (ECB) to decide on the possible adoption of its own retail central bank digital currency (so-called "digital euro") it is worth taking a look at this project.

Recently several central banks, in particular the ECB and the Bank of England have shown explicit openness towards central bank digital currencies (CBDC) stipulating that CBDCs will be needed to anchor the value of money in a cashless digital age.

At European level we often hear that a digital euro would boost Europe's strategic autonomy and would make Europe less dependent from third country entities and BigTechs. As a matter of fact, Europe does not have its own payment champions like the USA as of today. In a world of geopolitical tensions, there is certainly a bit of discomfort about being rather reliant on third country private sector companies for its payment infrastructure. Besides that, there is hope that issuing a digital euro would provide an incentive and make it easier for European banks to come up with a national European champion, that could challenge third country-based payment providers.

The questions, however, arise what the expected market share of the digital euro with all its unique design features could be and how this digital euro could then be contributing to the above mentioned strategic autonomy of the EU. Forecasting any future market share is rather challenging. Thus, we should focus on the main drivers of and obstacles to the expected market share and the digital euro's potential contribution to Europe's strategic autonomy.

The design feature that has the biggest impact on the potential market share of the digital euro derives from ECB's commitment to ensuring that both ECB (Eurosystem) and traditional commercial banks are not in competition, but in cooperation. Many bankers had articulated mistrust towards the digital euro saying that the digital euro as risk-free public money issued directly by the ECB would become a safe haven in a crisis and therefore make bank runs more likely. In response to this concern the ECB decided to set limits to individual digital euro holdings - at for example EUR 3.000 (final amount to be determined) - in order to ensure there is not massive outflow from commercial bank accounts into digital euro wallets.

Taking a closer look at this design feature, it becomes obvious that this holding limit results in reducing a lot of potential of

the digital euro to be broadly adopted and successful. In the end, we face a Goldilocks problem where the ECB wants the digital euro to be quite successful but not too successful to avoid market distortions amongst commercial banks and the banking system as a whole causing financial instability.

Another pivotal aspect having a significant impact on the potential market share of the digital euro is a convincing narrative promoting a broad adoption, meaning that European citizens need to understand why this digital euro with a holding limit of e.g. EUR 3.000 is their "number one payment method of the future". The tricky thing is that for most consumers the digital euro would be absolutely indistinguishable from their ordinary retail deposits and the unique feature of the digital euro wallet being fully backed by public money is something most people already mistakenly think is true for their deposits at the bank.

Need to come up with a compelling use case that really wins people over.

Another key reason why it is so hard to explain the added value of the digital euro by saying that we need government-backed public money fit for the digital age could be the following: the past decades lots of very honorable and important economists and politicians have argued and the narrative has gotten established that the monetary system could not function well without certain anchors to gold or the USD. And in the end, it proved to be wrong with fiat currencies in place without anchor today. ECB's narrative justifying a potential introduction of the digital euro is likely to suffer the same fate.

To conclude, the ECB and every central bank across the globe thinking about introducing their own retail CBDC need to come up with a compelling use case that really wins people over to establish a retail CBDC with relevant market share. Central bankers often bring forward reasons why they as a central bank think it is crucial to have a retail CBDC, but struggle with demonstrating "real-life" advantages. So, the following questions need to be answered: why do we need a digital euro with all the other existing digital payment methods in place? Why would it be great for consumers to have the digital euro in their daily life?



FIONA VAN ECHELPOEL

Deputy Director General - European Central Bank (ECB)

Digital euro: designing a new means of payment for Europeans

In the last years, the preference for electronic payments in the industrialized world has been growing, the euro area being no exception. The European Central Bank (ECB) has launched the digital euro project to guarantee that European citizens can continue paying with public money, also digitally.

Same as banknotes, a digital euro would be accepted at any shop, in all countries of the euro area, including e-commerce. By providing an additional way to pay with public money, we would ensure that our monetary system remains resilient. In addition, a digital euro would provide a platform for innovation and in turn reinforce the strategic autonomy of the European payments sector.

Since the launch of the digital euro investigation phase in July 2021, the ECB has been looking into the most suitable design choices and ways to distribute a digital euro. The goal is to ensure that it brings benefits for all stakeholders while tackling any potentially negative consequences.

