INSTITUTE of INTERNATIONAL FINANCE

Digital euro package: Summary of the 28 June 2023 'single currency package' proposals

IIF Staff Note

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This note is an IIF staff assessment of the extent to which the digital euro package released on 28 June 2023 by the European Commission (**EC**) aligns with the 14 June 2022 IIF submission to the EC in response to its targeted consultation, and similar consultations in other jurisdictions.[1] The digital euro package is now being considered by the European Parliament and the Council in line with the EU's co-legislation procedures.

As proposed, the digital euro package poses a range of concerns for commercial banks and payment service providers (**PSP**s). Among these are disintermediation risks, revenue pressures, operational costs, market share impacts, and data protection obligations. The effectiveness of proposed mitigation measures is still uncertain. Ongoing consultation with the industry will be crucial as the framework evolves.

The IIF has previously observed that the value of an occasion to build a new payment system, such as the one under consideration in this legislative proposal, is in the opportunity to create a multi-asset system that envisions the incorporation of a range of digital currencies and tokenized assets. In this context, if built, infrastructure supporting a CBDC should not be envisioned as entirely independent from such a multi-asset system. There is little-to-no value in settling for recreating parallel systems that could tie up capital and liquidity, face similar pain points, and be expensive. As envisioned, for a digital euro to achieve the objectives of EU authorities, a CBDC would need to operate on platforms where other digital currencies otherwise operate.

1 IIF staff assessment

The key elements of the Digital euro package are the EC's proposed legal text and the accompanying impact assessment. Key features of the proposal are outlined in an annex following this summary assessment. IIF staff have reviewed the package noting the following issues:

Need for comprehensive cost-benefit analysis before launch: **Partly addressed.**

The Impact Assessment accompanying the proposal evaluates costs, benefits, and risks. The IIF has previously argued for more detailed quantitative modeling and analysis in collaboration with the private sector. The Impact Assessment does attempt some modeling of possible holding limits

[1] See also the IIF's submission to the UK authorities on a digital pound dated June 30, 2023 and its earlier submission to the U.S. Federal Reserve Board of Governors concerning a digital dollar dated May 20, 2022.

(in Annex 11); however, the modeling is somewhat basic and high-level, and mainly relies on previous studies. It is not clear to what extent it was done in collaboration with the private sector.

One major gap in the studies cited in the Impact Assessment is there is no attempt to model individual holding limits that may apply to corporates, which have the potential to hold quite significant balances depending on the prevailing interest rate environment.

Maintaining financial stability and bank intermediation: **Partly addressed.**

The proposal allows the ECB to limit digital euro holdings to mitigate disintermediation risks. At this stage, there is no specific limit set in the legislation and the ECB will be free to change the limits (we note, however, that it must report to the Parliament before doing so: see Article 40(2)).

Significant questions remain about the enforceability of the limits. For example, the consequences of a user subsequently opening a new account and failing to inform the existing PSP(s) of this fact are not clear. The ECB is also not obliged to set up the single access point referred to in Article 35, which could be an important anti-avoidance element.

Economic and liability model challenges: **Partly addressed.**

The proposal leaves limited room for PSPs to recover the potentially very significant costs of connecting to and remaining connected to (through upgrades, etc.) the digital euro infrastructure, and operating/developing their own front-end wallet software. In addition, there are quite severe restrictions on PSP fees and charges, including the obligatory offer by credit institutions, specifically (not other PSPs), of free "basic digital euro payments services". This differential treatment of credit institutions is a potential source of disparity and inconsistent or uneven treatment of financial institutions within the legislation. There are also obligations, including compliance obligations, on PSPs that will be a significant source of cost.

There is no attempt to restrain the ECB from subsidizing the digital euro infrastructure and thus crowding out private sector means of payment.

There is also no accounting in the Impact Assessment of the costs of this infrastructure, nor of the additional seigniorage which the ECB may be able to derive from the proposal.

Privacy controls and data protection: **Partly addressed.**

Privacy and General Data Protection Regulation (**GDPR**) compliance are addressed, but specific privacy controls are still to be defined by the EC under Articles 34, 35, and 36. There is much emphasis on the need of PSPs to deploy "state-of-the-art" security and privacy-preserving measures to ensure that individual users are not identifiable, but it is not clear that such measures either are available and scalable, or will be in time for the issuance of a digital euro.

Processing of personal data by the ECB is allowed for certain purposes under Article 35, including verification of limits. The ECB, alone or jointly with national central banks, can operate the "single access point", but segregation of data held in the access point is envisaged such that the ECB and NCBs cannot directly identify individual digital euro users (Article 35(8)). This may contradict Article 35(1).

AML/CFT compliance costs and challenges: **Partly addressed.**

Offline digital euro transactions will be almost cash-like in terms of the level of privacy. This may create AML challenges for institutions. Much will rest on the envisaged guidelines to be jointly issued by the EBA and the yet-to-be-established Anti-Money Laundering Authority (**AMLA**) specifying the interaction between AML/CFT requirements and basic digital euro payment services under Article 14(5).

Cybersecurity and operational resilience: **Partly addressed.**

The ECB is expected to implement "state of the art" security and privacy protection. As for cybersecurity, the Impact Assessment states that while the ECB and the Eurosystem would not fall under the scope of the EU's Digital Operational Resilience Act (**DORA**), the Eurosystem is, however, expected to be subject to the new Cybersecurity Regulation proposed in March 2022 by the Commission, which aims to establish a framework for governance, risk management and control in the cybersecurity area across the European Union institutions, bodies, offices and agencies. By contrast, the legal text does not mention this Regulation cited in the Impact Assessment. Also, there is no specific mention of operational resilience requirements and expectations for the digital euro infrastructure other than a brief mention in Recital 77.

