

Federal Reserve Seeks Comments on a US Central Bank Digital Currency

January 31, 2022

The Federal Reserve Board <u>recently released a discussion paper and is seeking public comments</u> on the potential benefits and risks, and related policy considerations, of introducing a central bank digital currency (CBDC) in the United States. The Federal Reserve emphasizes that the paper is "the first step in a public discussion between the Federal Reserve and stakeholders about CBDC," and that it "will only take further steps toward developing a CBDC if research points to benefits for households, businesses, and the economy overall that exceed the downside risks, and indicates that CBDC is superior to alternative methods." The Federal Reserve will also not issue a CBDC without "clear support" from the executive branch and Congress. Accordingly, the Federal Reserve makes clear it is not signaling it will make any imminent decisions regarding whether to introduce a CBDC.

As the development of a CBDC would be a "highly significant innovation in American money," the Federal Reserve is seeking public comments on 22 questions related to this topic. Comments are due by May 20, 2022, and <u>may be submitted online</u>.

Function and characteristics of a CBDC

The Federal Reserve envisions that a CBDC could be used by individuals, businesses and governments to make payments using a risk-free asset. For example, users could use a CBDC for purchases of goods or services, and governments could collect taxes or make benefit payments. Importantly, CBDC transactions would be final and complete in real time. A CBDC might also be able to be programmed to deliver future payments.

The Federal Reserve states that a CBDC would best serve the needs of the United States if it were:

- **Privacy protected** to safeguard the privacy rights of consumers, while also providing sufficient transparency to deter criminal activity.
- Intermediated such that the private sector could offer accounts or digital wallets to facilitate management of CBDC holdings and payments.
- Transferable between customers of different intermediaries, making the payment system more efficient.
- Identity verified to help combat money laundering and terrorist financing.

Potential benefits of a CBDC

The paper outlines a variety of potential benefits of introducing a CBDC. The Federal Reserve believes that a CBDC could:

- Offer broad public access to digital money that is free from credit risk and liquidity risk.
- Improve cross-border payments, provided there is significant international cooperation.
- Help preserve the dominant role of the US dollar globally.
- Promote greater financial inclusion (e.g., facilitate access to digital payments and provide a secure means to save).
- · Extend access to safe central bank money to the general public.

Potential risks of a CBDC

The paper also identifies potential key risks posed by the introduction of a CBDC. In the Federal Reserve's view, a CBDC could:

- Reduce the aggregate amount of deposits in the banking system and cause a shift away from lower-risk assets, both of which
 could decrease credit availability or raise credit costs for market participants.
- Increase the risk or severity of runs on financial firms.
- Impact monetary policy implementation and interest rate control.
- · Be susceptible to operational disruptions and cybersecurity risks.

Comments and outlook

A CBDC would be a liability of the Federal Reserve available to the general public. In this regard, a CBDC would potentially provide a safe, digital payment option for individuals and businesses. While the development of a CBDC would be a significant innovation itself, the issuance of a CBDC would also spur innovation in the private sector. Under the intermediated model discussed in the paper, banks and nonbank financial services providers could offer accounts or digital wallets to hold or make payments with a CBDC, as the Federal Reserve Act does not authorize individuals to hold Federal Reserve accounts.

Notwithstanding the potential benefits of a CBDC, the paper also highlights existing developments in the US payment system that are focused on making payments faster, cheaper, more convenient and more accessible. Nonbank providers of payment services have played an important role in advancing these goals, and the development of new interbank settlement services offers greater capabilities for instant payments. The request for comments indicates that the Federal Reserve is interested in both understanding how the US payment system might evolve in the absence of a CBDC and gathering input on issues that would have to be addressed if it were to move ahead with implementing a CBDC.

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