DIGITAL ASSETS AND THE FUTURE OF FINANCE: EXAMINING THE BENEFITS AND RISKS OF A U.S. CENTRAL BANK DIGITAL CURRENCY

VIRTUAL HEARING

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DIGITAL ASSETS AND THE FUTURE OF FINANCE: EXAMINING THE BENEFITS AND RISKS OF A U.S. CENTRAL BANK DIGITAL CURRENCY

Thursday, May 26, 2022

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 12:06 p.m., via Cisco WebEx, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Sherman, Scott, Cleaver, Perlmutter, Himes, Foster, Beatty, Gottheimer, Axne, Casten, Pressley, Lynch, Garcia of Illinois, Garcia of Texas, Williams of Georgia, Auchincloss; McHenry, Posey, Luetkemeyer, Huizenga, Barr, Hill, Zeldin, Loudermilk, Mooney, Davidson, Budd, Kustoff, Gonzalez of Ohio, Rose, Steil, and Timmons.

Chairwoman WATERS. Thank you very much. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency."

I now recognize myself for 5 minutes to give an opening statement.

While cryptocurrencies have the potential to offer several efficiencies in the way that we send and receive money, the early stages of innovation in this round are revealing the clear risk associated with some cryptocurrencies, including significant volatility, and even so-called stablecoins, that, despite their name, have been anything but a stable value. Earlier this month, we saw the dramatic collapse of Terra, which, according to one analysis firm, resulted in investors losing more than $40 billion in a product that was supposed to always return $1 for each dollar invested.

Central bank digital currencies (CBDCs) have the potential to harness the efficiency of cryptocurrencies, while providing the security and stability of the U.S. dollar backed by the full faith and credit of the Federal Government. As we explore the possibility of a U.S. CBDC and the future of the global financial system, we must keep in mind that we may very well be in the midst of a new digital asset space race, with countries around the world competing to deploy digital versions of their own currencies, and America can't be left behind.

The U.S. dollar has long been the global leader and reserve currency worldwide, and Americans reap enormous benefits from having their currency widely accepted across the globe. For example, a reserve currency means that the United States Government's cost of financing is lower, which translates long term into lower mortgage and credit card rates than consumers see in other countries. But it is not hard to imagine how another major economy's CBDC could chip away at the dollar's leadership status because of the efficiencies that CBDCs could offer in making instantaneous and secure payments at lower cost.

According to estimates, over 90 nations, representing 90 percent of the global GDP, are researching, piloting, and developing CBDCs, including China, which rolled out its CBDC at the Winter Olympic Games in Beijing. As the U.S. explores the potential for our own CBDC, I believe the design of this digital dollar should balance the need for privacy protections, while retaining mechanisms to prevent money laundering and other illicit uses. I also strongly believe that a U.S. CBDC should be designed to promote financial inclusion. These are values that I believe that Democrats and Republicans share in this digital asset race to space share. This is why it is critical for the U.S. to stay competitive in this field to ensure that our values prevail as a way that the global financial system evolves.

First, let me extend my congratulations to Dr. Lael Brainard on her confirmation as the Vice Chair of the Board of Governors of the Federal Reserve System. I am so happy you have joined us in this new capacity to discuss the potential of central bank digital currencies, or CBDCs, as part of the future of our financial and monetary system.

Today, we continue the committee's bipartisan series of hearings on digital assets. This hearing will allow us to examine and discuss the Fed's ongoing research on CBDCs and to learn how the Fed is working with other Federal agencies, as encouraged by the White House in its recent Executive Order on digital assets, to ensure that the U.S. is properly regulating the cryptocurrency industry. While cryptocurrencies have the potential to offer several efficiencies in the way that we send and receive money, the early stages of innovation in this realm are revealing the clear risks associated with some cryptocurrencies, including significant volatility, even so-called stablecoins, that again, I repeat, despite their name, have been anything but a stable value. Earlier this month, we saw, again, the dramatic collapse of Terra, which according to one analysis firm, resulted in investors losing more than $40 billion in a product that was supposed to always return $1 for each dollar invested. And I am repeating all of this because I want it to be clear.

And now, I will recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 5 minutes.

Mr. McHENRY. Thank you, Madam Chairwoman, and Vice Chair Brainard, thank you for being here today as we seek to understand what problems a Fed-issued digital currency would solve. Despite this being our third hearing focused on CBDCs, and the Fed issuing its report, we still have many unanswered questions, but we knew that would happen. We all have to get a better understanding of the consequences of a central bank digital currency and understand the technical aspects as well.

This is why prior to the reports released from the Fed, my Republican colleagues and I developed a set of principles to guide our evaluation of a U.S. central bank digital currency, or CBDC. For more than a year, we have been exploring the potential impact of a CBDC on monetary policy. We have been trying to understand the impact of the Fed's dual mandate and the implications for our banking system. Most importantly, we have been reviewing the Federal Reserve's current authority, if any, to issue a digital currency. Our principles provide a coherent framework to evaluate the Fed's report. In its report, the Fed listed a number of potential benefits of a CBDC, most of which, in my view, could be realized through private-sector alternatives. There seems to be a disconnect about how innovation truly happens, which is outside the walls of government bureaucracies.

We also don't know the impact of a digital currency on the Fed's ability to effectively perform its monetary and regulatory functions, and we are trying to explore that and understand it better, and no one has made a compelling case on why we should expand the Fed's mandate into retail banking or how a Fed-issued CBDC won't politicize the Fed.

I understand that this issue is obviously in its exploratory phase. However, there is the potential for significant harm to our financial system if we move forward without sorting through potential consequences. That is why last week, committee Republicans sent a letter to Chair Powell outlining exactly where the Federal Reserve should focus its next steps. Chair Powell has been outspoken in his view, stating, "It is more important that we get it right, which means that we not only look at the potential benefits of a CBDC but also the potential risks, and recognize the important tradeoffs that have to be thought through carefully." And I strongly agree with Chair Powell's assessment.

Chair Powell, in the discussion paper, emphasized that, "The Federal Reserve does not intend to proceed with the issuance of a central bank digital currency without clear support from the Executive Branch and from Congress, ideally in the form of a specific authorizing law." Since the job rests with Congress to make this decision, we should be thorough in our review. Congress should not rush to issue a digital currency, nor should the Fed. We both should understand whether the benefits of a digital currency actually outweigh the risks before any further congressional action is considered.

Thank you, Madam Chairwoman, and I yield back.

Chairwoman WATERS. Thank you very much. I want to welcome today's distinguished witness, Dr. Lael Brainard, Vice Chair of the Board of Governors of the Federal Reserve System.

You will have 5 minutes to summarize your testimony. You should be able to see a timer that will indicate how much time you have left. I would ask you to be mindful of the timer and wrap up your testimony before your time has expired.

And without objection, your written statement will be made a part of the record.

Vice Chair Brainard, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF THE HONORABLE LAEL BRAINARD, VICE CHAIR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BRAINARD. Chairwoman Waters, Ranking Member McHenry, and members of the committee, I am very pleased to join you today.

There has been explosive growth in the digital financial system built around new digital assets and facilitated by crypto asset platforms with stablecoins as settlement assets. And in recent weeks, two widely-used stablecoins have come under considerable pressure. The recent turmoil makes it clear that the actions we take now, whether on regulations or on explorations surrounding a digital dollar, should be robust to the future evolution of the financial system. That rapid ongoing evolution of the digital financial system should lead us to frame the question not as whether there is a need for a central bank-issued digital dollar today, but rather whether there may be conditions in the future that may give rise to such a need. No decision has been made about whether a U.S. CBDC will be a part of that future. But it is important to undertake the necessary work to inform any such decision and to be ready to move forward, should the need arise. There are risks on both sides, both risks of acting and of not acting.

The share of U.S. payments made by cash has already declined by one-third, to 20 percent just over the last 5 years, and of course, the share is even lower for people who are under the age of 45. While digitalization of the financial system continues, it is prudent to consider how to preserve ready public access to safe central bank money. And that is where questions around the issuance of a digital dollar akin to the Federal Reserve's issuance of physical currency arise.

In addition to the migration away from cash, we are also seeing growth in new forms of digital private money, such as stablecoins. They don't share the same protections that underpin confidence in commercial bank money, such as deposit insurance, access to central bank liquidity, and banking regulation and supervision. They can lose their promised value relative to fiat currency, harming consumers and creating broader financial stability risks, and, indeed, we saw in the 19th Century that active competition among issuers of private paper banknotes led to instability, inefficiency, and fraud that was so widespread that it led to the need for a uniform national currency and, ultimately, the protections I just noted.

In addition to consumer protection and financial stability risks, if private money such as stablecoins were to become very widespread, we could see fragmentation of the U.S. payment system into so-called walled gardens. In those kinds of circumstances, a central bank digital dollar could improve the stability and efficiency of the payment system by coexisting with and complementing stablecoins and commercial bank money, much like cash currently coexists with commercial bank money. It could provide a safe central bank liability as the neutral settlement layer in the digital financial ecosystem that would actually facilitate and enable private-sector innovation, but it is very important to consider the risk of bank intermediation. A vibrant, healthy banking system with banks of all sizes is very important to the economy and to the Federal Reserve. And in some circumstances, a widely-available CBDC could serve as a substitute for deposits, and a CBDC would be attractive to risk-averse users during times of stress. That is why we want to make sure that banks are among those intermediaries, if, in fact, we were to have such a system with intermediaries, which we have said is very important, and to develop design features to mitigate those risks.

Finally, in addition to those two reasons, in future states where one or more major foreign currencies are issued in CBDC form, it is prudent to think about what the risks are in the presence or absence of a U.S. central bank digital dollar. And, of course, China's actions are important, but other central banks in Europe and elsewhere are also pretty far along in terms of thinking about issuing their own digital currency. And of course, we shouldn't take the dollar's global status as the dominant payment currency for granted.

Thank you very much. I look forward to engaging with you on this important issue.

[The prepared statement of Vice Chair Brainard can be found on page 44 of the appendix.]

Chairwoman WATERS. Thank you very much. I now recognize myself for 5 minutes for questions.

Vice Chair Brainard, one potential benefit that the Federal Reserve highlighted in its January CBDC report was that a CBDC could support the dominant international standing of the U.S. dollar, and could help to ensure that our currency is positioned to remain the world's reserve currency and primary medium of exchange internationally in this digital age. The report noted that, "Today, the dollar is widely used across the globe because of the depth and liquidity of the U.S. financial markets, the size and openness of the U.S. economy, and the international trust in United States institutions and the rule of law. It is important, however, to consider the implications of a potential future state in which many foreign countries and currency unions may have introduced CBDCs."

Some advocates have noted that if foreign CBDCs become more widely used than existing forms of the U.S. dollar, the global power of our currency could decrease. As you look at the CBDC development in China and elsewhere, do you think that a U.S. CBDC is essential to preserve the international role of the dollar?

Ms. BRAINARD. Thank you, Madam Chairwoman. I think this is one of the important considerations informing the work to better understand the design and potential importance of a digital dollar. We do derive important benefits from being the dominant payments currency. It does lower our borrowing costs and our transaction costs, and that does flow through to businesses and consumers. So, it is very important for us to retain a dominant position in international payments, and as you noted, China has already introduced a digital yuan. The ECB is pretty far along in its thinking. If a number of major foreign jurisdictions do, in fact, issue digital currencies, it is important to think how that would look for the dollar if the U.S. did or did not join that.

Regardless of whether or not the decision is made to move forward, it is very important for us to be involved in standard setting in cross-border transactions. And of course, our ability to shape those standards will be influenced by whether or not we actually have a digital offering to bring to the table as well.

Chairwoman WATERS. Thank you very much. I just want to ask you about the President's direction. It seems that he said that all of these agencies should work together. And we talked with Mr. Xu just yesterday, and he said there has been no real discussion on CBDCs. Is that true?

Ms. BRAINARD. The Executive Order on digital assets does, I believe, include an important role for Treasury in bringing together the banking agencies to discuss the issue of a central bank-issued digital dollar. So, I do think it will be very important for Treasury to convene those discussions and, of course, we look forward to fulfilling our role under the Executive Order.

Chairwoman WATERS. But it has not happened yet. Is that right?

Ms. BRAINARD. It has not happened yet, to the best of my knowledge, but we are working with other agencies on the Executive Order and we do expect to have discussions convened by Treasury.

Chairwoman WATERS. Thank you very much. The gentleman from North Carolina, Mr. McHenry, who is the ranking member of the committee, is now recognized for 5 minutes.

Mr. MCHENRY. Thank you, Madam Chairwoman. Vice Chair Brainard, you obviously are very steeped in the details of the mechanics of a CBDC. We have seen the MIT report. We have seen the Boston Fed report. We have seen the overall Fed report on CBDCs. The one thing that the Federal report makes clear is that legislation is necessary for the Fed to issue a central bank digital currency. Is that your view?

Ms. BRAINARD. Ranking Member McHenry, the report is clear that the Federal Reserve would not move ahead without support by the Executive Branch and by Congress, and ideally, that would take the form of authorizing legislation.

Mr. MCHENRY. Yes, I mentioned that in my opening statement, and that was my question. I was asking your view.

Ms. BRAINARD. Of course, I don't have any expertise on what kind of authorizing legislation would be necessary, but I think our view as an institution was clearly stated.

Mr. MCHENRY. You are the Vice Chair for Regulation, and I just want to ensure that it is your understanding that the Fed is constrained by statutes, and that is why I am asking. This is not supposed to be a hard question. It is supposed to be the easy opener.

Ms. BRAINARD. Yes. It is clear that the Federal Reserve does not have the authority, for instance, or is precluded from individual accounts, so we have taken a very strong position on that in the report. And, yes, it is important for us to have strong support from both the Executive Branch and Congress, and ideally, that would come in the form of authorizing legislation.

Mr. MCHENRY. Okay. I think you will hear from me on this, because it seems like there is some wiggle room you are trying to show. Let me move on to my question, if I may. What specific problems, if any, will a central bank digital currency solve?

Ms. BRAINARD. I think this is a very important question and set of considerations. And the way that I think about it is that it is really the future states of the financial system that we should be thinking about as we think about the costs and benefits. There are potential risks to creating a CBDC, depending on the future evolution of the financial system. There are also potential risks to not having a CBDC, and what is really important is that it takes a long time. If, for instance, Congress were to decide that it is very important for the Federal Reserve to issue a central bank digital currency, it could take 5 years to put in place the requisite security features, the design features. And I cited earlier the enormous changes that have taken place in our financial system just over the past 5 years, a one-third decrease in the use of cash, a huge amount of migration to mobile apps for payments in and out of the banking system, an introduction by several foreign central banks of their own digital currencies and plans by 90 percent—

Mr. MCHENRY. Okay. I understand. And my question is, what problem are we trying to solve for, and I have not gotten a clear answer on this. For most consumers, payments are digital. The movement of cash between banks is digital. In the private sector, we see the payment system working well. We see the FedNow system is expected to go live in 2023. So, what are the differences here from all of those alternatives, and why would the Fed need to have a CBDC?

Ms. BRAINARD. There are three reasons that I cited earlier, including the declining use of cash. Potentially, consumers no longer having direct access to a safe, central bank-issued digital currency is one significant risk. A second significant risk is that stablecoins become the dominant form of U.S. digital dollar. And in that world, you could have fragmentation of the payment system, instability of those digital currencies, the kind of instability that Congress chose to move away from 100 years ago.

Mr. MCHENRY. Thank you, Vice Chair. And, Madam Chairwoman, thank you for this hearing. I think this is the reason why we need to have a well-regulated stablecoin regime, or to at least have a conversation. Thanks so much.

Chairwoman WATERS. Thank you. The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on Housing, Community Development, and Insurance, is now recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. And Vice Chair Brainard, thank you so much for being with us today. I appreciate it very much. As you well know, the Federal Reserve Bank of Boston has partnered with MIT to conduct CBDC-related research through Project Hamilton. Together, they have studied the technological aspects of a potential CBDC, and it was going to be hard because I would say, "CDBG," all the time in my committee, but CBDC, with the first phase of the project released in February 2022, which looks into cryptography, distributed systems, and blockchain technology. Some have argued that existing American digital initiatives for real payment time, such as Pay It Now, will likely have slower settlement times when compared to Project Hamilton or the CBDCs being developed by other nations.

What is your view? Is there a Fed view? What is the Fed likely to do now? Will your study be laid out to us and to the Senate? We are, of course, very much interested in any sensible, well-studied work that will help us deal with this issue. That is scary, at least to me. It is frightening to me. So, what will happen with the research?

Ms. BRAINARD. Thank you. The work that we are doing now on FedNow is on a real-time payments platform. It is the first system that we are building that is cloud native. And I think that we are learning a lot about the cyber security requirements, potential settlement times, and the execution requirements, so it is a very important build experience for us. And it is also, I think, a good example of how long it takes from the time that the decision is made to build such a new platform, to the time when it is ready to be connected up to financial institutions.

There is relevance there for a central bank digital currency. And as you noted, we have a variety of research around the system that is potentially relevant both to what it would take to execute on a digital dollar issued by the Federal Reserve, but also relevant to simply understanding some of the private-sector platforms that have stablecoins or are building stablecoins. It is very helpful to us, for instance, to Project Hamilton, to experiment with what kind of throughput, what kind of settlement times, how many transactions per second you might be able to see when you layer on the kind of cryptography that is necessary to make these transactions secure and private.

So, I think the work that we are doing helps give us some background, and it is very important for us to continue with technological research and experimentation, not only for purposes of our own payments infrastructure, but more broadly, to understand the private sector and where some of the risks may lie and where some of the efficiencies may lie.

Mr. CLEAVER. Do you believe that the Fed will likely have slower settlement times when compared to Project Hamilton or the CBDCs?

Ms. BRAINARD. I would be a little hesitant to compare simply because Project Hamilton is entirely experimental in nature. And of course, with FedNow, we are building in very significant operational resilience and security. And so, I would be a little cautious about thinking about settlement times comparably between those two.

Mr. CLEAVER. Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you very much. The gentleman from Florida, Mr. Posey, is now recognized for 5 minutes.

Mr. POSEY. Thank you very much, Chairwoman Waters. Dr. Brainard, if working people got paid in central bank digital currency, could it threaten the viability of commercial banks using deposits to fund their lending activities?

Ms. BRAINARD. One of the things that I have focused most on in thinking about this debate is how important it is to our economy, and to the Federal Reserve, to have a vibrant, resilient banking system with banks of all sizes, and we want to make sure anything we do continues to support that really important banking system. As we think about some of those issues, I think one thing that is important to recognize is that anything that we would want to do in this space would have to be consistent with banks remaining really important intermediaries of any future evolution of the U.S. payments and financial system. And that is one of the reasons that we emphasize in our report that it should be an intermediated system with banks as intermediaries or among intermediaries.

In terms of the deposits, there is certainly a lot of consideration that we have been doing in terms of thinking about potential implications for deposits. Banks are very important in terms of credit provision, in terms of monetary policy transmission. Of course, we are already seeing massive changes where payments are made increasingly through mobile payments apps. We have seen a tenfold increase of the leading mobile payments app, a sevenfold increase just in the last few years of the second mobile payments apps. Those already hold balances largely outside the banking system.

Similarly, we have seen those having some implications for cash usage. So, I think any future evolution of the financial system with digitalization is going to lead to some diminished use of cash and some diminution of bank deposits, but that is also true for stablecoins. You could see some reduction in bank intermediation and bank deposits there, so I think we want to think holistically about it. And it is very important to think about limits, potential limits on central bank digital currency holdings, whether to pay interest. That would be another way to make holdings of central bank digital currency really only for payments in ways that wouldn't compete with deposits, if for instance, they didn't pay interest. There are a variety of ways people have been thinking about designing these so that they wouldn't diminish deposits in the banking system.

Mr. POSEY. Thank you. Do you think the interest rate of a central bank digital currency could increase the threats to diminishing the role of the banking system in our economy as we currently know it?

Ms. BRAINARD. I think that question about whether or not a central bank digital currency would be interest bearing is a really important one. I think there are a variety of reasons to think it would be probably preferable not to have an interest-bearing digital currency. And I think the one that you mentioned is one of the most compelling reasons; it would be less attractive than deposits if it were not interest bearing. And of course, consumers are accustomed to making payments on mobile apps without interest on those balances. In that sense, it seems like a natural way to go to me, but it is one of the design questions that our paper raises and that we asked for feedback on in the comments.

Mr. POSEY. Thank you very much. Madam Chairwoman, I see my time is just about to expire, so I yield back. Thank you.

Chairwoman WATERS. Thank you very much. The gentleman from California, Mr. Sherman, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. SHERMAN. Thank you. CBDCs will not meet the primary need that is aspired to be met by cryptocurrencies. With cryptocurrencies, the name tells you everything—"crypto" means hidden, and "currency" is money—and it is designed to meet the needs of those who need hidden money: drug dealers; sanctions evaders; human traffickers; and especially, tax evaders. And I don't think that a central bank digital currency will help those folks because you are going to enforce the Know Your Customer and Anti-Money Laundering (KYC/AML) rules. There is a second need that is met by cryptocurrencies and those who may not care whether they hide their own money, but they want to heap high-risk investment wagers on whether other people will want hidden money and bid the price of cryptos up.

Mr. McHenry asked what a CBDC could do, and I would point out that accounts of over a quarter million dollars are not insured by the Federal Government. So if you want an account, rather than in, say, T-bills, you could buy it, then sell it, then use the money, but you want in the account money, and you want to take zero risk, and you have more than a quarter million, CBDCs could do that. But there will be a disadvantage that I think Mr. Posey identified in his question.

Governor Brainard, given your role at the Fed, it is logical that you would focus on digital currencies, but I also want to tap your knowledge about stablecoins. We have seen that Terra was not, "terra firma." It was, "terra incognita." We see that Tether is completely untethered. I am concerned particularly that Tether's investors are being told it is linked one-to-one with immediately-redeemable cash reserves. We don't really have reliable financial statements, no, that there are any reserves at all, but if we take it at face value, the release is out of Tether. They own commercial paper cryptocurrencies, which could go up or down on any day, and a lot of investments in the notes of Chinese real-estate companies, which are highly impaired.

Earlier this month, the Treasury Secretary testified about the need for Congress to take action, and laid out a framework for doing so. Congress is somewhat divided, as you may have heard, so we may not be able to pass anything. Is there anything you can do or that the regulatory agencies can do to protect those who think they are buying something stable and, in fact, they are buying anything but?

Ms. BRAINARD. I have certainly been very focused on the potentially unstable nature of the so-called stablecoins for some time, and I do think the first best answer would be for Congress to specifically legislate a regulatory regime for stablecoins. I do believe we have just seen, in the last few weeks, exactly the kinds of risks that we have all been talking about for some time: a run on the platform; a collapse in the value of a stablecoin; a stablecoin breaking the buck or moving off of its one-for-one value because of lack of transparency into the reserve assets and supposedly underlying that stablecoin. All of those things we have all been talking about, and that is why I think the President's Working Group principles for regulating are good, and it would be best to first see some legislation there. There are consumer protection risks. There are investor protection risks. There are financials that involve risks.

Mr. SHERMAN. I am going to sneak in one more question. I think Mr. Posey brought this up. We tend to focus on the financial services system, but the real impact is what impact financial services then has on the real economy. We want business loans made. We want home loans made. If we had a CBDC, would that cause deposits to move out of banks, particularly community banks and credit unions, and into the Fed in a way that would provide less money available for the loans we want banks to make?

Ms. BRAINARD. I think with the right design features, that could be avoided. Again, we already have payments apps that would operate quite similar to central bank digital currencies, so the financial system is already moving in that direction. And simply doing things like not having interest on a digital currency potentially limits how much people could hold. It would confine their use to payments and not impede those important functions of a vibrant banking system. And of course, again, it is really important for banks to be intermediaries in any such future system.

Chairwoman WATERS. Thank you. The gentleman from Missouri, Mr. Luetkemeyer, is now recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. Good morning, Vice Chair Brainard. I just want to kind of get a little bit of clarity here. You keep saying that the Fed will move forward, but you are not moving forward without congressional approval, ideally in the form of legislation. That is kind of a hedge there that I am concerned about. Do you or do you not believe that we have to have legislation? And if you don't believe we have to have legislation, what other forms of a nod toward approval would you accept—some sort of a letter from the Administration, from Congress, a Floor speech on the lack of action, for instance? Would that imply that everything was okay? Can you give me a little more definitive answer on this, please?

Ms. BRAINARD. Let me just repeat what we have said, that the Federal Reserve discussion paper that was released in January said that the Federal Reserve would not move forward without strong support from the Executive Branch and from Congress, ideally in the form of authorizing legislation. And of course, I think that was—

Mr. LUETKEMEYER. That is what I want to clarify, ideally here. Is that the only form that you could you go forward with or are there other things, other ways that you would consider approval from Congress or the Administration? I want to nail this down. What do you think it takes to make this happen?

Ms. BRAINARD. I believe in the Executive Order on digital assets, the Department of Justice has the responsibility for opining on this topic. Others who are lawyers probably are better placed to give you a very precise answer. I can tell you that we believe that Congress should be very engaged on this issue. That is why I am so delighted that you are holding this hearing today. There are a lot of really important questions that I think you are asking here, and our job is to make sure that at least the part of this that I think I have some responsibility for is to make sure any decision that you make is well-informed. That is why we put out the discussion paper. That is why we think it is important to have technology research. I would hate for Congress to decide 5 years from now that the Federal Reserve needs to catch up. China is out there. The ECB is out there. And we would be serving you very poorly. We have done a lot of work.

Mr. LUETKEMEYER. Okay. Thank you. Along that same line, you have opened up another question for me here with regards to other countries—China, Europe, UAE—that are acting in the space. And the Fed is thinking about doing something with, I guess, consent and approval, with direction from the Congress and from the Executive Branch. My question is, do you think that you can move fast enough to be able to compete with these other currencies? And if not, do you think that the private sector, which I think we have all agreed can innovate and do this much more quickly, that if you worked in concert with them or turned them loose with the innovation that they could come up with, may be able to make us more competitive, more quickly?

Ms. BRAINARD. In any circumstance, we operate alongside the private sector. That is true of all of our payment systems that we operate today. It is true of the coexistence of cash and central bank money, and that is one of the great strengths of our system. In any circumstance, I would think of the central digital dollar as creating a neutral settlement layer that would actually allow our private sector to innovate more effectively and more rapidly. And if I think about where other countries are by doing the kind of technology research and policy research and soliciting input today, I am hoping that we, working with the private sector, can be in a good position.

Mr. LUETKEMEYER. Can you give me an instance of how you are working with them? How are you working with the private sector?

Ms. BRAINARD. In all of the work that we do, we have private-sector partners. In FedNow, for instance, we have a group of private-sector partners that have helped inform the design of our system, and, of course, all of our payment infrastructure is kind of a neutral infrastructure that allows interoperability between private-sector solutions. And that is how I would continue to see the role of the Federal Reserve in the future.

Mr. LUETKEMEYER. Okay. Thank you. I see my time is up, so I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you. The gentleman from Connecticut, Mr. Himes, who is also the Chair of our Subcommittee on National Security, International Development and Monetary Policy, is now recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman, and thank you very much, Dr. Brainard, for your presence here.

As the chairman of the subcommittee that has jurisdiction over the possibility of a CBDC, I am really excited that we are having this conversation, and I am deeply appreciative of the work that you have done, and I am appreciative of the Minority's engagement here. I studied their letter of May 18th, and I want to make some observations and maybe get your view on some of this. Just for the record, the Minority is very focused on the statutory authority. I think it would be very wise, whatever the legal niceties are, for the Fed to move forward with statutory authorization because this is a big deal.

But I want to make an observation. The Minority has accused you of failing to identify the payment system inefficiencies. I think

I am quoting them right in their letter. They write about identifying the problems in the current payment system. That is not a hard question to answer, Dr. Brainard, right? There are still millions of Americans who don't feel comfortable using commercially-backed payment systems. They tend to be immigrants. They tend to be lower-income people. That is correct, isn't it?

Ms. BRAINARD. Yes.

Mr. HIMES. Yes, and I suspect that is always going to be true, and, look, I think it is important for them to have the option to do it. But there is something unique about the full faith and credit of the United States Government, and that is why, of course, people use physical currency.

I also want to spend a moment—I was a technology banker back in the 1990s, and I watched the internet develop. And the truth is that in the mid-1990s, we had no idea what the internet was going to be. We had no idea in the late 1990s that someday the internet would enable your refrigerator to text you at your office to tell you that you needed more milk. We didn't dream of that. I am not sure that we wouldn't have looked at travel agents and said, that is a clearly inefficient system, at the time. My point is that we just don't know, but we would be making a terrible mistake if we stood in the way of innovation because the problems of today don't actually indicate where this may go.

The second issue I want to maybe get your agreement on, too, and I worry about the Minority, sort of, because I think the outcome here is one in which the Federal Government, the Federal Reserve provides a foundation upon which the private sector innovates in a big way. The government should not squeeze out the private sector.

But I wave this thing around a lot. This is the iPhone that I use. We are all enslaved to these things. But this is the metaphor for what we are doing because this thing is made by a private company. It has apps, and semiconductors, and all sorts of things that have created immense wealth in the private sector. But this thing is cool because decades ago, the Federal Government invested a huge amount of money in semiconductor research. It is pretty cool because when the Federal Government created the Advanced Research Projects Agency Network (ARPANET), in the Advanced Research Project, they didn't see that it would lead to the internet. The only reason location services work on this device is because the United States Government maintains 31 global positioning satellites above our heads.

And the reason I tell that story is because this is the story of innovation. You can call it a partnership. You can call it a foundation that the government sets up that the private sector builds on. But it is really important that we remember that is the nature of innovation because, look, I am a general cryptocurrency skeptic here, but I don't ever want to do something, including demanding use cases that are very, very specific at a time when we could find ourselves at a competitive disadvantage.

So, Dr. Brainard, I worry about this. If we wake up 6 months from now and the EU has created a digital CBDC equivalent of the Euro, or if the British have developed a CBDC sterling and their private sector in Europe is innovating on top of that foundation, could we find ourselves at a real innovative disadvantage?

Ms. BRAINARD. Yes.

Mr. HIMES. And you talked about this before, but if that happens, and the apps that get built on a euro or a sterling, CBDCs are really attractive, is it possible that around the world, people would migrate away from the dollar as not just a reserve currency, but as a used currency?

Ms. BRAINARD. I think it is, yes.

Mr. HIMES. So, there is a very real risk to our traditional position as an innovator if, by having some ideological split that doesn't exist between the government and the private sector, we allow—I don't worry so much about China; who is going to trust the Chinese digital currency?—Europe, or the U.K., or someone else to move ahead of us. There are some really important risks, and you have highlighted them, associated with a CBDC. We do not want to disintermediate the banking system. We don't want to create a flight to quality and panicked moments. But is it possible that an intermediated system like you called for with wallets that perhaps are held in the private sector, but which are capped in the amount that one can hold and that perhaps are not interest bearing, can you sort of conceive of a structure like that which really creates no risk for the existing financial services system?

Ms. BRAINARD. Certainly in the research that we have done and the paper we put out, it is those caps, the lack of interest that would help to protect the banking system from any disintermediation of deposits.

Chairwoman WATERS. Thank you.

Mr. HIMES. Thank you, Dr. Brainard. My time has expired.

Chairwoman WATERS. The gentleman from Kentucky, Mr. Barr, is now recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman, and Vice Chair Brainard, thank you so much for your insights into this important topic.

I wanted to follow up on Ranking Member McHenry's and Congressman Luetkemeyer's questions about the need for congressional authorization. You reiterated that your January report states that the Fed would not issue a CBDC without congressional authorization. In that report, the Fed committed to moving forward with a CBDC only with clear congressional support, "ideally in the form of a specific authorizing law." You have reiterated that today.

But I want to get into this Executive Order that you mentioned in response to Congressman Luetkemeyer. That March 9th Executive Order requires the Attorney General, in consultation with the Secretary of the Treasury and the Chair of the Fed, to provide an assessment of whether legislative changes would, in fact, be necessary to issue a central bank digital currency should it be deemed appropriate and in, "the national interest." This, to me, suggests that the Administration is not yet convinced that Congress has a role here.

Tell us how the Fed is coordinating with Treasury on this? And if Treasury and the Attorney General take the position that congressional authorization is not necessary, will you, Chairman Powell, and your General Counsel, Mr. Van Der Weide, commit to pushing back to protect the important role of Congress?

Ms. BRAINARD. I appreciate the question. I can certainly say that you are right, that is what the Executive Order asked for. No, I have not been engaged in any of those conversations, but, of course, that is not my expertise, so it would not be likely. But I believe that there have been some staff-level discussions between the Federal Reserve, the Department of Justice, and Treasury, and, of course, I don't know where those discussions are going to go. So, the kind of hypothetical circumstance that you mentioned is very hard for me to speculate on.

Mr. BARR. What I think Congress is expecting, and I hear some bipartisan support for this from Mr. Himes, is that your General Counsel, and Chairman Powell, as the Executive Order requires to coordinate with the Attorney General, take the position you are taking here today, that congressional authorization is required, and we will be following up with you on that.

Let me let me follow up on this deposit substitution concern about a CBDC. You mentioned that a key objective of a CBDC is to promote financial inclusion. You are hearing concern today that this actually might compromise access to credit, that a CBDC would compromise access to credit, especially in rural, community bank-dependent areas like my district, that moving deposits off of bank balance sheets may be harmful to the very people we are trying to help. Talk about that a little bit more. And as you do, I will just quote the Fed itself: "A widely-available CBDC could serve as a closed substitute for commercial bank deposits or other low-risk assets, such as government, money market funds, and Treasury bills. A shift away from these assets could reduce credit availability or raise credit costs for households, businesses and governments."

Ms. BRAINARD. Let me just start by saying that I am very focused on the role of community banks in rural communities, and the really important and unique role they play in providing credit, in particular, to small businesses and to communities there. So, it is a very important link to financial inclusion for rural communities, and I certainly care a lot about making sure that our community banks are vibrant.

Mr. BARR. Can I reclaim my time quickly, and get to your point about intermediation and caps, because I know that is your solution. But I worry that a CBDC, even an intermediated CBDC, where the caps are capped at $5,000 per end-user, would still result in $720 billion in deposits leaving the banking system. And that would, in fact, impact community banks the worst because 46 percent of community bank deposit accounts have less than a $5,000 balance.

Ms. BRAINARD. I think what you can already see today is that there is a big migration of consumers, particularly young consumers, to mobile apps for payments, particularly for peer-to-peer (P2P) payments. We have just seen a tenfold increase just over the last few years alone in those balances that are already not being held in community banks. If you saw stablecoins being prominent in payments, that would also lead to migration. So, I think we need to think broadly about the future of community banks and the vibrancy of deposit holdings in a world that is rapidly digitizing on payments. And of course, as you noted, any system, any design considerations would include a prominent role for banks of all types as intermediaries. And we certainly have been thinking a lot about, are there kinds of restrictions, like no interest payments, restricted caps, that would help guard against risks in moments of instability?

Mr. BARR. How does the intermediary—

Chairwoman WATERS. Excuse me. The gentleman's time has expired.

Mr. BARR. So many questions. Thank you.

Chairwoman WATERS. The gentleman from Illinois, Mr. Foster, who is also the Chair of our Task Force on Artificial Intelligence, is now recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman. There has been some discussion here about what problem this might be solving. And if everyone had access to either a Fed account or Fed bank stablecoins, which were widely used for consumer and commercial payments at negligible cost, roughly how much would vendors and consumers save in credit card fees?

Ms. BRAINARD. I don't have a specific estimate for you, but certainly, transaction costs are very high currently as we know from—

Mr. FOSTER. If you could get back to me with an estimate, I would appreciate it, because that is a big potential consumer benefit.

Now, it seems to me the first, safest step here would be stablecoins issued by a regulated financial institution that were 100-percent backed by Fed Reserves. That seems like the safest thing you can imagine. And the main thing that would be required for this to happen is that the Fed would provide an Application Programming Interface (API) to verify in real time the reserve account balances so that any time anyone was going to mint a stablecoin, the minting process could not complete until the Fed had verified that the updated account balance was, in fact, on reserve. It seems like, technically, this should be a fairly straightforward thing, and I wouldn't be surprised if the parts were already in place in the regulated financial system to make that happen. This approach would also neutralize any monetary effects of changing stablecoin balances. So it seems, from that point of view, it would be a pretty safe thing.

What would be the residual dangers in an initial approach like this, and is this really a project that would take 5 years?

Ms. BRAINARD. Of course, private stablecoins could and are growing in usage every day, and so, what would be different? First, as you say, an entirely reserve-backed stablecoin with very strong regulations and guardrails around it would mitigate some of those financial stability risks. It would not mitigate risks of fragmentation of the payment system or of walled gardens. And that is another really important aspect, I think, of thinking about whether you want a neutral settlement layer that might underpin a variety of stablecoins and other private, innovative solutions. And fragmentation of the payment system is costly. As we know from previous periods, when it makes it difficult to move from platform to platform, it introduces large inefficiencies.

Similarly, if you think about the cross-border case, and, in particular, the cross-border wholesale case, where I think banks are particularly focused as potentially lowering transaction costs, there, too, you would either have a large number of stablecoins, in which case you might have some fragmentation and inefficiencies, or you end up potentially with one very concentrated stablecoin which would require even more regulatory oversight. And, of course, any special stablecoin would lead to the same kind of disintermediation risk as a central bank digital currency.

Mr. FOSTER. Okay. In your testimony, you highlighted the fact that the discussion paper indicated that a Fed-issued CBDC would best serve the needs of the United States by being privacy-protected, intermediated, widely transferable, and identity-verified. You mentioned that you would also need legislation to proceed with CBDCs. Do you also feel that you would need legislation on the digital identity front to make this a realistic possibility? Is that a necessary part of any CBDC program? Are the standards in place already sufficient for that?

Ms. BRAINARD. I would say two things there. One, we talk about trying to strike that balance between privacy and identity verification by leaning on the current system that we have with banks as intermediaries where banks are responsible for verifying identities, and consumers, as a result, have privacy. There is no direct visibility into consumer transactions on the part of the government. But you are asking a broader question about digital identities, and that is really outside the purview of what the Federal Reserve is knowledgeable about or responsible for. And I think it is a much broader and very important question.

Mr. FOSTER. Okay. If you could just let us know who is actually carrying the ball, I would appreciate it.

Chairwoman WATERS. Thank you.

Mr. FOSTER. Okay. Thank you. I yield back.

Chairwoman WATERS. The gentleman from Arkansas, Mr. Hill, is now recognized for 5 minutes.

Mr. HILL. Thank you Chairwoman Waters, and, again, my congratulations, Dr. Brainard, on your new position as Vice Chair for Regulation at the Fed.

This committee's work on digital assets has been one of the bright spots in recent years, and I thank our members for their hard work. I think our committee is among the best-informed Members of Congress on the subject of digital assets, and that is due to the strong bipartisan engagement on that over the past few years. And I particularly appreciate the work of the ranking member and of the chairwoman of the committee and for working on a bipartisan basis here.

I have been urging full consideration of the central bank digital currency, or CBDC, for about 3 years now. And last year, I introduced with my friend from Connecticut, Mr. Himes, the 21st Century Dollar Act to make sure that the U.S. Government has a strategy to maintain the dollar as the primary global reserve currency now and well into the future, with or without a central bank digital currency.

And in 2019, Congressman Foster and I authored H.R. 2211, the Central Bank Digital Currency Study Act, which directed the Fed's

Board of Governors to study a potential CBDC, and its impact on consumers, businesses, monetary policy, and the U.S. financial system. And while that bill hasn't passed, we are here today talking about precisely that kind of a study, so I am delighted to see the work by the Fed, both with the private sector and MIT to conduct this study. And I was also pleased that I think I heard Dr. Brainard confirm that they would not issue a central bank digital currency without clear legislation from Congress, so I thank Mr. Himes and Mr. Foster for working with me on these issues.

In thinking back, looking at the Fed's report, one quote stood out to me: "The Federal Reserve Act does not authorize direct Federal Reserve accounts for individuals, and such accounts would represent a significant expansion of the Federal Reserve's role in the financial system in the economy." Dr. Brainard, just confirming with you, you stand by that and you don't support direct consumer accounts at the Fed. Is that correct?

Ms. BRAINARD. Yes, I think our statute is clear on that.

Mr. HILL. Thank you. And it seems like a clear indication to me, also, that the Fed understands that if a CBDC were to be created here in America, it should be intermediated through the private sector. Whereas companies, not the government would offer these accounts and digital wallets to facilitate the management of CBDC holdings and payments and innovations, that would be also reserved for the private sector. Is that also, again, your confirmation today?

Ms. BRAINARD. Yes.