This seems to be a significant gap. If up-take is strong, the digital euro infrastructure would become an extremely important piece of payments infrastructure and should be held to the same rigorous standards regarding cybersecurity and operational resilience as equivalent privately-operated infrastructures.

Governance and conflicts of interest: **Not addressed.**

There is no mention of the conflict of interest that will need to be managed and mitigated carefully, and how this will be achieved. There is also no mention of the need for additional governance around the digital euro infrastructure provision. As issuer, administrator, and fee-setter for a digital euro, the ECB may face conflicts or trade-offs between promoting adoption/use of a digital euro and managing risks like disintermediation. As a supervisor of banks, the ECB must aim to ensure bank stability and lending capacity, which could clash with digital euro goals if disintermediation occurs. As a potential provider of front-end services for a digital euro, the ECB may compete with private sector providers, potentially presenting conflicts with its regulatory role. There is also no independent oversight envisioned of the ECB's adherence to any operational resilience and availability standards it chooses to adopt.

2 Annex: key features of the proposal

2.1 Design and issuance

- The digital euro will be a central bank digital currency (**CBDC**) issued by the Eurosystem (i.e., the European Central Bank (**ECB**) and national central banks (**NCBs**) as a digital form of euro (Articles 1, 3-4). It will be a direct liability of the Eurosystem towards digital euro users, not involving commercial banks (Article 4).
- The ECB will decide on timing, amounts and details of issuance (Article 4).

2.2 Access and distribution

- All authorized payment service providers (**PSPs**), including banks, can provide digital euro services (Articles 13, 14).
- Public entities such as post offices must also be nominated to distribute basic services to unbanked consumers (Article 14).
- Non-euro area residents can access digital euro under certain conditions (Articles 18-21).
    - For European Union (**EU**) states that are outside the eurozone, there must be an agreement between the ECB and the relevant central bank, and the Member State concerned must have implemented legislation to adopt the digital euro rules and standards (Article 18).
    - For non-EU states (including the UK of course), there must be an international agreement with the EU and the state must have implemented legislation to adopt the digital euro rules and standards (Article 19).
    - The limits on holdings apply in the same way to non-EU residents.

2.3 Use cases and functionalities

The digital euro is intended for retail payments by individuals and businesses (Article 2).

- It will provide both online and offline functionalities (Article 23).
- It will support programmable "conditional" payments, but is not "programmable money" (Article 24).
- Users can hold digital euro accounts with multiple PSPs and switch accounts (Articles 13, 31).
- Use is to be integrated with the proposed European Digital Identity Wallets (Article 25).[2]

2.4 Economic and business model

- Credit institutions **must** distribute basic digital euro services to consumers on request (Article 14). They are also prevented from charging any fee for so-called "basic digital euro payment services." These services are defined in Annex II (see Annexes) so as to exclude automatic funding and defunding of digital euro accounts from other payment accounts.
- The ECB does not charge PSPs for costs of supporting digital euro distribution (Article 17).

[2] See proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 910/2014 as regards establishing a framework for a European Digital Identity – COM(2021) 281 final

- The ECB bears the costs for developing and operating the digital euro infrastructure.
- PSPs are not charged by the ECB for integrating with or accessing the digital euro system.

- Merchant service charges are capped based on costs and comparable private payment scheme fees (Article 17):
  - Caps are based on the lowest of PSP costs and comparable payment system fees.
  - While there is allowance for "reasonable profit," that is based on the 25th percentile in terms of profit, and cost is also based on the 25th percentile.
- An inter-PSP fee may compensate PSPs for distribution costs (Article 17):
  - Fee paid between distributing and acquiring PSPs.
  - Covers distribution costs since basic services cannot be charged to individuals.
  - Provides reasonable margin for profit.
- The ECB will monitor and publish maximum fee amounts (Article 17):
  - ECB will regularly review PSP costs and payment system fees and publish reports on maximum merchant and inter-PSP fees.
  - There will be uniform fee caps across the euro area.

2.5 Limits on individual holdings

- The ECB will be empowered to issue delegated legislation to protect financial stability (Article 16). The ECB's potential tools are to include but not be limited to individual holding limits and transaction limits.
- A digital euro user may set its offline holding limit at any amount between zero and the offline holding limit set by the EC (not the ECB) in accordance with Article 37.
- The limit that applies to online digital euro will equal the overall limit determined by the ECB minus the holding limit for offline digital euro set by users (Article 16(4)).
- If a user has multiple digital euro accounts, the user will specify to the PSPs how the individual holding limit is to be allocated between the different accounts (Article 16(6)).
- There are some anti-avoidance elements in the legislation. Article 35 allows (but does not oblige) the ECB alone or jointly with NCBs to set up a "single access point a single access point of digital euro user identifiers and the related digital euro holding limits" which may allow PSPs to exchange information about individual users.

2.6 Delegated legislation

- There is extensive reliance on delegated acts and reports, as is habitual with EU legislation.
- The ECB oversees the digital euro's issuance and management, such as authorizing its release (Article 4), setting limits (Article 16) and fee caps (Article 17) and establishing security measures (Article 28).
- NCBs cooperate with the ECB in areas like issuing the digital euro (Article 4) and enforcing holding limits (Article 35).
- Meanwhile, the European Commission addresses particular tasks, like setting legal tender exceptions (Article 11), regulating data processing (Articles 34, 35, 36) and fixing offline holding limits (Article 37).
- The European Banking Authority (EBA) and the EU's proposed Anti-Money Laundering Authority (AMLA) and will also have a role in issuing joint guidelines specifying the interaction between AML/CFT requirements and basic digital euro payment services (Article 14(5)).