Consumers would benefit from a new means of payment, in addition to cash and other electronic payments. It would be secure, user-friendly and inclusive, usable online and offline. As a public good, it would be free for daily use for citizens – as is cash.

The “free basic use for private individuals” principle is a key pillar of the compensation model. Supervised intermediaries, like banks, would be responsible for distributing a digital euro to citizens. The Eurosystem thus proposed a compensation model that would offer economic incentives for intermediaries similar to other electronic payments, and that would cover operational costs of distributing a digital euro. At the same time, intermediaries would be able to negotiate fees with merchants for digital euro services. However, the model allows for a cap to prevent excessive fees not in line with comparable electronic means of payment. All these aspects are now reflected in the recent legislative proposal by the European Commission. Besides the incentives foreseen in the model, merchants would benefit from a European-based solution to receive payments instantly from anywhere in the euro area.

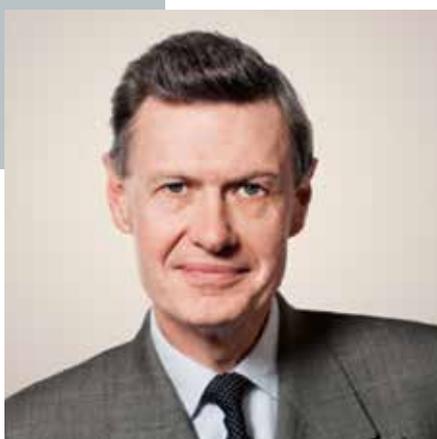
To achieve a seamless and harmonized payment experience for Europeans, the distribution of a digital euro would rely on a scheme: a single set of rules, standards and procedures that would be applicable to all intermediaries across the euro area. The cost of establishing and maintaining a digital euro scheme would be solely born by the Eurosystem. The scheme also seeks to re-use existing rules, standards, and infrastructure as much as possible to minimise any additional investment costs for intermediaries. For that, the public-private collaboration in the Rulebook Development Group is essential and testimony of our commitment to engage closely with all stakeholders.

The distribution model for a digital euro would keep intermediaries at its core, as they are in today’s financial system. To prevent undue risks to this functioning system, the amount of digital euros users could hold would be limited. The exact specification of this limit can and should only be done closer to a potential issuance.

A digital euro aims to make digital payments easy and secure for every European.

In terms of privacy, which is a key concern for consumers and policymakers, the ECB would not have access nor store personal information from users. Digital euro transactions would be as private as allowed by European law. Similarly, a digital euro would be designed in a way that it is also inclusive of elderly citizens, people with disabilities as well as users with limited financial or digital abilities. For instance, the Eurosystem could develop a dedicated digital euro app to which all euro area citizens could have equal access. Likewise, intermediaries could integrate digital euro services into their existing banking apps. People without a bank account would also be able access digital euro via public, designated intermediaries, like a post office, and people without digital devices may use a physical card to pay with digital euro.

In short, a digital euro aims to make digital payments easy and secure for every European citizen everywhere in the euro area. The findings of the two-year investigation phase of the digital euro will soon – in autumn this year – inform the ECB’s Governing Council decision whether to move to a preparation phase.



PHILIPPE BORDENAVE

Senior Executive Advisor to General Management
and the Chair of the Board - BNP Paribas

Why is ECB so hastily wanting to build a direct current account to citizen?

Many central banks are conducting research about CBDC but only three countries have undertaken an effective launch through June 2023: Jamaica (JAM-DEX), Bahamas (Sand Dollar) and Nigeria (e-Naira)¹.

China is extending progressively the experimentation with its e-Yuan for its own motives – including regaining control of the payments ecosystem from private sector players – which are quite distant from European values.

We do not see any urgency to build the Digital Euro. Of course, central bank money should not be left aside of the digitalization of society but the ECB makes clear that the digital euro is to complement cash not replacing it. Existing means of payment cover all citizens' needs to date. The request to pay in central bank money for e-commerce needs to be demonstrated. The cost of the project for all stakeholders shall be extensively evaluated to make sure it does not overweight the expected benefits.

The argument of an absence of a pan-European payment solution neglects the SEPA framework that already provides a complete offer. It will be further developed with Instant Payments, unless their adoption is slowed down by under investments arising from the need to finance the launch of the D€.