Mr. HILL. Yes. We have been talking a lot about consumer benefits, about payments being reduced in fees, for example, in offshore dollar exchanges like MoneyGram and things like that, which was a big part of our hearing a few years ago with Libra and Facebook. But I wouldn't call current digital asset transfers on blockchains cheap. Would you say it is inexpensive now to do that?

Ms. BRAINARD. Yes, the numbers I have seen are actually quite expensive.

Mr. HILL. Yes. And also settlement times are long, are they not, compared to if I use my debit card at the Longworth cafeteria and debit my account through Visa Debit, blockchain settlement times are also not instantaneous. Is that not correct?

Ms. BRAINARD. That is correct.

Mr. HILL. Yes. So, there are operational issues that we have, as you say, a lot of work to do before we just instantaneously think this is going to be successful. Are you testifying in a general way that you really prefer a CBDC over a stablecoin innovation regime? Is it unfair for you to say that is your view, or is that a fair way to describe it? Do you actually prefer a U.S. Government-issued CBDC through an intermediary overseen by the Government versus a number of stablecoins?

Ms. BRAINARD. No, I really see the potential for a digital dollar as being complementary to a more stable, efficient system that would include stablecoins and commercial bank money. So, I really see them as potentially enabling private-sector innovation and being fully complementary. And, of course, just to your earlier question on blockchain, obviously blockchain has some real inefficiencies associated with the proof of work. The way that it verifies any kind of ledger with a central permissioned authority like a central bank wouldn't have those kinds of inefficiencies on settlement.

Mr. HILL. Thank you, Dr. Brainard. And, Madam Chairwoman, I have some additional questions I will submit for the record.

I yield back.

Chairwoman WATERS. Thank you. The gentleman from Georgia, Mr. Scott, who is also the Chair of the House Agriculture Committee, is now recognized for 5 minutes.

Mr. SCOTT. Thank you, Madam Chairwoman. Dr. Brainard, I am also, as the Chairwoman said, the Chair of the House Agriculture Committee, in addition to being a senior member on this Financial Services Committee, for 20 years. And it has put me in the pivot of the two essential things that we cannot survive without: access to food; and access to money. So, let me share with you why I am worried, because we have unbanked and underbanked people who don't have access to the infrastructure of our financial system. I am also worried and concerned about the failure of us having financial education to educate people. We are making drastic moves with this cryptocurrency and the subject we are addressing today.

Let me ask you this, so you can address my concerns. How would a Fed-backed digital currency address the various reasons that our low-income consumers say why they are unbanked? They say specifically that they have a lack of physical branches in their communities. What role would that be? They say they have minimum balance requirements, and then also this general distrust of our financial system. How do you address that? You made a statement in your report. You said that a central bank digital currency could have helped millions of unbanked and underbanked Americans during the pandemic. You suggested that if the Federal Government had the option of providing digital cash, people without a bank account could have received relief payments faster and more efficiently. How can you back that up, ma'am?

Ms. BRAINARD. I think the reasons that you noted are the reasons that we see in our surveys, in FDIC surveys, why more than 5 percent of our population doesn't have a bank account, and that does include cost-related concerns, first and foremost, such as minimum balance requirements and unpredictable or high fees, as well as lack of trust, and, as you also noted, lack of convenience, and potentially, a lack of branches. Of course there are some products out there, like the Bank On initiative, where banks are offering low-cost, low-risk consumer checking accounts. I certainly hope that will improve financial inclusion, but many consumers are also moving to payments methods outside the banking system because they are accessible, they are on apps, and because they don't have those kinds of minimum balance requirements. So, it is possible that a digital dollar issued by the central bank could be part of an ecosystem that lowers transactions costs—

Mr. SCOTT. I only have a moment here.

Ms. BRAINARD. Sorry. Yes.

Mr. SCOTT. With all that you said, answer this for me: How do we overcome the challenge of having unbanked and underbanked communities view a central bank digital currency exactly the same as if they had a bank account?

Ms. BRAINARD. A central bank digital currency is really more like a cash analog. It is really in the digital world, the equivalent of holding on to cash or currency. It is direct central bank-issued safe money. Consumers hold that right now in the form of currency, but currency is not always accepted any longer. It is hard to—

Mr. SCOTT. Okay. I have 7 seconds, 6 seconds, but please make a point to address this. We have to bring everybody along with us, including the unbanked and underbanked. And until we have that done, we cannot move ahead and be functionable for all Americans.

Chairwoman WATERS. Thank you. The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Madam Chairwoman, and Ranking Member McHenry. And Vice Chairwoman Brainard, thank you and congratulations for your testimony, and I am glad we are doing this hearing. I wish we had scheduled it when we were in town. I think being live and in-person adds a lot of value, but I am glad we are doing it, nevertheless.

Ms. Brainard, earlier when my colleague, Mr. Barr from Kentucky, was talking with you about your inquiry from the Executive Branch, you pointed out that you hadn't personally been contacted, but you also said that you wouldn't be the subject matter expert. If that is the case, why are you our witness? I think I want clarity there. You seem to be handling the questions well. Who is the subject matter expert that the Administration would be working with, if not you?

Ms. BRAINARD. I think our General Counsel's Office would be the group of people who interpret our statutory language.

Mr. DAVIDSON. Okay. So you mean on statute, not necessarily on the subject at hand, central bank digital currencies?

Ms. BRAINARD. No, my apologies. I was really referring to that specific question about statutory language.

Mr. DAVIDSON. Okay. Wonderful. Thank you for that. And I appreciate the chance to clarify it. And just recently, with my colleague, you pointed out that the analog is more to cash. So, if a person holds $100 of cash in their wallet, is it something the Fed would consider a vulnerability to public safety that must be reported or monitored?

Ms. BRAINARD. No, there is a really important difference, I think, in terms of the anonymity of cash, the potential anonymity of cash. And of course, any future stake cash would continue to be an option for consumers.

Mr. DAVIDSON. Yes. So, is it a vulnerability if a person holds $1,000, or what about $10,000? Is there a point where holding cash is some sort of vulnerability to the financial system?

Ms. BRAINARD. The financial system and consumer preferences are moving away from cash, so this is really just an observation about what is actually happening. We are very committed to provision of currency. We have a lot of really important responsibilities in that regard, and we will continue to be very committed to currency.

Mr. DAVIDSON. I asked the question that way because, frankly, while cash isn't really illegal yet, there is an effort to make the digital equivalent of cash illegal. This is a rulemaking, frankly, first attempted under Secretary Mnuchin and now contemplated under

Secretary Yellen that would ban self-custody. And self-custody of digital currency is essentially the same as self-custody of physical currency or cash. Why do you believe there is scrutiny there?

Ms. BRAINARD. That really sounds like something that Treasury would be best placed to address.

Mr. DAVIDSON. Yes. So as you contemplate central bank digital currencies, what would you consider a permissionless peer-to-peer transaction, because that is the nature of cash. If we are trying to preserve that, wouldn't that make it essential that any future central bank digital currency also preserve those characteristics?

Ms. BRAINARD. That is one of the most, I think, profound questions that we raised in our discussion paper. There is that tension between potential anonymity and concerns, as were noted by other members of the committee earlier, about potential illicit activity and anti-money laundering.

Mr. DAVIDSON. Yes, that is why the government has almost banned cash, not entirely. And to Mr. Scott's concern, the unbanked and underbanked community is already distrustful of banks, and they tend to not have accounts. They want to stay in cash, and sometimes for good reason, and not illicit activity. And I know, frankly, in an adjacent point, 40 of my Democratic colleagues sent a letter to Google because they were concerned that the geolocation tracking could be used by people to regulate abortion, and the reality is their concern on abortion might seem more partisan. But the concern is the surveillance state, and while geolocation can do that, there is a reason they say, just follow the money. We have made cash almost impossible to use, and I think that hurts the unbanked and underbanked the most. Lastly, I will say if you turn the central bank digital currency into this creepy surveillance tool and don't preserve the permissionless characteristics of it, it is going to hurt. It literally is what China is developing, and we shouldn't imitate them. We should protect America's way of life.

Chairwoman WATERS. Thank you very much. The gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Mrs. BEATTY. Thank you very much, Chairwoman Waters, and I would also like to thank Vice Chair Brainard for appearing before our committee today. Much has been touched upon, but it gives me a great opportunity to segue from Mr. Himes, Mr. Davidson, and Mr. Scott.

When I think of technology—going back to Mr. Himes—in my districtc, because of the Intel Project hopefully that will be here, we are going to have a small microchip that is going to control just about everything that we are doing. And I put this in the same alignment when we start talking about whether it is Sandbox, whether it is Coinbase, and any other form of cryptocurrency is education and awareness. We know what happened with the stimulus checks. We had a great idea. We got the monies out there but because of the lack of education, the lack of banking for those who had bank accounts with businesses, but to be in good standing meant you had to have had that much money.

My question, Madam Vice Chair, is, how do we get the underbanked and unbanked educated on this? I am hearing well-educated people on the Financial Services Committee say, "I am a skeptic." Many would say this is the Wild, Wild West. I believe it is the new frontier. I am not a skeptic. I just returned from a CODEL in the Caribbean with Chairwoman Waters, where I got probably the best education on cryptocurrency there with many experts in the Bahamas. So, what is our education and awareness plan? That would be part two, and for everyone, but especially for the underbanked and unbanked.

And then, I will just give you my next question and you can roll the response in, and you have touched on it, and it has been asked in different ways. But when we look at 85 percent of central banks, that is a good portion that currently are exploring a digital currency and end up issuing one. And theoretically, let us just say the United States does not. How does that affect us in our international landscape?

Ms. BRAINARD. Let me just quickly respond to the second question first. I think it is very important for your committee and for Congress generally to be asking that question. I don't think we can take the global status of the dollar for granted. And in a world where other major jurisdictions move to the issuance of their own digital currencies, it is important to think about whether the United States would continue to have the same kind of dominance without also issuing one. It is possible, but it is a very important question.

Mrs. BEATTY. Yes, one other thing. Is broadband important for us to be engaged in this digital currency world?

Ms. BRAINARD. Yes, although offline usage is also an area that will be important to explore for areas that don't have good coverage.

Mrs. BEATTY. And, "good coverage" is the operative phrase, as we weave in other things. Let me remind everybody who didn't necessarily support the infrastructure bill, that as we move forward, broadband was a part of it. So as we keep coming back, we need to think about that in relationship to how we survive financially. Thank you.

In fact, I am not sure what my time period is, so I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you, Mrs. Beatty.

The gentleman from Ohio, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman, and thank you, Dr. Brainard, for being here and sharing your thoughts.

You talked with Mr. McHenry about two of the benefits of a CBDC—avoiding fragmentation and instability—and you cited the recent instability in the stablecoin market as your example for that. Just so we have a base level of understanding, would you agree that, one, the stablecoin that broke and basically went to zero, that was backed by low-quality assets or at least volatile assets? Would you agree that was an algorithmic stablecoin not backed by fiat currency in any way, shape, or form? You would agree with that, correct?

Ms. BRAINARD. It appears that way, yes.

Mr. GONZALEZ OF OHIO. Okay. Would you also agree that the other one that you cited that broke the peg for a period of time does not have the same transparency or isn't as transparent from an asset quality standpoint as maybe we would like in an ideal world? Would you agree with that?

Ms. BRAINARD. Yes.

Mr. GONZALEZ OF OHIO. Okay. Would you also agree that another prominent stablecoin, which is more transparent and claims to have higher quality assets, that did not break the buck, correct?

Ms. BRAINARD. Yes.

Mr. GONZALEZ OF OHIO. Okay. Tell me if this leads you to the conclusion that it leads me to, which is that a well-regulated stablecoin, where we have high standards for quality of assets, and liquidity transparency, and where we really tighten the definitions around what a stablecoin is and what it can hold, would it solve the instability issue that you cited?

Ms. BRAINARD. A very robust set of regulation, akin to bank-like regulations, would solve a bank-run type of instability, yes.

Mr. GONZALEZ OF OHIO. Again, quality of reserve. I think we would probably disagree on sort of the scope of that, but quality of reserves, liquidity, transparency, redemption rights, these are the sorts of things we should be talking about when we are talking about well-regulated stablecoins.

Ms. BRAINARD. Yes. It won't solve the fragmentation problem. It won't solve the interoperability problem. It wouldn't solve the potential—

Mr. GONZALEZ OF OHIO. I want to get to that fragmentation point for a second. You also said that you are in favor of a world where we have coexisting alongside of each other, CBDCs and stablecoins. When you say what you just said about all of these other problems that don't get solved, but then you say that you are for this coexistence, help me understand why that is not speaking out of both sides. You are not both the—

Ms. BRAINARD. Let me just say first, one way or the other, I think the decision about whether to issue a CBDC lies in the future. So, it is really in that world I would see a CBDC as potentially complementary.

Mr. GONZALEZ OF OHIO. Let me just ask you really quickly, in a world where we have well-regulated stablecoins, and there are various providers, you have said that leads to fragmentation. Help me understand why that world, plus a CBDC, in your view doesn't also lead to fragmentation? How are we less fragmented if you are in the camp of saying, I am for both coexisting?

Ms. BRAINARD. Yes, the currency that is backed by the full faith and credit of the U.S. Government naturally provides interoperability between different platforms. And so, in that kind of a world, you would still have a digital asset that would have the backing of the U.S. Government and, therefore, would naturally be that kind of neutral self-settlement asset layer. And different stablecoins could then have different attributes and be part of different ecosystems, but you would have that basic interoperability built in.

Mr. GONZALEZ OF OHIO. Yes, I guess I am still having trouble understanding how, in your view, these could coexist and there not be fragmentation, but I will set that aside for a second. My final question, with 20 seconds left is, have other central banks reached out to your team and expressed concern from a reserve currency status if the U.S. does not have a CBDC?

Ms. BRAINARD. Other central banks have certainly asked us to participate in some of their work in the hopes that the U.S. would—

Mr. GONZALEZ OF OHIO. Specific to the reserve currency status question.

Ms. BRAINARD. Specific to being one of the most important central banks that values privacy and transparency and a set of values around digital currencies that they share.

Mr. GONZALEZ OF OHIO. Thank you. I yield back.

Chairwoman WATERS. The gentleman from Illinois, Mr. Casten, who is also the Vice Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is now recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman, and I am really enjoying this conversation. And thank you, Vice Chair Brainard, for being here today.

I want to start with just some structural issues that I have. I am still having a hard time getting my head around this as long as we have had these conversations. For a U.S. CBDC, my understanding, and correct me if I am wrong, just, "yes" or "no," is that for it to work, it always has to be a liability of the Federal Reserve. Is my understanding correct?

Ms. BRAINARD. Yes.

Mr. CASTEN. Okay. So if that is the case, does that not mean that from a money supply perspective, it is always limited to M1 money supply? There is no multiplier effect, the banks can't lend against deposits, it is always limited to just an M1 money supply issue. Is that essentially correct?

Ms. BRAINARD. It would be akin to cash. It would be the digital analog of cash, currency.

Mr. CASTEN. Okay. I asked that because I am getting to a larger question, so we will get there. But I am hard pressed to think of how a private bank would ever have a specific incentive to take CBDC deposits. I can't imagine the interest rate that gives them the same incentive that they would have if they can lend against deposits. What is the case for why the private banking sector would find CBDCs valuable in their business model?

Ms. BRAINARD. Banks are very important in payments. Consumers are moving away from, to some degree, using their deposit accounts for payments. We have seen that kind of growth in some of the leading mobile payments apps, and so I certainly don't know. Again, I think the reason that we are trying to think in the future about this is because we don't actually know how the financial system is going to evolve, but I would imagine that banks would continue to want to be very active in the payment space, and this is an important service.

Mr. CASTEN. I am not raising these as criticisms of your work or our work. It is just that I understand that you know, as an intermediary of money charging fees, that different types of currency are fungible but with the opportunity to make money in a bank. If I deposit $1,000 in the bank and lend out $800, I just can't see that opportunity existing in a CBDC space. And that is such a huge engine not only of the bank's incentives, but our economy's incentive.

Let me shift if I could, and I am still going to get to the bigger question here if I run out of time. Let's talk about stablecoins that are not CBDC stablecoins. In a world where we have satisfied that there is no differential money laundering advantage or payment time advantage, is there any reason why a stablecoin doesn't fundamentally present the same liquidity and risk issues as a money market fund does and shouldn't have the same sorts of protections around it from a depositor investor protection perspective?

Ms. BRAINARD. Yes. You could think about it as a money market fund or you could think about it as requiring even higher protections as a kind of tokenized deposit, but yes.

Mr. CASTEN. Okay. The reason that I asked those questions, and I don't mean this to sound like a leading question, but I think I am somewhere between Congressman Himes and Congressman Sherman. I love the new technology. I think there is sex appeal. I think we should embrace these things. I also agree with Mr. Sherman that there is the potential for a lot of grift on these devices because they are so sexy and they are attracting a lot of relatively unsophisticated money. Do you have a view, from where you sit as a Vice Chair on FSOC or otherwise, that if we have this thing that is very technologically sexy, lots of people are coming into it. There are sophisticated players that are taking advantage of it.

Do we have enough visibility into the transactions that are going on in these markets, whether inside the exchanges or inside the wallets, to ensure that people are not essentially running a whole lot of pump and dump schemes, for lack of a better word or taking advantage of insider information? Do we have enough regulatory protection to understand what is happening there, because I have a concern, and I would love your thoughts on the time we have left?

Ms. BRAINARD. We certainly don't at the Federal Reserve, and I am guessing several of the other financial regulators might share that concern.

Mr. CASTEN. I would love to follow up offline, because it scares me. That feels like a lot of what is driving the volatility in the space, and it scares me if we don't know how to actually identify how big a deal that is. I see I am out of time, so I yield back. Thank you for your thoughtful responses.

Chairwoman WATERS. Thank you very much. The gentleman from Georgia, Mr. Loudermilk, is now recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Madam Chairwoman. Vice Chair Brainard, thank you.

I know this has been touched on, but I think it is very important. I want to make sure we have a clear understanding in Congress about this CBDC White Paper and the intention of the Federal Reserve to potentially move forward. And I am sure it has been said that the White Paper states that the Federal Reserve does not intend to proceed with the issuance of a CBDC without clear support from the Executive Branch and from Congress, ideally in the form of a specific authorizing law. That is a very loosely-worded phrase, and my estimation is that the Federal Reserve does not intend to proceed with the issuance of a CBDC without clear support from the Executive Branch and Congress, ideally in the form of specific authorizing law.

Could you touch on or confirm that the Fed won't proceed with the CBDC without a specific authorizing law from Congress, or what is the intention?

Ms. BRAINARD. Yes. I think the intention is just as you described it, that we don't intend to proceed without the support of the Executive Branch and Congress, and it would be ideal to have authorizing legislation that is specific to this. It is really as simple as that.

Mr. LOUDERMILK. Okay. If there was an authorization in the form of an authorizing law which would indicate clear support from Congress, but if there wasn't an authorizing law, would there still be an intention to move forward in some way?

Ms. BRAINARD. I think we really want to see that support coming both from the Executive Branch and the Congress before moving forward on actually issuing a digital dollar if the decision was made to move in that direction.

Mr. LOUDERMILK. Okay. We will keep an eye on it, because the words, "we don't intend," leave a lot of ambiguity as far as I would like to hear that we are not going to do it without, but I understand what you are saying. So, we will keep an eye on it. I will move on to another subject.

One of the Fed-cited reasons why a CBDC could be helpful is that about 5 percent of households are currently unbanked, but the FDIC's data indicates that many of those people simply do not want a bank account for various reasons. It is really that a massive government undertaking with a CBDC would be vastly out of proportion to the relatively small scope of the problem. In my mind, that issue, digital currency alone, would not help the unbanked because if they want to be unbanked, they will stay unbanked.

A CBDC would have to be paired with some Fed-sponsored checking accounts to actually have an impact on that, and I think that would be a wildly misguided idea. Our payment systems already work well for the most part, so the best thing to do is to make improvements to the existing system rather than just completely overhaul it, in my estimation.

But another concern with a CBDC is cybersecurity, which is something that I have been very interested in since I have been in Congress, having come from the IT sector. The Federal Government is probably the single biggest cyber risk, and virtually every Federal agency has experienced a data breach.

My question is, if the Fed ever did proceed with a CBDC, it would be catastrophic if cybercriminals were able to manipulate our currency, so how could you ensure that it would be protected against cyberattacks?

Ms. BRAINARD. Yes. Operational and cybersecurity risks are an ongoing challenge for all payment systems, and I think any digital dollar would be the same. And of course, we already are responsible for providing critical pieces of the wholesale payments infrastructure and the retail payments infrastructure. We provided both to the public and to the government. I would just call your attention to Fedwire, to FedACH, and, of course, we are working on

FedNow. So, we already have really important responsibilities in the payment system in collaboration with and in support of the private sector, and we already have very significant cybersecurity responsibilities there. And we recognize how important those risks are and how important each operational resilience is.

Mr. LOUDERMILK. Okay.

Chairwoman WATERS. Thank you.

Mr. LOUDERMILK. Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. The gentleman's time has expired. Thank you.

The gentleman from New Jersey, Mr. Gottheimer, who is also the Vice Chair of our Subcommittee on National Security, International Development and Monetary Policy, is now recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you so much, Madam Chairwoman. And thank you, Vice Chair Brainard. It is good to see you. Thanks for being here to discuss digital assets and Federal Reserve's research on central bank digital currencies.

Vice Chair, as you know, many Americans are already storing their hard-earned dollars in privately-issued digital assets, like stablecoins, as we have been talking about today. While some stablecoins are less stable than others, I believe it is possible to establish guardrails to ensure Americans can distinguish stablecoins that are backed one-to-one with liquid assets from others that have questionable or nonexistent financial backing.

My draft legislation, the Stablecoin Innovation and Protection Act, would establish a definition and requirements for qualified stablecoins, and in the bill, qualified stablecoins are defined as cryptocurrencies redeemable one-to-one for U.S. dollars. This legislation would reduce financial instability in markets, protect consumers, and support innovation in American fintech. It would also create a pathway for both banks and nonbanks to acquire a qualified status for stablecoins they issue.

With Federal oversight, do you believe that non-bank entities can be reliable issuers of qualified stablecoins if they can prove they are fully backed by cash or cash equivalents?

Ms. BRAINARD. Yes.

Mr. GOTTHEIMER. Excellent. And if a system of qualifying stablecoins was implemented, what specific guardrails would you like to see in place for non-bank issuers?

Ms. BRAINARD. I think that the present working group put out a variety of requirements that would be important. Of course, they are focused on bank-issued stablecoins. But I think any set of stablecoins would need to have a similar, very strong set of protections regarding assets, the actual consumer protections, investor protections, transparency, and cybersecurity. There is a very important list of protections that would be very important for a stablecoin to be able to redeem reliably and to not be subject to consumer and investor fraud and other kinds of protection concerns.

Mr. GOTTHEIMER. Thank you so much. I appreciate your insight, and I am looking forward to continuing with the conversation there. I would like to shift, if it is okay, with you a bit to discuss the need to support continued innovation in digital assets. In the Federal Reserve's recent report, "Money and Payments: The U.S.

Dollar in the Age of Digital Transformation," the Fed explored the potential benefits and risks associated with issuing a central bank digital currency, as you have also obviously been addressing. The technology that supports digital assets is rapidly evolving, as everyone knows, in this area of finance and has been a great source of innovation in recent years. And if one were established, how do you see a CBDC interacting with privately-issued digital assets like stablecoins?

Ms. BRAINARD. I think that having a digital currency that is backed by the full faith and credit the U.S. Government as currency is unique, and would be unique, and could actually be an important support to a broader system of private-sector innovation, much as the Federal Reserve today, the payment services it provides, and the issuance of currency it provides under BIRD private-sector innovation. In the comments we have gotten back from innovators and payments providers, they really talk about the potential for a digital currency issued by the central bank to provide a neutral settlement asset on a neutral layer in the technology stack that would enable interoperability and be a stable underlying neutral asset.

Mr. GOTTHEIMER. Thank you for that. I appreciate it, and I appreciate you for your work. I yield back the remainder of my time. Thanks.

Chairwoman WATERS. Thank you. The gentleman from North Carolina, Mr. Budd, is now recognized for 5 minutes.

Mr. BUDD. I thank the Chair. Vice Chair Brainard, thanks for being here today to discuss the Fed's plan for a CBDC or digital dollar.

Historically, the Federal Government has not had the best track record when it comes to innovative thinking versus the private sector. Government innovation seems like sort of an oxymoron, if you will. Here is what I want to know: What is the Fed trying to achieve by issuing a CBDC that the private market hasn't already been able to do? Here is why I asked. It is because when I look at private-sector innovations, like stablecoins, I already see that many of the claims of a CBDC have been achieved by stablecoin providers, for example, USDC, the U.S. dollar coin issued by Circle.

Ms. BRAINARD. Yes. First of all, no decision has been made. We are really exploring this topic, and there are risks with action, and risks with inaction. But the U.S. Federal Reserve uniquely can issue currency that is backed by the full faith of the government. Of course, no private entity can do that, so it just plays a different role. And I think what Congress has always asked the Federal Reserve to do is to play a role alongside the private sector. That is why we have really important payment systems, like Fedwire.

I think there is a general recognition that when there is a completely secure, trusted asset that underpins the system, private innovation can actually be stronger and more robust. And that is really the question here, whether by being that neutral settlement asset, that foundational layer, it might actually lead to greater ability for the private sector to add value and innovate.

Mr. BUDD. Vice Chair, thanks for that. So, there is some possible outcome where the Fed would say they don't need to do anything, the private market just has this handled. You could see that possibly being an outcome?

Ms. BRAINARD. Absolutely. I think that it would simply be different, going into the international payment space with a stablecoin as the kind of dominant digital form of the dollar when other central banks from other countries issue their digital currency from their central bank. That is just a really different approach, but it is certainly one that some people would favor.

Mr. BUDD. Vice Chair, what has gotten us the most on edge or concerned about the Fed issuing a CBDC are the concerns around financial freedom and privacy. Privacy and the lawful use of money without Big Brother keeping tabs is a universal right, so I am not convinced that a centralized digital payment system issued by the government would fully protect users' privacy. What steps would the Fed take to prevent the government from monitoring Americans' financial transactions or prevent certain legal—with an, "L"—transactions from occurring that the government deems high risk or that the government just doesn't generally support?

Ms. BRAINARD. Privacy is a huge issue. It is incredibly important. And that is why the discussion paper that we put out in January says that one of the core principles of any such digital currency, digital dollar is that it would need to be privacy-protected. And what the paper talks about is an approach that is just like your bank deposits today, that there would be no direct connection between the Federal Reserve and consumers, that it would be an intermediated system. Banks could play the same role as they do now with having the transaction records or having obligations in terms of the privacy of those transaction records and being responsible for verifying identities. So, it wouldn't be any different from the system we have today in that regard.

Mr. BUDD. Thank you, Vice Chair. I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Massachusetts, Ms. Pressley, who is also the Vice Chair of our Subcommittee on Consumer Protection and Financial Institutions, is now recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Madam Chairwoman. The creation of a digital dollar is certainly a hefty responsibility. This technology, if properly designed and administered, has the potential to promote financial inclusion, enhance consumer protection, and completely revitalize our public payment and banking services. Today's hearing is on a CBDC, but I do want to begin by highlighting the currently outdated payment system that brought us here, a system where families still have to wait days at a time just to access their own hard-earned money. While the U.K. switched to a real-time payment system back in 2007, the Fed delayed action for an entire decade, and the FedNow system is not expected to be implemented until at least 2023 or 2024.

Vice Chair Brainard, this delay by the Fed has had devastating consequences for working families and, some would argue, has contributed to many people turning towards riskier systems like cryptocurrency, stablecoins, and other private options in search of faster payments. Why should we trust the Fed with the responsibility of designing and implementing a CBDC? Given the Fed's track record, is it safe to trust the Fed with this responsibility, and how do we know this project would not face the same decade-long delays?

Ms. BRAINARD. I think FedNow is going to be very important in terms of offering real-time payments. I agree with you that from the perspective of those small businesses and families that need access to their funds the most quickly, real-time payments can have the largest effect. FedNow didn't get started for a long time because of public debate of the nature that we are having here today. We are a public institution, so unlike a private institution, there needs to be support from Congress and broader support among a whole variety of stakeholders. And that is why FedNow took some time to get that kind of support, get off the ground, but we are now on track to deliver it at this time next year.

And the private sector is quite excited about it at this juncture, although there was a lot of ambivalence in the lead-up to that announcement, and I think it is a really important analog to today. The financial system is moving very rapidly. It is very hard for us to see 5 years out; if we wait until 5 years to decide to launch, it will probably be another 5 years before we could actually deliver. And that is why I think it is really important to do that work.

Ms. PRESSLEY. Thank you, Vice Chair. I'm sorry. I have a couple of other questions I want to get in, so I am just going to reclaim my time here. I think the point here is that many countries have been able to set up a real-time payment system much more quickly and efficiently than us, and it is critical that our nation is meeting the evolving needs of the digital economy. And let me be clear: The Fed is not and has never been the sole Federal entity responsible for issuing currency or administering public payments. The U.S. Mint issues coins, and the Postal Service provided postal banking services for decades until it was shut down. Today, Treasury's Bureau of the Fiscal Service partners with banks to issue prepaid debit cards to millions of unbanked and underbanked individuals.

Vice Chair Brainard, do you agree that instead of expecting the Fed to solely shoulder the burden of determining any kind of CBDC architecture, we should be bringing in other key agencies and actors into this process from the onset that are proven?

Ms. BRAINARD. We do partner with Treasury on those prepaid cards. We do partner with other agencies. We provide a lot of the services in the rail. We are in partnership with a variety of agencies. So yes, I agree with you.

Ms. PRESSLEY. That is good to hear, because as we evaluate how to design and build our digital currency architecture, we should be involving other public agencies like Treasury, and the Postal Service as well. The design and implementation of public digital money will affect everyone, and it is imperative that this process be as inclusive and as democratic as possible, with an explicit focus on financial equity and establishing faster payments while safeguarding communities' right to privacy at the same time. Thank you, and I yield back.

Chairwoman WATERS. Thank you very much. The gentleman from Tennessee, Mr. Rose, is now recognized for 5 minutes.

Mr. ROSE. Thank you, Chairwoman Waters, and Ranking Member McHenry, and thank you, Vice Chair Brainard, for being with us today.

In its discussion paper, the Federal Reserve included a request for public comment on several questions on design considerations as well as on the benefits and risk of the Fed-issued digital currency. One question asked, for example, if cash usage declines, is it important to preserve the general public's access to a form of central bank money that can be widely used for payments. A few responses that you are probably familiar with from commenters include, "That is a loaded question. Stop phasing out cash." Another, "Cash is king. Leave cash alone. Some form of cash will always be necessary. We should always have access to non-digital forms of currency." Yet another, "There will always be a need to use cash." And finally, "We should always have access to non-digital forms of currency."

Vice Chair Brainard, following up on a line of questioning from Mrs. Beatty earlier, if the use of cash declines or continues to decline, I might say, how would individuals in areas that lack access to broadband utilize a central bank digital currency?

Ms. BRAINARD. First, let me just say, we are absolutely committed to continuing to issue currency, and we have a lot of investments in providing cash. So, we are really just going to respond to consumer preferences there, but we couldn't agree more that it is very important for access to cash. Whether there may be less acceptance of cash and payments over time, that is not something that we would obviously have any control over, but we are certainly providing cash, and we think it is very important to continue to do so.

In terms of rural areas, areas that may lack connectivity, one of the areas of research is to think about offline transactions stored value cards. It is a very important set of considerations about making sure that if there were some kind of digital currency, there would be around-the-clock access, including offline.

Mr. ROSE. And you have touched on my next line of questioning, which is, are there any workstreams underway or analysis being done that you could comment on, on the ability to issue a CBDC and maintain an offline option for payments and transmissions, and could you comment on those?

Ms. BRAINARD. Yes, it is one of the workstreams. It is certainly something that we are also in collaboration with some of our pure central banks who are very focused on this issue as well. Obviously, for this to really be an inclusive form of payment, there need to be solutions that address offline usage when the access to the internet is low or nonexistent.

Mr. ROSE. Another question in the Fed's request for public comments was, "Are there additional ways to manage potential risks associated with CBDC that were not raised in this paper?" The responses included things like, "Keep politics out of monetary policy." "The potential risk of corruption and abuse of centralized power and control over all economic activity is too great." And another, "Once the door to the kind of power CBDC creates is opened, it will be abused." And then finally, simply, "Don't do it."

Vice Chair Brainard, we saw how dangerous it can be when the government weaponizes the financial system for political purposes under the Obama Administration's Operation Choke Point. More recently, the Canadian government instructed banks to freeze accounts linked to the trucker protests over vaccine mandates. Vice Chair Brainard, without appropriate safeguards, would a CBDC make it easier for the Federal Government to block individuals it disagrees with from accessing the financial system?

Ms. BRAINARD. I really don't see a CBDC raising questions that are different from deposits and bank accounts, for instance. And the paper that was released in January, in particular, talks about an intermediary model, akin to what we see with commercial bank deposits, where the central bank doesn't have any direct interaction with consumers, doesn't see transactions by consumers, but there are intermediaries, very importantly, including banks that would be responsible for both identity verification and for keeping that transaction data private. So in that sense, I don't see it as really any different than the issues that are raised with commercial bank deposits, and privacy is one of those areas that I think is most important to think really hard about. We asked some really important questions there, and we got some good answers.

Mr. ROSE. Thank you. I appreciate that insight and I hope to hear more going forward. I yield back, Chairwoman Waters.

Chairwoman WATERS. Thank you. The gentlewoman from Michigan, Ms. Tlaib, is now recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Madam Chairwoman, and thank you, Vice Chair, for being with us.

I know given the reliance on electricity and internet access for a functioning central bank digital currency, many folks are not touching on the impact of climate, and I truly believe that the CBDC must take into account severe weather events and climate change impacts. Over the last several years, I have been alarmed at companies like Greenidge reactivating a coal-fired power plant solely for the purpose of mining energy, intensive proof-of-work-based cryptocurrency. When our communities are flooding and our forests are burning, this is simply a huge step in the wrong direction and cannot be a viable model going forward, particularly for CBDC. Vice Chair, how is the Fed approaching these challenges when developing a CBDC?

Ms. BRAINARD. Yes. I think the proof-of-work that is needed as a consensus mechanism in some forms of blockchains is extremely energy-intensive, as you say. Any kind of system that is permissioned where you have a central ledger or a central authority, like a central bank, doesn't require that kind of very energy-intensive consensus mechanism because there is a trusted—

Ms. TLAIB. We have these environmental concerns, and you are talking about proof-of-work. Again, how are we addressing those environmental concerns through the—

Ms. BRAINARD. Any kind of system that would be run by the central bank or where the central bank would be the central authority in terms of who can issue would be on an existing payment system. It would not require those consensus mechanisms that use up all that energy because all these servers would have to be involved in establishing that a transaction had taken place. So, it really wouldn't be very different from our existing payment infrastructure, which doesn't require that kind of energy intensity.

Ms. TLAIB. As you probably know, I represent the third-poorest congressional district in the country. It is a significantly unbanked and underbanked population. And throughout the pandemic, I saw how difficult it was for many of my neighbors who lack access to traditional banking services to receive their stimulus checks or collect unemployment insurance. Our traditional banking ecosystem really failed them precisely when they really needed the money the most. I understand the appeal of digital assets and better payment systems. However, the Fed's current CBDC proposal requires the use of a bank account. And earlier today, you noted that you do not believe the Fed has the authority to authorize direct accounts for individuals.

Vice Chair, can a digital dollar truly function, as you mentioned, as, "a cash analog," while using this intermediate whatever model? How can we make sure that we are removing barriers to financial inclusion, not shifting them around?

Ms. BRAINARD. Yes. I think what a central bank-issued digital currency can sort of help with is reduce transaction costs in real-time payments. What it would need to also see in order to really make a dent in this very important underbanked and unbanked problem that we are all very concerned about is there would have to be other partners, I think, either nonprofits or public partners who would be able to be that intermediary. And, of course, banks are also now starting to offer or are offering Bank On accounts, which are low-cost accounts, so maybe banks can also do that.

Ms. TLAIB. Yes, I know. And Vice Chair, I have said this to my colleagues on this Financial Services Committee. It is not free to bank with these institutions. It actually costs money, and that is sometimes the biggest barrier, right? If I have time, Madam Chairwoman—I don't know if I do. But I know that earlier this week, the Fed's 2021 report on the economic well-being of U.S. households found that low-income and underbanked users were more likely to use cryptocurrency for transactional use, for obvious reasons, because of those barriers, while high-income users were most likely to use crypto purely for investment purposes, and typically had other retirement funds. I am really concerned that many individuals who are currently using cryptocurrency solely for financial access have no choice but to expose themselves to a highly volatile ecosystem. Are you addressing that?

Ms. BRAINARD. Correct. That was a very important finding in this survey. And I agree with you that it would be really important not just to have banks as intermediaries, but also to potentially have other kinds of intermediaries whose business model might be specifically to provide that bridge to consumers who currently, for a variety of reasons, are not comfortable with bank accounts.

Ms. TALIB. Thank you. I yield back.

Chairwoman WATERS. Thank you very much. The gentleman from Wisconsin, Mr. Steil, is now recognized for 5 minutes.

Mr. STEIL. Thank you, Madam Chairwoman. And Vice Chair Brainard, thank you for being here today.

A lot of the conversation today seems to assume that the ease of use of other countries' CBDCs poses a threat to U.S. dollar dominance in the future. And while I recognize that the sophistication and liquidity of our financial markets enhances the utility of the dollar worldwide, I think a big part of the dollar's appeal as a reserve currency is the strong, stable position of the United States.

With that in mind, I am becoming more and more concerned about the worsening fiscal position and how it will threaten the U.S. dollar's central role in global finance.

In its Budget and Economic Outlook, the CBO projected the growing danger posed by rising interest costs. We have taken on a lot of debt. We are running persistent deficits. Meanwhile, interest rates are rising and by all indications are going to continue to rise. And so, I think it is relevant for the committee just to take stock that for reference, the last time inflation was this high, about 40 years ago, the yield on the 10-year note was around 11 percent. We are not close to 11 percent today, but most forecasters, including the CBO, expect the cost of debt to continue to rise. In fact, the CBO projections show net interest costs rising from about $400 billion this year to nearly $1 trillion by the end of the decade, and this, I think, is the number-one issue that we should be discussing, particularly as it relates to maintaining the supremacy of the United States dollar as our global reserve currency.

So with that in mind, with that kind of construct, Vice Chair Brainard, over the course of today's hearing I have noticed that a lot of the disagreement about the structure of the CBDC stems from our different views of what problems the CBDCs are supposed to solve. We have kind of heard financial inclusion. We have heard other things discussed today. And I think one thing that is of note is in the FDIC's survey of how Americans bank, 36.3 percent of unbanked respondents said they didn't have a bank account because they simply don't trust banks, 36 percent said they avoided banks for privacy reasons, and 19.6 percent said banks don't offer the products or services they need.

It is not obvious that a CBDC would necessarily inherently solve these problems, so I would like your input here from a global perspective. Other countries are exploring a CBDC. Specifically, what problems are other countries attempting to solve through their implementation of a CBDC?

Ms. BRAINARD. I think there are a variety of motivations. Financial inclusion is certainly among the problems that some other jurisdictions are solving. There is declining use of cash. That is a very important motivation among several pure central banks, and the focus there is on making sure that consumers, households still have direct access to central bank money as the use of cash as consumer preferences and business preferences decline regarding cash. There is also the motivation of concern about fragmentation of the payment system and potential instability associated with the increased use of stablecoins. And, of course, there is also concern about the very opaque and costly nature of cross-border transactions. That is just a quick summary.

Mr. STEIL. Understood. But have they achieved any of these early goals? Let us just take financial inclusion for a minute, because it is a topic we spent a lot of time working on and thinking about, so I think it is appropriate to discuss. As I noted earlier, many of the reasons folks are not banking in United States involve privacy concerns, I think made worse by the proposals of this Administration to see aggregate inflows and outflows of Americans' bank accounts. In other countries, for our own lessons, have they seen any success with those stated goals, for example, financial inclusion?

Ms. BRAINARD. I think it is a little too early to assess that. The central bank digital currencies that are being issued in foreign jurisdictions are quite recent, and other countries are in the process of developing but have not yet issued them. Some jurisdictions have seen some really, really big improvements in financial inclusion through the use of a government-provided payments app, interestingly. There is a lot of focus, for instance, on Brazil in that regard, and there you have seen a really big increase in financial inclusion.

Mr. STEIL. I appreciate you being here. I am cognizant of the time, Madam Chairwoman, so I will yield back.

Chairwoman WATERS. Thank you. The gentleman from Illinois, Mr. Garcia, is now recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Madam Chairwoman, and thank you, Vice Chair Brainard, for being here today.

