Q&A

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Is the digital euro fit for purpose?

Is there a clear use case for the digital euro? What are its factors of success?

The major criterion for launching a digital euro should be a clear benefit for citizens. There is no clear new-use case identified for the digital euro, however, and citizens, as in China, would have difficulty understanding the added-value of Central Bank Digital Currencies (CBDCs) compared to current digital payments.

Although the technology is available, it is difficult to predict how customers will react to this new form of central bank money and to what extent the general public will adopt it. A failure would have a negative impact on the euro, which is now very popular, and on the ECB itself.

The success of a digital euro cannot be taken for granted. For the moment, the needs and expectations of citizens have been neglected, as the digital euro has mainly being seen as a way to cope with the challenge of private stable coins or foreign CBDCs.

What are the main business-model challenges faced by the digital euro? What will be the price/cost and investments for using digital euros for citizens, merchants (physical point of sale) and e-merchants? Who earns what for what service in the scheme?

The digital euro could require major investments by the ECB and, consequently, public costs. At the same time, intermediaries (banks, merchants, etc.) will support significant expenses for the build and run of new infrastructures. These costs will be in addition to those already incurred and unavoidable for many players (EPI, instant payment). All these cumulating costs should be carefully assessed before any decision.

The ECB will also have a large room of manoeuver to set or cap prices and fees, which may disadvantage existing and future private payment solutions. Banks would be obliged to participate in the digital euro system without a clear view on financial compensation. Nevertheless, in order to encourage innovation and offer real value-added services to customers, Payment Service Providers (PSPs) must be able to price their services according to the costs incurred. The list of free basic services should be reduced and the criteria for identifying comparable means of payment should be precisely defined to serve as a reference for the pricing of the future CBDC.

Today, payment systems in the euro area work correctly at a reasonable cost and cover the needs of the population.

The area in which the service can be improved is instant payment, because only a small proportion of payments is instant now. There is, however, a new regulation in the pipeline to foster instant payments, and huge private investments are being made, which should not be put at risk by public-private competition.

Commercial banks should not be driven out of the payment business in favour of a public scheme, and sufficient revenues must cover the cost of new infrastructure for the financial sector.

The central bank's digital currency could also threaten the business model of commercial banks by competing with their collection activities and disrupting their funding capacity.

In order to minimise the negative impact on banks' lending capacity and their crowding out of payments, a limit on the holding of digital euros should be set. This cap should be consistent with the banks' role in financing the economy, with the use of this digital euro as a payment method rather than a store of value, and, lastly, with the average amount of retail payments. Indeed, a massive outflow of bank deposits into the digital euro would negatively affect banks' lending capacity and pose a serious threat to financial stability.

Of course, the digital euro should not be remunerated, as rightly proposed by the draft regulation of the Commission. Otherwise, it could massively drive liquidity outflows from commercial banks and launch competition between the public and private sectors.

Beyond these elementary precautions, it may be necessary for the ECB to provide banks with specific access to liquidity, in case of significant outflows of deposits towards digital euros.

Does the recently published legislative proposal provide an appropriate framework for the launch of the digital euro?

A solid legal framework will also be vital. The European Commission presented a long-awaited legislative proposal. It is important that there is a level playing field between digital euro and cash. We believe it is necessary to allow Member States to propose exceptions within their own jurisdictions in order to meet the specific needs of each Member State.

Certainty and clarity on the modalities regarding the holding limits as well as compensation for intermediaries are crucial.

The legislative proposal on the digital euro gives a major role to the ECB. It is questionable whether the ECB's current mandate is sufficient to implement a solution that goes far beyond a digital form of cash. This is a main issue for the European Parliament and the Council.

According to the legislative proposal, the digital euro will be legal tender, which will lead to its mandatory acceptance with minor exceptions. We believe that Member States should be able to decide exemptions within their jurisdictions in order to meet specific national needs. Ultimately, the legislative draft on digital euro on the one hand and the ECB project on the other hand, are highly mutually dependent. A digital euro can only be issued with firm backing from European legislators. However, political consensus alone is not enough. Acceptance can perhaps be mandated, but usage cannot be forced.

What are the potential risks and concerns associated with the introduction of a digital euro? How may they be addressed?

Firstly, there may be a contradiction between citizens' aspirations for anonymity and protection against money laundering or other fraud. Indeed, to prevent illegal activities such as money laundering or terrorist financing, the authorities should be able to trace transactions in individual and justified cases.

The ECB is considering specific privacy features such as anonymity below certain thresholds or a low holding limit. Finding the right balance will be difficult, however, many countries are accustomed to cash payments, which are anonymous, even for large amounts.

The second point of concern is that of 'knowing your customer' because that is the role of commercial banks and not of central banks.

Banks have numerous regulatory requirements including anti-money laundering and combating the financing of terrorism (AML/CFT). In this context, for security and operational reasons, data relating to digital euro transactions for the benefit of customers should be transparent for banks.

Information sharing in the fight against financial crime is essential between commercial banks, financial intelligence units, law enforcement agencies and authorities. Restricting commercial banks' access to transaction data would facilitate domestic or cross-border criminal activities.

It seems essential that the deployment of the digital euro relies on commercial banks being capable of ensuring proper customer identification (KYC) while respecting the protection of privacy (GDPR).

This role must be remunerated, however. It is currently paid via the fees for the services provided by banks. Nevertheless, what will happen for the digital euro, and how to avoid duplication of costs for commercial and central banks' digital euro payment schemes?

Finally, liability rules in the event of fraud during the funding or defunding process should be clearly defined. Particularly in the case of a third party payment initiation process: the liability for fraud must be the responsibility of the PSPs that initiated the funding or defunding transaction and not with the PSPs that holds the commercial account.