Hold off on digital pound until financial stability and other risks are addressed, lawmakers caution

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By Abhishek Kumar

No UK central bank digital currency should be fully implemented until financial regulators have addressed privacy concerns, financial stability risks and interest rate risks, an influential committee of lawmakers have warned in a new report. Bank failures arising out of people switching large amounts of funds into digital pounds in times of market turmoil were a key financial stability risk cited by Parliament's Treasury Committee.

No UK central bank digital currency should be fully implemented until financial regulators have addressed privacy concerns, financial stability risks and interest rate risks, an influential committee of lawmakers have warned in a new report.

Unless carefully managed, a digital pound issued by the Bank of England could introduce potential risks to financial stability, Parliament's Treasury Committee said (see here).

It gave an example of financial stability risk from bank failures arising out of people switching large deposits in commercial accounts to digital pounds in times of market turmoil.

The committee recommended lower limits on initial retail holdings of a central bank digital currency, or CBDC, to mitigate the risk instead of an upper limit of 10,000 pounds ($12,500) to 20,000 pounds proposed by the BOE and the finance ministry, known as the Treasury.

A retail digital pound could exacerbate financial exclusion by hastening the demise of physical cash, on which many people depend, the committee cautioned. “The digitization of money can’t, in any way, leave those people behind,” said Harriet Baldwin, the committee chair.

She urged regulators to proceed with caution and be open minded about whether a retail CBDC is needed or not needed in the first place.

“The government and Bank of England must resist the temptation to believe that a digital pound can fix problems it can’t … and a digital pound must not make financial exclusion worse,” she said.

The retail digital pound might have some benefits, such as stimulating innovation in domestic payments, building the UK’s international competitiveness in payments technologies and guarding against the risks posed by new forms of digital money, the committee said.

“We recommend that the Bank of England and Treasury undertake further analysis on the monetary policy impact of paying interest on the digital pound, and in the meantime ensure that their design work does not preclude the possibility of paying interest on the digital pound,” the committee said.

“It’s important that the Bank of England and Treasury are open to modernizing the use of money in a way which keeps pace with technology while preserving economic stability and individual security.” Baldwin said.

On privacy, the committee advised financial regulators to put in place strong privacy safeguards to prevent user data from being misused. “There could be potential misuse of consumer data by firms managing digital wallets,” lawmakers said, urging regulators to put in place robust regulatory mechanisms from the prudential and conduct points of view and impose strong penalties on violators.

The next stage of work on a retail CBDC could incur significant costs, the committee said, and it advised financial regulators to maintain transparency through their annual reporting.

“It must be clearly evidenced that a retail digital pound will provide benefits to the UK economy without increasing risks or leading to unmanageable costs before any decision is taken to introduce it into our financial system,” Baldwin said.

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