I want to, of course, talk about the use of digital assets and payment technologies. As they continue to grow and integrate into our daily lives, it is important that we offer safe and efficient digital tools and assets that will protect consumers and maintain financial stability. I applaud the Federal Reserve for taking the next steps toward improving U.S. payment systems so that vulnerable customers are not left behind in the digital age.

Vice Chair Brainard, I recently co-sponsored the Electronic Currency and Secure Hardware (ECASH) Act, introduced by my colleague, Mr. Lynch of Massachusetts, which directs the Treasury to establish a two-stage pilot program to develop and issue an electronic version of the U.S. dollar e-cash for use by the public. The bill has a major financial inclusion element, because ECASH will not require the use of a bank account. According to the FDIC, over 7 million Americans are unbanked. The ECASH Act ensures that those who rely on physical cash due to mistrust or lack of access to traditional financial services will have the option to use ECASH, allowing users to facilitate online payments and access to the digital marketplace.

Vice Chair Brainard, as the Fed considers its central bank digital currency design, it seems that the Fed has a two-tier system in which a consumer would need to go through a private banking institution to access a central bank digital currency. How will the Fed work to ensure that all consumers have access to a central bank digital currency, specifically the unbanked and underbanked population?

Ms. BRAINARD. I think that financial inclusion question is one that we have and will continue to focus on in our research. My sense is that because of the concern about privacy, and wanting to have an intermediated solution here, or at least if we were to go in that direction, our paper recommends that the question about who might those intermediaries be becomes very important for financial inclusion. And again, the private sector can do a lot of innovation in this arena.

So, if you have a payment asset which is low cost to use, and where you have immediate settlement, there are likely to be nonprofits or other private intermediaries that may innovate on top of that in order to reach underbanked consumers. And of course, it is also true as in your suggestion that other government agencies might be quite relevant there, but it is not the tradition of the Federal Reserve, and statutorily, we are proscribed from directly providing those accounts.

Mr. GARCIA OF ILLINOIS. Thank you. Dr. Brainard, I would like to shift gears briefly and discuss the use of stablecoins for remittances. As you know, Facebook failed in its attempt to use its own stablecoin in 2019 after this committee and other policymakers raised serious consumer protection, financial stability, and consolidation of economic power questions. However, in 2021, Facebook launched a much narrower digital wallet pilot program called Novi, which would facilitate remittances using a stablecoin called the Paxos dollar. While the Paxos dollar is not an algorithmic stablecoin, I worry that there is a potential for the Paxos dollar to lose its alleged dollar peg, like we have seen with the algorithmic stablecoin, Terra. In fact, Tether, the largest stablecoin, briefly lost its peg, as you know, earlier this month, due to this month's crypto crash.

Would a U.S. central bank digital currency provide the potential for a safer and lower-cost alternative to remittances?

Ms. BRAINARD. Remittances is one of the use cases that I think is cited most often. In terms of the potential benefits of a digital currency, that is certainly the main motivation of some foreign central banks, and moving to issue a digital currency is for remittances. And as you know, remittances currently are very, very costly. It's [inaudible] flow to make international remittances. So yes, that is one of the areas that is seen as most fruitful potentially.

Mr. GARCIA OF ILLINOIS. Thank you. My time is up, Madam Chairwoman. I yield back.

Chairwoman WATERS. Thank you. Thank you very much.

The gentleman from South Carolina, Mr. Timmons, is now recognized for 5 minutes.

Mr. TIMMONS. Thank you, Madam Chairwoman. And thank you, Vice Chair Brainard, for being with us today, and congratulations on your recent confirmation.

I want to build on what my friend, Congressman Steil, just touched on. I believe it is more critical than ever that we maintain the dollar as the global reserve currency. But the current state of the U.S. economy with skyrocketing inflation, our $30 trillion debt, and increasing erosion of the confidence of our position as a global leader are all causing some to bring into question the future of the dollar. Just a few years ago, most would argue that there was no real alternative to the dollar, but these conversations have now begun to gain traction.

Recent events have brought forces to bear that could speed up a potential alternative. China is working tirelessly to challenge the dollar, and they are playing the long game. Their Belt and Road Initiative has given them considerable leverage, especially among developing countries all around the world. That, combined with filling the vacuum created by U.S. and EU financial sanctions on Russia and Belarus, gives China the possibility of challenging the dollar far sooner than we may have expected. As the chairwoman just said, trust and confidence in the U.S. institutions provides the global community the ingredients to maintain the dollar as the global reserve currency, but China can possibly browbeat their way past the necessary trust to get a large portion of the world to abandon the dollar, and this is extremely concerning to me.

Additionally, the recent CBO report showed that our national debt will continue to skyrocket to unfathomable levels in the coming decades. Their report tells us that the debt will be 110 percent of GDP by 2032, an all-time record, and we will reach 185 percent of GDP by 2052, 30 years from now. This is all driven by the staggering $72 trillion of spending over the next 10 years, $11 trillion more than the CBO projected in February of 2021.

Admiral Mike Mullen, in 2010 when he was the Chairman of the Joint Chiefs, said that the greatest threat to our national security is Congress' inability to spend within its means, and we had $11 trillion or $12 trillion in debt then. And here we are, we are talking about tens and tens of trillions more in debt just in a few short years. In my opinion, this is the single greatest threat to maintaining our global position. The world needs to be able to trust that we can continue to pay our bills, and the CBO report paints a picture that will make it much harder for us to continue to make that argument.

Do you agree that debt is the greatest threat to maintaining the dollar's current status as the world's global reserve currency? If not, what is? And how would a potential Fed-issued CBDC play into this discussion?

Ms. BRAINARD. I think the U.S. status as a reserve currency is reflective of a host of things: the resilience and dynamism of our economy; the depth and liquidity of our financial markets; and the trust in our institutions and our legal system. And when you think about other residents from around the world, why would they wish to invest in the dollar, all of those things go into it. And certainly, I think that fiscal sustainability is a piece of that picture, but we do have a very dynamic and resilient economy, as we have seen just in the last few years.

In terms of the payments dominance of the U.S., that is really the piece that I think a digital currency goes to. The payments dominance of the U.S. is not something that we can take for granted. As you noted, there are other countries who would prefer not to be using dollars for international payments, and who would wish to be moving away from the kind of international payment system that is very centered around the U.S. dollar. In that context, if other central banks issue their own digital currencies, it is very important for the U.S. to be at the table, to have an important leadership role at the table in determining standards for those kinds of cross-border transactions. And it may be very important for the U.S. to have its own digital currency offering. That is a question, but I think it is an important question that we should just keep in mind as we are thinking about the pluses and minuses of the potential future state of the U.S. and global financial systems.

Mr. TIMMONS. Thank you for that answer. Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you. The gentlewoman from Texas, Ms. Garcia, who is also the Vice Chair of our Subcommittee on Diversity and Inclusion, is now recognized for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Madam Chairwoman, and thank you, Madam Vice Chair, for being here with us today as we discuss the implications of creating a digital currency. And I am not going to call it the fancy, "CBDC," because, frankly, a lot of viewers who are listening to us probably don't understand what that means. So, I am going to just talk generally about the digital dollar equal to our dollar.

So if cash is king, and the dollar is king, then the queen that is equal would be that digital dollar. And I don't mind, for one, that we have some little princes and princesses around the king and the queen, whether it be cryptocurrency, or debit cards, or anything else. I just think we need to make sure that whatever is out there, that as Mr. Scott, my colleague, said earlier, that everyone is brought along and that everyone is included. I know one of my colleagues said that we are all enslaved to the phone. Well, some of us are not. I know I am not. I still have a checkbook, and I still keep it and maintain it, and I have a debit card that I was issued by my bank that I almost never use. One size will not fit all, so we are going to have to keep the options. And I find 5 years a long time to develop this, and, quite frankly, I am not sure that China or the Bahamas took that long.

My first question is, how long will it really take? And then, how will we kind of wean off or balance and make sure that we have the different options for people?

Ms. BRAINARD. The truth is, I don't know what the right number of years is. It really depends on where we are in that decision process. But the piece that takes the most time—

Ms. GARCIA OF TEXAS. I want you to wait and stop interrupting. Where are we in the decision process, because I am a little frustrated, and I am here toward the end, and I have sat here and listened to all of it. It seems that when we had the Fed Chair here, he kind of pointed the finger and said that he was waiting for the Treasury Secretary to say something. Then, she came in, and she said they were waiting for the President's Working Group. Then, the Working Group came in and they said that they need something from Congress. Where does it stop? Who is going to decide, and how long is it going to take, because we don't want to have to have you back here and say, where are we, we are having to catch up. Where are we on this? Tell us what the roadmap is?

Ms. BRAINARD. We have put out a discussion paper, but, of course, Congress has this really important role to play. And so, as we have said, we would like, in making that decision, clear support from both the Executive Branch and Congress. Let me just put that aside because that is really all of you.

In terms of other countries that have built, it probably took China about 6 years to go from their decision to a pilot. What I have said I think is important is that while the public debate and discussion and education are really important and we need to take the amount of time that is appropriate, we can be doing some things at the Federal Reserve. And that is what I am hoping that I can, and my colleagues at the Federal Reserve can, move around.

If you were in Congress to make that decision, we would be further along in that process. We wouldn't be starting from the first day, but we would know a lot about those policy design questions and technology build questions. So, that is the piece that I think we can—

Ms. GARCIA OF TEXAS. Okay. And you keep talking about stakeholders. Could you define what that means? Are you talking to consumer groups? What consumer groups are at the table, what minority groups are at the table, what women's groups, what groups representing rural America, what groups representing just poor people who have little access to cash but actually don't even depend on checkbooks either? They just go cash the check, paycheck to paycheck, and deplore payday lenders. So, who set the table, because they were not at the table when they were not going to be a part of the result?

Ms. BRAINARD. Absolutely. Part of the reason this is a long process in our system is because we have a very rich set of stakeholders. We get comments. That is our first step, is soliciting comments. And consumer groups did submit important comments: payments companies; tech companies; banks. We got a rich set of comments, and now we are kind of systematically going through and making sure we do reach out, particularly to the underbanked, to rural areas, to those who do not otherwise—

Ms. GARCIA OF TEXAS. Madam Chairwoman, I don't believe the witness answered my question. I want to know who is at the table, what consumer groups? So, who is it? Is it the Consumer Federation of America, or are the credit unions at the table? Are the community banks at the table? I think I am struggling with trying to find out just where we are in this process, and I was hopeful that we would get some answers today.

With that, I yield back.

Chairwoman WATERS. Thank you very much.

Ms. BRAINARD. I am happy to go through it. We have talked to the National Consumer Law Center and—

Chairwoman WATERS. We will follow up. I will make sure.

Ms. BRAINARD. I have a whole list for you if that would be helpful.

Chairwoman WATERS. Okay. The gentleman from Michigan, Mr. Huizenga, is now recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman, and it's good to see you again, Vice Chair Brainard.

I want to follow up a little bit on a couple of my colleagues actually on the other side of the aisle. Mr. Himes expressed his view that the benefits of a digital currency are quite clear. I imagine you had a chance to review the letter that Republicans from our committee sent and the questions and concerns highlighted throughout. The crux of the question that Mr. Himes was referring to is whether or not the obstacles in our payment system could best be addressed by a centralized digital currency. And since it is obvious, I am curious, do you believe that is the case or not?

Ms. BRAINARD. The kinds of issues that a central bank digital currency is uniquely able to solve really go to having the full faith and credit behind the issuance of currency. We have that now in physical space. We don't have that in digital space. The financial system is moving extraordinarily rapidly to a primarily digital system. Consumers, households have direct access to safe central bank money today and they can use that for payments, but payments are moving to digital. So the question is, in the future, do we want households to continue to have direct access to safe central bank money? The question also is, in the future, if stablecoins become the predominant mechanism for a digital representation of the dollar, what kinds of instability and fragmentation that may lead to. And if stablecoins are the only digital representation of the dollar, does that potentially handicap us in the international environment? Those are just the questions—

Mr. HUIZENGA. I am going to interrupt you. I am getting Fed-speaked and a little filibustered on that. So is that a, yes, you do agree with that?

[No response.]

Mr. HUIZENGA. Now, I can't hear. I don't know.

Ms. BRAINARD. I really think the right way to think about this is the future state of the payment system, not what the payment system looks like today. Again, it is just evolving so rapidly.

Mr. HUIZENGA. Okay. Well, I look forward to the answers from Chair Powell, in response to our letter I assume you will have involvement on, and so I will move on to an additional question. And I know this was something that has been on the mind of a number of colleagues. I am curious why you think a well-regulated stablecoin would reduce the deposit base even more than a CBDC, and even an intermediated CBDC, could that still possibly erode the deposit base like the digital one?

Ms. BRAINARD. I don't actually have any way of knowing whether a well-regulated stablecoin—how much that might influence the deposit base relative to a digital dollar, really the—

Mr. HUIZENGA. Okay.

Ms. BRAINARD. Yes. I can't assess that.

Mr. HUIZENGA. I want to get to my final question. In February, when we had Treasury Under Secretary Liang here to testify on the President's Working Group on Financial Markets stablecoin report, I asked her about agency coordination. And like Treasury, the Federal Reserve was part of the working group. Just about a month or so before the release of the report, SEC Chairman Gensler stated in an interview that stablecoins, "may have attributes of investment contracts, have some attributes like banking products, but the banking authorities right now don't have the full gamut of what they need and how we work with Congress to sort through that." And since then, the SEC has continued to offer contradictory statements, providing little or no clarity on the issue.

Vice Chair Brainard, we have talked a lot this afternoon about stablecoins and how a CBDC would be in direct competition to them, but clearly the SEC has a role to play in all of this. Can you briefly explain to the committee how the Federal Reserve is coordinating with the SEC on that particular issue?

Ms. BRAINARD. Yes. I actually see a potential digital dollar issued by the central bank as complementary to private-sector innovation and to stablecoins as coexisting with a central bank with commercial bank money and stablecoins and potentially actually spurring private-sector innovation, so a little different. And of course, we collaborate closely with the SEC. That is very important.

Mr. HUIZENGA. I yield back.

Chairwoman WATERS. Thank you very much. The gentleman from Massachusetts, Mr. Auchincloss, who is also the Vice Chair of the committee, is now recognized for 5 minutes.

Mr. AUCHINCLOSS. Thank you, Madam Chairwoman, and Vice Chair Brainard, I appreciate your time today and your answers in this long session. When you get to me, you are almost done.

I am also glad that over the course of this session, you have really cleared up that you agree that you require congressional authorization to issue a CBDC. You had me a little nervous there at the top of the hearing, but I am glad because I strongly believe that both the letter and the spirit of the law is such that you would need congressional authorization to issue a CBDC.

And that is important because I think there is a lot of skepticism still that I am hearing and that I share about the utility of a CBDC, both because it is a solution in search of a problem, although you have offered a couple of potential solutions, because of the security cybersecurity of this, because of its potential to infringe on Americans' privacy, and because any time you have programmable currency in the hands of a centralized power, you risk the fact that it can be politicized very easily, and that would be hugely detrimental to the United States dollar being the world's reserve currency. However, I strongly support your pursuit of research and development on a CBDC, because I do think it gives us better standing in negotiations for international protocols, and so I think the R&D is good, even though I am not sold that it should go on to the product stage.

I want to continue with the line of questioning from my colleague from Ohio, Mr. Gonzalez, about fragmentation. You have offered as one of the potential reasons for CBDC, that it is the only way that you have the full faith and credit behind a stablecoin. I don't really understand that because a well-audited and transparent stablecoin regime, like we have seen with USDC, really does, de facto, have the full faith and credit of the United States dollar behind it. Because it has U.S. dollar-denominated securities behind it, it is really just one step removed. Am I missing something there?

Ms. BRAINARD. I think it is quite different to actually issue the digital asset as opposed to a digital asset that has reserves behind it.

Mr. AUCHINCLOSS. Why? For purposes of actual use in the market, why is that different? If you have a stablecoin that is directly backed, audited, and disclosed by fiat currency that is the full faith and credit, what is the missing link there?

Ms. BRAINARD. The missing link is that you would have one tokenized asset that would be seen as having the full faith and credit of the U.S. Government behind it, because the U.S. Government actually issued it and—

Mr. AUCHINCLOSS. Yes. But again, we are kind of going in circles here because something like a USDC is backed by U.S. dollar-denominated currency that is the full faith and credit. So as long as there is an auditing and disclosure regime for the stablecoin, you have the full faith and credit behind it. Now, the market can price whether they think the liquidity is appropriate, whether it is 90-day securities or 180 day or—

Ms. BRAINARD. That may be right. But clearly, in the case of money market funds, that ability hasn't been foolproof, and so we have seen runs on money market funds repeatedly actually. It is different to have a stablecoin than to have a currency issued by the central bank, and there are a number of protections that you can kind of layer on. The more you layer on those protections, of course, the more that private sector asset may be less able to be used in certain ways. So, there is a tradeoff there.

Mr. AUCHINCLOSS. Reclaiming my time then, Vice Chair, you have been promoting this idea of a CBDC also as a solution to fragmentation and as even undergirding public-private coexistence here. I still was unclear with your answers to Mr. Gonzalez. How would it help fragmentation to add a CBDC into the mix? What is the actual technical process by which you are improving interoperability in some way?

Ms. BRAINARD. It is creating one asset that every other stablecoin can be seamlessly transferred into and out of, so—

Mr. AUCHINCLOSS. We can do that without a CBDC.

Ms. BRAINARD. Not unless they are interoperable, which requires a standard setting and some kind of central agreement around interoperability.

Mr. AUCHINCLOSS. But we could focus on the standard setting and get to the same interoperability without a CBDC.

Ms. BRAINARD. Yes. I think the question is just whether you want that amount of complexity in the regulatory regime.

Chairwoman WATERS. Thank you.

Mr. AUCHINCLOSS. I yield back.

Chairwoman WATERS. Thank you very much. I would like to thank Vice Chair Brainard for her testimony today.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place her responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, this hearing is adjourned. Thank you all so very much.

[Whereupon, at 2:46 p.m., the hearing was adjourned.]

A P P E N D I X

May 26, 2022

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Statement by

Lael Brainard

Vice Chair

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

May 26, 2022

Chairwoman Waters, Ranking Member McHenry, and other members of the Committee, I am pleased to join you today. With technology driving profound change, it is important we prepare for the financial system of the future and not limit our thinking to the financial system of today. No decision has been made about whether a U.S. central bank digital currency (CBDC) will be a part of that future, but it is important to undertake the necessary work to inform any such decision and to be ready to move forward should the need arise.

There has been explosive growth in an emergent digital financial system built around new digital assets and facilitated by crypto-asset platforms and stablecoins as settlement assets. In recent weeks, two widely used stablecoins have come under considerable pressure. One widely used algorithmic stablecoin declined to a small fraction of its purported value, and the stablecoin that is the most traded crypto asset by volume temporarily dipped below its purported one-to-one valuation with the dollar.

These events underscore the need for clear regulatory guardrails to provide consumer and investor protection, protect financial stability, and ensure a level playing field for competition and innovation across the financial system. The recent turmoil in crypto financial markets makes clear that the actions we take now—whether on the regulatory framework or a digital dollar—should be robust to the future evolution of the financial system. The rapid ongoing evolution of the digital financial system at the national and international levels should lead us to frame the question not as whether there is a need for a central-bank-issued digital dollar today, but rather whether there may be conditions in the future that may give rise to such a need. We recognize there are risks of not acting, just as there are risks of acting.

Congress recognized the importance of safe, efficient, and widely accessible payments when it created the Federal Reserve and included payments as a core part of our mission. It entrusted to the Federal Reserve the issuance to the public of government, risk-free currency. The Federal Reserve has operated alongside the private sector, providing a stable currency and operating key aspects of the payments system, while also supporting private-sector innovation.

Today, physical currency provides the public with access to safe central bank money, exchangeable without concern for liquidity or credit risk. The share of U.S. payments made by cash has declined from 31 percent to 20 percent just over the past five years, and the share is even lower for those under age 45. As we assess the future digital financial system, it is prudent to consider how to preserve ready public access to safe central bank money, perhaps through the digital analogue of the Federal Reserve's issuance of physical currency. At present, consumers and businesses do not consider whether the money they are using is a liability of the central bank, as with cash, or of a commercial bank, as with bank deposits. Confidence in commercial bank money is built upon deposit insurance, banks' access to central bank liquidity, and banking regulation and supervision.

New forms of digital money such as stablecoins that do not share these same protections could reintroduce meaningful counterparty risk into the payments system. As we have seen, such new forms of money can lose their promised value relative to fiat currency, harming consumers or, at large scale, creating broader financial stability risks. We have seen before the risks posed by the widespread use of private monies. In the 19th century, active competition among issuers of private paper banknotes led to inefficiency, fraud, and instability in the U.S. payments system, which ultimately necessitated a uniform form of money backed by the national government. A predominance of private monies of this type could introduce consumer protection and financial stability risks because of their potential volatility and the risk of run-like behavior, as was demonstrated at a smaller scale in recent weeks.

In addition, if private monies—in the form of either stablecoins or cryptocurrencies—were to become widespread, we could see fragmentation of the U.S. payment system into so-called walled gardens. In some future circumstances, CBDC could coexist with and be complementary to stablecoins and commercial bank money by providing a safe central bank liability in the digital financial ecosystem, much like cash currently coexists with commercial bank money.

It is also important to consider the potential risks of a CBDC associated with disintermediating banks, given their critical role in credit provision, monetary policy transmission, and payments. In some circumstances, a widely available CBDC could serve as a substitute for commercial bank money, possibly reducing the aggregate amount of deposits in the banking system. And a CBDC would be attractive to risk-averse users during times of stress. Accordingly, if the Federal Reserve were to move forward on CBDC, it would be important to develop design features that could mitigate such risks, such as offering a non-interest bearing CBDC or limiting the amount of CBDC a consumer could hold or transfer.

The future evolution of international payments and capital flows will also influence considerations surrounding a potential U.S. CBDC. The dollar is the most widely used currency in international payments and investments, which benefits the

United States by reducing transaction and borrowing costs for U.S. households, businesses, and government. In future states where other major foreign currencies are issued in CBDC form, it is prudent to consider how the potential absence or presence of a U.S. central bank digital dollar could affect the use of the dollar in global payments. For example, the People's Bank of China has been piloting the digital yuan, and several other foreign central banks are issuing or considering issuing their own digital currencies. A U.S. CBDC may be one potential way to ensure that people around the world who use the dollar can continue to rely on the strength and safety of the U.S. currency to transact and conduct business in the digital financial system. More broadly, it is important for the United States to play a lead role in the development of standards governing international digital finance transactions involving CBDCs consistent with the norms of privacy, accessibility, interoperability, and security.

In January, the Federal Reserve issued a discussion paper, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, to solicit input from the public on this important matter.[1] The paper's comment period closed on May 20, and as of that date, we had received nearly 2,000 comments from a wide range of stakeholders. We plan to publish a public summary of comments in the near future.

The paper emphasizes that a CBDC would best serve the needs of the United States by being privacy-protected, intermediated, widely transferable, and identity-verified. Consistent with these principles, many commenters emphasized the importance of privacy, suggesting innovative ways to protect the privacy of consumers and how to

[1] See Board of Governors of the Federal Reserve System, *Money and Payments: The U.S Dollar in the Age of Digital Transformation* (Washington: Board of Governors, January 2022), https://www.federalreserve.gov/publications/money-and-payments-discussion-paper.htm.

balance privacy with the prevention of financial crimes. It is very important to strike the right balance here, just as commercial banks provide strong privacy protections alongside robust controls to combat money laundering and the financing of terrorism. Other commenters emphasized the importance of a continued role for banks as intermediaries, as suggested by our paper. An intermediated system, in which private intermediaries, including banks, would offer accounts or digital wallets to facilitate the management of CBDC, would leverage the private sector's existing identity frameworks and service provision to consumers while mitigating the risk of disintermediation.

As we move forward, it is essential that we continue to engage with Congress. I appreciate that members of this Committee are bringing a critical focus to this issue.

Statement for the Record

On Behalf of the

American Bankers Association

Before the

House Financial Services Committee

May 26, 2022

American
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Statement for the Record`

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May 26, 2022

Chairwoman Waters, Ranking Member McHenry, The American Bankers Association (ABA)[1] appreciate the opportunity to submit a statement for the record for the hearing titled "Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency." The debate on Central Bank Digital Currency (CBDC) has significant implications for our financial system, economy, and most importantly for the American consumer.

Contrary to popular belief, a U.S. CBDC is not necessary to "digitize the dollar," as the dollar is largely digital today. However, the issuance of a CBDC would fundamentally rewire our banking and financial system by changing the relationship between citizens and the Federal Reserve. The Federal Reserve notes this in its recent Financial Stability Report, highlighting that "[a] CBDC could fundamentally change the structure of the U.S. financial system, altering the roles and responsibilities of the private sector and the central bank."[2]

There is a growing recognition that the deployment and use of CBDCs would be weighed down by very significant real-world trade-offs. The main policy obstacle to developing, deploying, and maintaining a CBDC in the real economy is the lack of compelling use cases where CBDC delivers benefits above those available from other existing options.

Today, we use both public and private money. In developed economies, public money, which includes cash and accounts held directly at the Federal Reserve, makes up about 5% of money.[3] The other 95% is private money—funds held as a liability of a private institution like a bank or credit union. Private money is important because it is created through productive financial intermediation by banks in the form of lending and hence represents expansion, and usually a multiplication, in real economic output. Introducing a CBDC would be a deliberate decision to shift this balance to public money. If, instead, our objective is to realize the benefit of technological innovation, we should look to leverage novel developments in private money (like real-time payments systems and well-regulated stablecoins). Private-sector innovation in banking and payments has made a significant contribution to establishing the U.S.

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[1] The American Bankers Association is the voice of the nation's $24.0 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.9 trillion in deposits and extend $11.4 trillion in loans.

[2] Federal Reserve Board, Financial Stability Report at 44 (May 2022), https://www.federalreserve.gov/publications/files/financial-stability-report-20220509.pdf.

[3] Harvard Business Review, Stablecoins and the Future of Money (Aug. 10, 2021), https://hbr.org/2021/08/stablecoins-and-the-future-of-money#:~:text=Public%20money%20includes%20central%20banks,in%20developed%20economies%20is%20private .

dollar as the reserve currency of the world and is best positioned to support the dollar's preeminent position in the years to come.

There are many proposed designs for a CBDC, and the design choices have a significant impact on the potential risks and benefits associated with each. For purposes of its discussion paper, the Federal Reserve has defined a CBDC as "a digital liability of a central bank that is widely available to the general public."[4] It has also suggested that any CBDC should be "privacy-protected, intermediated, widely transferable, and identity-verified."[5] This approach has helped focus the discussion on the intermediated CBDC model, where a CBDC would be delivered through private-sector financial institutions, but where individual holdings would sit at the Federal Reserve. Importantly, this definition would preclude "direct"[6] and "wholesale"[7] designs of CBDC. Given this focus, the majority of our analysis will evaluate the impact of this intermediated model except where explicitly stated.

As we have evaluated the likely impacts of issuing a CBDC it has become clear that the purported benefits of a CBDC are uncertain and unlikely to be realized, while the costs are real and acute. Based on this analysis, we do not see a compelling case for a CBDC in the United States today.

Proponents of CBDC are driven by a number of laudable goals like financial inclusion and promoting the U.S. dollar's international role as a reserve currency and a medium of exchange for international trade. ABA supports these important goals; however, we do not believe that a CBDC is well-positioned to accomplish them. In many cases, there are initiatives already underway that address these goals. There are also significant trade-offs that must be made between different design choices. These trade-offs are likely to undermine many of the key goals of a CBDC and make it essentially impossible for a CBDC to fulfill all the various purposes for which it is currently being discussed.

ABA is a strong proponent of financial inclusion and we have put significant effort into bringing unbanked families into the financial system. One such effort is our partnership with the Cities for Financial Empowerment Fund (CFE) to promote the Bank On program. A CBDC would do little to address the actual reasons why families report not having a banking relationship.[8] Importantly, a CBDC would only address the question of a deposit account. The benefits of a banking relationship go far beyond a deposit account. The goal of financial inclusion is to build a lifelong relationship that can help families access credit that can help them build for a secure financial future. A CBDC is likely to undermine this goal by failing to promote credit availability to the communities that need it the most.

Similarly, a CBDC does not appear well-positioned to support the role of the U.S. dollar internationally. While many countries have experimented with a CBDC, many have focused on a wholesale model, something not contemplated by the Federal Reserve's discussion paper. In addition, many have pulled these experiments back as the costs of implementation have become apparent. The Federal Reserve notes

[4] CBDC Report, *supra* n.1, at 1.
[5] *Id.* at 2.
[6] A "direct" CBDC means a liability of the central bank held directly by a member of the public, unlike a commercial bank deposit, which is a liability of the commercial bank owed to its customer.
[7] A "wholesale" CBDC means a CBDC designed for use among financial intermediaries only.
[8] These reasons include: inability to meet minimum balance requirements, concern about loss of privacy and/or government surveillance, and the amount or unpredictability of bank fees. Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services" at 3 (Oct. 2020), https://www.fdic.gov/analysis/household-survey/2019report.pdf.

that the dollar's status as the global reserve currency is driven by 1) the strength and openness of our economy, 2) the depth of our financial markets, and 3) the trust in our institutions and rule of law.

Recently, Acting Comptroller of the Currency Michael Hsu highlighted how a CBDC might undermine these critical factors when he noted that the lack of a CBDC was not a gap in the market. He went on to note that our current two-tier banking system is "not an accident. It is the result of a carefully architected monetary and banking system. The robustness and reliability of this architecture, combined with the strength of the rule of law in America and the dynamism of our economy, has supported the role of the U.S. dollar as the world's reserve currency."[9] His speech suggests that responsible, bank-issued stablecoins or tokenized deposits may be a better alternative if we believe that a tokenized form of money is desirable for ease of payments transmission or other purposes.

The risks associated with issuing a CBDC are often downplayed but are real and likely to undermine any possible benefit that a CBDC would have. Most importantly, every construction of CBDC requires moving funds from banks to the Federal Reserve. Regardless of the model chosen, a CBDC is a direct liability of the central bank. According to the Federal Reserve, "[a] widely available CBDC could serve as a close substitute for commercial bank deposits or other low-risk assets such as government MMFs and Treasury bills. A shift away from these assets could reduce credit availability or raise credit costs for households, businesses, and governments."[10]

In effect, a CBDC would serve as an advantaged competitor to retail bank deposits that would move money away from banks and into accounts at the Federal Reserve where the funds cannot be lent back into the economy. These deposit accounts represent 71% of bank funding today. Losing this critical funding source would undermine the economics of the banking business model, severely restricting credit availability. ABA estimates that even a CBDC where accounts were capped at $5,000 per "end user" could result in $720 billion in deposits leaving the banking system.

Policymakers are quickly coming to the same conclusion. In June, 2021, then Vice Chair for Supervision Randal Quarles suggested that CBDCs were an unfortunate fad like "parachute pants" that would be "puzzling or embarrassing" in hindsight. [11] Similarly, Federal Reserve Governor Christopher Waller called CBDC "a solution in search of a problem."[12]

Given the high stakes, it is important we get this right, which is why ABA supports the Federal Reserve's thoughtful and considered approach. The Federal Reserve's discussion paper takes a balanced view of the opportunities and risks associated with issuing a CBDC in the United States. The discussion paper also sets an appropriately high bar for action on a CBDC. We believe that the Federal Reserve should not move forward without a clear analysis that shows the benefits of issuing a CBDC outweigh the risks and that doing so would not create adverse impacts on consumers, markets, or the economy. This analysis must necessarily take into account whether a CBDC is the most effective way to realize these benefits.

[9] Acting Comptroller of the Currency Michael J. Hsu, Remarks Before the Institute of International Economic Law at Georgetown University Law Center, "Thoughts on the Architecture of Stablecoins" at 4 (April 8, 2022), https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-37.pdf.

[10] Financial Stability Report, supra n.2, at 44.

[11] Federal Reserve Vice Chair for Supervision Randal K. Quarles, Remarks at the 113th Annual Utah Bankers Association Convention, "Parachute Pants and Central Bank Money" at 1 (June 28, 2021), https://www.federalreserve.gov/newsevents/speech/files/quarles20210628a.pdf.

[12] Christopher Waller, Member, Board of Governors of the Federal Reserve System, Remarks at The American Enterprise Institute, "CBDC: A Solution in Search of a Problem?" at 11 (Aug. 5, 2021), https://www.federalreserve.gov/newsevents/speech/files/waller20210805a.pdf.

We share the Federal Reserve's view that the introduction of any CBDC should be subject to Congressional approval in the form of an authorizing law.

The recent Executive Order on Digital Assets[13] places an increased focus on CBDC. While much of the executive order calls on federal agencies to assess the expanding marketplace of digital assets before recommending new rules, we are concerned that it clearly directs federal agencies to begin pursuing a CBDC even before determining whether a U.S. CBDC is actually "in the national interest" as the order also requires. Secretary Yellen recently commented on this work, noting that "issuing a CBDC would likely present a major design and engineering challenge that would require years of development, not months."[14]

We look forward to engaging with the Congress and the Federal Reserve as they consider the important questions raised in this discussion paper. The remainder of our response will expand on the following three themes:

- Any potential benefits of a CBDC are uncertain and unlikely to be realized.
- The costs of offering a CBDC are real and acute. The Federal Reserve's discussion paper explores these but does not show the full extent to which they might impact our financial system and economy.
- There are better ways to achieve our shared objectives that do not put our financial system or economy at risk.

I. Any potential benefits of a CBDC are uncertain and unlikely to be realized.

A CBDC is not likely to promote financial inclusion

A foundational goal of many CBDC proposals is to promote financial inclusion. Access to banking services provides people with a means to save for their future and economic opportunity that is critical to promoting social equity. This is an important and urgent goal, but none of the CBDC proposals that seek to promote financial inclusion provide a rationale for how it would accomplish this.

The pandemic has laid bare the consequences of being unbanked, from delays in receiving stimulus payments to navigating additional barriers in the Paycheck Protection Program. Sustainable economic opportunity requires a long-term banking relationship, but according to the FDIC's 2019 "How America Banks" survey, despite some encouraging trends, over 7.1 million U.S. households—5.4%—remain unbanked, and another 24 million households are underbanked.[15] While the FDIC observed "particularly sharp" declines between 2017 and 2019 in the rates of unbanked Black and Hispanic households, 13.8% of Black households and 12.2% of Hispanic households remained entirely unbanked in 2019,

[13] Executive Order 14067 of March 9, 2022, "Ensuring Responsible Development of Digital Assets," 87 Fed. Reg. 14,143 (Mar. 14, 2022), https://www.govinfo.gov/content/pkg/FR-2022-03-14/pdf/2022-05471.pdf.

[14] Secretary of the Treasury Janet L. Yellen, Remarks at American University's Kogod School of Business Center for Innovation, "Digital Assets Policy, Innovation, and Regulation," Sec. IV (Apr. 7, 2022), https://home.treasury.gov/news/press-releases/jy0706.

[15] Underbanked means that a household has an account at an insured institution but also obtained financial products or services outside of the banking system.

"substantially above" the unbanked rate for White households (2.5%).[16] Our nation and industry can do better.

America's banks are committed to promoting financial inclusion and are working to address this challenge. Today, unbanked customers have numerous options to open bank accounts that are designed to address the reasons most unbanked individuals cite as barriers to becoming banked.[17] Through the Bank On program, run by the Cities for Financial Empowerment Fund and other efforts, free and low-cost bank accounts are widely available at banks of all sizes, with new account products being certified every day. Bank On sets account standards that provide a benchmark for safe, affordable accounts at mainstream financial institutions, setting consumers on a path toward financial inclusion. Today, these accounts are available at over 32,500 branches across the United States. And, importantly, they represent the beginning of a banking relationship, which can grow to include lending, saving, investing, and other opportunities.

As the government rushed to distribute millions of Economic Impact Payments during the COVID-19 pandemic, the FDIC, the IRS, Bank On and ABA worked to promote awareness of such accounts so American taxpayers could receive their payments quickly and securely.

It is unclear how access to a Federal Reserve liability would address the reasons for which families report not having a banking relationship. Moreover, by taking too narrow a view of the problem, these CBDC proposals risk undermining the real progress underway with Bank On and similar efforts.

CBDC proposals focus solely on the question of access to a deposit account. While it is true that deposit accounts are often the first step toward financial inclusion, the benefits of a long-term banking relationship go well beyond a deposit account. The same is not true of a CBDC account with the Federal Reserve, which could not grow into a lending or investing relationship as the central bank is neither equipped nor authorized to become a retail bank.

Not only do CBDC proposals not address this serious issue, but they would also likely exacerbate it. Philadelphia Federal Reserve Bank research referenced below found that these proposals would create a "deposit monopoly" that would "attract deposits away from the commercial banking sector." As discussed below, this monopoly would have the effect of reducing the funds on banks' balance sheets that are available to lend and to support loan and investment portfolios, which would reduce access to credit by the communities that need it the most.

A CBDC is not necessary to maintain the dollar's international role

The dollar's status as the world's most widely used currency for payments and investments results from numerous historical, economic, political, legal, and technical factors, but fundamentally stems from the overall size of the U.S. global economic presence, our open financial markets, their deep financial liquidity, widespread international trust in U.S. public and private institutions, and the U.S. commitment to the rule of law.[18] Other countries' use of non-dollar CBDCs will not automatically duplicate any of these key factors. To the extent a non-dollar CBDC is claimed to offer improvements in payments functionality and financial inclusion, as demonstrated above, these innovations are already occurring in U.S. dollar markets, independent of any introduction of a U.S. CBDC. Moreover, as discussed in more

[16] How America Banks, *supra* n.8, at 1–2.
[17] *Id.* at 3.
[18] CBDC Report, *supra* n.1, at 15.

detail below, a CBDC could enable government control over private financial activity in novel ways that could potentially threaten property rights, privacy, and freedom of private economic activity.

Other countries are engaged in CBDC-related research and, in some cases, CBDC pilot programs. For some countries like China, the motivation for issuing a CBDC is to increase the government's ability to supervise and control their economy. These objectives will inevitably undermine such a currency's value to international investors. Many countries that share our objectives in evaluating a CBDC have pulled back on their efforts in a recognition that the significant costs outweigh any benefit. Canada and Australia have recently pulled back on their pilots and the UK House of Lords Economic Affairs Committee found no witnesses articulated the case for a retail CBDC.[19]

II. The costs of offering a CBDC are real and acute. The Federal Reserve's paper explores these costs but does not show the full extent to which they might impact our financial system and economy.

The introduction of a CBDC would risk undermining the important role banks play in financial intermediation

Every construction of a CBDC currently being considered would require moving funds from banks to the Federal Reserve. Regardless of the structural model chosen, a CBDC is a direct liability of the central bank. This arrangement contrasts with bank deposits, which are a liability of an individual bank insured (up to legal limits) by the Federal Deposit Insurance Corporation (FDIC). In effect, a CBDC would serve as an advantaged competitor to retail bank deposits that would move money off bank balance sheets where it can be used to support loan and investment portfolios and lent back into the economy, transferring the funds into accounts at the Federal Reserve. Research by the Federal Reserve Bank of Philadelphia found that these proposals would create a "deposit monopoly" that would "attract[] deposits away from the commercial banking sector."[20]

While depositors at FDIC-insured banks have never lost a penny of an insured deposit, it is hard to compete for deposits with a government agency that prints that money. The Philadelphia Federal Reserve Bank found that depositors value this advantage and will, in equilibrium, choose to hold their funds at the Federal Reserve instead of at retail banks, thereby establishing the Federal Reserve as a "deposit monopolist."

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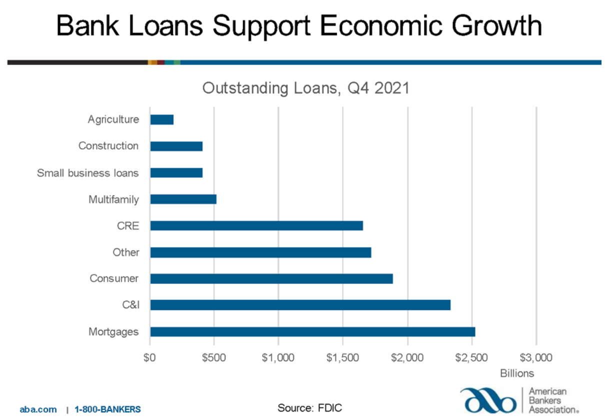
[19] *See, e.g.*, **Bank of Canada:** "We . . . don't see compelling need." https://www.reuters.com/world/americas/bank-canada-not-planning-launch-digital-currency-least-now-2021-10-18/; **Australia:** "[W]e have not seen a strong public policy case to move in this direction, especially given Australia's efficient, fast and convenient electronic payments system." https://www.rba.gov.au/speeches/2021/sp-gov-2021-12-09.html; **UK House of Lords Economic Affairs Committee:** "We have yet to hear a convincing case for why the UK needs a retail CBDC." https://committees.parliament.uk/publications/8443/documents/85604/default/.

