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European Commission – Proposal for a digital euro for the EU

Feedback from the French Banking Federation (FBF)

Feedback period (Have your say) : 30 June 2023 - 08 September 2023

A. Summary of the position of the French Banking Community - "Have your say".

The French Banking Community wishes to share its positions following the publication by the European Commission of the legislative proposal for the issuance of a central bank digital currency (CBDC) by the European Central Bank (ECB).

The French banking community has expressed several warnings on the opportunity of such a project which raises numerous questions on its purpose, its objectives, its cost, and its implementation methods. The CBDC project also raises questions about its consistency with European initiatives on instant payment and could have impacts on financial stability and economy.

- **Existing solutions respond to the issue related to European sovereignty.**

The main question relates to the lack of specific use case for the consumer. Apart from off-line use, there is currently no envisaged use case for the future CBDC which would not already be covered by an existing solution (credit transfer, instant payment, payment initiation) or a future solution (EPI wallet). The existing means of payment, based on European standards designed by the European Payment Council (EPC), are already used by the European ecosystem (individuals, corporates, administrations, etc.) and, beyond the usual and known concrete uses, respond to the strategic issue of sovereignty in the field of the payment industry in the EU.

- **An expensive project whose financing must be precisely evaluated.**

A first estimate of the project costs was carried out as part of the Commission's impact study. We nevertheless consider that this evaluation must be refined to have a more global vision of the project costs. We believe that the CBDC project will require significant investments for the ECB, thus generating significant public costs. To this, we also need to add the significant costs that should be borne by the payment ecosystem (banks, merchants, public administrations) to finance the build and the run of a dedicated infrastructure meeting the requirements of robustness, security and resilience. In addition to the costs of building a specific infrastructure, it will be necessary to evaluate the cots of the change for merchants (new equipment at point of sale, payment solution software evolution, business processes evolution, etc) in order to deploy the future CBDC functionalities. For all stakeholders, these expected expenses will add up to existing and unavoidable costs (current card and cash activity, EPI, etc.). Thus, these expenses will probably be borne to the detriment of high priority patters such as technological innovation necessary to be at the same level of actors such as GAFAM. We then believe that, beyond allowing the coverage of operating costs, the CBDC business model must provide concrete guarantee about the recovery of investment borne by the intermediaries.

Finally, in an environment where sustainability issues are becoming major for private companies and public administrations, assessing the ESG (Environmental, Social and Governance) risks and impacts (therefore the induced costs) for such a project seems to us to be an essential prerequisite and must be a major criterion in the decision-making process. In the case of the CBDC project, as proposed by the ECB, the massive use of automatic funds transfer functionalities such as “waterfall” and “reverse waterfall” could lead to a multiplication of transactions and accounting entries in the systems, with energy consumption and significant ecological impacts (a single payment can generate up to three transactions).

- **A lack of consistency with the European Commission's retail payment strategy**

We believe that the CBDC project proposed by the ECB comes into opposition with the retail payment strategy of the European Commission, based on the development of instant payments. It is also in direct competition – or at the very least likely to contravene its development – with the EPI project (European Payments Initiative) which will launch in 2024 a unified account-to-account instant payment solution for European consumers and merchants. The initiative, supported by major players in the payment’s activity (banks, industrialists) – and officially supported by the ECB – responds to the challenges of innovation and sovereignty put forward by the European Commission in its strategy and aims to deploy throughout Europe by presenting new use-cases and value-added services.

Moreover, the European Commission, from its launch phase, has indicated its support for EPI project: “Valdis Dombrovskis, Executive Vice-President for an Economy that Works for People said: *“The European payments initiative fits into our ambition that European consumers and businesses should have access to fast, efficient and competitive payment solutions. I hope banks from other countries, innovative European fintechs and other European payment service providers will join the first 16 members, bringing their own expertise and assets to this ground-breaking project, and making it even more innovative and competitive at global level” - (July 2020).*

- **Impacts on financial stability and the financing of the economy.**

The operational model based on a centralization of digital euro assets at the ECB level will have significant impacts on the banks' balance sheets, with a risk of increased financial disintermediation and consequences on the financing of the economy. Indeed, the banking sector is characterized by its solidity and resilience thanks to stable deposits, which is a guarantee of its capacity to finance the economy. Greater volatility of deposits could affect this solidity: any situation which contributes to weakening deposits has an impact on the financing of the economy and can thus have a negative effect on the cost of credit for individuals and companies. In addition, the envisaged holding limit for a CDDC account (3,000€) appears far too high and inconsistent with the observed uses of cash holding. As an example, in France this amount is higher than the median salary. It will not prevent a risk of a excessive hoarding situation on digital euro accounts.