The European Payments Initiative (EPI) – which received public support from European institutions – will offer its first services in 2024 after a pilot phase by the end of 2023.

Public intervention should be limited to addressing market failure. Subsidiarity should prevail.

While Distributed Ledger Technologies projects (Libra...) were at the origin of the initiative, the ECB says now that the D€ will probably be a simple scriptural euro just as the existing payment systems. In the absence of DLT, the D€ will not bring added value to the tokenisation of the economy. It will be of no use as an exchange currency for the crypto asset being developed in the markets.

By itself, a digital euro is not a solution that can guarantee European sovereignty in the payment's domain. Actually, it could be feared that large digital players would leverage on the digital euro to lock even more their customers within their ecosystems. Everybody noticed that Amazon has been selected by the ECB in its front-end prototyping exercise.

As an European bank, we strongly believe in European values notably primacy of private enterprise, free market, fair competition and privacy. Public intervention should be limited to addressing market failure by setting high level principles-based regulation. Subsidiarity should prevail.

Co-legislators will hopefully take all the time needed to carefully analyze all aspects of the project notably privacy issues and financial stability and draw a clear line between public intervention and private initiatives.

1. Source: cbdctracker.org



JOSÉ ANTONIO ÁLVAREZ

Vice Chair - Banco Santander

From high-level policy objectives to day-to-day payments

In October, the European Central Bank will present the conclusions of the digital euro investigation phase. It has been two years of intensive work in which the ECB has evaluated different design options to respond to the policy objectives to be achieved with the digital euro, those are to reinforce Europe's strategic autonomy, and to provide a monetary anchor against a potential disappearance of cash in everyday payments.

This initial phase has shown the complexity of the project and the importance of ensuring the right design. It is essential to avoid by design the potential risks that the digital euro poses to financial stability, limiting the use of the digital euro as a store of value, and ensuring an orderly deployment that avoids any potential abrupt adoption scenarios. Besides, it is necessary to create the conditions for the private sector so that the digital euro contributes to making payments, and ultimately Europe, more competitive. As it would happen with any other means of payment, the digital euro will be adopted only if it provides value for citizens and businesses. At the same time, intermediaries should also play a key role in this new ecosystem, by integrating digital euro payments into people's day-to-day financial lives, explaining how to use it, solving citizens' doubts, and offering new services to customers.

From the point of view of future users, the question that immediately arises is what is the added value that the digital euro will bring to citizens in their everyday payments. Although the level of payments development across Europe is not the same, in general European citizens already have a wide variety of available means of payment that they use daily. And we see new solutions appearing every year. It is therefore not obvious how to translate the high-political objectives that the digital euro aims to achieve into concrete benefits that would motivate citizens to use it.

From the payment service providers point of view, the digital euro will inevitably compete with existing private means of payment. It is the aim of the Commission and the ECB to bring optionality to citizens in their payments. The challenge for authorities is then how to:

- Avoid artificially crowding out existing domestic private solutions which are being successfully used, when trying to encourage the adoption of the digital euro;
- Create the conditions for the private sector to provide digital euro services and to innovate and build new added-value services on top of the digital euro.

The market shows that there are no free of charge services, and when they are free it is because they are being monetised in another way. And the costs for the private sector for first deploying the digital euro, and then to provide services can be very significant. Leveraging on existing payments

infrastructures and domestic solutions that are being successful as much as possible would be the most efficient and effective way to distribute the digital euro reducing these costs. However, still there will be a cost for providing these services.

We need to think of the right compensation model that ensures on the one hand that the costs for providing these services for intermediaries are properly covered, and at the same time, that the digital euro competes on an equal footing with other existing private solutions, avoiding the crowding-out effect that would be detrimental for the competitiveness of the sector.

The legislative proposal submitted by the European Commission, which will be discussed extensively by the legislators in the coming months, opens a new phase for further deepening the design of the digital euro. The ECB will also continue to analyse these issues during the new preparatory phase which is expected to start later this year.

The digital euro will only be successful if creates value for citizens, merchants and intermediaries.

A calm and in-depth analysis of these matters is needed to ensure that, if the digital euro is issued, it will deliver value to citizens, businesses, and intermediaries, and will contribute to a more competitive, efficient and innovative payments market. Otherwise, there might be other possible solutions that could be considered to achieve the policy objectives set for the digital euro.