[20] Federal Reserve Bank of Philadelphia, "Central Bank Digital Currency: Central Banking for All?" at 27, Working Paper WP 20-19, (June 2020), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2020/wp20-19.pdf.



Deposits held at commercial banks are the primary funding source of bank loans. These loans are critical drivers of economic growth and prosperity. In the United States today, banks fund more than $11 trillion in loans. This includes $2.5 trillion in residential mortgages, $1.9 trillion in consumer loans, and $407 billion in small business loans.[21] Any reduction in the banking industry's deposit base would quickly impact consumers and small businesses in the form of reduced credit availability and increased cost, undermining the goal of financial inclusion and undercutting economic growth.

These impacts are likely to be significant. ABA's analysis suggests that deposits accounting for 71% of bank funding would be at risk of moving to the Federal Reserve. This could increase the average cost of funding for banks by approximately 170 basis points.[22] Such an increase in average funding costs would be unsustainable and would undermine the economics of the banking business model with profound implications for the cost and availability of credit in the United States.

Attempts to limit this deposit outflow by capping account size are unlikely to be successful. Our estimates suggest that a CBDC account capped at just $2,500 would drain $446 billion in deposits to flow out of the banking system. A cap of $10,000 would lead to over $1 trillion in deposits leaving the system. This result would affect all banks but would impact community banks most severely. For context, we believe that 38% of deposit accounts have balances under $2,500 and 53% of accounts have a balance below $10,000. The European Central Bank estimates that a CBDC with account limits of €3,000 would lead to commercial bank deposit outflows of €1 trillion. If these relationships leave the banks, it would not only undermine the bank's business, but leave those customers without a relationship with a financial institution that can provide access to credit. In addition, enforcing compliance with caps and preventing evasion would require tracking individual CBDC holdings throughout the financial system, a serious operational challenge for an intermediated CBDC. Caps, while likely necessary to stem outflows from commercial banks, would also limit the potential benefits of a CBDC account—further diminishing the already theoretical and unlikely benefit of a CBDC. These limits would reduce the business use cases often cited in arguments for CBDC's ability to promote international payments and, thus, international competitiveness.

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[21] Federal Deposit Insurance Corporation, Quarterly Banking Profile, Fourth Quarter 2021 (Dec. 31, 2021), https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2021dec/qbp.pdf.

[22] Assuming cost of funds reflect the 2002–2010 average, and that banks replace these lost deposits with central bank credit.

Moreover, net of any reduction in reserves held at the Federal Reserve by depository institutions, the expansion of the Federal Reserve System's liabilities would be accompanied by a corresponding increase in its assets.[23] Assuming these assets were financial instruments, the new regime would radically increase the relative share of the Federal Reserve's direct credit/funding and, thus, its impact on the economy. To the extent that this balance-sheet expansion was influenced by the relative liquidity, asset supply, and other characteristics of different market sectors, introduction of a CBDC could radically change the allocation of credit and investment in the economy.[24] In times of economic hardship, the bank balance-sheet driven model is even more important—banks' balance sheets and strong capital position allow them to make long-term investments and continue lending throughout a downturn, just when it is needed most.

A CBDC would exacerbate a stress event as consumers opt out of private money

We agree with the Federal Reserve that Central Bank money would be perceived as the safest form of money and that, "a widely accessible CBDC would be particularly attractive to risk averse users, especially during times of stress."[25] The degree to which retail deposits and a CBDC could coexist, which would depend on the design details of a potential CBDC, is unknown, particularly over the medium to longer-term. What is more certain is that during a time of economic or systemic stress, a CBDC would become not just an innovative form of payment, but a risk-free store of value. Even with FDIC deposit insurance, it is likely that many consumers, small businesses, and other "end users" would view direct access to the Federal Reserve as the safest place to weather the storm.[26]

While estimating the effects a CBDC would have on deposits through a period of stress, and the resulting economic impact, is by its nature speculative, we can look to regulatory conventions about the behavior of retail and small business to form a reasonable estimate of stressed deposit outflows. For example, the Liquidity Coverage Ratio[27] assumes that three percent of insured retail and small business deposits will be withdrawn during a time of stress. It is reasonable, then, to assume that at least a comparable amount of deposits would be converted to a CBDC during an economic or financial disruption. Based on the analysis discussed above, an additional $1.3 billion, $2.1 billion or $3.2 billion could potentially flow out of banks to the Federal Reserve's balance sheet during a time of stress, under a regime with an account cap of $2,500, $5,000 or $10,000, respectively.

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[23] *See* CBDC Report, *supra* n.1, at 17.

[24] Furthermore, if the Federal Reserve's asset expansion went beyond financial assets, perhaps in an effort to mitigate changes in credit allocation, it would radically change the nature of the central bank itself, with unforeseeable consequences for monetary policy and the role of government.

[25] CBDC Report, *supra* n.1, at 17.

[26] We believe that a CBDC has would create dynamics and risks similar to those outlined in the Federal Reserve's ANPR on offering interest on balances to Pass-Through Investment Entities (PTIEs), which states: "Deposits at PTIEs could significantly reduce financial stability by providing a nearly unlimited supply of very attractive safe-haven assets during periods of financial market stress. PTIE deposits could be seen as more attractive than Treasury bills, because they would provide instantaneous liquidity, could be available in very large quantities, and would earn interest at an administered rate that would not necessarily fall as demand surges. As a result, in times of stress, investors that would otherwise provide short-term funding to nonfinancial firms, financial institutions, and state and local governments could rapidly withdraw that funding from those borrowers and instead deposit those funds at PTIEs. The sudden withdrawal of funding from these borrowers could greatly amplify systemic stress." 84 Fed. Reg. 8,829, 8,831 (Mar. 12, 2019), https://www.regulations.gov/document/FRS-2019-0067-0001.

[27] 79 Fed. Reg. 61,440, 61,481 (Oct. 10, 2014), https://www.govinfo.gov/content/pkg/FR-2014-10-10/pdf/2014-22520.pdf.

Moreover, a CBDC would likely also cause outflows from deposit equivalent vehicles such as money market funds. While retail MMFs tend to be predominantly invested in Treasury securities, it is reasonable to expect that during times of stress some participants in financial markets will prefer to hold a CBDC. The outflow of funds from the money markets would take additional funds out of financial markets and disrupt money markets and the U.S. Treasury markets.

This likely flight to CBDC would impair the availability of banks to continue to provide credit or meet their customers' emergency liquidity needs, and could potentially create significant systemic strain, as money flows out of the financial sector. Moreover, it is unclear if the funds would return to the financial system once the disruption passed, leading to a further disintermediation of banks and pushing the Federal Reserve further into the space traditionally occupied by the private sector. We do not believe that any design options would sufficiently mitigate the potential outflows of bank deposits and deposit-like vehicles during a time of stress.

A CBDC is likely to balloon the Federal Reserve's balance sheet and impede the transmission of monetary policy

In order to assess the impact of CBDC on the Federal Reserve's balance sheet one could start with the characterization of CBDC in the discussion paper as "analogous to a digital form of paper money." [28] This would be equivalent to cash in circulation and, hence, lead one to a conclusion that it will not have any material impact on the size of the Federal Reserve's balance sheet and its policy rate regime. As we have argued elsewhere, we do not believe this to be a steady state; rather, CBDC would cause a substantial share of bank deposits to shift from bank deposits (and thereby shrink bank balance sheets) to CBDC and consequently, a corresponding increase in the Federal Reserve's balance sheet.

Conventional monetary policy relies on the Federal Reserve's policy rate to impact the amount of credit supplied by banks to the households and businesses—the U.S. economy. Once banks lose their deposit base, unless they can replace it with another source at the same cost, the banking system would no longer be a key source of credit to the U.S. economy. Hence, the Federal Reserve's policy rate would no longer be a viable monetary policy tool.

Brunnermeier and Niepelt[29] have argued that this replacement risk could be addressed by a swap or transfer of CBDCs with bank deposits. This would neutralize the deposit loss for banks from the switch to CBDCs and, hence, not impact their funding to supply credit. This would also help neutralize any impact on monetary policy. Unfortunately, there is no clarity regarding the contractual agreement between the Federal Reserve and banks for such swaps—Would this be a loan from the Fed? What would be the interest rate charged by the Federal Reserve for such loans?[30] What would be the term of these loans (to replicate the duration of different types of deposit accounts)? In addition to fundamentally altering the asset/liability management (ALM) process for the U.S. banking system, there are numerous other important considerations which would likely render it difficult for the Federal Reserve to fully replace the lost deposits for banks. For example, deposit flows to banks are not stationary, and it would just not be possible for the Federal Reserve to replicate the dynamics of these flows. How would the Federal Reserve conduct CBDC-deposit swaps if non-banks are allowed to offer CBDC wallets?

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[28] CBDC Report, *supra* n.1, at 1.

[29] Brunnermeier, Markus K. and Niepelt, Dirk, "On the Equivalence of Private and Public Money", Journal of Monetary Economics 106: 27-41 (2019).

[30] It would also be important to assess the impact on banks' funding costs and deposit rate today are driven by banks competing in the open marketplace.

The discussion paper argues that "an increase in CBDC that pushed reserves lower would also have little effect on the federal funds rate if the initial supply of reserves were large enough to provide an adequate buffer"; but it is unclear how the Federal Reserve would calibrate the size of any buffer. Even if the sizing of the initial supply of reserves is appropriate, we simply do not have any models to figure sizing of reserves over a business cycle.

It is evident that as the deposit base of banks shrinks due to the issuance of CBDC, it would be essential to develop ways to continue funding credit to U.S. households and businesses. As banks would have been disintermediated from the credit supply business, the Federal Reserve could begin to play a more direct role in supplying credit, which, in turn, would lead to a further increase in the size of the Federal Reserve's balance sheet. The serious and troubling implications for the role of the Federal Reserve and the wider government are discussed in more detail below.

We would now be in a fundamentally different state of the world, one where traditional banking services have been fully unbundled and re-bundled in unknown ways, and the Federal Reserve having a permanently bigger footprint in direct credit to the U.S. economy. Accordingly, we believe these theoretical solutions would fail to address the funding loss to banks and force the Federal Reserve to completely rethink its approach to conducting monetary policy.

Direct Federal Reserve credit would also impact its balance sheet. To date, we have seen the Federal Reserve increase the size of its balance sheet to conduct unconventional monetary policy. In a world where bank deposits have shifted to CBDC, and the Federal Reserve is playing a direct role in supplying credit to the U.S. economy, it is fair to presume that any quantitative easing during stressed conditions would only cause the Federal Reserve's balance sheet to grow to an unprecedented size. It is impossible at this stage to predict the effectiveness of current monetary policy tools, and the ability of the Federal Reserve to maneuver its now bloated balance sheet tool in any nuanced manner. We would now be in a world where the policy rate is no longer relevant and the Federal Reserve's balance sheet is permanently bigger even during normal times and the Federal Reserve would have to invent new tools to achieve its monetary policy goals.

A CBDC must carefully balance the need to prevent financial crimes with protecting privacy

For many years, there has been an ongoing debate between the need for transparency, which is critical for combatting illicit finance, and the need to protect the privacy of those conducting transactions. The two competing concerns require a balancing act that is the responsibility of policymakers. [31]

A significant challenge associated with CBDC is ensuring that the central bank is able to identify users and track the movement of funds. Unlike cash, which can be moved anonymously, digital transactions, including CBDC, offer the ability to track the movement of funds. This is a key component to the transparency required to combat illicit finance, since transparency and sharing that information with appropriate government authorities and law enforcement agencies when suspicious transactions involving CBDC are detected is critical. The responsibility for tracking and monitoring for potentially suspicious transactions is a new responsibility that would fall on the Federal Reserve, something it has never handled previously. The critical element is to ensure that the Federal Reserve could determine whether anything is

[31] *See* FATF Guidance: Private Sector Information Sharing (Nov. 2017), https://www.fatf-gafi.org/media/fatf/documents/recommendations/Private-Sector-Information-Sharing.pdf.

suspicious or out of the ordinary for that customer and should be brought to the attention of authorities through the filing of a suspicious activity report (SAR).

While it is necessary to share information about transactions to combat illicit finance, it is also important to recognize that the information shared is often a suspicion only and not a proven determination. Therefore, protecting the privacy and data security of subjects also becomes important. While banks have long-standing policies and procedures for protecting privacy and data security under the Gramm-Leach-Bliley Act and other statutes, it is not clear that similar protections apply to the Federal Reserve or how they will be extended.

Apart from transparency, CBDCs present another unique challenge that is distinct from the movement of actual currency. Physical currency is bulky and difficult to move in large amounts.[32] However, digital currencies, including CBDCs, can be easily moved in large amounts, making them more appealing to criminals and terrorists as a mechanism to move funds. Here again, the ability to track transactions becomes important to combatting illicit finance.

Fundamentally, the Federal Reserve would be taking on an entirely new role for monitoring customers and their activity, an issue that it has not yet addressed but that would be critical if it takes on the role of issuing and holding CBDCs.

A CBDC would expand the role of government

By issuing a CBDC and bringing millions of retail accounts onto its balance sheet, the Federal Reserve would risk becoming politicized as the central control point for monitoring and potentially denying transactions and making decisions about the allocation of credit. For controversial purchases subject to significant local regulation, such as cannabis and firearms, a CBDC would entangle the Federal Reserve as a national arbiter of social issues.

The deposit substitution effect of a CBDC would lead to increased political influence (and possibly manipulation) of monetary and credit policy. As former Federal Reserve Vice Chairman for Supervision Randal Quarles noted recently, if introduction of a CBDC removes deposits from the commercial banking system:

> …that's going to have to be re-intermediated somehow…and either way [whether deposits are re-intermediated directly by the Federal Reserve, or equivalent resources returned to the commercial banking system], those will come with strings. The political system will not allow that re-intermediation from the central bank to the private-sector banking system… [or] to the private-sector economy, … that will come with strings. It will be directed to where the politicians would like it… differential interest rates depending on who the preferred borrowers are in any particular jurisdiction.

The Federal Reserve's discussion design leaves open (or at least does not expressly exclude) the possibility it could exercise affirmative control over private parties' holdings of CBDC. The objectives could vary widely: as an extreme example, the possibility of restricting use of CBDC, or even mandating its expiration or cancellation, could be viewed as a powerful monetary tool, either for tightening

[32] *See* FATF Report: Money Laundering Through the Physical Transportation of Cash (Oct. 2015), https://www.fatf-gafi.org/media/fatf/documents/reports/money-laundering-through-transportation-cash.pdf

(restricting or cancelling existing CBDC), or for stimulus (adding CBDC to the financial system that will expire if not spent within a specified time). The potentially enhanced ability for law enforcement to track private financial activity, noted above, and to impound or seize CBDC would serve very different policy objectives (and may well be appealing in pursuing those objectives), but would create similar uncertainties for holders of CBDC. Particularly when impounds could be executed based only on probable cause, if the mechanics of CBDC lead to more such seizures, the adequacy of procedural safeguards would likely need reexamination. The potential for enhanced surveillance raises similar concerns.

Though presenting both operational and legal/due process challenges, even the potential for such future uses, made possible by CBDC, would obviously present serious policy concerns. Moreover, the existence of such uncertainties, and the long period undoubtedly required to develop broad market confidence (if it could ever be achieved) that such risks were manageable, mean that the added transactional flexibility CBDC proponents claim likely would go unrealized.

The introduction of nonbanks would introduce risks to consumers and financial stability

Serving as an intermediary of CBDC would place significant obligations on the service provider to protect the funds, ensure the privacy of the customer, and process incoming and outgoing transactions without delay. The entities that are most qualified to provide this service are federally insured and supervised financial institutions. The baseline for providing this service must be oversight and supervision that is at least equal to the oversight of chartered financial institutions.

Federally chartered financial institutions are held to a high standard and are subject to stringent compliance and regulatory oversight and examination. Further, those that are federally insured are subject to FDIC oversight to ensure that the financial institution's balance sheet is in adequate condition for it to continue in business. Importantly, these institutions are subject to strict data security and privacy laws that protect their customers' data. Because Congress and regulators, including the Federal Reserve, have long recognized the highly sensitive nature of the customer data that banks hold, the agencies have developed detailed data protection requirements and examination protocols to assure protection. Though some state regulators have been active in creating similar data security regimes, leaving these important questions to the patchwork of state regulations (which would be a consequence of allowing significant nonbank participation) would not only deprive customers of critical protections, but also would curb willingness to use CBDC for significant levels of economic activity.

The introduction of other entities would introduce additional risk. Some may consider money transmitters as one group of potential intermediaries, but that option would significantly increase systemic risk. The current patchwork of regulations that money transmitters are subject to is not adequate. It relies on an uneven layer of requirements, as noted above, being enforced unevenly across the states. Providing CBDC services would be a significant endeavor, requiring that all entities be subject to the same regulation and oversight. The state money transmitter model does not meet this threshold.

Others suggest that some big tech firms could provide CBDC service. This would place customer security and privacy at risk. Most big tech firms mine their customer data and use it to direct more products to them, or they sell that data to third parties who use it to do the same thing. Data about financial transactions can be the most sensitive data a person has. Granting large technology firms and their business partners access to that financial data would put customers at risk.

There is an established regulatory framework for federally chartered financial institutions. They are subject to ongoing oversight and supervision. If unregulated big tech firms became intermediaries, the Federal Reserve would need to create and implement a new regulatory regime to determine entities capable of providing CBDC services and, more importantly, conduct ongoing oversight and examination of these entities. A separate regulatory initiative would be inefficient and ineffective. Moreover, technology companies are likely to have very different incentives in offering access to a CBDC that involves monetizing consumer data to bolster their non-financial services products. If entities want to provide CBDC services, there is already a path ready for them—becoming a federally-chartered financial institution.

There are no effective ways to mitigate the risks posed by CBDC that do not also undermine any potential value

The Federal Reserve's discussion paper recognizes many of the risks detailed above and seeks avenues to mitigate those risks. However, none of these strategies appear well-positioned to mitigate the risks and many would be counterproductive by undermining the potential use cases.

Caps on Account Size

As noted above, caps on CBDC holdings are unlikely to prevent the drain of a significant amount of funds from the banking system. Caps would constrict any payment efficiencies that a CBDC could offer. If private parties can hold only limited amounts of CBDC, larger-volume payment activities would still require use of the current payments system, and it would continue to evolve and improve independent of CBDC payments activity to serve those larger-volume transaction parties. Moreover, the existence of an attractive, conveniently available alternative to bank deposits, even amounts fully insured by the FDIC, seems likely to lead to further bank liquidity strains during market stress. Importantly, political pressure is likely to increase any cap set as time goes by.

The maintenance of account caps would present a serious operational challenge. It is likely that individuals would set up CBDC accounts at more than one financial intermediary. This could be done on purpose to try to get around the limits, unintentionally by those overlooking the aggregate amount in their different accounts, or due to ignorance of the limit. The Federal Reserve or some other agency would need to be tasked with monitoring accounts at every CBDC intermediary to be able to aggregate individuals' CBDC balances. Procedures would be needed to prevent balances above the limit in real time, or else force timely conversions out of over-balances once detected.

Moreover, experience with determination of FDIC-insurable balances demonstrates the complexity of knowing whether end-user account balances are below the limit even at financial intermediaries singularly. For example, how would CBDC balances be allocated for multiple owners of a CBDC account at an institution? And suppose some of those same individuals had other accounts at that institution? The FDIC allows accounts to be insured up to the "Standard Minimum Deposit Insurance Amount" in nine categories;[33] would the CBDC limit apply in these same categories? If not, how would the limit apply with respect to other accounts for overlapping end-users or for accounts of employee benefit plans and trust accounts? The FDIC can attest that trust accounts pose particularly thorny issues.

[33] The nine categories of FDIC insurance coverage include single accounts; joint accounts; certain retirement accounts; formal and informal revocable trust accounts; irrevocable trust accounts; corporation, partnership and unincorporated association accounts; employee benefit plans, and government accounts. (*See* www.fdic.gov/resources/deposit-insurance/brochures/documents/deposit-insurance-at-a-glance-english.pdf.)

To complicate the account data further, the Federal Reserve must realize that aggregate account balances per end-user per financial intermediary would have to be continuously maintained, or at least as of close of business every business day. The FDIC and institutions subject to FDIC rule 12 CFR § 370 (those required to make such insurance determinations daily) can attest to the complexity of such accounting. And yet, every financial intermediary that holds CBDC accounts would have to accomplish this level of recordkeeping, not just institutions with more than 2 million deposit accounts subject to 12 CFR § 370.

Beyond the logistical and civil liberties challenges with tracking and enforcing a cap on a per-person basis, a payments system where endpoints are constrained in their capacity to absorb the flow of funds would quickly become illiquid. A sender of funds would need to know whether the recipient had any "authorized" space in their CBDC quota and would need an entirely new framework for payments that fail because the recipient has "too much" CBDC. Does the sender send the "allowed" amount or does it all get returned? Who would hold liability in this case? Would the disclosure of the amount of remaining authorized capacity for a recipient violate the privacy rights of the recipient or create an easy way for fraudsters to test for the most rewarding accounts to compromise? Where could the sender "park" the excess CBDC while they await a resolution in order to receive more funds themselves?

Not Paying Interest on Deposits

The Federal Reserve discussion paper notes that the "interactions between CBDC and monetary policy implementation would be more pronounced and more complicated if the CBDC were interest-bearing at levels that are comparable to rates of return on other safe assets."[34] Ironically, noting current inefficiencies in the transmission of monetary policy decisions, some monetary policy experts have argued that interest-bearing CBDC would help improve the transmission process.

The theoretical efficiency gain in monetary policy execution would come from an increase in the amount (absolute or relative terms) of money in the economy that is sensitive to the Federal Reserve's policy rate. Here, disintermediating banks and opening up the reserve system to all, would arguably be an improvement. Proponents of CBDC argue that central banks should issue CBDC with a view to improving monetary policy transmission as a goal in itself.

While the Federal Reserve acknowledges that interest-bearing CBDC would further disintermediate other money market instruments like T-bills and money market mutual funds, it is unclear how to evaluate the trade-offs involved in making all these policy choices. The conflicts between policy goals and the design choices we alluded to earlier have to be addressed before attempting to pilot a U.S. CBDC and are a key reason that further study is essential.

Limit a CBDC to Consumers

As noted, concerning caps on CBDC holdings, other limitations, such as prohibiting nonpersonal or institutional CBDC accounts, would constrict any payment efficiencies that a CBDC could offer. Similar to the consequences of caps on CBDC accounts, larger-volume payment activities would still require use of the current payments system, which would still have to serve those larger-volume transaction parties, independent of CBDC payments activity. And even if CBDC holdings were limited to consumers, the existence of an attractive, conveniently available alternative to bank deposits, even if those are fully insured, seems likely to lead to further bank liquidity strains during market stress.

[34] CBDC Report, *supra* n.1, at 19.

III. There are better ways to achieve our shared objectives that do not put our financial system or economy at risk.

While we do not believe there is a compelling case for issuing a CBDC in the United States today, many of the goals outlined are laudable and are worth investing in. There are a number of initiatives underway that help address these. An important decision criterion the Federal Reserve lays out at the start of the discussion paper is that the benefits of a CBDC should outweigh any costs and that it should "yield such benefits more effectively than alternative methods."

The good news is that any innovation in the United States comes from a place of strength. Unlike many other countries, the United States has a well-developed and robust financial system that is the backbone of our economy and markets. Nearly every worker and person receiving government benefits is paid through Direct Deposit, with access to good, spendable funds on or before their pay or benefit date, indicating that essentially every dollar of income in the U.S. is digital. This is important progress toward addressing the family budget timing mismatches that can lead to overdrafts or declined payments. As they have done for hundreds of years, American banks today provide a broad array of essential financial and economic functions that benefit their communities, most notably, safekeeping deposits and making loans.

Financial Inclusion: Bank On

Today, the vast majority of consumers in the United States have a bank account and enjoy the safety, security and benefits that come with it. But there are still some who remain outside the banking system. For those individuals, access to a simple transaction account can be a first step toward long-term financial security.

As part of ABA's commitment to reduce the number of unbanked people in the country, we are encouraging all banks to join the Bank On movement by offering low-cost, basic accounts that meet the Bank On initiative's National Account Standards.

The Bank On national platform, led by the nonprofit, Cities for Financial Empowerment Fund (CFE Fund), helps individuals navigate the marketplace and easily identify accounts that meet their needs.

When an account is Bank On certified, consumers know it has features they are looking for, including low or no fees, no overdraft charges, online bill pay and other basic attributes—giving them more confidence to begin or restart their banking relationship with the right tools to manage their money. Thanks to the efforts of banks and other private-sector stakeholders, more than 230 certified accounts are available to consumers and the rate of individuals without a bank account has fallen to its lowest recorded level of 5.4% according to the FDIC.

Financial institutions offering Bank On certified accounts now comprise 56% of the national deposit market share providing access to over 36,000 branches in all 50 states, and the number continues to grow with more banks in the Bank On pipeline.

Payments system efficiency

For other countries, a CBDC could enhance their payments systems. The United States, however, has one of the most efficient, safe, and modern payments systems in the world. Banks have invested significant resources in expanding faster, safer, and more inclusive options, including P2P, real-time payments systems, and upgraded Automated Clearing House (ACH) products. Solutions to pay gig workers instantly and put funded bank accounts into the hands of disaster victims have recently come online, addressing key use cases proffered for CBDC.

Efforts to modernize and speed up our payments system have been underway for some time and are already being implemented. The Federal Reserve's 2017 Faster Payments Task Force examined the entirety of the payments system and its experts, including consumer groups, recommended faster networks—not a new currency. As a result of these efforts, the Federal Reserve is building out an instant payments solution called FedNow.

Industry has been driving these improvements as well. The RTP Network is a brand new instant payments system that represents an advancement equivalent to moving from dial-up to broadband in terms of speed and features. ABA was a strong advocate for using this capability as part of the Economic Impact Payment (EIP) program to speed electronic payments to those with bank accounts or even prepaid cards.

Together, RTP, FedNow, and faster ACH systems are forming a web of super-fast, low-cost or free digital payment options that will make waiting for days to receive a payment a thing of the past. These are all digital channels that contribute to the fact that the dollar is already digital today.

Bank-issued stablecoins

Private-sector innovation is quickly offering new and compelling financial products. Bank-issued stablecoins and tokenized deposits promise to bring fiat currency onto a blockchain-native platform, creating a programmable asset that can be the basis for further innovation. If policymakers want to leverage the potential of these platforms, they should not look to replace these private-sector innovations but create a regulatory structure that creates a clear path for regulated entities to offer these products in a safe and responsible manner. While we believe there are risks presented by some stablecoin arrangements in the market today, there is also a clear and credible path for regulation that can control for the risks and unlock potential for innovation.

For some policymakers, the risks in the market today are the reason to issue a CBDC. In the past when new forms of private money have emerged, we have not looked to replace them with a government program. Instead, policymakers identify emerging risks and craft regulation to control for those risks. Bank accounts and credit cards are just a few examples of innovations in private money that are well-regulated today, provide tremendous benefit to consumers, and support the role of the U.S. dollar internationally. There are few who believe we would be better off if they were replaced by government programs. The President's Working Group on Financial Markets (PWG) released a report recommending a regulatory framework for stablecoins. In this report they did not recommend that the government replace stablecoins, but instead suggested that the bank regulatory framework is well-equipped to control for the risks presented by stablecoins.[35]

A key recommendation made by this group is that stablecoin issuers be regulated as "insured depository institutions." ABA agrees with the recommendations of the PWG and believes this recommendation is particularly important. The stable nature of these assets means that they are a credible alternative to traditional bank deposits. The regulatory structure that banks are subject to is designed to evaluate the quality of a bank's reserves and ensure that the appropriate consumer protections are offered. While some have proposed a lower standard similar to Money Market Mutual Funds, we do not believe this is

[35] President's Working Group on Financial Markets, the FDIC and the OCC, Report on Stablecoins (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

sufficient. Acting Comptroller Hsu agrees, recently pointing out that "[i]f stablecoins were just an investment product, a money market fund approach based on public disclosure could, in theory, serve as a starting point. There are notable limits to disclosure's effectiveness in preventing runs, however. The need for money market fund emergency lending facilities in the 2008 financial crisis and in the spring of 2020 as part of the pandemic response stand out."[36]

In order to make this possible, we also need regulatory clarity that gives banks the ability to offer stablecoin products. While we believe banks have the legal authority to issue stablecoins, there is not a clear path for regulatory approval. While OCC Interpretive Letter 1174 gave banks explicit permission to engage in stablecoin activities, the more recent Interpretive Letter 1179 requires banks to obtain written non-objection prior to exercising this authority. The FDIC has issued a similar Financial Institution Letter that introduces further uncertainty for banks that want to offer these products in a safe and responsible manner.

In a recent podcast, former Vice Chair for Supervision Randal Quarles made the case that the bank regulatory structure is already well-equipped to supervise stablecoin issuance from banks. He notes that "if you are a bank, then there's nothing much more that needs to be done with respect to your ability to issue with the stablecoins. We will view those liabilities like the other liabilities on your balance sheet and determine in our prudential supervision of your institution in determining your compliance with regulations."[37]

Stablecoins do not necessarily introduce the deposit disintermediation concerns associated with CBDCs. Recent Federal Reserve research finds that stablecoin deposits held as transactional deposits at commercial banks have a neutral impact on deposit substitution so long as "the treatment of stablecoin deposits [is] the same as non-stablecoin deposits."[38] It is critical that we do not disrupt the important deposit intermediation role banks play in our economy. Some policymakers have suggested that banks may need to issue a stablecoin in a separate legal entity to control for intraday liquidity risks. Unfortunately, this approach would reintroduce the same risks and would effectively position stablecoins issuers as narrow banks. Moreover, this approach is not necessary as there are existing facilities designed to manage intraday liquidity risk associated with any form or real-time payment.

If policymakers believe that the bank regulatory framework is appropriate for stablecoin issuers, we cannot also prevent banks from offering stablecoins. If we can provide regulatory clarity that allows for the issuance of well-regulated stablecoins, they will offer any potential benefits of a programmable form of money without disintermediating bank deposits.

Other models of CBDC do not offer a more compelling case

While the Federal Reserve's discussion paper focuses on a CBDC that is "widely available to the general public" and suggests an "intermediated" model is the most appropriate, there are a number of other designs being considered globally.

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[36] Hsu Remarks, *supra* n.9, at 4.
[37] Quarles on Inflation, Politics at the Fed and CBDCs (May 3, 2022), https://podcasts.google.com/feed/aHR0cDovL2ZlZWRzLmxpYnN5bi5jb20vMjYxNjUzL3Jzcw/episode/Yzc4NTA5NGYtNTFjZi00NTkzLWI5NjMtMTUyNTc5NGY2MTE0?sa=X&ved=0CAUQkfYCahcKEwjgILWfjNH3AhUAAAAAHQAAAAAQDA&hl=en.
[38] Board of Governors of the Federal Reserve System, "Stablecoins: Growth Potential and Impact on Banking" at 14, International Finance Discussion Papers (Jan. 2022), https://www.federalreserve.gov/econres/ifdp/files/ifdp1334.pdf.

Direct Model
Policymakers throughout the world have generally concluded that the direct model is not feasible because of the increased costs and operational burdens placed on central banks.[39] A direct CBDC model would effectively set the Federal Reserve up as a retail bank available to every household in the nation. This would present an immense operational burden on the central bank, which would be responsible for onboarding customers and servicing those accounts. Today U.S. banks employ over 2 million people to accomplish the same goal. Among the most critical technical and operational challenges, the direct model risks creating a global target for cyberattacks or a new avenue for money laundering.[40] Moreover, the direct model would significantly amplify concerns about privacy and government surveillance.

Wholesale Model
In a wholesale model, the Federal Reserve would build a new form of master account that would leverage some of the insight learned from its exploration of CBDC. While this approach might mitigate a number of the risks associated with a retail CBDC, it is not clear what technology would be used and what benefits that might yield. As a country, we should always explore whether new technology can improve our payments system and there is work already underway to do just this. We do not fully explore the impact of this in our response and such an approach would require further consultation.

IV. Conclusion

A U.S. CBDC could fundamentally change the role of the central bank in the United States and reshape the banking system. Given the additional complexity, delay, and transition costs involved in creating a new form of money, there are strong efficiency interests that suggest CBDC should only be pursued as a final option to meet clearly defined public policy goals that cannot be achieved through payments innovations that leverage existing digital dollars. As of today, those use cases have not emerged.

Sincerely,

Rob Morgan

[39] This appears to be the position of the ECB. *See, e.g.*, Fabio Panetta, Member of the Executive Board of the ECB, "Evolution or Revolution? The Impact of the Digital Euro on the Financial System," Bruegel Online Seminar (Feb. 10, 2021), https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210210~a1665d3188.en.html ("[t]he ECB does not plan to interact directly with potentially hundreds of millions of users of a digital euro. We simply would not have the capacity or the resources to do so. Financial intermediaries—in particular banks—would provide the front-end services, as they do today for cash-related operations. We would provide safe money, while financial intermediaries would continue to offer additional services to users.").
[40] *See, e.g.*, Lael Brainard, Member, Board of Governors of the Federal Reserve System, "Cryptocurrencies, Digital Currencies, and Distributed Ledger Technologies: What Are We Learning?" Remarks at the Decoding Digital Currency Conference Sponsored by the Federal Reserve Bank of San Francisco (May 15, 2018), https://www.federalreserve.gov/newsevents/speech/files/brainard20180515a.pdf.

Appendix: Impact Analysis

In this section, we assess the potential impact of a U.S. CBDC on the ability of banks to provide credit intermediation. Per the baseline model proposed in the discussion paper, CBDC is defined as "a digital liability of a central bank that is widely available to the general public." Similarly, there is a commitment to follow an intermediated approach, wherein CBDC wallets would be available to consumers through banks and other authorized intermediaries but not through the Fed. Both of these core assumptions are factored into our analysis below.

Bank deposits today are a liability of the bank, and issuance of CBDC would trigger a shift of liabilities from banks to the Fed. The Federal Reserve discussion paper acknowledges that an interest-bearing CBDC would be a perfect substitute for bank deposits, and, hence, "reduce the aggregate amount of deposits in the banking system, which could in turn increase bank funding expenses, and reduce credit availability or raise credit costs for households and businesses."

In the context of this expected deposit substitution, one remedy proposed is that of the Federal Reserve somehow ploughing back the funds into the banking system. In theory, the Federal Reserve would know the amount of CBDC held in every bank's wallet and could credit an equivalent amount of reserves to each bank. To the extent nonbanks and Big Tech firms successfully compete with banks for these CBDC wallets, though, it is unclear whether the Federal Reserve would be able to fully mitigate deposits lost from the banking system.

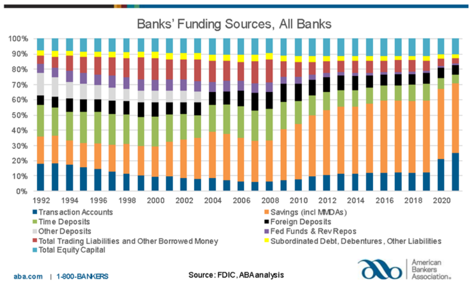
Assessing the potential impact of a CBDC requires making assumptions about design choices and how a CBDC would be used by the public. We first explore how a CBDC that is a perfect substitute for deposits would affect the industry. We find that a perfect substitute CBDC would create significant deposit flight risk that would undermine the economics of the banking business model.

Some CBDC models seek to minimize deposit flight risk by both capping the amount of funds that an individual or other "end user" can hold in CBDC and offering no interest on CBDC balances. Setting aside the challenges this would pose for conducting monetary policy (e.g., setting rates below 0%) and other proposed CBDC use cases (e.g., international payments), we incorporate these assumptions into the second section of our analysis. We find these design choices would not eliminate the deposit replacement problem, particularly for banks with higher shares of small-dollar deposit accounts.

The impact of a perfect substitute CBDC

Deposits are among the most stable sources of bank funding, for which banks fiercely compete. Between 2011 and 2021, deposits comprised 77%, on average, of total aggregate liabilities and equity of the U.S. banking system. Losing these deposits would mean that bank funding costs would increase as banks source alternative and more expensive funding in wholesale markets.

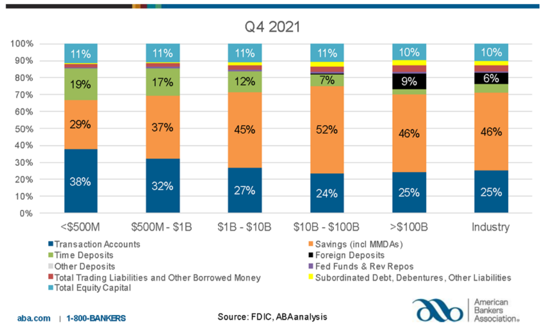
Chart 1: Banking Industry Funding Sources



An interest-bearing CBDC could offer either positive or negative remuneration. In fact, the ability to set the monetary policy rate below the 0-bound is one of the primary benefits cited by CBDC advocates. Since CBDC would be an advantaged competitor to bank deposits, it reasons bank deposits would offer more competitive interest than that offered on a CBDC. With this in mind, we assume that the deposit categories most susceptible to CBDC conversion would be transaction account deposits (which include checking accounts that offer little to no interest) and short-duration, variable-rate savings accounts (not time deposits).

Over the last decade, transaction accounts and savings accounts comprised 59%, on average, of total aggregate industry funding. However, as illustrated in chart 1, the share of industry funding attributable to these deposits has steadily grown over time. As of year-end 2021, banks held \$16.9 trillion of transaction and savings account deposits on their balance sheets—reflecting 71% of total industry funding. Banks of all sizes rely on these deposits to fund operations (Chart 2).

Chart 2: Banks' Funding Sources, by Asset Size



In the extreme case, where all transaction account and savings account deposits are converted into CBDC, the banking industry would lose 71% of its funding and would need to fill that hole with alternative sources. This would not only increase banks' funding costs but completely alter their asset/liability management (ALM) and, thus, the economics of the banking business model. Predicting the impact to cost of funds is complicated by uncertainties about how quickly funds run off bank balance sheets, what alternative funding sources banks turn to, what rates would look like at that time, what second- or third-order effects arise from banks' funding decisions, or whether federal action is taken to create for banks an alternative source of stable, long-term funding.

For the purposes of this analysis, we assume that the average cost of funds from 2002–2010 applies—a period when the federal funds rate steadily rose from 1.00% to 5.25% before being cut to near-zero (Table 1). If banks turned to Federal Reserve funds and repurchase agreements, for example, to fill their funding gap, we would expect an overall increase in funding costs of 71%*(3.32%-0.92%)—or approximately 170 basis points. Such an increase in average funding costs would be unsustainable and undermine the economics of the banking business model.

Table 1: 2002 - 2010 Average Cost of Funds	
Funding Source	All Banks
Transaction and Savings accounts	0.92%
Transaction Accounts	0.31%
MMDA's and Other Savings	1.09%
All Time Deposits	2.95%
Fed Funds and Repurchase Agreements	3.32%
Trading Liabilities and Other Borrowed Money	3.21%
Subordinated Notes & Debentures	4.68%
Source: FDIC, ABA analysis	

This simple example does not account for differences in duration between comparatively stable transaction deposits and alternate funding sources. Factoring in duration would increase the cost estimate via two drivers—the term premium and volatility. There would also be second-order and third-order effects as banks turn to alternate funding sources. For example, if banks turn to time deposits or other non-transaction accounts to make up the funding gap, competitive pressures would drive funding costs higher for these categories. More important, alternate short-term funding sources would drive higher volatility into banks' cost of funds, which, in turn, would fundamentally change their business models, including completely exiting certain product lines, customer segments, and geographies.

Also absent from this analysis is the additional impact one would expect from nonbank fintech and big tech competition. Today, money stored in PayPal or Venmo accounts are held in omnibus accounts at partner banks. In the same way banks compete for consumer deposits, they also compete for these brokered deposits. At the end of 2021, customers held $34.2 billion in accounts managed by just PayPal/Venmo and the Square Cash App. Estimating the additional potential deposit runoff from the loss of these deposits is complicated by data limitations—but the loss of these brokered deposits would only increase the size of the industry's expected funding gap.

The impact of a capped, non-interest bearing CBDC

The Federal Reserve's discussion paper posits capping the size of a CBDC account and making these accounts non-interest bearing as potential mitigants to addressing the deposit replacement concern highlighted above and elsewhere. In this section, we assume that CBDC is non-interest bearing, capped in an effort to reduce the deposit-replacement problem, and only available to natural persons and not to legal or other entities that have deposit accounts.[41] We explore a few different nominal amounts for these caps. For example, a cap set at $2,500 would meet the needs of many lower-income households based on data from the Federal Reserve's 2019 Survey of Consumer Finances (Table 2); a cap set at $5,000 would cover average monthly household cash flows; and a cap set at $10,000 could be considered a reasonable ceiling, as it is the level at which banks begin to file suspicious activity reports.