- **The need to guarantee compliance with competition rules.**

CBDC, which will by nature benefit from legal tender and therefore an obligation of acceptance for businesses and administrations, may be an obstacle to the development of future pan-European payment solution like EPI. Furthermore, any distortion of competition between the different types of intermediaries PSP should be avoided by harmonizing the rules governing the distribution and mandatory acceptance requirement. It is a question of not placing all the investment respnsability on a single category of PSP, in this case credit institutions, but on all payment institutions which have access to central bank money.

- **The impact on citizens and the use of their data.**

The CBDC project raises questions about personal data privacy and security. In addition, the equipment necessary to use the digital euro could exclude some categories of the population and accentuate a digital exclusion.

B. Deeper analysis of the European Commission's proposal on CBDC by the French Banking Community.

- ***Art. 13-1: Within the framework of Directive 2015/2366, payment service providers may provide the digital euro payment services set out in Annex I.***
    - The text must avoid any competition distortion between the different types of intermediary PSPs in charge of offering the CBDC services. To ensure a same level playing field, PSPs with a credit institutions status should not be the only ones subject to an obligation (and not a simple option) to distribute digital euro services, and therefore, that of investing in new tools. A more detailed definition of the intermediaries PSP that will have to distribute the CBDC must be carried. Major players who would also be legitimate to distribute CBDC services (e.g., big tech) should not be excluded, especially since an evolution to change the SFD directive is envisaged.
    - To ensure the balance of the future system and not impact the innovation capacity of PSPs, the overall economic model of the future CBDC, with a clear definition of billable services, must be specified to ensure costs are covered.
- ***Art 13.4 "Payment service providers providing account servicing payment services […] shall enable digital euro users to have their digital euros in excess of any limitations the European Central Bank may adopt*** **[…]** ***automatically defunded to a non-digital euro payment account, where an online digital euro payment transaction is received*** **[…]** ***and make an online digital euro payment transaction where the transaction amount exceeds their digital euro holdings"***
    - The reverse waterfall feature creates a substantial windfall effect for PSPs that provide payment wallets without offering bank accounts. It will be easy for them to provide wallets to their customers and use a reserve waterfall for each transaction (like a basic PayPal functionality). By doing so, dominant non-European payment players could capture a substantial share of the "inter-PSP fees" while transferring the liability in case of fraud to European banks, free of charge thanks to the reverse waterfall.
    - Filling this structural gap requires explicitly placing the liability in case of fraud on the issuer of the wallet that authenticated the customer when a transaction is financed by a reverse waterfall; and this, at the first request of the credit institution whose client disputes a transaction. The CBDC solution must therefore provide for the mechanism allowing the automatic restitution of funds. ***Additional security would consist in giving the ECB the ability to limit the maximum amount of transactions in order to limit the potential for fraud.***
    - The "reverse waterfall" feature creates the conditions for sub-optimal functioning with responsibilities unfairly distributed between the players. Thus, PSP distributing CBDC accounts, benefiting from inter-PSP fees, would only "trigger" transactions with non-digital euro accounts, leaving the related charges (compliance, fraud, etc.) to the PSPs operating them without remuneration. We believe that a limitation of the volumes of automatic movements of "funding" and "defunding" is necessary to control this risk and ensure a same level playing field.
- ***Art. 13-2: "Payment service providers that provide servicing payment services within the meaning of Directive 2015/2366 shall enable digital euro users to manually or automatically fund or defund their digital euro payment accounts from or to non-digital euro payment accounts, or euro banknotes and coins when a payment services provider provides cash services, subject to any limitations***

that the European Central Bank may adopt in accordance with Article 16 of this Regulation."