Finally, in my view there would be value in also exploring the benefits of issuing a CBDC in the wholesale space, which are probably clearer. A wCBDC could offer significant improvements in cross-border transactions in terms of costs, speed, access, and transparency, and could also contribute to the secure development of tokenised financial markets enabling market participants to benefit from the advantages of DLT (such as programmability), while continuing to provide safe settlement in central bank money.



MANUEL GALARZA PONT

Head of Compliance, Control
and Public Affairs - CaixaBank

Building a safe and solid path towards a Digital Euro

The path towards a Digital Euro (D€) is being built as we speak. The ECB's technical investigation-phase is expected to end by October. In addition, the ECB is working on a Rulebook to support the distribution of the D€ via supervised intermediaries. Private sector professionals are actively contributing to this work. In parallel, the European Commission has proposed a legislative framework for the D€, involving three Regulations. This legislative process is also expected to consider feedback from stakeholders.

The path towards the D€ is completely new, without precedents in the EU. Perhaps, the closest experience was the adoption of the physical euro in 1999. Despite differences, some lessons can be drawn. A clear one is gradualism. In due time, and if the final decision is to go ahead with the D€, a "start small" approach can prevent disruptions, giving authorities some flexibility, and time for people to adapt. In fact, for the physical euro, there was a transitional period between 1999 and 2002 with phases of introduction. A start small approach has also the benefit of avoiding irreversible scenarios.

From a customers' experience and needs perspective, the D€ has two key differential features in comparison with other digital payments options. First one is privacy. Yet, the consensus is that privacy should not hamper AML/FT and fraud controls. For the on-line D€, the same AML/FT and fraud procedures/monitoring applied to existing digital payments can be replicated. The off-line D€ is more challenging though. A solution could be to define a threshold below which access to personal data by Payment Service Providers (PSPs) will be minimised. The second clear feature is the possibility of doing instant payments between individuals, including EU cross-border payments, both inside and outside the euro-zone. These two features rank at the top of EU citizens' preferences.

The D€ is expected to have a legal tender status. As such, the path towards the D€ has also to define the financial intermediaries that will distribute it. Distribution by banks will be mandatory. In principle, distribution by payments and electronic money institutions would also be possible. Banks are financial entities with a long and proven experience bringing certainty with regard fraud controls – with digital fraud attempts increasing at double-digits rates in the last years – and ensuring compliance with AML/FT requirements. All this reinforces the need to start small in a controlled environment, particularly in a scenario with off-line operations. Therefore, it would make sense to start by restricting distribution only to PSPs with a strong and testable track-record in AML/FT and fraud monitoring.

The ECB is also considering a holding limit, which would limit the amount of D€s a person can have. As defined by the EU Commission proposed Regulation, the D€ should work as

mean of payment – not as an investment or to store substantial amounts of D€s. The holding limits aims to ensure this, thereby preserving financial and monetary stability. Evidently, these are key concerns.

The initial proposal by the ECB set the holding limit at 3000 euros. By contrast, the amount of cash payments that most consumers make, and the amount of cash consumers store in physical wallets appears to be much lower (eg: 500 €). This calls for a detailed bottom-up impact study to set the limits, along with an assessment of the suitability of a transaction limit and overall volume limit on wallets. But, to actually enforce any limit will be equally important. One wallet (vs the option of multiple) will allow a better control of the limits, with lower costs and fewer technical barriers, and will provide a better customer experience.

The path towards the Digital Euro should be gradual and guided by careful assessments.

The D€ should also provide right incentives for financial intermediaries, also considering operating costs and the stock of investment in new infrastructure – very significant in some cases. As proposed by the EU Commission, merchants will pay a service charge accordingly to a compensation scheme. Such a scheme should be mindful of existing remuneration models in terms of fees for services, should offer a similar level of incentives as electronic payment alternatives, and be competitive with other providers.

In addition, it would be efficient to use existing instant payment infrastructures in place. Just in Spain, Italy and Portugal there are more than 40 million users. This is material if compared with the 110 million end users of D€s estimated by the ECB in a medium scenario. Most importantly, using existing infrastructure would work as a catalyst for the D€, as it would be integrated into platforms that have already been able to consolidate habits among users.