Table 2: 2019 Median Checking Account Balance, by Income Percentile

Checking Account Percentile	Income Percentile <20	20-40	40-60	60-80	80-90	90-100
10th	**$40**	**$140**	**$300**	**$790**	**$1,500**	$2,900
20th	**$101**	**$350**	**$650**	**$1,400**	**$2,600**	$5,000
30th	**$240**	**$600**	**$1,100**	**$2,000**	$3,600	$7,000
40th	**$400**	**$1,000**	**$1,700**	$3,000	$5,000	$10,000
Median	**$660**	**$1,300**	**$2,110**	$4,000	$6,500	$14,100
60th	**$1,000**	**$2,000**	$3,000	$5,000	$9,000	$20,000
70th	**$1,500**	**$2,500**	$4,000	$7,000	$12,000	$32,500
80th	**$2,300**	$4,000	$6,000	$10,400	$18,500	$58,000
90th	$5,100	$9,000	$10,400	$19,500	$30,000	$118,000
99th	$50,170	$71,000	$72,000	$86,000	$121,000	$505,000

Source: Fed Survey of Consumer Finances

For the purpose of this analysis, we exclude interest-bearing savings accounts and instead focus on transaction accounts. To assess the potential impact of CBDC caps, we consider the case where every banked U.S. adult holds the maximum allowable amount of CBDC and that these funds are sourced from checking accounts. There were 258.3 million adults in the U.S. in 2020 and, according to the FDIC, 94.6% of U.S. households had a bank account in 2019—leaving approximately 244.4 million banked

[41] If CBDC accounts were made available to legal entities, charitable organizations, individual retirement accounts, trusts, estates, and other "end users," the potential leakage from bank deposits could be significantly larger.

adults. Not every individual has $2,500 or more, however, so we combine this assumption with checking account decile data from Table 2 to calculate projected deposit losses.

To illustrate this calculation, let us first focus our attention on households that fall within the 0-20 income percentile. These households reflect 20% of the total adult U.S. population, roughly 48.9 million banked adults. Each checking account decile in this column reflects 10% of the 0-20 income percentile—or 2% of all banked U.S. adults. Therefore, we can expect that 2% of banked adults would only be able to convert $40 into CBDC, regardless of the cap, as that is the average money available to households that fall within both the 0-20 income percentile and first checking account balance decile.

With a CBDC cap set at $2,500—and under our assumption that customers hold the maximum amount of CBDC their checking account can fund—the first 80% of households in the 0-20 income percentile will be able to fully convert their checking account balances into CBDC. The remaining 20% of households convert $2,500—with the residual left as bank deposits. As a result, these households would be expected to convert an average of $1,124.10 into CBDC.[42] Therefore, issuance of a non-interest bearing, capped CBDC is estimated to cause households in the 0-20 income percentile to convert $54.9 billion of deposits into CBDC ($1,124.10 * 48.9 million banked adults). Table 3 below illustrates that CBDC caps of $2,500, $5,000, or $10,000 would result in expected deposit losses of $445.7 billion, $720.9 billion, or $1.08 trillion, respectively.

Table 3: Expected Checking Account Balances Converted Into CBDC

Income	$2,500 CBDC Cap		$5,000 CBDC Cap		$10,000 CBDC Cap	
Percentile	Avg CBDC Conversion	Total Deposits Lost	Avg CBDC Conversion	Total Deposits Lost	Avg CBDC Conversion	Total Deposits Lost
0-20	$ 1,124.10	$ 54,944,376,931	$ 1,624.10	$ 79,383,651,431	$ 2,134.10	$ 104,311,711,421
20-40	$ 1,539.00	$ 75,224,086,911	$ 2,189.00	$ 106,995,143,761	$ 3,089.00	$ 150,985,837,861
40-60	$ 1,836.00	$ 89,741,015,964	$ 2,786.00	$ 136,175,637,514	$ 3,886.00	$ 189,942,041,414
60-80	$ 2,169.00	$ 106,017,572,781	$ 3,619.00	$ 176,891,468,831	$ 5,319.00	$ 259,985,002,131
80-90	$ 2,400.00	$ 58,654,257,600	$ 4,270.00	$ 104,355,699,980	$ 6,820.00	$ 166,675,848,680
90-100	$ 2,500.00	$ 61,098,185,000	$ 4,790.00	$ 117,064,122,460	$ 8,490.00	$ 207,489,436,260
		$ 445,679,495,187		**$ 720,865,723,977**		**$1,079,389,877,767**

Source: Federal Reserve, ABA analysis

The banking industry held a combined $23.8 trillion in assets at the end of 2021. Therefore, deposit losses of $445.7 billion, $720.9 billion, or $1.08 trillion from a capped, non-interest bearing CBDC would result in aggregate funding gaps of 1.9%, 3.0%, or 4.5%, respectively. While these percentage may appear small at a macro level, disaggregated analysis reveals that the impact would be significant at a micro level.

In 2021, transaction accounts comprised just over a quarter of aggregate industry funding (Chart 2). However, aggregate figures mask the impact that would be felt across the industry. Transaction accounts comprise a larger share of aggregate funding for smaller banks than their larger counterparts, but even some large banks rely on these deposits to fund credit creation. Transaction accounts comprised greater than 40% of funding for more than two-in-five banks at the end of 2021 (Table 4).

[42] E.g., With a $2,500 CBDC cap, the average household in the 0-20 income percentile would convert ($40+$101+$240+$400+$660+$1,000+$1,500+$2,300+$2,500+$2,500)/10 = $1,124.10.

Table 4: Transaction Accounts' Share of Banks' Total Funding, by Asset Size						
Share of Funding	<$500M	$500M - $1B	$1B - $10B	$10B - $100B	>$100B	Total Banks
<10%	126	116	174	33	7	456
10-20%	181	72	142	40	15	450
20-30%	413	96	92	8	4	613
30-40%	846	172	121	6	1	1,146
40-50%	831	184	160	18	2	1,195
50-60%	354	89	73	11	5	532
60-70%	89	15	15	3	-	122
>70%	22	4	10	2	-	38
Total Banks	2,862	748	787	121	34	4,552
Source: FDIC, ABA analysis. Q4 2021 consolidated by holding company						

This data shows that deposit account relationships and funds are not allocated evenly across the banking industry. Just as some banks are more reliant on transaction account funding than others, some banks have higher shares of low-value deposit accounts that would be at greater risk of CBDC conversion under these theoretical caps. Determining how many banks this might impact, however, is complicated by data limitations.

To assess how differently sized banks could be impacted, we exploit two data sources: call report data and responses to an ABA survey. The call report includes two line items that can help us get a better picture of the number of banks potentially at risk of significant deposit replacement under the aforementioned caps: the total number and dollar amount held in non-retirement deposit accounts with balances less than $250,000. Together, these figures can be combined to calculate the average balance in these deposit accounts.

Over the years, we have observed that low-balance deposit accounts make up a higher share of deposit relationships (measured in terms of number of accounts), while high-balance deposit accounts make up a higher share of total deposit dollars used to fund bank operations. At the end of 2021, banks held a combined $7.38 trillion across nearly 800 million accounts (31% of bank funding). In aggregate, the average deposit balance in these accounts was only $9,313. Moreover, the average deposit balance was less than $15,000 for over a third of the banking industry (35%)—suggesting a significant share of customer relationships would be at risk at these institutions, even if a CBDC were capped and non-interest bearing.

These figures are consistent with the findings of ABA's CBDC survey. Banks were asked to provide the total number and dollar amount in retail and small business accounts whose average balance in Q4 2021 was less than a given threshold. For consistency across responses, banks were asked to report dollars based on call report item RCON 2215 in schedule RC-E of the call report and total number of accounts based on item RCON F050 in schedule RC-O of the call report. While a CBDC cap set at $2,500 may result in a 1.9% funding gap for the industry, in aggregate, it would place 38% of banks' customer relationships at risk. Table 5 below shows the share of deposit accounts and deposit dollars at risk, by asset size, under our theoretical CBDC caps.

Table 5: ABA CBDC Survey Results						
Asset Size	Share of depost accounts (#) with balances less than			Share of depost dollars ($) with balances less than		
	$ 2,500	$ 5,000	$ 10,000	$ 2,500	$ 5,000	$ 10,000
<1B	35%	44%	51%	4.6%	6.1%	20.6%
$1B-$10B	40%	49%	57%	2.4%	4.9%	9.4%
$10B-$100B	40%	48%	54%	3.6%	6.1%	10.0%
>$100B	38%	45%	50%	1.8%	3.5%	6.2%
All respondents	38%	46%	53%	3.3%	5.4%	13.1%

Source: ABA member survey. Number of accounts based on schedule RC-O item RCON F050. Total transaction account deposit dollars based on schedule RC-E item RCON 2215

This has important longer-run implications for the sustainability of the banking business model. Deposit accounts at a bank are often the first step in the customer relationship journey. Disintermediation of the customer entry-point into the banking system obviously would negatively affect banks but could also have negative consequences for customers. Customers would lose out on having a banking relationship and the ancillary benefits that come with a deposit account. Customers that rely on a CBDC wallet rather than making responsible use of credit cards or other short-term financing could miss out on opportunities to build up their credit history for larger purchases later in life. Any impact study of CBDC on financial markets must explore how banks of all sizes, including community banks, would be affected and how those impacts would ripple through their local communities. This is particularly important if the motivation behind a CBDC includes financial inclusion. Community banks play a critical role in providing financial services to rural and other underserved communities.

May 26, 2022

Central Bank Digital Currency: Significant Risks Must Preclude Adoption

The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency." ICBA believes that clear and significant risks would be derived from the adoption of a CBDC and few if any clearly defined benefits. For the reasons set forth in this statement, ICBA strongly opposes the creation of a U.S. CBDC and urges Congress to oppose this unprecedented and transformative step as well. The policy goals identified in support of a CBDC would best be addressed through alternatives that are readily available in the market today.

ICBA recently filed a comment letter with the Federal Reserve Board of Governors on its public consultation paper, "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," which solicits views from stakeholders on the risks and benefits of a potential U.S. CBDC. The views summarized in this statement are set forth more comprehensively in our comment letter and reflect extensive consultations with community bankers serving rural, suburban, and urban markets in all regions of the United States.

Disintermediation of Community Bank Deposits

The Federal Reserve defines a CBDC as "a digital liability of a central bank that is widely available to the general public." Under the "intermediated" model contemplated by the Federal Reserve, "the private sector would offer accounts or digital wallets to facilitate the management of CBDC holdings and payments. Potential intermediaries could include commercial banks and regulated nonbank financial service providers and would operate in an open market for CBDC services."

Bank deposits are a liability of the issuing bank and reside on its balance sheet. As such, deposits serve as a source of bank lending. By contrast, as a liability of the Federal Reserve, a CBDC, even one that is "intermediated," would not be available to support bank lending. A CBDC would position the Federal Reserve as a direct, advantaged competitor for bank deposits. The Federal Reserve concedes that a CBDC "substitution effect could reduce the aggregate amount of deposits in the banking system, which could in turn increase bank funding expenses, and reduce credit availability or raise credit costs for households and businesses." In other words, a CBDC could create an outflow of deposits from community banks with a direct and adverse impact on credit availability. The risk of this scenario would be accentuated in a financial crisis. Because a CBDC would not have credit or liquidity risk, depositors might "run on the bank" and transfer their balances to CBDC wallets. The digital nature of CBDC would allow these transfers to occur with unprecedented speed, triggering a chain reaction of events that could lead to bank failures.

ICBA strongly objects to any policy change that would disrupt credit availability needed to support consumer spending, home purchasing, business working capital, investment, and hiring. The impact would be especially felt in rural and agricultural communities which are primarily served by community banks. Community banks are small business lending specialists responsible for approximately 60 percent of small business loans. Any policy change that would disrupt community bank deposit availability and the lending that depends on it is an unacceptable risk for communities across America and the economy.

A CBDC Would Be Costly for Community Banks

In the intermediated model, banks would provide a CBDC "wallet" for customers, but CBDC would not fund loans or otherwise serve as a source of bank revenues. Nevertheless, banks would remain saddled with the identity verification, customer service, know your customer (KYC), anti-money laundering (AML), sanctions screening and other compliance burdens associated with maintaining CBDC wallets.

Holding CBDC would create a net cost for community banks, which already operate on narrow margins. Compliance costs may well increase in the future, and sources of non-interest revenue are likely to decline. Today, deposit compliance and operating costs are effectively subsidized by loan interest revenues and non-interest income. Community banks would also be required to make significant technology investments in order to provide CBDC wallet services. Banks would have to offset these costs by charging significant fees.

The compliance costs and technology investments associated with a CBDC would put community banks at a disadvantage relative to larger institutions, creating a less competitive market for financial services. Community banks rely on core providers for technological services that larger institutions maintain in-house. This is an advantage for these larger institutions, and to the extent that CBDC is adopted by consumers, it would shift market share away from community banks and accelerate industry consolidation to the detriment of consumers and small business borrowers. Rural communities served almost exclusively by community banks would be particularly harmed.

The Federal Reserve proposal envisions banks in competition with regulated nonbank financial service providers in an open market for CBDC wallets. This could introduce regulatory arbitrage risk and unfairly advantage these nonbank providers if they are not regulated as stringently as banks.

A CBDC Would Risk a Consumer Privacy Backlash

A CBDC would require a public record of all transactions conducted in CBDC to be maintained by the central bank. ICBA believes that consumers would be strongly resistant to using a digital asset that undermines their financial privacy. For this reason, a CBDC would not be an effective means of drawing more Americans into the banking system – a benefit proponents claim for the proposal. Surveys of unbanked households consistently show that financial privacy is a primary reason they choose not to use the banking system.

In addition to concerns about granting the federal government visibility into consumer transactions, a CBDC would create an irresistible target for criminal hackers and rogue states. A CBDC would depend on the Federal Reserve to serve as a hub, validating all transactions between CBDC wallets. A breach of the Federal Reserve's cybersecurity could disrupt or misdirect countless transactions, inflicting financial harm on consumers and damaging the credibility of the CBDC and potentially the dollar as well.

FedNow℠ Is an Imminent and More Viable Solution

ICBA does not believe that the benefits claimed for a CBDC withstand scrutiny. As noted above, it is an implausible means of reaching the unbanked. ICBA's comment letter to the Federal Reserve argues against other supposed benefits, such as supporting the global dominance of the dollar. We address here the claim that a CBDC is needed to modernize the U.S. payments system and ask Congress to consider alternatives for payments modernization currently being implemented.

CBDC proponents argue that more competition is needed in the payments system. There is a wealth of evidence that demonstrates the U.S. has a diverse and highly competitive payments system today, with significant consumer choice. Safe, efficient Federal Reserve and private-sector interbank payment systems exist now that offer increased transaction speed and reduced costs. The FedNow service, launching in 2023, will enable financial institutions of all sizes to provide safe and efficient instant payment services in real time and around the clock. FedNow will provide many of the benefits of alternative payments rails without the risk and will accomplish many of the stated goals of a CBDC.

In public comments addressing unequal access to the financial system, Nellie Liang, Treasury Undersecretary for Domestic Finance, said that FedNow "will be low cost to users. Because FedNow relies on the banking system, there already are safeguards for consumers and businesses."[1] With the impending introduction of FedNow instant payment services, increased Same Day ACH adoption, and The Clearing House's introduction of Real Time Payments (RTP®), Americans are enjoying faster transactions clearance and can expect further innovations to be built upon these rails. ICBA urges policymakers to give FedNow a chance to succeed in advancing payments modernization. The launch of a CBDC, if adopted, will be many years away. A decision at this time to establish a U.S. CBDC would be premature. FedNow must be given a chance to work and be evaluated in the market before a CBDC is considered.

The Volatility of Unregulated Stablecoins Must Not Drive Adoption of a CBDC

Recent market developments have shattered the pretense of stablecoin stability. Tether and Terra have both lost their peg to the dollar. They are anything but a stable source of value and must not be viewed by consumers as the equivalent of bank deposits. ICBA urges policymakers to develop a consistent regulatory definition and framework

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[1] https://home.treasury.gov/news/press-releases/jy0673

INDEPENDENT COMMUNITY BANKERS of AMERICA®

for stablecoins to protect consumers and the safety of the financial system.

However, a CBDC must not be viewed as an alternative to privately issued stablecoins nor a substitute for their regulation. There is no binary choice between a CBDC and stablecoins. A CBDC will neither outcompete stablecoins out of existence nor solve the regulatory challenges and systemic risks presented by privately issued stablecoin arrangements.

The Role of Congress

The Federal Reserve promised in its report not to move forward "without clear support from the executive branch and from Congress, ideally in the form of a specific authorizing law." Federal legislation would be required to establish the roles and responsibilities of the various stakeholders—including the Treasury Department, Federal Reserve, and the private sector. Congress would need to exercise its authority to preclude any actions that would disrupt the stability of the economy and inject safety and soundness risks to the financial system. Congress must not be sidelined in a policy choice with such far reaching, and potentially damaging, significance.

Closing

Thank you for convening today's hearing to highlight the significant stakes in any creation of a CBDC. ICBA urges the members of this committee to carefully consider ICBA's objections to a CBDC as expressed in this statement and more fully in our recent comment letter to the Federal Reserve.

NACS Advancing Convenience & Fuel Retailing | convenience.org

May 20, 2022

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

RE: Comments on "Money and Payments: The U.S. Dollar in the Age of Digital Transformation"

Dear Ms. Misback:

Thank you for providing the opportunity to comment on "Money and Payments: The U.S. Dollar in the Age of Digital Transformation." This step in the public discussion of a potential central bank digital currency (CBDC) is an important one for the future of U.S. currency and the U.S. economy. The National Association of Convenience Stores (NACS) strongly supports the Federal Reserve creating a CBDC to modernize U.S. currency, improve payments, and strength the position of the United States in the world economy for the years to come.

Background on NACS

NACS is an international trade association representing the convenience store industry with more than 1,500 retail and 1,600 supplier companies as members, the majority of whom are based in the United States. The convenience industry's sole objective is to sell legal products, in a lawful way, to customers who want to buy them.

Among those products are motor fuels. The industry's fuel retailers sell 80 percent of the motor fuels in the nation and are generally independent businesses. Although some might bear the name of a large oil company, this is not indicative of any ownership stake in the business or the real estate, but simply of a marketing relationship or announcement to passing motorists that a certain company's product is available for purchase at that location (comparable to a soft drink advertisement in a grocery store window).

The convenience and retail fuels industry employed approximately 2.34 million workers and generated more than $705 billion in total sales in 2021, representing more than 3 percent of U.S. gross domestic product.

The industry, however, is truly an industry of small businesses. More than 60 percent of convenience stores are single-store operators. Less than 0.2% of convenience stores that sell gas are owned by a major oil company and about 4% are owned by a refining company. More than 95% of the industry, then, are independent businesses.

Members of the industry process more than 160 million transactions every single day. That means about half the U.S. population visits one of the industry's stores on a daily basis. In fact, ninety-three percent of Americans live within 10 minutes of one of our industry's locations. These businesses are particularly important in urban and rural areas of the country that might not have as many large businesses. In these locations, the convenience store not only serves as the place to get fuel but is often the grocery store and center of a community.

Problems with U.S. Payments

One assumption articulated in the Federal Reserve's paper on digital currency requires more focus. The paper states that the U.S. payment system is "generally effective and efficient."[1] In our view it is not. According to the Federal Reserve Bank of San Francisco's Diary of Consumer Payment Choice, credit cards accounted for 28 percent of consumer transactions in 2021, debit cards accounted for 29 percent, and cash was 20 percent.[2] But there are profound problems with credit and debit card payments in the United States. These payments carry with them the most fraud and the highest interchange fees in the world. These outcomes are the result of serious competition law and policy problems with payment cards. While the Federal Reserve's Regulation II has made substantial improvements with regard to the debit card market, some challenges remain. And, the credit card market has far more extensive problems.

The U.S. Senate Committee on the Judiciary had a hearing on the lack of competition in payments on May 4, 2022. The testimony submitted by NACS discussing those issues is attached to these comments in order to provide the Federal Reserve with background on the extensive problems currently plaguing the U.S. payment system. In particular, competition problems in U.S. payments have the most negative effects for lower income Americans. The negative cost externalities associated with the dominance of two payment card networks hit the most vulnerable Americans hardest and work against financial inclusion. The findings of the report recently released by the Hispanic Leadership Fund verify and dimension some of these inequities, confirming earlier findings from the Boston Federal Reserve.[3] These and other failures with current U.S. payments establish part of the reason why establishment of a CBDC should be a top priority.

Role of U.S. Currency in the World

Establishing a CBDC is also important to maintain the position of the U.S. dollar as the world's reserve currency and its use in many contexts around the world. Much of commerce and modern life has moved (or is moving) to digital platforms. Everything from large business deals to everyday transactions are increasingly happening in a digital environment. That is leading moves worldwide toward CBDCs. The United States needs to move in that direction to ensure that the dollar can continue to fulfill its role in the world economy. If there is no CBDC for the U.S. dollar, technological progress will ultimately mean that another currency takes the dollar's place.

That is particularly true given the clear momentum from nations around the world to adopt digital currencies. According to the Atlantic Council, nine nations have launched CBDCs, fifteen are in the pilot phase, sixteen are in development, and forty nations (including the United States) are categorized to be in the research phase.[4] In light of these moves, the United States should keep pace with the rest of the world so that it does not risk the prominence of the U.S. dollar.

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[1] "Money and Payments: The U.S. Dollar in the Age of Digital Transformation" at 8.
[2] Emily Cubides and Shaun O'Brien, "2022 Findings from the Diary of Consumer Payment Choice," Federal Reserve Bank of San Francisco (May 5, 2022) available at https://www.frbsf.org/cash/publications/fed-notes/2022/may/2022-findings-from-the-diary-of-consumer-payment-choice/#_ftn2.
[3] *See* Efraim Berkovich and Zheli He, "Rewarding the Rich: Cross Subsidies from Interchange Fees," (May 3, 2022) available at https://hispanicleadershipfund.org/new-hlf-report-highlights-effect-of-retail-swipe-fees-on-consumers-and-small-businesses/.
[4] *See* "Central Bank Digital Currency Tracker," Atlantic Council, available at https://www.atlanticcouncil.org/cbdctracker/.

Key Policy Considerations

When establishing a CBDC, the Federal Reserve should be fully aware of the following considerations.

Open Financial Offerings and Innovation

The Federal Reserve should ensure that there is an open market for financial services relating to CBDCs. While regulated banks would clearly provide such services, limiting financial services to those institutions would be a mistake that would inhibit innovation and the development of the market to the detriment of American consumers. Technologies relating to CBDCs could develop at a very rapid pace if technology providers are allowed to do that. We are already seeing important innovations with open banking systems around the world which can provide some helpful examples of ways to ensure that new technologies and players are able to participate in financial services and bring innovations to the market. Regulators in the European Union, United Kingdom, Australia, Hong Kong, and other nations have moved toward open banking.[5]

For a CBDC, the Federal Reserve should ensure that consumers have access to wallets or other technologies that allow individuals to hold CBDC without the involvement of a bank being necessary. Banks should be able to offer such services and compete for consumer-owned CBDC funds, but that industry should not be a required part of the chain for consumers to have and use CBDC.

Facilitating new innovations may be even more important in a world with CBDCs. Traditional banks will not have the incentive to provide innovative financial products and services if they have a monopoly on servicing consumers with CBDCs. That monopoly will get in the way of consumers getting the best products and services that new technological innovations can provide. The Federal Reserve should allow and encourage those innovations.

There are several functions for intermediaries to perform and the markets for those functions should be as open as possible. That is, whatever regulations are necessary to ensure businesses meet key standards, any business meeting the standards should be allowed to participate in the market – and regulations should not be designed to favor one industry (such as banking) or block others from participating. So, for example, as wide a variety as possible of financial companies and technology providers should be able to offer wallets, processing services, infrastructure and more. This should include a robust set of entities that can develop and deploy these services directly to consumers and businesses to allow everyone to use the CBDC to the greatest extent possible.

No Monopoly Providers

Similar to the need for an open market for financial services providers, the dominant payment card networks should not be brought into the Federal Reserve tent to develop CBDCs or systems for handling them. In whatever manner the Federal Reserve uses to develop CBDC technology, Visa and Mastercard should not be contractors to create it. As noted in the testimony included with this comment letter, those two companies have used and continue to use their positions of market power to dominate the payments market and unfairly disadvantage their competitors. They should not be put into a favored position in which they create a CBDC which could allow them to build-in advantages for themselves and their

[5] "Open Banking Around the World," Deloitte, available at https://www2.deloitte.com/global/en/pages/financial-services/articles/open-banking-around-the-world.html.

business models.

Clearance at Par (no exchange fees)

A benefit of a CBDC is that it would be currency. It must then be accepted as such. One of the Federal Reserve policies that had the greatest impact allowing the checking system to grow and benefit the U.S. economy in the twentieth century was the prohibition on exchange fees on checks – that is, the requirement that checks clear at par. That prohibition did not undermine the ability to develop value-added services. Instead, it ensured that value-added services had clear price cues to the customers deciding to use that service (such as a check guarantee service) rather than having a system of fees burden transactions that are not charged directly to the user of the service (and therefore are not transparent).

The counterexample that provides a cautionary tale is the development of credit cards. That market is characterized by a duopoly and has stifled innovation – particularly relating to security and fraud. Because of the interchange fees that are not transparent, credit card transactions have grown more expensive as the cost of handling transaction data has dropped and innovation has been limited to creatively assigning liability for fraud rather than preventing it (as well as increasing consumer rewards that further obscure actual price cues). As detailed in the attached testimony submitted to the U.S. Senate Judiciary Committee, that structure has led to negative outcomes for the U.S. economy, consumers, and merchants. A CBDC should be designed to ensure that such a system could not develop with respect to CBDC transactions.

Interoperability and Standard-Setting

One important way to ensure the benefits of a CBDC is facilitating the interoperability of different services to handle and transfer CBDC among and between consumers and businesses. As noted, there should be a wide variety of such services and providers to ensure innovation and create value for all users. Interoperability of systems to handle and process CBDC will be important to ensure it is accepted like physical cash and that Americans get the full convenience and value from a CBDC that they expect from cash.

Ensuring interoperability likely requires some standard-setting. The Federal Reserve should ensure that such standards are set by a broad cross-section of affected industries and not by organizations controlled by Visa or Mastercard. Such closed organizations include EMVCo and PCI. For a more detailed explanation of some of the ways in which Visa and Mastercard use standards as a tool to secure and expand their market power, we recommend reviewing a report from RPGC Group titled "Payment Insecurity: How Visa and Mastercard Use Standard-Setting to Restrict Competition and Thwart Payment Innovation."[6] Standards should facilitate open markets and interoperability, not solidify market share for dominant players.

Off-line Functionality

Providing for off-line functionality can help ensure financial inclusion and make a CBDC better fulfill the role played by physical currency. There are times when online functionality is not available. A CBDC should not be unusable in these contexts. To be an effective form of currency, a CBDC should be designed to meet as many use cases as possible. That can and should include times when there is no online option. Meeting these situations will be particularly useful for low-income consumers and those who live

[6] Available at Microsoft Word - Payment Insecurity V0.1 (2 Columns)-c2.docx (securepaymentspartnership.com).

in more remote locations across the nation. Americans expect to be able to use physical currency in virtually any scenario and the same should be true for a CBDC.

Speed of Settlement

Payment systems should increase the speed at which transactions are settled. This is particularly relevant in light of the current economic environment with rapidly changing inflation and interest rates. But, transaction speed is always an important facet of payments. The current card-based payments systems in the U.S. – particularly dual message debit and credit – should settle faster. The Federal Reserve's faster payment efforts will help improve the overall payment landscape and move things toward real-time settlement. A CBDC could significantly advance these efforts. A CBDC, because it is actual currency, could transfer in real time. And, allowing open interoperability with a full range of technologies may allow any number of additional services to be enabled and enhanced by this speed of settlement. Transaction speed can and should be a key consideration in the development of a CBDC.

* * *

Payments in the United States need greater innovation and competition. The current card-based system is dominated by a duopoly which increases costs and squelches innovation. A CBDC can help bring technology to bear in a way that will increase efficiency across the economy, open up new advances in financial services designed to handle the CBDC in ways that enhance Americans' experiences on a global scale, and it can protect and extend the critical role that U.S. currency already plays in the world. Moving forward expeditiously should be seen as an imperative for the nation.

We look forward to future opportunities to engage with the Federal Reserve during its work on a CBDC and urge you to ensure a full role for retailers across the nation during the consideration and work on a CBDC so that the diversity of business cases engaged in by these businesses and their customers are served by a CBDC. Retailers should be involved in every step of the development of a CBDC to ensure it meets the significant transaction needs of the industry – and to help protect against the potential for the businesses that currently dominate the card-based payment system and make it less efficient and effective than it should be to extend that dominance to the design of a CBDC. A CBDC can and should be an opportunity to improve upon the current state of the U.S. payments system and avoid the problems that market dominance by a small number of firms has created.

Thank you for your work and for the opportunity to comment.

Sincerely,

Doug Kantor
General Counsel

Attachment

1600 Duke Street | Alexandria VA 22314-3436 | 703.684.3600 office | 703.836.4564 fax

TESTIMONY OF
DOUG KANTOR
GENERAL COUNSEL, NATIONAL ASSOCIATION OF CONVENIENCE STORES
BEFORE THE
U.S. SENATE COMMITTEE ON THE JUDICIARY
HEARING ON
"EXCESSIVE SWIPE FEES AND BARRIERS TO COMPETITION IN THE CREDIT AND DEBIT CARD SYSTEMS"
MAY 4, 2022

1600 Duke Street | Alexandria VA 22314-3436 | 703.684.3600 office | 703.836.4564 fax

Thank you for providing me with the opportunity to testify on the swipe fees that are imposed by the credit card industry on merchants. Most consumers are not aware of these fees and do not see the effects they create on the cost of goods and services and the U.S. economy, but those effects are dramatic. For merchants, the fees are a constant source of stress and financial difficulty, while for the economy the fees reduce economic efficiency and contribute significantly to inflation.

I am testifying today on behalf of my association, the National Association of Convenience Stores (NACS), as well as a coalition that we helped found to try to address these issues, the Merchants Payments Coalition (MPC). NACS is an international trade association representing the interests of the convenience industry. In the United States, the industry includes more than 148,000 stores employing 2.3 million people. It is truly an industry of small business with a full 60 percent of the industry comprised of single-store operators. The industry handles about 165 million transactions each day – a number equivalent to about half of the U.S. population. An efficient and competitive payment system is critical to the health of the industry and its employees.

The MPC is a group of retailers, supermarkets, restaurants, drug stores, convenience stores, gas stations, online merchants, and other businesses focused on reforming the U.S. payment system to make it more transparent and competitive.

I. Executive Summary

The credit and debit card systems in the United States are burdened by anti-competitive conduct that makes the systems less efficient and effective than they should be. Two payment card networks, Visa and Mastercard, dominate the market and bring together thousands of banks across the nation to wield market power in ways that harm competition in the marketplace. Merchants have no realistic options to the dominant networks. With very few exceptions, merchants must accept all credit and debit cards that run over those two networks no matter how high the fees the networks charge and no matter how onerous the rules and conditions they impose. The high fees that result from this exercise in market power inflate the costs of goods and services across the nation in a way that harms consumers.

Visa and Mastercard each separately set the fee rates for the swipe, or interchange, fees that all the banks that issue cards with those networks charge to merchants. Because the swipe fees are centrally set in this way, the banks don't compete on price. That leads to problems that are common for anti-competitive arrangements – high and escalating prices and neglect of key aspects of the service (such as protection against fraud). Visa and Mastercard also dictate a complex set of terms or rules that govern how credit card transactions happen. These terms further insulate swipe fees from competitive market pressures and, in most cases, keep the fees confusing for merchants and hidden from consumers.

In particular, by imposing a rule that requires a merchant to accept all cards issued with a Visa (or Mastercard) logo if the merchant wants to accept any cards carrying those networks, the two largest networks remove the incentives for banks to negotiate with merchants on price or acceptance of their cards – and remove almost all bargaining power that merchants otherwise might have had. This is a central element of the credit and debit card systems in the United States today and creates additional competition policy problems.

The problems caused by all this for consumers, merchants and the economy are immense. Total card fees imposed on merchants were $138 billion last year – up from $64 billion in 2010. Of that total, $77.5 billion are fees for Visa and Mastercard branded credit cards and $28 billion are fees for Visa and Mastercard branded debit cards - $105.5 billion on just those two networks. The size of the fees and the fact that they are set largely as a percentage of transaction amounts means that they are an inflation multiplier. The United States already pays the highest swipe fees in the industrialized world. The roles played by the two dominant card networks and the fees and terms they set cause other problems as well by reducing incentives for innovation in new payment products and improvements in services such as fraud protection. The United States should have the most efficient, effective and innovative payment system in the world, but we don't. This market desperately needs changes so that there are competitive market forces that improve payments for everyone.

This testimony will cover a few topics relating to swipe fees. First, it will lay out some background on how credit and debit card payments work. Second, it will address the competition policy problems created by those payment systems. Third, the testimony will discuss the negative impact these fees have on merchants. Fourth, the testimony will note the negative impact of the fees on consumers. Fifth, it will describe the negative impact of swipe fees on the U.S. economy. Sixth, it will walk through a number of the myths that the credit card industry regularly espouses in order to distract from the problems with these payments.

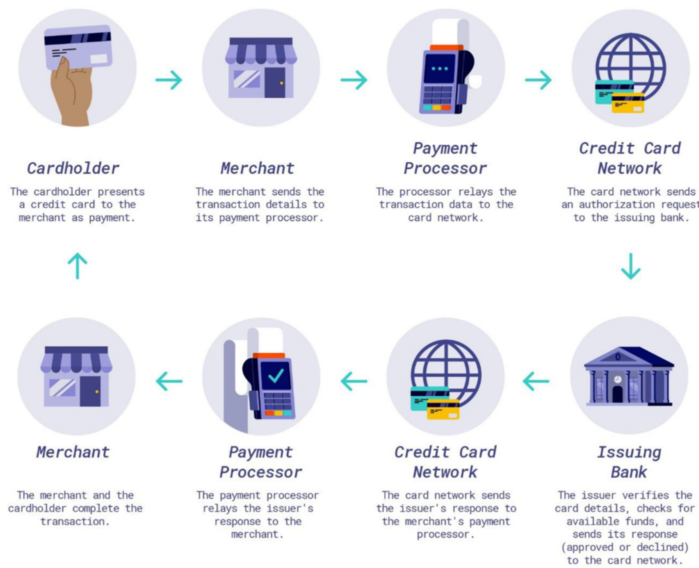
II. How Card Payments Work

In order to understand the competition problems with the credit and debit card markets, it helps to have some background on how these payments work. Neither Visa nor Mastercard, the two largest card networks, has a direct relationship with individual cardholders. Financial institutions such as banks and credit unions actually enter into agreements with individuals and issue cards to them. The structure is similar with merchants. The merchants contract with banks or payment processors to handle the merchants' acceptance of payment cards.

Visa and Mastercard actually started as associations of their bank members.[7] They do a few things to make card payments happen. They maintain data lines that connect the banks that issue cards to consumers with the banks that work with merchants. They also advertise their brands to make the cards more appealing to consumers and businesses. And, they set the prices that the card issuers charge to merchants as well as the rules that govern how cards are issued and processed. It is this price- and rule-setting role that raises antitrust issues to be addressed below.

A good explanation of the process of a card payment can be found at knowyourpayments.com.[8] In the simplest terms, when an individual dips or swipes a payment card at a store, the information necessary to process that payment goes to the merchant's bank (or processor) who sends the information to a card network (e.g., Visa or Mastercard) and that network sends the information to the card issuer (the bank that gave the consumer that card), then a message authorizing the transaction (or declining it) goes back through each of those entities to the merchant's payment terminal allowing the transaction to take place. The clearance and settlement of the funds takes place later through a similar process. The graphic below depicting this basic process can be found at corporatetools.com.

[7] Both companies changed their structures in the 2000s in order to try to insulate themselves from antitrust liability after a court of appeals held in 2003 that Visa and Mastercard "are not single entities; they are consortiums of competitors" and that the rule then challenged by the DOJ was "a horizontal restraint adopted by 20,000 competitors." *United States v. Visa U.S.A. Inc.*, 344 F.3d 229, 242 (2d Cir. 2003). Some major banks still own billions in restricted shares in the companies that they cannot sell pending final outcomes of antitrust litigation.
[8] *See* Know Your Payments » Transaction Basics.



According to the Federal Reserve Bank of San Francisco's Diary of Consumer Payment Choice, credit cards accounted for 27 percent of consumer transactions in 2020, debit cards accounted for 28 percent, and cash was 19 percent.[9] This represented a large jump in credit card payments, which had been 24 percent of payments in 2019.

There are fees that each player involved in the processing of the card takes out of the amount that the merchant gets paid in the transaction. By far the largest fee is the swipe fee, or interchange fee, which goes to the bank that issued the consumer the card. That fee alone can account for about 80-85 percent of all of the fees involved in the transaction. The networks, such as Visa and Mastercard, impose their own separate fees, called network fees, in addition to the swipe fees. And, the merchant's processor or bank receives a fee for its services. Processing is a reasonably competitive market. Merchants don't always like how much they pay in those processor fees, but they have options to do business with different processors (or negotiate new agreements) and that helps discipline that cost. Merchant concerns about network fees are different than concerns about swipe fees. Networks set their own fee amounts, which is appropriate. Unfortunately, the two major networks have structured and applied their network fees to have certain anti-competitive effects to protect and grow their market power. The networks' market share and the way the networks bring together the card-issuing banks has enabled them to do this. Those concerns are related to,

[9] Kelsey Coyle, Laura Kim and Shaun O'Brien, "2021 Findings from the Diary of Consumer Payment Choice," Federal Reserve Bank of San Francisco (May 5, 2011) available at 2021 Findings from the Diary of Consumer Payment Choice – Cash (frbsf.org). Credit cards make up a larger percentage of payments in e-commerce.

but different than, the problem created by anti-competitive behavior in the setting of swipe fees by the two major networks on behalf of card-issuing banks, which is discussed below.

Credit card issuing is very concentrated among a small number of very large banks. The ten largest credit card issuers in the United States collectively have about 80 percent of the credit card issuance market.[10] Those issuers compete to get consumers to get and use their cards. They do this through a complex set of pricing mechanisms that include interest rates, a variety of rewards offerings, and a number of potential penalty fees and related terms. These complex pricing mechanisms can be difficult for consumers to evaluate and may lead them to choose offers that are less favorable than other offers.[11] And, the enticement of credit card offers can lead consumers to create financial problems for themselves that are challenging to fix.

Because credit card issuers receive fees from merchants every time one of their cards is used, they have a strong incentive to push for those cards to be used as many times as possible. They have been particularly aggressive in trying to get consumers to use their cards for small, everyday purchases. Using credit for everyday purchases, of course, can create financial problems for consumers if they are not careful. Unfortunately, card issuers can be less concerned about individuals' financial problems due to the revenue those issuers earn from merchants.

Though there are problems, consumers at least have the benefit of competition among different credit card issuers that try to get their business. That can lead to helpful offers. Merchants, however, do not have that benefit due to the way that the two dominant card networks bring together card issuers from across the country into their two networks.

III. The Credit Card Industry's Anti-Competitive Activity

The central problem with credit cards in the United States is that the two largest networks, Visa and Mastercard, set the amounts of the swipe fees that the card-issuing banks charge for each transaction and they set the terms governing how these transactions happen. All of those card-issuing banks – particularly the largest ones which have the vast majority of credit card market share – could set their own prices and compete with each other for merchants' business. Those card issuers all compete that way for consumers' business. But, they refuse to compete for merchants' business. One hundred percent of the banks that issue cards with Visa logos agree to charge merchants the same schedule of network-fixed fees. The same is true for the banks that issue cards with Mastercard logos on them.