- As explained in connection with article 13.4, the French banking community considers that liability rules in case of fraud during the funding and defunding processes must be defined more precisely, in particular in case of a payment initiation by a third party: the responsibility must be taken by to the PSP that carried out the funding or defunding transaction on behalf of its client, and not by the PSP that holds the non-digital euro account. Furthermore, this risk must be covered for automatic waterfall and reverse waterfall transactions, as long as they are backed by a transaction.
- As worded, this article could be interpreted as an obligation for institutions that offer cash services to provide CBDC cash deposits and withdrawals for all account holders and not only for their customers. This would require the creation of an interbank deposit and withdrawal system, not based on the existing card solution. The costs of such a system would be prohibitive.

  It is therefore appropriate to amend this article by specifying: *"… shall enable* ***clients to whom they provide a digital euro payment account*** *to manually or…"*

- ***Art. 14: "Access to the digital euro in Member States whose currency is the euro".***

  "For the purpose of distributing the digital euro to natural persons referred to in Article 13(1)(a), credit institutions that provide payment services as referred to in points (1), (2) or (3) of Annex I to Directive (EU) 2015/2366 shall, upon request of their clients, provide those persons with all basic digital euro payment services as referred to in Annex II."

  - The French banking community believes that PSPs must offer CBDC services at the request of their clients only. This provision is key to optimizing the cost and effectiveness of the necessary KYC and AML procedures. We propose to rewrite the article as follows:

    "For the purpose of distributing the digital euro to natural persons referred to in Article 13(1)(a), credit institutions that provide payment services as referred to in points (1), (2) or (3) of Annex I to Directive (EU) 2015/2366 shall, upon request of their only clients, provide those persons with all basic digital euro payment services as referred to in Annex II."

- ***Art.15-1: "Article 15 Principles"***

  - To limit the risks of excessive holding of CBDC, which would promote financial instability, we believe that the text must more strongly assert the need for a holding limit associated with each CBDC account. Thus, we propose to reformulate article 15-1 as follows:

    "With a view to enabling natural and legal persons to access and use digital euro, to defining and implementing monetary policy and to contributing to the stability of the financial system, the use of the digital euro as a store of value ~~may~~ shall be subject to holding limits."

- ***Art 16-6 "The digital euro user shall specify to the PSPs with which of the digital euro payment accounts are held how the individual holding limit is to be allocated between the different digital euro payment accounts".***

- Controlling the application of the holding limit, which is otherwise mandatory, seems to be a challenge when, according to the text, users will be able to have several CBDC accounts. The establishment of a declaration system, which seems to be suggested by the text, would not make it possible to respond to the issue, and the ECB must clarify the means it will implement to ensure compliance with the usage of the holding limit.

- ***Art 17-2: "Fees on digital euro payment services".***
  - To encourage innovation and offer real value-added services to their customers, PSPs must be able to charge services based on the incurred costs.
  - To guarantee a full compliance with competition rules, it is essential that the methods of setting prices for CBDC services do not disfavour the other means of payment. Article 17-2 should precisely define the criteria for identifying comparable means of payment to serve as a reference for the pricing of the future CBDC.
- ***Art 28- 1: "Front-end services to access and use the digital euro".***
  - We believe that the obligation for users to simultaneously subscribe to "front-end" services offered, respectively, by the ECB and by one or more PSP intermediaries does not seem appropriate. The question of the ECB's liability arises, for example, in the event of an anomaly or fraud on the application. An intermediary PSP cannot be held responsible for a service that it does not provide. We propose to rewrite the paragraph as follows:

    "Payment service providers distributing the digital euro shall provide digital euro users with the choice of using the following digital front-end services to allow digital euro users to access and use digital euro payment services:

    a) front-end services developed by payment service providers; ~~and~~ or

    b) front-end services developed by the European Central Bank."

- ***Art 25-1: et considérants 55 et 58 «European Digital Identity Wallets »***
  - To date, the DIW functionalities are not stabilized or being defined. We propose not to link the design of a CBDC to the DIW future features. Once the DIW targeted functionalities have been defined, amendments to the text may be proposed to improve interoperability between the DIW and CBDC. Therefore, we propose to rewrite article 25-1 as follows:

    "Front-end services shall be interoperable with ~~or integrated in~~ the European Digital Identity Wallets."