There is no avoiding the destructiveness of these agreements not to compete on price. Merchants have no ability to refuse accepting payment from virtually all the banking institutions across the nation. That is in part because retail is incredibly competitive in the United States. There are many different types of merchants trying to out-compete each other on price and service for the business of the American consumer. If one of them stops taking these credit cards, the competitor across the street will take some of their business. So, merchants take the cards and the fees increase at dramatic rates. In fact, economists with the Kansas City Federal Reserve Bank have studied these fees and found that, in light of the central fee-setting structure and the competitiveness of U.S. retail, swipe fees will increase to the point that retailers

[10] Bianca Peter, "Credit Card Market Share by Issuer," (Feb. 24, 2022) available at https://wallethub.com/edu/cc/market-share-by-credit-card-issuer/25530.
[11] For an explanation of some of these confusing prices and terms, *see* Consumer Reports, "What Credit Card Offers and Rewards are Best for you?" (November 2012) available at https://www.consumerreports.org/cro/magazine/2012/11/the-best-credit-card-for-you/index.htm; and Adam Levitin, "Testimony Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs," (July 19, 2011) available at https://www.banking.senate.gov/imo/media/doc/LevitinTestimony71911.pdf.

may go out of business.[12] That is the only effective brake on the steep rise on these fees.

It is also important to note that the swipe fees banks charge merchants to accept their cards (the ones set by Visa and Mastercard) are not the same every time. In fact, they can vary dramatically. Visa and Mastercard set complex schedules of fee rates, and the fees vary based on the level of rewards associated with the card, the type of merchant accepting the card, the manner in which the card is accepted (online versus in-person and other aspects of acceptance) as well as, in some sectors, the card network's view of the merchant's level of security.[13] The fees for the most expensive cards can be about triple the amount of the fees for the least expensive cards for some merchants.

In addition to the fee-setting, however, Visa and Mastercard impose a set of terms that further insulate those prices from the possibility of any competitive market forces keeping the fees in check. There are hundreds of pages of these terms and problems with them are detailed well in ongoing antitrust litigation that is pending in the U.S. District Court for the Eastern District of New York.[14]

There are a few of these terms that merit particular attention. One, of course, is the central price-setting engaged in by Visa and Mastercard noted above. Another is the so-called "honor all cards rule." This "rule" is imposed by both Visa and Mastercard on merchants. It creates an all-or-nothing proposition for every merchant across the country and says that if a merchant wants to accept any Visa- (or Mastercard-) branded credit card, that merchant must take every credit card with that brand (and the same with debit cards). "Honor all cards" completely removes any possibility for a merchant to negotiate prices or terms with any bank – and completely removes the incentive for any bank to try to negotiate prices or terms with any merchant.

Removing those normal market incentives for price competition and negotiated deals is very significant. Because the fees are so much higher for some cards than for others, merchants very sensibly might want to accept some of them but not others (for fear of going out of business). But, they can't make that choice. If they could, of course, banks issuing the most expensive cards might be inclined to cut their prices, but they don't need to worry about that because Visa and Mastercard have removed the normal market dynamics from the playing field.

Visa and Mastercard also put restrictions on banks to stop competition from creeping into the picture. They both prohibit banks from making any network that competes with them active on those banks' credit cards.[15] That way, one hundred percent of the transactions on credit cards that have Visa enabled on them go through the Visa network (and the same is true for Mastercard).

These prohibitions are very similar to rules that were the subject of litigation the U.S. Department of Justice filed against Visa and Mastercard in 1998. The rule in question was known as the exclusionary rule. It prohibited banks that issued cards under Visa's or Mastercard's brands from issuing cards from any of their competitors (including companies such as American Express and Discover). The U.S. Circuit Court of Appeals for the Second Circuit ruled in favor of the Department of Justice in that case and the

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[12] Fumiko Hayashi, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" Federal Reserve Bank of Kansas City (2004) available at https://ideas.repec.org/p/fip/fedkpw/psrwp04-02.html.
[13] There are other factors that can change the economics as well such as other services (including tokenization, fraud detection, and other services) that the networks have tried to control.
[14] A redacted version of the complaint filed in the case by NACS and others can be found at: https://constantinecannon.com/wp-content/uploads/2022/04/13-cv-5746-Doc.-183-6th-Amd.-Complaint-Redacted.pdf.
[15] Federal Reserve Regulation II prohibits these types of exclusivity requirements on debit cards.

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exclusionary rule is no longer permitted.[16] NACS filed comments with the Federal Trade Commission last fall discussing how Visa and Mastercard's prohibitions against banks issuing credit cards with other networks on them violates the antitrust laws and harms competition.[17]

Visa and Mastercard also have a long history of restricting how merchants price their products to their customers. These restrictions formed a veil of secrecy around swipe fees that further insulated the fees from competitive market pressures. Some of those restrictive terms have been eroded through legal challenges over time. For example, the Department of Justice and seventeen states entered into a consent decree with Visa and Mastercard that became final in 2011 which prohibited those two networks from preventing merchants from offering their customers discounts for using less expensive payments.[18] Prohibiting merchants from giving American customers discounts strikes directly at the heart of how competitive markets should work. But, that is just one in the long line of actions the two largest networks have taken to undercut competition in the credit card market.

In fact, Visa and Mastercard's fee- and term-setting have turned competition on its head. While competition normally causes businesses to try to keep prices low in order to attract market share, Visa and Mastercard don't compete for merchants' business. The honor all cards rule and lock-up of all the banks takes care of that. Instead, Visa and Mastercard only compete to attract banks to issue more of their cards. They do that by trying to push the swipe fees they set on behalf of those banks higher and higher.[19] It is the opposite of what real competition does and demonstrates how the market is broken.

The major card networks have also taken actions that erode competition from smaller networks. One recent example of these anti-competitive activities was the subject of an opinion by the U.S. Fifth Circuit Court of Appeals in litigation brought by Pulse, a debit network, against Visa. In that case, the Fifth Circuit found that Pulse's claims that Visa had violated antitrust laws to squeeze Pulse out of the debit market should be decided by a jury, "And a reasonable jury could find that some of Visa's volume-based agreements amount to exclusive-dealing contracts designed to squeeze Pulse out of the PIN-less transaction market."[20] That was just the latest legal action raising troubling concerns about what the largest payment networks do to harm competition.

Visa has also sought to bolster its hold on the market and keep out innovative competitors through acquisition. Its attempt to acquire Plaid – a potential competitor in the debit market – led to a lawsuit from the Department of Justice to block the deal.[21] Plaid offers a potential alternative technology for consumers to access funds in their bank accounts to pay for things which "likely would drive down prices for online

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[16] *United States v. Visa* U.S.A., Inc., 344 F.3d 229 (*2d Cir. 2003*), cert denied, 543 *U.S.* 811 (2004), available at Second Circuit Decision in U.S. v. Visa (02-6074) | ATR | Department of Justice. American Express and Discover each sued for the damages they suffered due to the rule and reached settlements with Visa and Mastercard. Discover, Visa and MasterCard settle antitrust suit | Reuters.

[17] NACS-Comments-to-FTC-on-Unfair-Contract-Clauses-Fi.pdf (convenience.org).

[18] Final Judgment as to Defendants Mastercard International Incorporated and Visa Inc. | ATR | Department of Justice. The states that joined the action and consent decree were: Arizona, Connecticut, Idaho, Illinois, Iowa, Maryland, Michigan, Missouri, Montana, Nebraska, New Hampshire, Ohio, Rhode Island, Tennessee, Texas, Utah, and Vermont.

[19] Andrew Martin, "How Visa, Using Card Fees, Dominates a Market," New York Times (Jan. 4, 2010) available at https://www.nytimes.com/2010/01/05/your-money/credit-and-debit-cards/05visa.html ("Competition, of course, usually forces prices lower. But for payment networks like Visa and MasterCard, competition in the card business is more about winning over banks that actually issue the cards than consumers who use them. Visa and MasterCard set the fees that merchants must pay the cardholder's bank. And higher fees mean higher profits for banks, even if it means that merchants shift the cost to consumers.")

[20] *Pulse Network, LLC v. Visa, Inc.*, No. 18-20669, 18 (5th Cir. Apr. 5, 2022).

[21] Complaint, *U.S. v. Visa, Inc. and Plaid, Inc*. (Nov. 5, 2020).

debit transactions, chipping away at Visa's monopoly and resulting in substantial savings to consumers."[22] Visa wanted to block the innovation and cost savings that Plaid could bring to the market by acquiring it – similar to Visa's past pattern of trying to block competition.[23] Acquisitions, exclusivity contracts and other moves have been used by Visa to protect its market power and block potential competition. All of this, of course, has been a detriment to the market, merchants, consumers, and the economy.

IV. Swipe Fees Hurt Merchants

Credit and debit card swipe fees are huge business and are growing at an alarming rate. Collectively, U.S. merchants paid $138 billion in fees to accept card payments last year.[24] That was a huge jump from the $110 billion that merchants paid in 2020.[25] That is on top of the fees nearly doubling in the decade between 2010 (when the fees were $64 billion) and 2020.[26] And, it followed the decade between 2001 and 2010 when the fees more than tripled from $16 billion to $64 billion.[27] The huge multiples by which the fees have grown seem impossible, but that is what happens when there is price-fixing in place of competition.

In the convenience industry, recent fee increases have been even more dramatic. In 2021, the fees paid by convenience retailers to accept payment cards jumped by 26.5 percent.[28] Not only that, but the rate of increase has been even higher thus far in 2022 – and that was even before Visa and Mastercard moved forward with rate increases in April that, combined with the rate increases that Visa publicly said it would delay last year amount to an additional $1.2 billion per year in additional fees.[29] These increases are completely unsustainable.

Even before these dramatic jumps, swipe fees, on average, were convenience retailers' second-largest operating cost after labor. In fact, that is true for retailers in every sector. That means swipe fees are more than the average retailer pays for rent or utilities or for any other operating cost. Some convenience retailers have even reported that the fees are approaching their labor costs.

One reason for these dramatic increases is the destructive interaction between swipe fees and inflation. The majority of the amount of credit card swipe fees are set as a percentage of the total amount of each transaction. That means swipe fees increase along with every dollar of inflation. And, those swipe fees act as an inflation multiplier forcing retailers to try to increase their revenues to keep up with the spiraling fees.

During its last two earnings calls, in fact, Visa made clear that it is "a beneficiary of inflation," and that inflation is "a positive for us."[30] Most Americans and American businesses would not say the same of

[22] *Id.* at ¶ 8.
[23] *Id.* at ¶¶ 44-45.
[24] Nilson Report (March 2022) available at Nilson Report | News and Statistics for Card and Mobile Payment Executives. As noted, $77.5 billion of the total are Visa and Mastercard credit card fees and $28 billion are Visa and Mastercard debit card fees.
[25] Nilson Report (July 2021) available at Nilson Report – Merchant Processing Fees in the United States—2020.
[26] Stephen Mott, "Industry Facts Concerning Debit Card Regulation Under Section 920," (Oct. 27, 2010) at 14, available at http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf.
[27] *Id.*
[28] NACS State of the Industry (April 2022).
[29] Lynne Marek, "There was no stopping credit card fee hikes this year," Payments Dive (April 7, 2022) available at https://www.paymentsdive.com/news/there-was-no-stopping-credit-card-fee-hikes-this-year/621741/.
[30] *See* Logan Kane, "Visa: A Great Business, But Wait for a Pullback," Seeking Alpha (April 26, 2022) available at https://seekingalpha.com/article/4503588-visa-great-business-wait-for-pullback; "Visa (V) Q2 Earnings Call Transcript," Motley Fool Transcribing (April 27, 2022) available at https://www.fool.com/earnings/call-transcripts/2022/04/27/visa-v-q2-

themselves.

An area that has among the largest impacts for the convenience industry and for American consumers are gas prices. This industry sells about 80 percent of the gasoline used across the nation. Retailers, similar to their customers, like an ample supply of gasoline and low prices. That is because as gas prices rise, the margins retailers make actually get smaller. Competition in the market means that retailers cannot pass along their own increased wholesale costs as quickly as they pay those costs. At the same time that retailers' margins are getting squeezed, however, their credit card fees are rising because they are a percentage of the total transaction amount. That means there have been many times during the past few months when retailers were paying more in swipe fees (often about 10 cents per gallon) than they were ultimately making on those sales. That makes no sense given the costs retailers incur and risks they take to maintain a site with underground storage tanks, transport fuel, and sell it to customers (often staying open 24 hours per day in the midst of a labor shortage and, in the past two years, a pandemic). Processing those transactions should not cost more than the profits that can be made after all of that effort.

What is particularly troubling for many businesses, however, is that they are powerless to plan for or deal with these rising costs. They can take measures to keep other costs in check – installing more energy-efficient equipment, using a different supplier, and the like. But there is no dealing with swipe fees because of the competition problem noted above and the unpredictability of the increases. Businesses just don't know how much the fees will go up. Even after new rates are announced it is difficult to predict how those rates will impact a merchant's fees because the card networks have made the system so complex. GAO reported that Visa and MasterCard each had four credit card rate categories in 1991, but by 2009 Visa had 60 rate categories and MasterCard had 243.[31] The numbers have grown since that time and that complexity helps obscure the consistent, large fee increases that merchants must bear.

It is worth noting that the fees increase even when Visa and Mastercard do not "raise" them. As noted, inflation is one reason that happens. Another reason is that the banks issuing cards simply push higher fee cards into the market. That is true for their new and existing customers. Many cardholders receive notification from their bank that they now have a different level of rewards or other perks. It might not be clear to the cardholder why that is, but it is not a mystery to merchants – it means the merchant must pay higher swipe fees. By systematically moving cardholders to more expensive cards, banks can drive up swipe fees without Visa and Mastercard changing their rate schedules at all.

Of course, merchants do not have visibility into the card issuing decisions that drive up their fees. Frankly, merchants have very little visibility into the price-setting engaged in by Visa and Mastercard. Merchants don't receive direct communications of these changes from Visa and Mastercard. Those notifications go to banks and processors. Typically, when sent, those notifications are confidential so that they cannot be passed along to merchants. The price changes that can so dramatically impact merchants' bottom lines become rumors in the marketplace until they are sprung on merchants with very little notice. The price increases that both Visa and Mastercard instituted just a couple of weeks ago followed this pattern of poor communication and notice. The lack of clarity is just another sign of how broken this market is.

2022-earnings-call-transcript/.

[31] Government Accountability Office, "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges," (2009) at Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges | U.S. GAO.

V. Swipe Fees Hurt Consumers

Ultimately, of course, all of us pay for these overinflated swipe fees in the prices of the goods and services we buy. The fierce price competition in retail ensures this. Retail profit margins are notoriously low. As of January of this year, for example, net profit margins for general retailers were 2.65 percent.[32] For convenience stores, those margins were 2.47 percent.[33] For grocers and other food retailers, those margins were even narrower – 1.11 percent.[34] With those margins, which are around or below the level of swipe fees these businesses pay, those fees must be passed on to consumers or retailers would go out of business.

It is worth noting that while retailers' margins are notoriously thin, banks' and credit card networks' margins are very large. The money center banks that dominate credit card issuing have net margins of 32.61 percent.[35] Visa's net profit margin as of the end of 2021 was 51.59 percent and Mastercard's was 46 percent.[36] All of those margins are instructive as to the relative competitiveness of these sectors. No other industry sector reported on by NYU had net profit margins as large as the money center banks, and it is likely that none would dare dream of margins at the level of Visa's and Mastercard's.

The current system fools consumers by hiding the large interchange fees that are built into the cost of their purchases. To quote one of my fellow witnesses today, Ed Mierzwinski of U.S. PIRG, "Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately, those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more."[37] In addition, over the years, consumer groups including the Consumer Federation of America, Consumer's Union, and Consumer Action have all submitted Congressional testimony criticizing the current system of swipe fees because it is not fair to consumers.

In addition, the European Commission has found that interchange fees harm consumers. In December 2007, the Commission found MasterCard's multilateral interchange fee illegal and Competition Commissioner Neelie Kroes said that interchange "inflated the cost of card acceptance by retailers without leading to any advantage for consumers or retailers. On the contrary, consumers foot the bill, as they risk paying twice for payment cards. Once through annual fees to their bank. And a second time through inflated retail prices . . ."[38] Kroes concluded that MasterCard's interchange "acts like a 'tax on consumption' paid not only on card users but also by consumers using cash and cheques."

One of the most troubling aspects of the high swipe fees imposed by the broken credit card market is the way they impact low-income Americans. The fees get baked into the prices of goods and services with very few exceptions in part due to the longtime pricing constraints imposed by Visa and Mastercard.

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[32] New York University, "Margins by Sector (US)," at Operating and Net Margins (nyu.edu).
[33] NACS State of the Industry (April 2022).
[34] *Id.*
[35] *Id.*
[36] *See* Visa Profit Margin 2010-2021 | V | MacroTrends and Mastercard Profit Margin 2010-2021 | MA | MacroTrends.
[37] "Testimony of Ed Mierzwinski before the House Judiciary Committee Antitrust Task Force," (May 15, 2008).
[38] "**Commission Prohibits MasterCard's intra-EEA Multilateral Interchange Fees:** Introductory remarks at press conference," available at https://www.parlement.com/id/vhqtky3qp9z8/nieuws/toespraak_eurocommissaris_kroes_over.

So, those who do not have or cannot qualify for credit cards pay the cost of these fees as well – as do cardholders with basic cards that don't carry rewards. In 2009, the Hispanic Institute published a paper showing how payment card swipe fees and rewards systematically transferred wealth from low income to high income individuals.[39]

A working paper published by Boston Federal Reserve economists came to the same conclusion: that swipe fees combined with rewards programs amount to a regressive system in which low-income Americans subsidize high-income Americans.[40] This disproportionate negative effect on low-income consumers is particularly unfair.

An updated study was just released by the Hispanic Leadership Fund. That study found:[41]

1) "Lower income Americans are losing money to higher income individuals.
    - American families earning less than $75,000 per year send a total of $3.5 billion to families earning more than $75,000 per year
    - More than $1.9 billion of that money goes into the pockets of those making more than $150,000 per year.
    - Families making less than $20,000 per year pay more than $1.2 billion of the $3.5 billion that gets transferred to higher income people"

2) "Black families are disproportionately harmed by today's credit card schemes.
    - The average American Black family pays nearly $60 per year to subsidize higher income people's rewards through these fees
    - Black families in the United States lose more than $1 billion each year from these transfers"

3) "The current swipe fee structure drives up shelf prices for all Americans regardless of how you pay.
    - The study found that swipe fees cost some retailers between 17 and 19 percent of annual profit.
    - Annual variation in interchange costs drives profit up and down by about 4.5 percent for smaller stores. This added risk generates economic inefficiency, and the entire economy suffers from this unneeded risk."

Those findings are staggering. Low income Americans should not be forced to pay for their wealthy neighbors' airline tickets, but that is precisely what Visa and Mastercard's anti-competitive practices cause.

Not only have fees increased dramatically and moved money from low-income to high-income Americans, but these fees change the nature of the credit card business in a way that hurts consumers. As Georgetown Law professor Adam Levitin observed in testimony before the House Judiciary Committee, the huge fee revenue the banks earn from credit card transactions taking place has created bad incentives.

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[39] Hispanic Institute, "Trickle-Up Wealth Transfer: Cross-subsidization in the payment card market," by Efraim Berkovich (Nov. 2009) available at Trickle-Up Wealth Transfer: (thehispanicinstitute.net).
[40] Marie-Helene Felt, Fumiko Hayashi, Joanna Stavins, and Angelika Welte, "Distributional Effects of Payment Card Pricing and Merchant Cost Pass-through in the United States and Canada," Federal Reserve Bank of Boston (Dec. 2020) at 4, available at https://www.bostonfed.org/publications/research-department-working-paper/2020/distributional-effects-payment-card-pricing-merchant-cost-pass-through-united-states-canada.aspx.
[41] Efraim Berkovich and Zheli He, "Rewarding the Rich: Cross-Subsidies from Interchange Fees," Hispanic Leadership Fund (May 2022) available at https://hispanicleadershipfund.org/.

He testified, “The card industry’s business model is the heart of the problem and needs to change. Just as with subprime mortgages, the credit card business model creates a perverse incentive to lend indiscriminately and let people get into so much debt they can’t pay it back.”[42]

Others have clearly observed this trend as well. For example, Acting Comptroller of the Currency Julie Williams said in March 2005, “Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset . . . it’s not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities.”[43] These changes mean that banks are less worried than they should be about consumers’ welfare. It should be in the interest of banks for consumers to do well and be able to pay back credit card loans. But the huge fee income the banks generate through interchange and other means gives them another incentive – milk consumers for all they are worth and don’t worry about the money getting paid back.

The bottom line is that abuse of consumers by banks will continue as long as they have the incentive to treat people that way. Interchange fees are the key incentive with which Congress has not yet dealt. The abuses of consumers and using credit cards as predatory lending vehicles will continue until something is done about interchange fees.

The credit card industry strenuously argues that if anything at all happens to reduce swipe fees, then other fees paid by consumers will increase and consumers will be in a worse position than they are today. This is false. In fact, the European Commission’s Directorates for Competition and Financial Services jointly conducted a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The Commission found no evidence to support the card systems’ arguments that the high fee levels associated with the existing interchange system benefit consumers. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers:

> “There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees. The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent.”[44]

VI. Swipe Fees Hurt the U.S. Economy

Payments should not cause all of these negative outcomes. The purpose of having money is to reduce transaction costs and make buying and selling things more efficient. Our credit card system does

[42] Adam J. Levitin, Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law, “Consumer Debt – Are Credit Cards Bankrupting Americans?” (April 2, 2009).
[43] Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, (March 21, 2005) available at http://www.occ.treas.gov/ftp/release/2005-34a.pdf.
[44] European Commission, Directorates on Competition and Financial Services, *Competition: Final report on retail banking inquiry – frequently asked questions*, Jan. 31, 2007, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/40&format=HTML&aged=0&language=EN&guiLanguage=en.

the opposite. The comparison to our hundred-year-old system of paper checks is instructive. It was not that long ago that the originals of those checks had to be transported around the country to the proper banking institutions in order to clear payments. That was an expensive way to do things. But, remarkably, the Federal Reserve had prohibited the equivalent of swipe fees (known as exchange fees) from being charged on checks. There were (and are) still costs to processing checks, but the system works efficiently and those who accept and handle checks are able to make decisions about how to conduct business and how best to keep their costs under control.

Electronic payments should be much more efficient than paper payments. The actual costs of handling electronic payments are indeed lower. But, the prices paid by all of society are much, much higher due to competition problems inflating the associated fees.

The United States is an outlier in the world in this area – and not in a good way. Swipe fee rates are higher in the United States than anywhere in the industrialized world.[45] This harms American retailers and consumers – disadvantaging them compared to the rest of the world. Just to take one example, merchants and consumers in China pay much lower rates than their American counterparts.[46]

These fees are stunting business growth and hurting efforts to hire more workers and expand operations. One study of this impact in 2010 concluded that without the higher prices caused by fees above and beyond costs plus a reasonable rate of return, consumers would have an additional $26.9 billion to spend and the economy could add 242,000 jobs.[47] Of course, the fees have nearly tripled since that report was written. The lost economic growth during that time period is immense.

The overinflated swipe fee rates cause other economic problems as well. The U.S. credit card system has the most fraud in the world.[48] These problems are related. The high fees reduce the economic incentives for the credit card industry to fight fraud – because they make money even with relatively high fraud rates and would have to spend money to make the system safer for all of us. And, not incidentally, much of the fraud on credit cards gets charged back to merchants so the credit card industry does not lose those funds – the merchants do.

Rather than taking straightforward actions that have proven to be effective in fighting fraud, like requiring the entry of personal identification numbers (PINs) or using other means of authenticating the person making the transaction, the card networks have pushed most of the costs of fighting fraud onto merchants. The switch to chip cards in the United States is a primary example. While the vast majority of the world required PINs as part of that switch, Visa and Mastercard not only did not do that, but they threatened retailers that tried to require PINs with fines.[49] Instead of the common-sense measure that had been successful around the world, merchants were forced to spend $30 billion to upgrade their point-of-sale equipment and software to make the transition to chips without the protection of PIN usage. And, for their trouble, many merchants were still required to pay more to cover fraud.

[45] *See* Kansas City Federal Reserve, "Credit and Debit Interchange Rates in Various Countries August 2021 Update," CreditDebitCardInterchangeFeesVariousCountries_August2021Update.pdf (kansascityfed.org).
[46] *Id.*
[47] Robert J. Shapiro and Jiwon Vellucci, *The Costs of Charging It in America: Assessing the Economic Impact of Interchange Fees for Credit Card and Debit Card Transactions*, Feb. 2010, at 2.
[48] "Credit Card Fraud Statistics," Shift Processing (Sept. 2021) available at Credit Card Fraud Statistics [Updated September 2021] Shift Processing.
[49] Robin Sidel, "Kroger Sues Visa Over PIN Debit Transactions," Wall Street Journal (June 27, 2016) at Kroger Sues Visa Over PIN Debit Transactions - WSJ.

In fact, a 2019 report found that the card networks use their positions in setting card security standards to entrench their own market share at the expense of focusing on card security and fraud protection. They do this through their control of a standard-setting body called EMVCo.[50] According to the report, "Our research reveals an insidious pattern in which the card companies use EMVCo as a tool to maximize their share of transaction volumes: when the card companies feel threatened by competitive pressures or economic challenges, they — or EMVCo supporting their strategies — assume responsibility for the definition of a standard, which results in technical specifications that only benefit the card companies, not the U.S. payments industry at large."[51] Security standards should be made to protect against fraud, not to secure market share for already-dominant companies.

The large amounts of fraud on U.S. credit cards add costs to the economy. All of us must pay for that as well as swipe fees. The collective price tag for all of these inefficiencies is far higher than it should be. The United States has the largest economy in the world and should have the most effective and cost-efficient payment system. It doesn't. That should change.

VII. Dispelling Myths the Card Industry Uses to Distract From Its Anti-Competitive Behavior

As noted, anti-competitive behavior on the part of the major card networks causes serious problems for merchants, consumers, and the U.S. economy. Because the card networks cannot justify their actions and do not want to defend them, they typically try to distract any focus on their activities with complaints about the reforms Congress and the Federal Reserve put in place more than a decade ago to deal with anti-competitive activity in the debit card market. These arguments are a distraction, as well as factually wrong, and the Committee should not let the card networks try to distract its attention with those points – particularly when legislative attempts to derail those reforms have repeatedly failed over many years.

Nonetheless, the section below addresses many of the most often repeated myths that the credit card industry raises in order to ensure that you actually have the facts before you on these claims.

- Consumers and Businesses Have Benefitted from Debit Reform

Debit reform authored by Senator Durbin, which was enacted in 2010 and took effect in 2011, has been helpful in curtailing debit swipe fee rates and providing competition among networks.[52] One report showed that debit reform saved consumers $5.86 billion in 2012 alone - the first year the reforms were in effect.[53] That was nearly 70 percent of the overall savings from debit reform that year with merchants saving an additional $2.64 billion.[54] Collectively, these savings supported more than 37,000 jobs[55] – a significant economic stimulus.

In addition, *Moody's Investor Service* has reported that debit reform savings have shielded

[50] RPCG Group, "Payment Insecurity: How Visa and Mastercard use standard setting to restrict competition and thwart payments innovation," (Dec. 2019) available at https://securepaymentspartnership.com/paper.pdf. EMVCo was started by Visa, Mastercard and Europay but the governing body now includes American Express, Discover, Japan's JCB and China's Union Pay.
[51] *Id.* at 8.
[52] While reform has been beneficial, the rates paid by merchants remain higher than they should be. Costs have declined over the past decade and the rates are not proportional to costs.
[53] Robert Shapiro, "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," (Oct. 2013) available here.
[54] *Id.* at
[55] *Id.* at

consumers from higher prices that would have resulted from increases in other operating costs for businesses such as transportation and fuel costs. The report says, "As merchant acquirers pass on debit fee savings to retailers, we believe retailers will use them to help shield customers from the impact of these other rising costs."[56] The report also noted, "While on the surface it would be easy to presume that retailers would benefit from a reduced debit interchange fee, we do not expect retailers to see a material improvement in their earnings due to the Durbin Amendment."

The Moody's report is supported by analysis of how pricing moved following the implementation of debit reform. The data shows that there was inflation in the U.S. economy in the years after debit reform was implemented. Cost increases, as reflected in the Producer Price Index for retail trade industries, rose 9.4 percent from the time reform went into effect in October 2011 through the end of 2016, while price increases to consumers, reflected in the Consumer Price Index, increased only 4.3 percent.[57] That is a large spread between the higher costs that merchants had to pay for the goods they sold and the prices that they charged consumers. Those numbers demonstrate clearly that merchants shielded their customers from the majority of the cost increases the merchants themselves faced. And, that experience has held true even during the past year with increased inflation. During 2021, the Producer Price Index rose by 9.7 percent while the Consumer Price Index rose by 7 percent.[58]

Retail profit margins show the same pattern. Those margins did not grow following debit reform. In fact, in the grocery industry, pretax profit margins in the two years prior to debit reform were 2.3 percent – and following debit reform those margins fell to 2.1 percent (in 2012) and 1.9 percent (in 2013).[59]

This data reconfirms the intensely competitive nature of U.S. retail. It is very clear that savings from debit reform (and more) have been consistently passed along from merchants to consumers in the form of prices that are significantly lower than what consumers would have been forced to pay in the absence of those reforms.

Anyone who believes free markets work would need to recognize that cost savings to retail businesses help hold down prices to consumers – unless they believe that there is a market failure in the retail sector of the economy. Of course, there is not. Retail is one of the most competitive sectors of the U.S. economy and has been for decades. Without a market failure, there is no question that reduced costs pass-through into lower prices. By arguing otherwise, it makes it sound as though the credit card industry has lived with centralized price-setting so long that they have forgotten how real competitive markets work.

The credit card industry likes to point to a report released by the Richmond Federal Reserve to try to disprove consumers' clear benefits from debit reform. The problem is that, in talking about that report, they never mention the cautionary notes that the study's authors themselves included in the report – which make clear it should not be used to prove the point for which the credit card industry tried to use it. First,

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[56] "New Debit Rules Hurt Banks and Reshape the Payment Processor Market," Moody's Investor Service (June 20, 2012) at 10.
[57] Producer price index figures from the St. Louis Fed can be found here: https://fred.stlouisfed.org/series/PCUARETTRARETTR and consumer price index figures from the Minneapolis Fed can be found here: https://www.minneapolisfed.org/community/teaching-aids/cpi-calculator-information/consumer-price-index-and-inflation-rates-1913.
[58] The U.S. Bureau of Labor Statistics' release on the producer price index can be found here: Producer Price Index News Release summary - 2021 M12 Results (bls.gov) and the 2021 increase in the consumer price index can be found here: CPI Home : U.S. Bureau of Labor Statistics (bls.gov).
[59] "Grocery Store Chains Net Profit," FMI available at FMI | Grocery Store Chains Net Profit.

the report made clear they did not look at actual costs and prices - it was just an opinion survey.[60] Second, the survey sample was small and could have been biased by getting responses primarily from those dissatisfied with the way the Fed wrote its regulation. Finally, it is worth noting what may be obvious given today's economic environment. Inflation is always present and matters. The actual data shows that merchants held prices down as their costs increased. That is real consumer savings. But a survey that asks whether prices were reduced would not get that information.

- Free Checking Increased Following Debit Reform

The credit card industry like to claim that consumers had fewer options for free checking accounts following debit reform, but their claims are demonstrably wrong. At the outset, it should be noted that the banking industry has admitted that "free" checking is a fallacy, "Customers never had free checking accounts. They always paid for it in other ways, sometimes with penalty fees."[61]

In addition to Bank of America's doubts about free checking ever having existed, it should be noted that the banking industry rapidly got rid of many free checking account offerings in the years *before* debit reform ever took effect. First, the banking industry blamed the financial crisis as the reason why they had to take away free checking and charge consumers higher fees.[62] Then, the industry pivoted and started blaming overdraft regulations for their decisions to increase checking account fees.[63] In fact, some even

[60] Renee Haltom and Zhu Wang, "Did the Durbin Amendment Reduce Merchant Costs?" (Dec. 2015) at 4, available here.
[61] Bank of America spokeswoman, Anne Pace, quoted in "Bank Accounts: Free Checking Fading Fast," The Christian Science Monitor (Oct. 19, 2010), available at http://www.csmonitor.com/Business/Latest-News-Wires/2010/1019/Bank-accounts-Free-checking-fading-fast
[62] *Rising Bank Fees are Setting Records,* USA Today (Oct. 27, 2008), available at http://www.usatoday.com/money/industries/banking/2008-10-26-atms-fees-checks-banks_N.htm ("The high fees come at a time when banks are struggling to unload bad mortgage loans."); *Banks Boost Customer Fees to Record Highs,* Wall Street Journal (Nov. 12, 2008), available at http://online.wsj.com/article/SB122645109077719219.html ("Banks are responding to the troubled economy by jacking up fees on their checking accounts to record amounts."); *Banks Find Ways to Boost Fees; Checking Accounts Latest Target,* USA Today (May 28, 2009), available at http://www.usatoday.com/money/industries/banking/2009-05-27-checks-fees-banks_N.htm ("Banks defend their policies, saying that as unemployment rises, consumers have become riskier, and the higher fees reflect that risk. Banks may also be raising some account fees to compensate for higher borrowing costs and to keep prices in line with other financial institutions, says Scott Talbott of the Financial Services Roundtable, which represents the nation's largest banks."); *Bank Fees Rise as Lenders Try to Offset Losses*, New York Times (July 2, 2009), available at http://www.nytimes.com/2009/07/02/business/02fees.html?_r=1 ("Scott E. Talbott, a lobbyist for the Financial Services Roundtable, said that the banks' fees reflect the cost of providing those services and the rise in overdraft charges reflects increased risk. 'There is an increased riskiness around repayment because of the recession, he added.'").
[63] *Is Free Checking on its Way Out?* CNNMoney.com (July 2, 2009), available at http://moremoney.blogs.money.cnn.com/2009/07/02/is-free-checking-on-its-way-out/ ("Bank customers used to the perks of free checking accounts -- unlimited check writing, online banking, debit card use and ATM access, to name a few -- might have to recalibrate their expectations soon. That's because overdraft fees, which banks use to subsidize the expense of free checking accounts, have been under fire by consumer advocacy groups."); *Banking Expert: Free Checking Accounts aren't Long for this World,* WalletPop.com (Aug. 31, 2009), available at http://www.walletpop.com/2009/08/31/banking-expert-free-checking-accounts-arent-long-for-this-worl/ (Following the Credit Card Accountability Responsibility and Disclosure Act and overdraft regulations, "banks are already trying to think of new ways to make their profits."); *Banks' Struggle May Mean End of Free Checking,* msnbc.com (Nov. 10, 2009), available at http://www.msnbc.msn.com/id/33840681/ns/business-consumer_news/ ("The change by Citi comes as Congress considers legislation that would limit banks' ability to levy overdraft fees on checking accounts."); *The End of Free Checking?* MoneyTalksNews.com (Dec. 30, 2009), available at http://www.moneytalksnews.com/2009/12/30/the-end-of-free-checking/ ("[N]ew Congressional regulations like the CARD Act have limited the amount of money banks can make from credit cards. The Federal Reserve also has plans to address the highly lucrative "overdraft fee industry", estimated to be worth $38.5 billion in 2009 by industry consultants Moebs Services. In other words, free checking accounts may soon be going the way of the dinosaur."); *The End of Free Checking,* NPR Planet Money

had the temerity to suggest that they had to increase checking fees because they couldn't make the same money from risky mortgages anymore.[64]

All of these various excuses for the steep drop in free checking offerings were made long before debit reform came into being. The litany of excuses was summed up well in a 2011 article written when banks were blaming debit reform for their increases in checking fees – remarkably, doing this even before debit reform had ever taken effect – "The pattern is getting old and weary. Banks will raise checking fees whenever and wherever they think they can get away with it. And they will blame any convenient development for their choices."[65]

This background matters because the credit card industry typically relies on two fatally flawed studies to try to show that reductions in free checking that came before debit reform – reductions they blamed on the financial crisis and limits on overdraft fees – were actually caused by debit reform. These studies take January 2009 as the measuring point for free checking prior to debit reform even though those reforms did not come into effect until October 2011, nearly two full years later. And, they pushed these studies onto the Government Accountability Office which cited them in a recent report without recognizing that the timing of the studies meant that the studies were blaming debit reform for things that happened prior to reform coming into effect.[66]

The number of checking accounts without monthly fees fell by 11 percentage points just from 2009 to 2010 – still a year before debit reform.[67] But, by counting the remarkably swift and steep reduction in the number of free checking accounts that occurred during the financial crisis and blaming that on debit reform (which came later), these studies magically find that debit reform reduced free checking. It didn't.

Banking industry data demonstrates that free checking increased from the time debit reform went into effect at least for its first few years in operation. The ABA reported that 61 percent of banks had free checking in 2014 which compares favorably to the 50 percent of banks with free checking that the ABA reported in 2010 and the 39 percent of large banks that Moebs Services reported offered free checking two

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(June 17, 2010), available at http://www.npr.org/blogs/money/2010/06/17/127899418/you-may-have-to-pay-for-that-checking-account ("It costs banks a few hundred bucks a year to maintain a customer's checking account. Banks have been able to make that up (and more) largely by charging overdraft fees. But new federal rules mean banks can only charge those fees to customers who sign up for overdraft protection."); *The End of Free Checking,* The Atlantic (June 21, 2010), available at http://www.theatlantic.com/business/archive/2010/06/the-end-of-free-checking/58444/ ("Free checking is on life support. . . . The main reason why, of course, is the imminent prohibition of overdraft fees, which had been a boon for banks."); *End of Free Checking a Financial Squeeze: How Employers Can Help*, The Huffington Post (June 28, 2010), available at http://www.huffingtonpost.com/clare-j-morgan/end-of-free-checking-a-fi_b_627540.html ("The free checking accounts many Americans enjoy will soon be a thing of the past as banks scramble to find new ways to recoup overdraft charges and other fees they're no longer allowed to impose.").

[64] *The End of Free Checking? Not at Credit Unions!* Credit Unions Online (June 17, 2010), available at http://www.creditunionsonline.com/news/2010/The-End-of-Free-Checking-Not-at-Credit-Unions.html ("Since banks can no longer charge many credit card fees of the past and high risk (high fee) mortgages are gone, banks are finding themselves short of revenue. . . . Now the banks are coming after your checking account to make up the difference.")

[65] David Balto "The Bankers' New Goat," HuffPost (May 25, 2011) available at https://www.huffpost.com/entry/the-bankers-new-goat_b_834615.

[66] *See* "Banking Services," Government Accountability Office (Feb. 2022) available at https://www.gao.gov/assets/gao-22-104468.pdf.

[67] *Region Banks Refrain from Raising Checking Account Fees,* Nwi.com (Nov. 9, 2010), available at http://www.nwitimes.com/business/local/article_337b378b-3f74-5a00-9d86-b9e6b3d58799.html ("Bucking a national trend, the region's community banks aren't raising fees or putting the breaks on free, non-minimum-balance checking accounts, yet. A recent Bankrate.com national survey on checking accounts indicates the percentage of checking accounts with no monthly service charges and no minimum balance fell to 65 percent in 2010 from 76 percent in the 2009 study.")

months prior to debit reform taking effect.[68]

- Rewards Will Not End (and the Sky Will Not Fall) if Competition Comes to Credit Cards

The credit card industry consistently argues that any reforms to the current credit card market will end credit card rewards. In fact, they have spread advertisements all over the Internet depicting Senator Durbin as a cartoonish figure and alleging that he wants to end credit card rewards. That is remarkable given that neither Senator Durbin nor any other Senator has to date proposed legislation to reform the competition problems with credit cards. You might think that the credit card industry would want to review any such proposal and analyze its effects before giving a reasoned evaluation of its impact – but you would be wrong. The industry clearly prefers insult to reasoned debate. And, of course, the credit card industry wants to warn other Senators that they could be the subject of its ridicule if they have the temerity to support potential reforms.

The credit card industry resorts to these tactics because the facts are not on its side. The nation with the longest track record of credit card fee reforms is Australia. After more than a decade under reforms there, the Reserve Bank of Australia has found, "The existence of significant credit card rewards programs suggests that credit card interchange fees are currently materially higher than is necessary for banks to provide payment cards with credit functionality. The Bank's 2013 Payments Cost Study shows that – for the average-size transaction for each payment method – the existence of the interest-free period and rewards means that the effective price paid by a cardholder to use a credit card is lower than that for a debit card, even though the resource costs are substantially higher."[69]

When Australia acted, MasterCard said it would mean the end of the credit card system in that nation – arguing that there would be a "death spiral."[70] They were wrong. More consumers use more cards for less than ever before in Australia. In fact, rather than Visa and MasterCard competing to raise interchange fees so that banks will issue more of their cards, they have had to give consumers what they really wanted – lower interest rates on their cards. This interest rate competition has benefitted consumers immensely. The only ones who don't like it are Visa and MasterCard (and their member banks) because they don't make as much on interchange fees and must now compete more thoroughly on the value they deliver to consumers. The Reserve Bank of Australia reviewed the interchange reforms instituted there and concluded, "Overall, consumers are benefiting from this greater competition and lower merchant costs . . . one group of consumers clearly better off are those who regularly borrow on their credit cards. They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year . . . Consumers who do not use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services than would otherwise have been the case. For many years,

[68] Cadence Bank, "ABA: Most Americans Pay Nothing for Bank Services," available at https://cadencebank.com/about/resources/aba-survey---most-americans-pay-nothing-for-bank-services; American Bankers Association, "ABA Survey Shows Majority of Bank Customers Pay Nothing for Monthly Bank Services," available at http://www.prnewswire.com/news-releases/aba-survey-shows-majority-of-bank-customers-pay-nothing-for-monthly-bank-services-104516904.html; Ismat Sarah Mangla and Tali Yahalom "Bank Accounts: Get a Fair Shake, not a Shake-Down," CNN Money (Aug. 31, 2011) available at https://money.cnn.com/2011/08/31/pf/bank_accounts.moneymag/index.htm ("This was backed by data from Moebs Services, which found that 39% of big banks offered free checking in 2011, down from 64% in 2010").

[69] Reserve Bank of Australia, "Review of Card Payments Regulation," at sec. 3, available at https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/conclusions-paper-may2016/interchange-fees-and-transparency-of-card-payments.html.

[70] *See* Alan S. Frankel, "Toward a Competitive Card Payments Marketplace," at 40, available at https://www.rba.gov.au/payments-and-infrastructure/resources/publications/payments-au/paymts-sys-rev-conf/2007/5-compet-card-payment.pdf.

these consumers have helped subsidise the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[71]

Lower fees, competition, and other reforms in other countries have not stopped Visa and Mastercard from aggressively marketing their networks to banks around the world. It is clear that there is plenty of revenue in nations with far lower fees for the credit card business to be very profitable.

- Visa and Mastercard Do Not Provide a Meaningful Break on Swipe Fees at Gas Pumps

Swipe fees have jumped by enormous amounts on motor fuel purchases during the past year. As noted, the convenience industry saw its fees rise by 26.5 percent in 2021 and are seeing more rapid increases this year. These large increases add a significant economic pressure to increase gas prices at the worst possible time. The card industry has tried to defend themselves from criticism for these rapidly rising fees by saying that they have capped swipe fees at $1.10 per fill-up. But they know that cap is largely ineffectual. The average amount of gas put in a car during a fill-up is 11.7 gallons.[72] So, using the average credit card interchange rate of 2.22 percent, a cap of $1.10 does not impact what the merchant pays for that fill up until gas costs about $4.25 per gallon. Other than in California, even recent gas prices have only rarely reached that number.

Swipe fees are often near 10 cents per gallon on a fill-up today. That is simply too much for local retailers or their customers to bear.

- Visa and Mastercard Do Not Need to Set Prices for Large Banks

One of the few ways that the credit card industry has tried to justify the centralized setting of prices by the networks for the banks that issue cards is by citing the large number of banks on each side of a credit card transaction. With thousands of banks issuing cards and thousands of banks and processors handling the merchant side of processing, they argue that it is too complicated and difficult for the prices of all those combinations to be negotiated in a free market.

But, the research has found that the card industry's protestations don't fit the facts. Nicholas Economides of New York University has studied this and found that credit card issuing and, on the other side, acquiring/processing of credit card transactions is very concentrated among small numbers of banks and processors with large market shares. As a result, in 2009, he found that a mere 90 negotiated agreements would cover a full 72 percent of all Visa and Mastercard transaction volume.[73] That, of course, is very doable – and there has been significant additional concentration in both markets since then.[74] There is no reason why the largest banks couldn't do business like other companies operating throughout the economy and negotiate their own pricing.

[71] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.
[72] https://www.statista.com/statistics/1143194/average-fuel-transaction-volume-us-gas-stations/#:~:text=Average%20quantity%20of%20fuel%20purchased%20per%20transaction%20in%20the%20U.S.%202019%2D2020&text=Americans%20bought%2011.7%20gallons%20of,the%20gas%20pump%20in%202020.
[73] Nicholas Economides, "Competition Policy Issues in the Consumer Payments Industry," at 122 In R. Litan & M. Baily, Moving Money: The Future of Consumer Payment, Brookings Institution (2009) available at 06-0277-1 CH 06 (nyu.edu).
[74] The top 5 Visa/Mastercard issuing banks accounted for more than 70% of purchase volume in 2021, and the top 10 banks comprised more than 80%. *See* Nilson Report, Issue No. 1214 at 8-9 (Feb. 2022).

- The Combination of Thousands of Banks Under the Visa and Mastercard Umbrellas Means that Merchants Can't Just Stop Taking Credit Cards

Economists have found that due to the market power of Visa and MasterCard, merchants have no real choice but to accept credit cards. While the credit card industry likes to say merchants have a choice, this argument would be like AT&T claiming in the 1980s that no one should worry about its monopoly because people could choose not to have a telephone. Accepting cards is essential for most businesses – as the U.S. Department of Justice has concluded.[75]

In fact, the Kansas City Federal Reserve studied this and concluded, "Only monopoly merchants who are facing an inelastic consumer demand may deny cards when the fee exceeds its transactional benefit. . . Merchant competition allows the network to set higher merchant fees. The network can always set higher merchant fees in more competitive markets. Moreover, in competitive markets the merchant fees in the long run may exceed the sum of the merchant's initial margin and the merchant's transactional benefit. . . . As long as the merchant fee does not exceed the level that gives merchants negative profits, merchants may have no choice but to continue accepting cards."[76] The courts also agree that Visa and MasterCard both have market power which means they have the ability to raise their prices above what would be sustained in a competitive market.[77]

- Debit Reform Has Helped Small Banks and Credit Unions Compete

Currently, the way that credit card swipe fees are fixed disadvantages small banks and credit unions. Those institutions typically have higher costs than do large institutions (which, unlike small banks, often pay nothing to the credit card networks). Credit union representative John Blum, for example, testified on behalf of the National Association of Federal Credit Unions in 2010 and told the House Judiciary Committee: "Credit unions have a higher per-transaction cost for processing card payments."[78] Community banks have similar disadvantages because of their relatively small size resulting, in many instances, in the need to outsource card operations.[79] By fixing fees for all banks at the same level, however, large banks have for years been guaranteed higher profit margins than their smaller competitors. Those large banks have used their advantage to aggressively market themselves to consumers. That is one of the reasons why the credit card market is more concentrated than the debit card market. Many consumers who have accounts and debit cards at small banks and credit unions receive credit card and other offers from large banks. The large banks take the small banks' customers in this way on a regular basis – paid for by their excess interchange earnings. The result is that large banks have a bigger share of both the credit and debit card markets than their share of deposits.[80]

[75] *See* Complaint, U.S. v. Visa, Inc. and Plaid, Inc. (Nov. 5, 2020) at ¶3.
[76] Fumiko Hayashi, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" Federal Reserve Bank of Kansas City (2004) available at https://ideas.repec.org/p/fip/fedkpw/psrwp04-02.html.
[77] *U.S. v. Visa U.S.A., Inc.*, 344 F. 3d 229 (2d Cir. 2003).
[78] John Blum, Hearing before the Task Force on Competition Policy and Antitrust Laws, House Judiciary Committee, May 15, 2008, House Report No. 110-179, at 80.
[79] Dave Carpenter, Hearing before the House Judiciary Committee on the Credit Card Fair Fee Act of 2009, Apr. 28, 2010.
[80] *See* Adam J. Levitin, *Interchange Regulation: Implications for Credit Unions*, 2010, at 39 (noting that 10 banks alone account for almost 90 percent of the credit card market and 51 percent of the debit card market, even though those 10 banks hold only 36 percent of insured deposits), *available at* http://www.federalreserve.gov/newsevents/files/levitin_filene_paper.pdf.

Debit reforms have helped to level the playing field. The Philadelphia Federal Reserve published a study on the impact of debit reform on small financial institutions in February 2016. The study found that after reform, "the volume of transactions conducted with cards issued by exempt banks *grew faster* than it did for large banks."[81] The study concluded that "the evidence does not support the claim that competitive forces have effectively imposed the interchange fee ceiling on small banks."[82]

The Credit Union Times has reported that debit reform created "a powerful way for credit unions to accumulate market share" and "what some say is a huge opportunity for credit unions."[83] According to Texas Trust President and CEO Jim Minge, debit reforms created "…a huge opportunity for credit unions like the Mansfield, Texas Trust Credit Union and everybody else below the $10 billion threshold…" Debit swipe fee reform "applies only to financial institutions with more than $10 billion in assets, which has created a huge opportunity for credit unions – especially those that want to attract millennials."[84]

Centralized price-setting of credit card swipe fees harms smaller financial institutions. More competition in the market would help give them additional levers to try to compete with the largest banks including by allowing them to negotiate among the different networks.[85]

- Debit Reform and Network Competition Enhanced Fraud Protection

Competition pushes businesses to provide lower prices and better service. That has been the impact that debit reform brought to payments a decade ago. By prohibiting exclusivity arrangements so that more than one network had to be available to handle debit card transactions, the market changed so that networks needed to find a way to improve their offerings. One way they did that was with enhanced protections against fraud. As soon as the debit reforms came into effect, the networks started introducing full end-to-end encryption of data.[86] They also accelerated the transition to chip cards in the United States.[87]

The credit card industry sometimes argues that high swipe fees are needed to cover fraud costs, but this is not the case – as is clear from the fact that fraud is much lower in nations with much lower swipe fee rates. Economists with the Federal Reserve Bank of Kansas City have found that fraud costs are not a

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[81] James Disalvo and Ryan Johnston, "How Dodd-Frank Affects Small Bank Costs," Economic Insights: Federal Reserve Bank of Philadelphia (Feb. 2016) available at https://www.philadelphiafed.org/-/media/frbp/assets/economy/articles/economic-insights/2016/q1/eiq116.pdf.
[82] *Id.*
[83] "Credit Unions Revive Debit Rewards" (Jan. 22, 2016) available at http://www.cutimes.com/2016/01/22/credit-unions-revive-debit-rewards; "Credit Unions Pile Into Debit Rewards" (Jan. 20, 2016) available at http://www.cutimes.com/2016/01/20/credit-unions-pile-into-debit-rewards?page=1&slreturn=1453333652.
[84] "6 Winning Credit Union Payments Strategies" (Apr. 15, 2016) available at http://www.cutimes.com/2016/04/15/6-winning-credit-union-payments-strategies?slreturn=1487974414&page=2.
[85] The two largest networks favor larger financial institutions in the terms of their deals. *See* "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Board of Governors of the Federal Reserve System (May 2021) at 15, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.
[86] *See*, e.g., Tracy Kitten, "Visa's New End-to-End Encryption Service," Bankinfo Security (Sept. 12, 2012) available at https://www.bankinfosecurity.com/interviews/visas-new-end-to-end-encryption-service-i-1650.
[87] *See* Visa presentation to Federal Reserve (Jan. 8, 2014) at 2, available at http://www.federalreserve.gov/newsevents/rr-commpublic/visa-meeting-20140108.pdf.

justification for over-inflated interchange fees. They wrote, "Card organizations have often argued that the reason why they impose proportional fees stems from the cost they bear from their 'payment guarantee' service which insures merchants against customers who pay with cards without having sufficient funds. We argue that the cost of fraud and insufficient funding is negligible compared with fees at the range of 1% to 3% commonly imposed by brand name cards. For example, industry studies show that the average net fraud losses are around 0.05% for signature debit cards, which do not extend credit to card users."[88] And, as noted above, the majority of fraud is paid by merchants, not banks.

The swipe fee system on debit cards prior to reforms created disincentives to the card industry taking fraud protection more seriously. Because the fees were much higher than losses from fraud, financial institutions were not highly motivated to make changes to cut down that fraud. A June 2011 Consumer Reports article pointed out these problems. It noted that thieves could "easily and cheaply" copy U.S. debit card data that is usually stored unencrypted in a magnetic stripe on the back of the card. According to the article, "The U.S. and some non-industrialized countries in Africa are among the only nations still relying on magstripe payment cards, which came into wide use in the 1970's."[89]

A representative from the New York Police Department explained in the Consumer Reports piece that the NYPD had "recommended to several of the large financial institutions that the biggest deterrent to skimming would be using the kind of cards that are issued in Europe and Canada with a chip that makes them pretty much impossible to skim."[90] The article noted that financial institutions had been reluctant to do that due to their large card revenues. After debit reform, however, the card industry had newfound motivation to reduce fraud and pushed the transition to chip cards – though, unfortunately, they failed to push PIN usage as they had in other parts of the world.

- Merchants Absorb More Card Fraud Than Banks

While the card industry often talks about a "payment guarantee," merchants are not guaranteed payment on credit or debit card transactions. In fact, merchants are forced to absorb the majority of the cost of fraudulent card transactions. When the merchant is forced to pay for the fraud, this is called a "chargeback." It means that the money the merchant was supposed to receive on the transaction is taken away (in other words, charged back). This can happen to a merchant without notice even months after the transaction takes place.

The Federal Reserve has collected data on debit card fraud every two years since debit reform was passed. Its 2019 data shows that merchants covered 56.3 percent of debit card fraud while card issuing banks only covered 35.4 percent.[91] The picture is similar for credit cards as merchants absorb most fraud

[88] Oz Shy and Zhu Wang, "Why Do Card Issuers Charge Proportional Fees?" The Federal Reserve Bank of Kansas City Economic Research Department, (December 2008) at 3 available at https://www.kansascityfed.org/documents/5325/pdf-rwp08-13.pdf.
[89] "House of cards: Why your accounts are vulnerable to thieves," Consumer Reports Magazine (June 2011).
[90] *Id.*
[91] "2019 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Board of Governors of the Federal Reserve System (May 2021) at 4, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2019.pdf.

losses – particularly since Visa and Mastercard implemented a liability shift to push chip card usage which pushed a significant share of fraud onto merchants. In fact, the Federal Reserve has reported that the merchant share of fraud on dual message debit cards (processed in similar fashion to credit cards) is more than 60 percent.[92]

Of course, all of the fraud chargebacks merchants must pay are on top of the swipe fees they pay. Those swipe fees amount to a prepayment of all fraud charges (and much more) to card-issuing banks. Merchants should not have to prepay for fraud and they should not have to pay when the fraud happens in addition to prepaying for it. They also shouldn't have to hear about the great "payment guarantee" they receive on credit and debit cards when the merchants pay for fraud multiple times.

It is worth noting that even with debit reform, merchants prepay all the fraud that banks otherwise cover. Federal Reserve Regulation II, which implements debit reform, includes 5 basis points as part of the regulated debit swipe fee to cover fraud losses by banks. That number was pegged to 100 percent of the fraud losses on debit cards paid by the average bank covered by the regulation. Of course, that means that fraud is a guaranteed profit center for many of the banks covered by the regulation (those with below average fraud losses). And, the vast majority of banks across the nation are not subject to the Fed's fee regulation. They charge even higher fees that exceed their fraud losses on debit cards. Why merchants must pay chargebacks to cover the majority of fraud that they have already prepaid (and then some) to the banks is inexplicable.

* * *

The harm done to merchants, consumers and the U.S. economy due to the anti-competitive actions of the card industry is far too large and should end. Market competition improves economic efficiency, innovation, and price competition. Bringing competition to the credit card market would produce real economic benefits across the spectrum. It is time for that to happen.

[92] *Id.*

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NAFCU
National Association of Federally-Insured Credit Unions

May 25, 2022

The Honorable Maxine Waters	The Honorable Patrick McHenry
Chairwoman	Ranking Member
Committee on Financial Services	Committee on Financial Services
U.S. House of Representatives	U.S. House of Representatives
Washington, DC 20515	Washington, DC 20515

Re: Tomorrow's Hearing – Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency

Dear Chairwoman Waters and Ranking Member McHenry:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) regarding tomorrow's hearing on a central bank digital currency (CBDC). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 130 million consumers with personal and small business financial service products. NAFCU appreciates your work to ensure the United States financial system remains competitive and up-to-date with the most recent technological systems, and we would like to share the perspective of credit unions in advance of your hearing.

In general, NAFCU believes that there are too many outstanding uncertainties and that the Federal Reserve should not proceed with the development of a CBDC at this time. We believe the hypothesized benefits of a CBDC are difficult to pinpoint given the lack of specific policy direction in current proposals. Despite recent investigations into the topic by the Federal Reserve, many questions remain unanswered. Many of the design features necessary to achieve certain benefits come with serious tradeoffs that could negatively impact credit unions and pose broader financial stability risks. In some cases, those tradeoffs are difficult to anticipate because underlying regulatory policies—such as what balance to strike in terms of protecting consumer privacy, or how to guard against retail deposit substitution—are not yet developed.

If the Federal Reserve were to offer a CBDC directly to consumers, it would be in essence offering consumer accounts, which would constitute a massive expansion of its mission and threaten to erode the financial system. Even in an intermediated model, where financial institutions act as providers of CBDC accounts, there is a risk that CBDC would displace commercial bank money and the Federal Reserve has acknowledged that this substitution could "increase bank funding expenses and reduce credit availability or raise credit costs for households and businesses."[1] Credit unions would also be affected. Even if the Federal Reserve were to design CBDC to be non-

[1] Federal Reserve, Money and Payments: The U.S. Dollar in the Age of Digital Transformation, 17.

interest bearing or impose limits on individual balances, CBDC could still be seen as a safe haven in times of crisis and this would have serious consequences on the liquidity of financial institutions, especially credit unions, if consumers substitute commercial deposits for CBDC.

One oft-quoted claim is that a CBDC would promote adoption of faster or cheaper payments. Not only is CBDC redundant as a payments rail given that the Federal Reserve is already pursuing development of FedNow, a real-time settlement service, but also the allocation of compliance responsibilities to financial institutions would likely complicate, rather than complement, existing private and public sector payments innovation. The real-time speed of CBDC payments coupled with any policy directive to anonymize certain transactions to preserve end user privacy could give rise to unique fraud risks. Financial institution intermediaries such as credit unions would assume these risks if consumer CBDC transactions are subject to the *Electronic Fund Transfer Act* (EFTA) and Regulation E. The involvement of nonbank intermediaries as facilitators of CBDC payments could also give rise to complex error resolution procedures that could divert resources away from other payments channels. It is also unclear how credit union intermediaries will recoup the costs of consumer compliance functions. Regulation E compliance is expensive on its own, but implementing *Bank Secrecy Acy*/anti-money laundering oversight, cybersecurity controls, and potentially new technology to accommodate an anonymous layer of CBDC transactions would overburden credit unions that are already struggling under the weight of excessive regulation.

A CBDC would also pose serious privacy concerns. Some of the purported benefits of a CBDC require tradeoffs that could erode either consumer privacy or the auditability of transactions.[2] While a maximalist view of CBDC often asserts that preserving both the anonymity and auditability of transactions can be achieved at a technical level, lack of tangible details makes evaluation of costs and benefits of proposed solutions and their associated tradeoffs difficult.[3] Privacy concerns would also do nothing to address the Committee's goal of increasing financial inclusion, as trust and privacy are some of the most often cited concerns of traditionally underserved populations.

Finally, NAFCU expects that future enhancements to cross-border digital payments will be driven by industry-led investments that are not dependent on the introduction of a U.S. CBDC. NAFCU anticipates a similar outcome for domestic payments, which will gain the additional benefit of public investment through the introduction of the FedNow Service. A CBDC is not the answer to increasing transaction speed.

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[2] *See* Federal Reserve Bank of Boston and Massachusetts Institute of Technology Digital Currency Initiative, Project Hamilton Phase 4-5 A High Performance Payment Processing System Designed for Central Bank Digital Currencies, (February 3, 2022).
[3] *See id.* at 5 ("Equally, clear public policy objectives and product design decisions are required to inform the appropriate technical design for the system.").

NAFCU expects that the net costs of a CBDC will exceed the benefits, and that administration of a CBDC will distract from the Federal Reserve's dual mandate of achieving both stable prices and maximum sustainable employment. Accordingly, the Federal Reserve should not proceed with further development activities. Additionally, the Federal Reserve should not allocate resources towards investigating hypothetical models of CBDC until it has identified clear regulatory parameters, with the input of Congress and key stakeholders, that are the necessary foundation for understanding CBDC design limitations and tradeoffs.

We thank you for the opportunity to share our thoughts in advance of tomorrow's hearing on a CBDC. Should you have any questions or require any additional information, please contact me or Lewis Plush, NAFCU's Associate Director of Legislative Affairs, at 703-842-2261.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the House Financial Services Committee

NCRC Calls on Federal Reserve to Refrain from Issuing CBDC

May 23, 2022

NCRC
National Community Reinvestment Coalition

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve
230 S LaSalle Street
Chicago, IL 60604

RE: CBDC Benefits, Risks, and Policy Considerations
Sent via electronic mail to digital-innovations@frb.gov

Dear Secretary Misback:

We appreciate the opportunity to provide our comments on the subject of a Federal Reserve central bank digital currency (CBDC).

The National Community Reinvestment Coalition and its grassroots member organizations create opportunities for people to build wealth. We work with community leaders, policymakers, and financial institutions to champion fairness and end discrimination in lending, housing, and business. We promote access to basic banking services, affordable housing, entrepreneurship, job creation, and vibrant communities for America's working families. Our 600 members include community reinvestment organizations, community development corporations, local and state government agencies; faith-based institutions; community organizing and civil rights groups, minority and women-owned business associations, and local and social service providers from across the nation.

We view the prospect of a CBDC with great skepticism for many reasons of discussed in this comment. In an initial analysis in its January 2022 white paper, the Federal Reserve suggests that the US economy would benefit from a CBDC that is "privacy-protected, intermediated, widely transferable, and identity-verified." However, it made that statement with two caveats – first, the Federal Reserve has not taken a position in favor of any policy outcome, and second, it remains agnostic on the "ultimate desirability" of a CBDC. When buttressed by those conditions, the white paper cannot be said to offer a proposal. Nonetheless, this comment will refer to the structure described as the "initial analysis."

I. An intermediated CBDC would undermine community reinvestment activities.

1. *A CBDC does not require deposit insurance and thus would not come with a community reinvestment obligation*
2. *The loss of community reinvestment benefits cannot be considered minor.*
3. *iii. An increase in uninsured deposits threatens the size of bank branch networks. Underserved communities will bear the brunt of the harm.*

II. Banks will prefer CBDC to insured deposits. The Federal Reserve will have to pick "winners and losers," dramatically expand its role in the economy, and CBDC could cause it to play a more significant role in how banks operate.

1. *Banks will prefer holding CBDC to accepting fiat deposits from consumers.*
2. *Consumers will prefer a CBDC because it will be less risky than deposits held at a bank.*
3. *The Federal Reserve would have to choose how it allocates CBDC to intermediaries. If the Federal Reserve wanted to control the amount of CBDC in circulation, it would be forced to pick "winners and losers" among its member banks.*
4. *The Federal Reserve would have to expand its asset holdings.*
5. *Issuing a CBDC through intermediaries would create a moral hazard where banks reduce their underwriting standards without increasing the risk to their balance sheets.*
6. *The likely remedy to help the Federal Reserve avoid expanding its balance sheet is highly suboptimal. The Federal Reserve could be put in a position of setting rules for how banks invest their holdings. This remedy would reverse the availability of credit.*

III. The Federal Reserve should prioritize the completion of FedNow

1. *FedNow will provide the benefit of real-time gross settlement of funds to all participants in the banking system.*
2. *By its use of ISO 2022, FedNow will enhance the information appended to payments and, in doing so, will mirror the capabilities of blockchain.*
3. *Before the Federal Reserve brings FedNow to market, it should clarify that the system must build strong protections against fraud.*

4. *The lessons learned from the United Kingdom's experience with RTGS serve as a cautionary story and underscore the need for regulators to protect consumers from sender-authorized fraud.*

IV. Claims that CBDC will enhance financial inclusion are unfounded and would be further compromised by intermediation.

1. *An intermediated CBDC will not lead to the financial inclusion benefits.*
2. *It may be hard to convince consumers that their privacy will be protected when they use a CBDC.*
3. *A simple and effective alternative would be to require depositories to offer fee-free bank accounts, without overdraft or insufficient funds fees, as a condition of access to a Fed master account.*

NCRC Calls on Federal Reserve to Refrain from Issuing CBDCDISCUSSION

I. An intermediated CBDC would undermine community reinvestment activities.

1. A CBDC does not require deposit insurance and thus would not come with a community reinvestment obligation

The Federal Reserve's white paper states that a CBDC will not require deposit insurance. Community reinvestment obligations apply to deposits held in insured bank accounts at national banks, savings associations, and state-chartered commercial and savings banks. [1] By definition, intermediated CBDC would fall outside of that criterion. The distinction is problematic on several levels.

On principle and as set forth in settled law, receiving a banking charter is a privilege. To benefit from that privilege, banks must have community reinvestment obligations. However, the requirement to perform community reinvestment activities only extends to institutions that accept deposits that the FDIC insures.

Communities depend on the work fostered by the Community Reinvestment Act as a source of funding for needed projects. These projects might never attract capital, even though they address critical social goals. Since its passage forty-five years ago, the CRA has developed an ecosystem whose components form the infrastructure for the creation of affordable housing, the expansion of credit to underserved consumers and small businesses, the existence of bank branches in low-and-moderate income communities, the provision of needed deposit services, programs to increase homeownership, and many other beneficial endeavors.[2]Any step in a direction that undermines CRA is a step in the wrong direction.

2. The loss of community reinvestment benefits cannot be considered minor.

Neither the Federal Reserve's *Money and Payments* paper[3] nor the February 2022 report to Congress by the Congressional Research Service[4] consider how a CBDC would undermine community reinvestment work. NCRC is very concerned. Given why consumers and small businesses could prefer a CBDC to the option of placing deposits at commercial banks, we fear that a very significant share of consumer deposits will migrate to CBDC. Absent the passage of legislation by Congress, the linkage between taking insured deposits and having a community reinvestment obligation will not expand to cover liabilities of the Federal Reserve.

If they could secure enough CBDC, some banks might decide to stop taking deposits from consumers entirely. In theory, those institutions would have a CRA exam but no deposits and no assessment areas. Alternatively, they could remain a Deposit Insurance Fund (DIF) member. Yet, they would not need to contribute to the DFI without insured deposits. While national banks must have deposit insurance, state-chartered banks do not. In the long run, if the management of a state-chartered bank elected to no longer have deposit insurance, they could cease to have a community reinvestment obligation.

A decision by the Federal Reserve to hold retail deposits as uninsured liabilities is a step in the wrong direction.

3. An increase in uninsured deposits threatens the size of bank branch networks. Underserved communities will bear the brunt of the harm.

Any version of a CBDC would harm consumers by reducing the amount of capital subject to community reinvestment obligations. The choice to place deposits in an insured private bank will compete against placing funds at the Federal Reserve. Because funds held at the Federal Reserve will have zero credit or liquidity risk, CBDC will be preferable. As a result, the concern is also one of magnitude. CBDC will offer advantages not just to the unbanked and underbanked, as its advocates have emphasized, but to everyone. It is entirely possible that all depositors will conclude that CBDC is a superior choice in the long run. In effect, the introduction of CBDC portends an existential threat to the CRA.

Relatedly, a macro reduction in insured deposits could reduce some of the impetus for banks to maintain their bank branch networks at current levels. The effect might undermine the quality of deposit services because it would break the linkage between serving consumers well and attracting deposits.

Moreover, not every community would suffer equivalently. Branches in underserved areas would be the highest threat of closure. If new CRA regulations establish quantitative incentives that link the number of branches in underserved areas to the size of a bank's asset holdings, banks will be secure that they have the regulatory moat to make these decisions. While intermediation would perpetuate the need for commercial banks to provide services through branches, the uncertainty is unsettling, and the possibility of unexpected problems seems high.

II. Banks will prefer CBDC to taking insured deposits. The Federal Reserve will have to pick "winners and losers," dramatically expand its role in the economy, and could cause it to play a more significant role in how banks operate.

In the initial analysis, the white paper suggests that a CBDC would not require deposit insurance, would be a liability of the Federal Reserve, and would not carry any credit or liquidity risk. By contrast, commercial bank money does contain some risk. Deposit insurance addresses some of the risks, but other risks remain.

Economists observe that rational actors will attempt to hoard the better form of money when there are two versions of a currency, where one has superior features. While there may be a time when the different versions still trade equivalently and at par, Gresham's Law says that the disequilibrium will ultimately result in a divergence of valuations.

CBDC thus will trend toward supplanting private bank money as the preferred form of currency, leading to the creation of moral hazards that increase systemic risk. For the reasons mentioned below, depositories and consumers will prefer CBDC to insured deposits.

1. Banks will prefer holding CBDC to accepting fiat deposits from consumers.

Banks, with very few exceptions, choose to insure their deposits. When they do, they incur the cost of paying into the FDIC's Deposit Insurance Fund (DIF). They will not have that obligation for CBDC, as those funds will not bear credit or liquidity risk.

Banks will have an unlimited appetite for more CBDC deposits. Except for very low-interest rate environments, depositories have had to pay interest to depositors. Banks could receive CBDC without paying interest in an intermediated system and hold those funds without paying deposit insurance. True, consumers might receive interest on the CBDC they place in a bank, but the Federal Reserve would pay those costs.

2. Consumers will prefer a CBDC because it will be less risky than deposits held at a bank

The provision of deposit insurance protects against runs, but it can take time to restore access to insured dollars. Historically, consumers who withdrew their funds had only one option to hold cash. With the rise of shadow banking, money market accounts emerged as a second option. However, cash has significant shortcomings – it can only be spent in person, is vulnerable to theft, does not provide a return, and cannot benefit from some payment services offered through a bank. Money market funds offer a return and are protected against theft but are riskier than insured deposits. In almost every way, a CBDC's benefits are more significant than cash or money markets. Moreover, it will be very easy to move funds from an insured account to a CBDC.

The Federal Reserve's January white paper asks if the relative attractiveness of a CBDC in comparison to private bank money could be mitigated by a policy of offering interest rates below those paid by insured commercial banks. In our view, this policy seems attractive on its face but would further advantage a Federal Reserve account above one at a commercial bank account.

At any moment, the prospect that a risk-free account would also pay interest at a rate above that offered by a commercial bank would drive more deposits to CBDC, but the effect could be potent during times of distress. Given that policymakers lower interest rates at times when there is a need to stimulate the economy, the difference at a time when demand deposit accounts pay almost nothing would pose a powerful attraction, leading to a scenario where the presence of a CBDC dampens the availability of credit in the market at a time when it is needed the most.

Some of the leading proponents of a CBDC have argued that a FedAccount could pay retail consumers an interest rate that matched that paid by the Federal Reserve to member banks and at rates that were higher than on offer to consumers through a retail bank.[5] That policy would seem only to drive more deposits away from insured banks.

If the Federal Reserve did issue an intermediated CBDC, it must allow fiat insured deposits to be interchangeable at par with CBDC. Versions of dollars must be interoperable.

3. The Federal Reserve would have to choose how it allocates CBDC to intermediaries. If the Federal Reserve wanted to control the amount of CBDC in circulation, it would be forced to pick "winners and losers" among its member banks.

Owing to the many benefits of CBDC versus commercial bank money, banks will be strongly motivated to serve as the intermediary institutions for CBDCs.

In forecasting the likely impacts on the market, it should consider a potential outcome where depositories petition the Federal Reserve to receive the highest possible allocation of CBDCs. The resulting pressure from banks and their political agents will put the Federal Reserve in an unenviable spot of picking winners and losers inside the commercial banking system.

The process of making these allocations will become a subject of great political controversy. Large banks may argue that they are the most efficient stewards of funds, and community banks are likely to contend that an unfavorable allocation by the Federal Reserve would be tantamount to a government-led policy to destroy small banks.

It is hard to overstate the degree to which banks will desire CBDC. It will become a matter of financial success or failure. For example, when the Federal Reserve allocates CBDCs, shares of recipient publicly-traded depositories will increase.

To the extent that the Federal Reserve's rules allowed CBDC intermediaries to lend any of their CBDC funds to consumers or businesses, it would be required to adopt regulations specifying the types of consumers and businesses that would qualify for such loans and the terms and conditions for such loans. The Federal Reserve's criteria for private sector loans would be highly controversial, and groups that were unhappy with the Federal Reserve's criteria would exert great pressure on the Federal Reserve to change them.

4. The Federal Reserve would have to expand its asset holdings

The Federal Reserve would have to purchase new assets to counterbalance the new liabilities it would accept from CBDC holders. While it is impossible to have certainty over such obligations' potential scope, we know that they could become substantial if CBDCs became widely utilized.

For each dollar liability of the Federal Reserve, it must hold a dollar in assets against it. Whereas dollars extended to commercial banks are self-balancing, CBDC is not. CBDC could dramatically expand the sum of liabilities on the Federal Reserve's ledger. The Federal Reserve would have to purchase assets to restore itself to balance.

The Federal Reserve's current practice is to buy US Treasuries and mortgage-backed securities. When the Federal Reserve buys these assets, it reduces the aggregate sum of debt available for purchase in the private market. By making these purchases, the Federal Reserve can influence yields on debt securities. Actions by the Federal Reserve to purchase debt have the cumulative effect of increasing bond prices and lowering yields. When the Federal Reserve has adopted a policy of quantitative easing, it has done so to reduce interest rates, increase asset prices, and increase household wealth. All of these results have a collective effect of stimulating the economy.[6] As of May 11th, 2022, the Federal Reserve held $8.9 trillion in assets on its balance sheet.[7]

The introduction of a CBDC would have profound implications for the Federal Reserve's balance sheet size and its level of involvement in the US economy. A 2021 working paper estimated that the size of the Federal Reserve's balance sheet might have to grow to an amount equivalent to one-third of US gross domestic product.[8]

5. Issuing a CBDC through intermediaries would create a moral hazard where banks reduce their underwriting standards without increasing the risk to their balance sheets.

Intermediaries will utilize CBDC deposits to extend credit. Any credit extended on CBDC would produce a higher net interest margin, all other things being equal.

A concern would be that the bank holding companies that own CBDC intermediary banks could hold risky assets. The Federal Reserve should only allow banks whose parent companies are subject to the Bank Holding Company Act to become intermediaries. Non-banks and industrial loan companies are not subject to consolidated supervision.

Allowing nonbank intermediaries would be especially problematic given the lack of federal supervision and the bigger problems they have had appropriately handling KYC issues. Nonbanks have both permitted widespread opening of fraudulent accounts (not only for stimulus money but also as vehicles for receiving money from payment scams) while at the same time overreacting to fraud concerns and shutting down or freezing legitimate accounts and preventing people from accessing their money.

6. The likely remedy to help the Federal Reserve avoid expanding its balance sheet is highly suboptimal. The Federal Reserve could be put in a position of setting rules for how banks invest their holdings. This remedy would reverse the availability of credit.

As soon as it begins to issue CBDCs, the Federal Reserve will face a quandary. For every liability on its balance sheet, it must add assets. Buying assets at a scale equivalent to CBDC in circulation, if CBDC is as popular as we imagine, would force the Federal Reserve to become a dominant asset holder in the economy. Many elected officials and political influences could respond to that prospect with alarm.

As mentioned above, the Federal Reserve has historically held Treasuries and government-backed securities. The Federal Reserve could increase its purchases of these instruments, but concerns about the size of its holdings would develop at some point.

Two alternative types of buyers would remain: "Wall Street" and CBDC intermediaries. While investors have an appetite for risk-free (Treasuries) and nearly risk-free debt (agency mortgage-backed securities), they face constraints in finding ideal baskets of risk-free and risky assets. They will not willingly shift their investment strategies away from Modern Portfolio Theory or other empirically-tested investment strategies. The only alternative for the Federal Reserve will be to condition a CBDC allocation on committing to purchasing Treasuries and agency debt.

Requirements would have the political benefit of increasing bond prices and lowering interest rates paid by the government on its debt, but it would represent a seismic shift in the independence of financial institutions. Many would argue that by setting rules for credit allocation, the Federal Reserve was overreaching.

While the political consequences would be suboptimal, the impact on economic growth would be even worse. These requirements would undermine the availability of credit. Deposits that once served as the basis for lending would not shift to holding these debt securities. With less capital, banks would make fewer loans. Loans create money, and fewer loans will generate less money. The effects will undermine economic growth. As an organization that calls for financial institutions to extend credit to underserved communities, we hold concerns that underserved communities would bear the worst impacts when financial institutions are forced to ration credit.

III. The Federal Reserve should prioritize the completion of FedNow

1. FedNow will provide the benefit of real-time gross settlement offunds to all participants in the banking system.

Real-time gross settlement of funds can solve many problems payers and payees face. Many current forms of payment present fundamental shortcomings. Pull payments, including checks and ACH, put consumers at risk of over-drafting their accounts. In 2020, consumers paid approximately $15.5 billion in overdraft and insufficient funds fees.[9] Additionally, in many cases, the recipients of those failed payments incurred fees as well. Retailers express their frustration with the frequency of returned ACH requests.

Industry journals already predict that if specific correctable issues regarding RTGS can be resolved, such as the lack of interoperability, RTGS will cannibalize ACH pull for P2B and reduce the use of checks.[10] Many retailers expect to implement QR codes to initiate real-time credit push payments at the point of sale, inside carts, bill pay, and in other significant contexts.

Many of the motives expressed by the supporters of CBDC focus on its benefits to underbanked and underbanked households. Chief among those claims is that CBDC provides immediate good funds settlement.[11] Advocates believe that RTGS will appeal to lower-wealth households who desire the opportunity to receive funds instantly or delay payment until a paycheck has settled, reducing their need to use non-bank money services and lowering the amount of money they spend to transact.[12]

While those claims bear truth, they ignore a crucial fact: many banks can offer RTGS services already, and once FedNow is launched, all member banks will have the ability to settle funds immediately. Our view is that opportunities to improve the payments system exist already and are not incumbent on the issuance of CBDC. When it introduces FedNow, for example, the Federal Reserve would improve on existing options by guaranteeing interoperability and ensuring strong consumer protections for faster payments.

2. By its use of ISO 2022, FedNow will enhance the information appended to payments and, in doing so, will mirror the capabilities of blockchain.

Another claim is that because CBDC runs on a blockchain, it will increase the amount of information that can be appended inside a payment, thus increasing the net value proposition for all participants. That claim also bears truth, but it is not exclusive to CBDC. FedNow will provide the same benefit. The Clearing House's Real-Time Payments network uses ISO 20022, and FedNow will likely choose to use the same system. ISO 20022 will dramatically expand the amount of information embedded with a payment. For example, ISO 20022 would enable a business to include an invoice inside a request for payment message. ISO 20022 will support innovation and foster additional payment services, empower fraud analytics, and help to leverage artificial intelligence.[13]

3. Before the Federal Reserve brings FedNow to market, it should clarify that the system must build strong protections against fraud.

The Electronic Funds Transfer Act was enacted forty-three years ago – well before Congress could have considered the use of payments apps through smartphones; its error resolution provisions are sorely out of date.

While Regulation E protects consumers from unauthorized transfers, it defines an "unauthorized transfer" as one "initiated by a person other than the consumer without actual authority to initiate the transfer and from which the consumer receives no benefit." 12 CFR § 1005.2(m).

Today, participants pay inside an inconsistent regulatory environment. Unauthorized transfers where the payment is requested by the fraudster using the consumer's account and routing number confer error resolution protections. Today, unauthorized transfers initiated from the p2p apps or digital wallets in the marketplace are not protected equivalently.

Consider the significant contradiction in the remedies available to consumers who are victims of essentially the same scam:[14]

In the first, a fraudster impersonates a representative of the IRS. The caller tells the victim that a warrant will be issued for their arrest if a payment is not made immediately. The victim provides their bank account and routing numbers. The caller makes an ACH debit from the victim's bank account.

In the second, the caller uses the same impersonation method. However, the caller provides their p2p account proxy. The victim sends a payment using a p2p app. While the funds came from deposits held inside a bank account, the payment order was made through an app.

In the first example, the victim has the right to resolve the loss of funds. In the second, the consumer has no right to redress.

We believe this gap unless clarified with protections, will ultimately undermine the adoption of all RTGS systems. The Federal Reserve asks about financial inclusion. The lack of protection from fraud is itself a hurdle to this goal.

We believe that a stepwise approach, where the Federal Reserve prioritizes FedNow above a new initiative of creating an intermediated CBDC, and where consumers enjoy protection from sender-authorized fraud schemes, will benefit participants in the payment ecosystem.

The Federal Reserve should clarify that faster payments will be protected from sender-authorized fraud, even if the payer authorizes the transfer and even if it is a credit push payment made through an app.

The Federal Reserve should establish these protections at the outset of FedNow. It should not implement FedNow without appropriate consumer protections.

4. The lessons learned from the United Kingdom's experience with RTGS serve as a cautionary story and underscore the need for regulators to protect consumers.

The United Kingdom (UK) introduced its faster payments service in 2008, and as a result, its experiences provide a valuable reference point for the governance of real-time gross settlement operations.

A key lesson learned from the UK experience is that faster payments create an opening for fraud. Over time, fraudsters moved to faster payments to instigate ender-authorized fraud. Sender-authorized fraud describes activities where a scammer induces a person to send funds under a pretense. Examples mentioned include romance scams, CEO scams, impersonation of bank and law enforcement professionals, and invoice scams.[15] The same schemes occur in the United States, but for the moment, scammers must rely on slower-to-settle techniques, often requiring victims to purchase a prepaid debit card reload pack. [16] These techniques take longer and require more effort from the victim. Faster payments will streamline the process of running a sender-authorized fraud scam.

Unfortunately, current rules do not protect consumers if they authorize a payment. Technically, victims of sender-authorized scams have authorized a payment, even though they do not receive the intended benefit.

The UK has created infrastructure to help consumers avoid these kinds of fraud and initiated a system that provides funds for victims. The UK faster payment system now offers a "confirmation of payee" tool. It provides a function that matches a sort code (their bank routing number) with the recipient's name. The software tells the sender if the name matches, if it is a close match, or if there is any inconsistency. Such a step will reduce "faster fraud." Separately, participating banks and building societies have committed to compensating victims of sender-authorized fraud. While the system is voluntary and the amount of compensation is left to the judgment of the financial institution, it is a step in the right direction.

Similar to the annual payments studies released by the Federal Reserve, financial regulators in the UK disseminate data on the use of its payments systems. UK Finance releases a report focused solely on fraud. In 2021, ninety-six percent of all fraudulent "sender-authorized" payments involved a faster payment.[17]

IV. Claims that CBDC will enhance financial inclusion are unfounded and would be further compromised by intermediation.

1. An intermediated CBDC will not lead to the financial inclusion benefits.

Many of those most in favor of a CBDC contend that "FedAccounts" would increase access to banking services, facilitate the distribution of government payments, and reduce the costs paid by the unbanked to transact.[18] Proponents claim that FedAccounts would work without transaction costs, have no overdraft fees, pay account holders positive yields on riskless funds, and clear and settle immediately.

We share their hope that underserved households could have access to no-cost, overdraft fee, interest-bearing transaction accounts. We are enthused by recent announcements from many prominent banks of their intent to reduce or eliminate overdraft fees.[19]

Its supporters skirt essential concerns about how to support the upfront and ongoing operational costs of FedAccounts. They claim that even without a system akin to interchange, the system would attract the investment necessary to support innovation. While these adherents acknowledge that the question of how FedAccounts would interface with "legacy physical media is an important practical issue," they suggest that the infrastructure and investments needed could be sourced from within the scope of existing commitments to the United States Postal Service, to engage banks in customer service (intermediation) or to engage non-bank retail stores in FedAccount customer service.[20]

It would be difficult to know exactly how much it would cost to operate a system of FedAccounts. The promise is undoubtedly enticing – transactions that are free for consumers, using accounts that pay interest on funds held, interoperable across payments systems, and ubiquitously accepted. While we cannot for sure know how much it would cost, it is undoubtedly non-zero on a per-transaction basis, and when multiplied by 174.2 billion (the number of domestic US non-cash payments made in 2018),[21] it could become a substantial non-zero sum. The Federal Reserve would bear some of those costs in an intermediated system, but many would fall to other ecosystem participants. True, FedAccounts could build their last-mile rails, including system-specific merchant acceptance terminals, but those efforts are directionally dissatisfying. With each new investment by the Fed in consumer-facing systems, more end-users experience disruptions, leading to more hurdles to adoption, resulting in less penetration among unbanked and underbanked households.

2. It may be hard to convince consumers that their privacy will be protected when they use a CBDC

One of the chief reasons cited by unbanked and underbanked consumers give for staying outside the financial system is privacy. In a context where CBDC is intermediated through a private bank, a privacy-concerned consumer will have more fear. In such an arrangement, they may believe private banks and the federal government will have access to their personal information. We acknowledge that the Federal Reserve is an independent body and not an agency of the federal government, but we believe the majority of the public maintains a view to the contrary. As a result, the net effect would double the hurdle among those who stay outside of the banking system because of privacy concerns.

We are inclined to agree that a CBDC could help support the increased usage of micropayments. It could also reduce the cost and hasten settlement times for cross-border payments. To the extent that those services constitute a small percentage of payments and do not pose moral hazards, deploying CBDC for these use cases may not pose some of the systemic risks mentioned earlier in this comment.

3. A simple and effective alternative would be to require depositories to offer fee-free bank accounts, without overdraft or insufficient funds fees, as a condition of access to a Fed master account.

The Federal Deposit Insurance Corporation's (FDIC) Survey of the Unbanked and Underbanked represents the most substantive examination of individuals who choose to remain outside the banking system.[22] Most of the most commonly-given reasons that unbanked households reveal for not having a bank account would be addressed by the accounts:

1. Don't have enough money to meet minimum balance requirements (first choice 29 percent, 48 percent referenced)
2. Bank account fees are too high (7 percent, 34 percent)
3. Bank account fees are too predictable (2 percent, 31 percent)

The 2nd and 3rd most common reasons – "don't trust banks" and "avoiding a bank gives more privacy" – are not addressable by any solution originating from a bank or through an intermediated CBDC. But of further significance, we call out that if accounts did not have the capacity to overdraft, it would overcome one part of the sixth most common reason. Policymakers should understand that the unbanked and underbanked population includes the "formerly banked."[23] Those individuals left because the status quo failed to address their needs.

Most banks would prefer to earn one million dollars on one customer than one dollar on one million customers. However, some banks have taken the opposite approach in recent years: they offer overdraft-fee accounts that generate their revenues primarily through interchange. Notably, almost all of these banks have assets of less than $10 billion. Policymakers should acknowledge the root reason for this seemingly unexplainable outcome. The reason reflects the Durbin Amendment and the subsequent interpretation of the Federal Reserve on how interchange fees are regulated. Banks with assets of less than $10 billion can offer accounts with greater functionality than big banks. Large banks must limit pull payment options. Small banks can offer those services. Banks that insist on offering pull payment options face a strict ceiling on their interchange – roughly twenty-four cents swipe. By contrast, small banks have no such limits. The lack of a ceiling also extends to payroll cards. The beneficiaries of these rules are not the unbanked or underbanked – but large merchants that want to reduce their interchange expenses.

The FDIC's findings suggest that conditioning the privilege of a master account on offering a genuinely inclusive bank account will promote financial inclusion. By contrast, building an intermediated CBDC is not an alternative that would move the payments system closer to financial inclusion.

The Federal Reserve provides four of the five "core" payment systems in the United States. A strong statement that puts an onus on depositories to create inclusive accounts will reduce the number of unbanked and underbanked households. A solution exists now. It will not require a CBDC.

CONCLUSION

We appreciate the opportunity to respond to the Federal Reserve's white paper. For the reasons mentioned in this letter, we believe strongly that the Federal Reserve should not pursue a program to issue a central bank digital currency. An intermediated CBDC presents an existential threat to community reinvestment activities. It will force the Federal Reserve to pick "winners and losers," and it may have to resort to influencing how financial institutions make credit allocation decisions. The Federal Reserve is still in the process of launching FedNow, so it would be a mistake to initiate a new effort of this scale and size. Moreover, real-time gross settlement of funds will satisfy some of the crucial needs that drive support for a CBDC. Finally, we are skeptical that a CBDC can lead to meaningful financial inclusion.

Please reach out to me or Senior Policy Advisor Adam Rust (arust@ncrc.org) to provide additional clarification on our comments.

Sincerely,
Jesse Van Tol
Chief Executive Officer
National Community Reinvestment Coalition
jvantol@ncrc.org

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May 19, 2022

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Ms. Misback:

The Retail Industry Leaders Association (RILA) appreciates the opportunity to provide comments on the Federal Reserve's discussion paper entitled, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*. As highlighted throughout the paper, this is an opening conversation between the Federal Reserve and key stakeholders in the payment ecosystem about the potential positive and negative impacts central bank digital currencies (CBDCs) would have on the American economy.

RILA is the U.S. trade association of the world's largest, most innovative, and recognizable retail companies and brands. We convene decision-makers, advocate for the industry, and promote operational excellence and innovation. Our aim is to elevate a dynamic industry by transforming the environment in which retailers operate. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities, and distribution centers domestically and abroad.

Competition is the hallmark of America's retail industry. It drives innovation and brings consumers lower prices and new products and services. However, the absence of competition in the payments ecosystem has resulted in the U.S. being one of the most expensive countries in the world to accept debit and credit cards. One of the core goals for the Federal Reserve if they move forward on the development of a CBDC, would be to ensure a more competitive payments market that is no longer controlled by the dominant legacy players. This competitive environment will benefit all parties in the payments arena, especially American consumers.

Outside of a competitive market, there are other factors the Federal Reserve should consider on the potential development of a CBDC. These topics include but are not limited to; addressing fraud in a new CBDC market, the type(s) of security and privacy regime(s) needed to be established to ensure consumers and retailers are protected, and what new financial products will be created to serve the underbanked and unbanked. Additionally, how retailers can partner in this effort, the role of Congress and lastly, ensuring that any CBDC be treated exactly like cash with no additional fees or interchange.

With the potential creation of a CBDC, fraud will be one of the most pressing issues that must be addressed from the onset. There are many lessons to be learned from today's payments system and the inequities and failures in the market, particularly around fraud. Strong authentication measures will need to be created and will have to constantly evolve and update to meet the growing threats in the market. It will be essential to prevent dominant legacy players from using proprietary technology to shift the fraud cost to one entity, or to use their market share to inhibit potential competitors from entering a new CBDC arena. In relation to fraud, it will also be vital to establish a privacy and security framework that protects consumers and businesses. RILA believes that a privacy framework should be designed to protect consumers and provide clear rules of the road for individuals, businesses, and the Federal Reserve. Any new CBDC must have strong fraud and consumer protections to be viewed as a safe and legitimate form of payment to American consumers and businesses.

The possible benefits of a CBDC could be substantial, unlocking future efficiencies and widespread adoption by consumers and businesses alike. But this will only happen at scale if merchants are viewed as key partners in the acceptance and facilitation of CBDCs. Therefore, it is essential the Federal Reserve make explicitly clear that just like checks and ACH transactions, a CBDC will clear "at par." This allows for competition from service providers, as is the case today with cash handlers, check clearing services, etc., to compete for a merchant's business, without introducing unnecessary networks that simply try to profit from hidden fees. In addition, business and operational rules that are developed should not require all merchants to accept a CBDC. Consumers and merchants should have the choice to use and accept digital currencies. Innovation and technological advancements should remove any unnecessary costs in the payments arena—not increase them. If the Federal Reserve does develop a CBDC, it should be treated exactly as cash, without any interchange fees tied to accepting this new type of payment. The federal law prohibiting the collection of interchange for check redemption, requiring they pass "at par", is clear precedence for such a protection. If interchange in any form is allowed to continue in a CBDC market, it will drastically limit the success of its acceptance and will mimic the frustrations and challenges merchants face today with credit and debit cards.

Finally, the creation of CBDC also has the potential to unlock and remove current barriers to the underbanked and unbanked and assist them to gain access to new financial instruments. As the Federal Reserve has highlighted in other reports, there are millions of Americans without access to the traditional banking and financial services arena. A new CBDC has the potential to address economic inequality across the country and RILA members are prepared to play an active role in achieving this goal.

Once again, RILA appreciates the opportunity to provide initial comments on the potential development of a CBDC by the Federal Reserve. As the association representing the most innovative and sophisticated retailers in the country, we look forward to future discussions on this topic to highlight the merchant perspective. RILA is also fully prepared to work as a collaborative partner with key stakeholders in the payment ecosystem and the Federal Reserve on possible future working groups to discuss the development of a CBDC. For additional information on this matter, please contact Austen Jensen, Executive Vice President, Government Affairs, austen.jensen@rila.org or at 703-244-0179.

Sincerely,

Executive Vice President, Government Affairs

Legal Authority to Issue a U.S. Central Bank Digital Currency

Paige Paridon| June 9, 2021

Central banks around the world are weighing the question of whether to issue a central bank digital currency – both the technological question (can we) and the policy question (should we).[1] An additional question that has not received much attention is who decides whether the U.S. should have a CBDC. Federal Reserve Chairman Jerome Powell recently recognized the significance of any decision on CBDCs noting that "we would not proceed with [a digital dollar] without support from Congress, and I think that would ideally come in the form of an authorizing law, rather than us trying to interpret our law to enable this."[2]

This blog post will explore whether Congress's role should be primarily to provide oversight as CBDC proceeds or whether legislation is legally required. Many who have proposed various forms of a United States CBDC have not addressed this question; others have raised the question but not ventured an answer.[3]

EARLY U.S. HISTORY OF COINS AND NOTES

Coins

In the Constitution, the Founders provided Congress with the power "to coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures."[4] They said nothing about paper money, "largely because . . . [they] had seen the bills issued by the Continental Congress to finance the American Revolution—called "continentals"—become virtually worthless by the end of the war."[5] In 1792, Congress passed the Coinage Act, which provided for a United States mint where silver dollars were coined along with gold coins

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[1] A recently released BPI working paper, "Central Bank Digital Currencies: Costs, Benefits and Major Implications for the U.S. Economic System," describes what a CBDC is and how it would function, and highlights several policy issues that should be considered prior to a decision on whether to adopt a dollar CBDC. Subsequently released BPI notes evaluate the monetary policy benefits and costs of a U.S. central bank digital currency, and whether it is a necessary or beneficial response to a potential Chinese CBDC.

[2] Comments by Federal Reserve Chairman Jerome Powell at the BIS Innovation Summit 2021, quoted in the Wall Street Journal, Powell Says Congressional Support Likely Needed to Adopt Fully Digital Dollar - WSJ (March 22, 2021).

[3] *See*, e.g., Jess Cheng, Angela N Lawson, and Paul Wong, *FEDS Notes*, "Preconditions for a general-purpose central bank digital currency," (February 24, 2021) ("[a] first-order consideration is whether the issuance of a general-purpose CBDC would be consistent with the Federal Reserve's mandates, functions, and powers as enshrined in . . . the Federal Reserve Act . . ."); Congressional Research Service, "Financial Innovation: Central Bank Digital Currencies," March 20, 2020 ("The Fed has highlighted legal uncertainty about whether all of the actions needed to successfully issue a CBDC could be taken under existing authority. These include whether a CBDC would be legal tender; whether the Fed could offer accounts or digital wallets to the public; and what legal rights, obligations, and protections CBDC users would have. Currently, the Fed must charge prices that reflect its costs to provide business services and can only pay interest to banks on balances at the Fed. If Congress chooses to facilitate CBDCs, it might pass legislation to remove any identified legal barriers."), available at: Financial Innovation: Central Bank Digital Currencies (congress.gov); Speech by Federal Reserve Board Governor Lael Brainard: "An Update on Digital Currencies," at the Federal Reserve Board and Federal Reserve Bank of San Francisco's Innovation Office Hours, San Francisco, California (August 13, 2020) ("There are also important legal considerations. It is important to understand how the existing provisions of the Federal Reserve Act with regard to currency issuance apply to a CBDC and whether a CBDC would have legal tender status, depending on the design."), available at: Speech by Governor Brainard on "An Update on Digital Currencies" - Federal Reserve Board.

[4] Article I, section 8, clause 5.

[5] "8 Things You May Not Know About American Money." August 22, 2018, 8 Things You May Not Know About American Money - HISTORY.

beginning in 1794.[6] Free minting privileges were granted to all citizens, whereby, citizens could take either gold or silver to the mint and have it minted into coins.[7] During the early 19th century, depositors such as banks supplied the silver and gold for coining and chose which coins they wanted back, preferring the largest denominations.[8] Various Coinage Acts followed over the years, changing the composition and ratios of gold and silver in U.S. Coinage.[9] In the Coinage Act of 1965, the Secretary of the Treasury was explicitly given authority to "coin and issue . . . half dollars or 50-cent pieces, quarter dollars or 25-cent pieces, and dimes or 10-cent pieces in such quantities as he may determine to be necessary to meet the needs of the public."[10] The Secretary of the Treasury possesses this authority today.

Notes

Congress enacted a series of laws beginning in 1861 authorizing the Treasury to issue various paper currencies. For example, in 1861, Congress authorized the Treasury to issue the first paper currency, referred to as "Demand Notes."[11] Other legislation followed.[12] All told, by the end of the 19th century, there were five forms of paper currency circulating in the U.S. economy.[13] However, the U.S. "continued to experience money-related economic and banking crises, as the supply of these currencies could not expand or contract to meet economic conditions."[14]

THE ROLE AND AUTHORITY OF THE FED

The Federal Reserve Act of 1913 was intended to, among other things, "furnish an elastic currency."[15] However,

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[6] Coinage Act of April 2, 1792, "Establishing a mint and regulating the coins of the United States," available at: Coinage Act of April 2, 1792 | U.S. Mint (usmint.gov). *See also* The History of American Money, *citing* "**The Making of America,**" by W. Cleon Skouson, by permission of The National Center for Constitutional Studies, Washington, DC. History Of American Money; History of Money In United States | CMI Gold & Silver (cmi-gold-silver.com). Altogether nearly 900,000,000 silver dollars were coined from that time until 1935 when the Treasury stopped minting them.

[7] *See* Coinage Act of April 2, 1792, sec. 14.

[8] U.S. Mint: "The History of U.S. Circulating Coins," (Content last updated on April 22, 2021), available at: History of U.S. Circulating Coins | U.S. Mint (usmint.gov). "As a result, smaller denomination silver coins – half dimes, dimes, and quarters – needed for daily transactions were rarely coined. In an effort to bring gold and silver coins into circulation, Congress passed various Acts to discontinue the silver dollar and gold eagle, and to change the weight of coins and ratio of gold to silver. With the help of these laws, new coining technology, and the opening of branch Mints around the country, production increased. Smaller denominations entered circulation in great enough numbers to provide for the country's needs."

[9] *See* Congressional Research Service, "Brief History of the Gold Standard in the United States" Craig K. Elwell (June 23, 2011), 2-3, Brief History of the Gold Standard in the United States (fas.org).

[10] Coinage Act of 1965, section 101(a), Public Law 89-81 (July 23, 1965).

[11] The Demand Note was the first paper currency issued by the U.S. government. These were "essentially government IOUs and were called Demand Notes because they were payable "on demand" in gold coin at certain Treasury facilities." See Bureau of Engraving and Printing "BEP History Fact Sheet," last updated March 2013, available at: FactSheet_DemandNotes_20130410.pdf (moneyfactory.gov)

[12] Congress then enacted the Legal Tender Act of 1862 authorizing the Treasury Department to issue United States Notes directly into circulation. *See* Legal Tender Status, United States Department of the Treasury, available at: Legal Tender Status (treasury.gov). The National Bank Act of 1864 created National Bank Notes that were redeemable at any National Bank of the Treasury. In that same year, Congress also created Gold Certificates, whereby one could deposit gold at the Treasury in exchange for Gold Certificates. In 1878, Congress introduced the Silver Certificate, which allowed people to deposit silver coins in the Treasury in exchange for certificates. The Treasury Note Act of 1890 authorized Treasury to issue Treasury Coin Notes. *See* A Brief History of U.S. Government, Currency, 1861 – Present: Part 1, A Brief History of U.S. Government Currency, 1861-Present: Part 1 (treasury.gov).

[13] *See* "A Brief History of U.S. Government, Currency, 1861 – Present: Part 2," A Brief History of U.S. Government, Currency, 1861 – Present: Part 2 (treasury.gov).

[14] *Id.*

[15] The official title of the Federal Reserve Act of 1913 provides that one of the statute's purposes was to "furnish an elastic currency." Federal Reserve Act of 1913, 38 Stat. 251, Official Title. The Senate Report accompanying the Senate Bill establishing the Federal Reserve provides that

"currency" is not defined by the Act.[16] Section 16 of the Federal Reserve Act granted the Federal Reserve the authority to issue one form of United States currency: "Federal reserve notes."[17]

The context of the Act, as well as other statutes, makes clear that "Federal reserve notes" are paper currency. First of all, in 1913, as noted, various forms of paper notes and certificates were already in circulation -- United States Notes, National Bank Notes, Gold Certificates, Silver Certificates, and Treasury Coin Notes.[18] It is against this backdrop that Congress authorized the creation of Federal Reserve notes. Thus, the Secretary of the Treasury is directed by statute to "cause plates and dies to be engraved in the best manner to guard against counterfeits and fraudulent alterations, and shall have [Federal Reserve notes] printed therefrom and numbered . . . Such notes shall be in form and tenor as directed by the Secretary of the Treasury under the provisions of this chapter. . . ."[19] Only a single regulation cites to this statute, and describes the "distinctive paper" used in dollar bills.[20] Further, the statute provides that "[a]ny Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require," which appears to suggest physical cash.[21] More pointedly, the Act provides that "Federal reserve notes shall bear upon their faces a distinctive letter and serial numbers" and provides a process for cancelling or destroying notes "unfit for circulation" – not a concern with a digital currency.[22] The statute also says that the plates and dies must be engraved.[23]

In 1933, the United States abandoned the gold standard.[24] As gold coins, gold bullion, or gold certificates were turned in, the American people received Federal Reserve notes redeemable in silver.[25] Congress then outlawed

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"there are certain great fundamentals recognized by all experts as essential and necessary" that were to be included in the legislation, including "[a]uthorizing the issuance of elastic currency against liquid commercial bills under proper safeguards." S. Rep. 63-133, Banking and Currency (Nov. 22, 1913). *See also* Michael Bardo, National Bureau of Economic Research, Working Paper No. 2549, "Money, History, and International Finance: Essays in Honor of Anna J. Schwartz," in *The Contribution of "A Monetary History of the United States, 1867-1960" to Monetary History* (1989), available at: The Contribution of "A Monetary History of the United States, 1867-1960" to Monetary History (nber.org) ("The Fed was established to provide elasticity to the money supply, specifically to provide easy convertibility between deposits and currency and to prevent a recurrence of the banking panics of the national banking era. This goal, according to Friedman and Schwartz (chapter 5) was to be achieved by the expansion and contraction of Federal Reserve notes and deposits.") (*citing* Milton Friedman and Anna Schwartz, "A Monetary History of the United States, 1867-1960" (1963)).

[16] FinCEN, a bureau of the Treasury, has defined currency as "[t]he coin and paper money of the United States or any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance." 31 C.F.R. § 1010.100(m). However, FinCEN has no interpretive authority under the Federal Reserve Act.

[17] Section 16(1) of the Federal Reserve Act states that "Federal reserve notes, to be issued at the discretion of the Board of Governors of the Federal Reserve System for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized." 12 U.S.C. § 411.

[18] *See* note 11, *supra*.

[19] 12 U.S.C. § 418.

[20] Bureau of Engraving and Printing, Distinctive Paper for United States Currency and Other Securities, 31 C.F.R. Part 601.

[21] 12 U.S.C. § 412 (emphasis added).

[22] 12 U.S.C. § 413.

[23] 12 U.S.C. § 418. Perhaps Treasury could argue that the "best manner" to secure Federal Reserve notes is to issue them as a CBDC—and perforce, Treasury may interpret "plates and dies" and "printing" broadly to include the architecture of a digital currency, in order to better achieve the purposes of the statute. But such interpretation likely would have to be made on policy grounds in light of statutory language. Further, such a determination would not clearly permit the Treasury to set up the architecture of a digital currency, nor authorize the Federal Reserve to do so per Treasury's determination.

[24] *See* Congressional Research Service, "Brief History of the Gold Standard in the United States" Craig K. Elwell (June 23, 2011), 9-11, Brief History of the Gold Standard in the United States (fas.org).

[25] *See* The History of American Money, *citing* "**The Making of America**," by W. Cleon Skouson, by permission of The National Center for Constitutional Studies, Washington, DC. History Of American Money; History of Money In United States | CMI Gold & Silver (cmi-gold-silver.com)

any obligation requiring payment in gold and provided that any obligation "heretofore or hereafter incurred . . . shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts."[26] That legislation also provided that "United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues,"[27] meaning that United States coins and currency "are a valid and legal offer of payment for debts when tendered to a creditor."[28]

While at least one observer suggests that the list could be viewed as authorization for the Federal Reserve to issue a CBDC, [29] two problems arise. First, this provision does not constitute further authority for the Federal Reserve to issue notes or the forms of currency but rather provides only what types of currency (whether that be Federal Reserve notes, bank-issued notes, or Treasury-minted coins) shall constitute legal tender. Second, assuming that some entity had authority to issue CBDC, this provision can be read to include a CBDC as legal tender only if the parenthetical list is read to be indicative (as in, "including but not limited to") rather than exhaustive. Given the variety of government obligations in circulation, there appears to have been good reason for Congress to specify an exhaustive list of what was in fact included. Even if the list were read to be indicative, under the legal principle of *ejusdem generis*, any instrument would have to be "similar in nature" to those listed in order to qualify. [30] It is difficult to consider a digital currency as similar in nature to paper currency and coins circulating in the early 20th century. This is not only because of its form (digital versus physical) but also because its function and technology raise a host of issues that physical notes do not. As the IMF has noted, "Launching a CBDC is a multidimensional undertaking that extends beyond the central bank's normal information technology project management frameworks.... The new currency could lead to major disruptions affecting monetary policy transmission, financial stability, financial sector intermediation, the exchange rate channel, and the operation of the payment system."[31] The Governor of the Bank of England has noted that potential issuance of a CBDC "raises profound questions about the shape of the financial system and the implications for monetary and financial stability and the role of the central bank."[32] Thus, a digital currency appears fundamentally different in nature from a paper one.

THE ROLE AND AUTHORITY OF THE U.S. TREASURY

Treasury has certain authorities over U.S. currency (some described above), but it does not appear that current statutes or regulations provide the Treasury a basis to issue a digital currency. The Secretary of the Treasury has the authority to mint and issue coins, which are separate from currency, but also a form of legal tender.[33] One could think of a CBDC as a digital coin, but the types of coins that the Treasury may mint and issue are specifically

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[26] 48 Stat. 31 (1933), An Act To provide for the establishment of a national employment system and for cooperation with the States in the promotion of such system, and for other purposes. (loc.gov)

[27] *Id.*

[28] 31 U.S.C. § 5103.

[29] *See* Marcelo Prates, "Legal troubles may delay CBDCs," February 24, 2021, in Official Monetary and Financial Institutions Forum (United States "law stipulates that US 'coins and currency (including Federal Reserve notes and circulating notes of Federal Reserve banks and national banks) are legal tender for all debts, public charges, taxes and dues'. The word 'including' hints that the list that follows is illustrative, allowing other currency formats to be legal tender."), *available at*: Legal troubles may delay CBDCs - OMFIF.

[30] *See Circuit City Stores Inc., v. Adams*, 532 U.S. 105 (2001) (describing *ejusdem generis as a "statutory canon that where* general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words." Here, obviously, the general words precede the specific objects enumerated, but the principle presumably would apply in the same way.

[31] *See* Kiff et al. "IMF Working Paper WP/20/104)" *International Monetary Fund* at *19 (2020).*

[32] Bailey, Andrew, "Reinventing the Wheel (With More Automation)," Brookings Virtual Event (September 3, 2020).

[33] 31 U.S.C. §§ 5103; 5111(a)(1); 5112(h).

described by statute, and the Secretary may "only" mint those coins described.[34] Legislation enacted in 1996 authorized the Secretary to "mint and issue platinum bullion coins and proof platinum coins in accordance with such specifications, designs, varieties, quantities, denominations, and inscriptions as the Secretary, in the Secretary's discretion, may prescribe from time to time."[35] While this raised interesting questions about the Treasury's authority to issue a trillion-dollar platinum coin during the 2011 and 2013 debt-ceiling crises, the language makes clear that such coin would be a physical coin made of "platinum bullion."[36] Thus, Treasury does not currently appear to have the authority to issue a new digital currency absent further legislation from Congress.

While the Treasury does not appear to have independent authority, its assent could be required if the Federal Reserve were to take the position that it had the authority to issue one. After the Federal Reserve Board orders banknotes from the Treasury's Bureau of Engraving and Printing, "[w]hen such notes have been prepared, the notes shall be delivered to the Board of Governors of the Federal Reserve System *subject to the order of the Secretary of the Treasury for the delivery of such notes* in accordance with this Act."[37] Thus, if a CBDC were read to constitute 'United States coins and currency,' then it would appear that the Federal Reserve could produce it only subject to the order of the Treasury.

THE FORM OF THE CBDC MAKES A DIFFERENCE

Further legal questions would be raised depending on the form any future CBDC would take. For example, a question at the forefront of the debate about CBDC is whether it would be directly or indirectly held by consumers. In the direct model, customers would hold CBDC in accounts at the Federal Reserve directly. However, the Federal Reserve is authorized to maintain accounts for U.S. depository institutions[38] and the U.S. Treasury,[39] among other entities, but not for individuals.[40] Thus, some who have proposed a direct model have noted that legislation would be required to allow individuals to hold accounts at the central bank.[41]

Another question that has arisen is whether the any future CBDC would pay interest. The Federal Reserve Act provides that the Federal Reserve may pay earnings on "balances maintained at a Federal Reserve bank by or on

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[34] 31 U.S.C. § 5112(a). This statute provides that "[t]he Secretary of the Treasury may mint and issue only the following coins: (1) a dollar coin that is 1.043 inches in diameter; (2) a half dollar coin that is 1.205 inches in diameter and weighs 11.34 grams," and so on.

[35] Public Law 104-208, "The Omnibus Consolidated Appropriations Act of 1997" (September 30, 1996).

[36] 31 U.S.C. § 5112(k). *See*, e.g., "Treasury Rules Out Trillion-Dollar Coin," Brendan Sasso, Jan. 12, 2013, The Hill, Treasury rules out trillion-dollar coin | TheHill.

[37] 12 U.S.C. § 419 (emphasis added).

[38] 12 U.S.C. § 342.

[39] 12 U.S.C. § 391.

[40] In addition, the Federal Reserve is authorized to open accounts for certain government-sponsored enterprises in the residential mortgage area, *see* 12 U.S.C. §§ 1435, 1452(d) & 1723a(g), foreign governments, banks, and central banks, *see* 12 U.S.C. §§ 347d & 358, certain international organizations, such as the International Monetary Fund and the World Bank, *see* 22 U.S.C. § 286d, and certain designated financial market utilities, *see* 12 U.S.C. § 5465, and other governmental and government-sponsored entities (citations omitted).

[41] *See* Morgan Ricks, John Crawford & Lev Menand, "FedAccounts: Digital Dollars" (April 2020), at 43, *available at*: Microsoft Word - FedAccount 2020.05.20 (retitled again) (ssrn.com). *See also* Hockett, Robert (2021) "Digital Greenbacks: A Sequenced 'Treasury Direct' and 'Fed Wallet' Plan for the Democratic Digital Dollar," *Journal of Technology Law & Policy*, Vol. 25, Iss. 1, Article 1. Available at: https://scholarship.law.ufl.edu/jtlp/vol25/iss1/1; *See also* Marcelo Prates, "Legal troubles may delay CBDCs," February 24, 2021, in Official Monetary and Financial Institutions Forum ("Evidence from different jurisdictions [including the United States] shows that legislative action is likely to be required before most central banks can issue CBDC. The crucial problem is not so much about central banks issuing currency in a digital form, but making that digital currency directly available to individuals and institutions."), available at: Legal troubles may delay CBDCs - OMFIF.

behalf of a depository institution."[42] A CBDC held by a depository institution for a consumer in the direct model may not be considered a "balance maintained" by or on behalf of a bank.

WHERE DOES THIS LEAVE US?

In summary, the Federal Reserve does not appear to have legal authority to issue a CBDC without congressional authorization, and any authority it did have would appear to require the concurrence of the Treasury Department. Furthermore, if it did issue a CBDC, the Federal Reserve would not have authority to hold accounts for CBDC holders (consumer or corporate) but rather would have to use an indirect model where accounts are held at banks or other intermediaries. It also would not have authority to pay interest on any CBDC.

Disclaimer: The views expressed do not necessarily reflect those of the Bank Policy Institute's member banks, and are not intended to be, and should not be construed as, legal advice of any kind.

[42] Section 19 of the Federal Reserve Act provides that the Board may prescribe regulations concerning the payment of interest on balances at a Reserve Bank. *See* 12 U.S.C. § 461(b)(12).

eta ELECTRONIC TRANSACTIONS ASSOCIATION

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May 26, 2022

The Honorable Maxine Waters	The Honorable Patrick McHenry
Chairwoman	Ranking Member
Committee on Financial Services	Committee on Financial Services
U.S. House of Representatives	U.S. House of Representatives
Washington, DC 20515	Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry:

On behalf of the Electronic Transactions Association (ETA), we appreciate the opportunity to submit this statement for the record before the Committee's hearing, "Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency."

As relevant stakeholders engage in conversations about the promises and challenges of central bank digital currencies (CBDCs), the adoption of a CBDC would have a profound impact on the U.S. economy and the existing financial infrastructure. In light of this, ETA believes there is a common set of principles against which any proposed CBDC should be measured. As the federal government assesses a potential CBDC, it should carefully consider these principles and ensure that any proposal best serves the needs of consumers, furthers financial inclusion, preserves and strengthens the financial system, and ensures that consumers continue to have access to a robust and innovative array of secure banking and payment options.

As policymakers and the Federal Reserve consider implementing a CBDC, ETA supports a CBDC that advances these *7 Guiding Principles for CBDC*:

1. Innovation: Continual investment in innovation is at the heart of past, present, and future improvements to the financial ecosystem — enabling new capabilities, strengthening cybersecurity and consumer protection, increasing efficiencies, and expanding access to financial services. Any public sector engagement with the financial sector, including the deployment of a CBDC, should serve as a catalyst and a platform for continued innovation.

2. The Right Tool for the Job: Policymakers should compare the suitability of a CBDC with existing systems and other ongoing improvements to payments infrastructure — such as real-time payments systems — to find the approach that best fits their country's transactions needs.

3. Private Sector Participation: Expanded financial inclusion, ongoing payments innovation, and the efficiency of national and international payment flows all depend on vibrant private sector competition in payments. A CBDC should seek to preserve those functions and minimize effects on the broader financial system through a two-tiered ecosystem that includes the private sector in its design, piloting, and distribution.

4. Interoperability: Any CBDC would be introduced into an established, robust, well-functioning payments ecosystem. Ensuring interoperability between a CBDC and other forms of

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national and international payments systems is necessary to avoid weakening existing mechanisms and harming consumers and businesses. Any CBDC must be able to interoperate seamlessly across the existing landscape.

5. Open Acceptance: Consumers will be more likely to adopt a CBDC if it can be used on existing acceptance infrastructure and is supported by known and identifiable payment methods (e.g., in-person and online) that are linked to the user's existing devices and accounts. To be useful to consumers, any CBDC would need to take advantage of existing acceptance networks and acceptance infrastructure to allow any merchant that accepts cards to also accept the CBDC.

6. Consumer Protection: A CBDC should require a framework of standards and rules that safeguards the privacy and security of every transaction, protects consumers' interests, and gives consumers the confidence necessary for in-person and online transactions. It should also ensure that consumers understand those protections and how they may differ from those offered by other payment methods.

7. Regulation Tailored to the Risk Profile of the Participant: Entities engaging with a CBDC should be subject to regulation that is tailored to the activities and risks that they pose due to their position in the payments ecosystem. Appropriate regulation should consider potential harm to consumers as well as safety, soundness, and financial stability risks.

We look forward to working with you and your staff to implement these principles. If you have any questions, please contact me or ETA's Senior Vice President of Government Affairs, Scott Talbott at stalbott@electran.org.

Sincerely,

Jeff Patchen
Director of Government Affairs
Electronic Transactions Association

May 25, 2022

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairwoman Waters and Ranking Member McHenry,

The American Bankers Association, Bank Policy Institute, Consumer Bankers Association, Credit Union National Association, National Association of Federally-Insured Credit Unions, National Bankers Association, and The Clearing House appreciate the opportunity to share this letter detailing our views on the topic of Central Bank Digital Currency (CBDC). The debate on CBDC has significant implications for our financial system, economy, and, most importantly, for the American consumer.

Contrary to the assertions of some CBDC proponents, a U.S. CBDC is not necessary to "digitize the dollar," as the dollar functions primarily in digital form today. Commercial bank money is a digital dollar, and is currently accepted without question by businesses and consumers as a means of payment. By the same token, some have argued that consumers have a natural right to hold an instrument backed by the central bank, and that the move away from cash will deprive them of that right. However, deposit insurance will continue to provide them exactly that – digital money in the form of commercial money, backed by the full faith and credit of the United States.

Furthermore, the issuance of a CBDC would fundamentally rewire our banking and financial system by changing the relationship between citizens, financial institutions, and the Federal Reserve, leading to a reduction in the availability and increase in the cost of credit. The Federal Reserve has recognized this potential, noting both in its recent Financial Stability Report and its CBDC consultative paper, that "A CBDC could fundamentally change the structure of the U.S.

financial system, altering the roles and responsibilities of the private sector and the central bank."[1]

There is a growing recognition that the deployment and use of CBDCs would be accompanied by significant real-world trade-offs. The lack of compelling use cases where CBDC delivers benefits above those available from other existing options, coupled with the significant risks of a U.S. CBDC, have, for good reason, cooled the enthusiasm for developing, deploying, and maintaining a CBDC.

Today, we use both public and private money. Public money, which includes cash and accounts held directly at the Federal Reserve, makes up about 5% of money in developed economies.[2] The other 95% is private money – funds held as a liability of a private institution like a bank or credit union that themselves have accounts at the central bank that settles transactions among those institutions. Private money is created through financial intermediation by banks and credit unions– the process in which financial institutions take deposits and lend out and invest those deposits. Private money is used by financial institutions to provide funding for businesses and consumers and thus supports economic growth Introducing a CBDC would be a deliberate decision to shift some volume of private money to public money, with potentially devastating consequences for the cost and availability of credit for consumers and businesses. In sum, the savings of businesses and consumers would no longer fund the assets of banks – primarily, loans – but instead would fund the assets of the Federal Reserve – primarily securities issued by the Treasury Department, Fannie Mae, and Freddie Mac. Businesses and consumers would seek the cost of borrowing rise, and government would see the cost of borrowing fall.

If the intended objective behind issuing a CBDC is to realize the benefit of technological innovation, we should look to leverage novel developments in private money (like real-time payments systems and well-regulated stablecoins). Private sector innovation in banking and payments has made a significant contribution to establishing the U.S. dollar as the reserve currency of the world and is best positioned to support the dollar's preeminent position in the years to come.

There are many proposed designs for a CBDC, and the design choices have a significant impact on the potential risks and benefits associated with each. For purposes of its discussion paper, the Federal Reserve has defined a CBDC as "a digital liability of a central bank that is widely available to the general public." It has also suggested that any CBDC should be "privacy-protected, intermediated, widely transferable, and identity-verified." This approach has helped focus the discussion on the intermediated CBDC model, where a CBDC would be delivered

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[1] Federal Reserve Board, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, (January 2022) (hereinafter, "CBDC Report" or "discussion paper"), https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf.

[2] Harvard Business Review, Stablecoins and the Future of Money (Aug. 10, 2021), https://hbr.org/2021/08/stablecoins-and-the-future-of-money#:~:text=Public%20money%20includes%20central%20banks,in%20developed%20economies%20is%20private .

through private-sector financial institutions, but where individual holdings will sit at the Federal Reserve. Importantly, this definition precludes “direct”[3] and “wholesale”[4] designs of CBDC. Given this focus, the majority of our analysis will evaluate the impact of this intermediated model.

The purported benefits of a CBDC are uncertain and unlikely to be realized, while the costs are real and acute. For these reasons, we do not see a compelling case for a CBDC in the United States today.

Proponents of CBDC cite a number of laudable goals in support of a CBDC, such as increasing financial inclusion and promoting the U.S. dollar’s international role as a reserve currency and a medium of exchange for international trade. The joint trades support these important goals; however, we do not believe that a CBDC is well-positioned to accomplish them

Banks and credit unions are strong proponents of financial inclusion and have put significant effort into bringing unbanked families into the financial system. For example, 235 “Bank On” certified accounts – low- or no-fee accounts with no penalty fees for overdrafts, non-sufficient funds, low balances or account dormancy -- are now offered by banks and credit unions at more than 39,000 branches nationwide.[5]

Even if a CBDC did attract unbanked consumers – which we do not believe will be the case – this could actually be counterproductive since a CBDC would only provide an alternative to a deposit account. However, the benefits of a banking relationship go far beyond a deposit account. The goal of financial inclusion is to build a lifelong relationship that can help families access credit that can help them build for a secure financial future. A CBDC is likely to undermine this by limiting, rather than promoting, credit availability to the communities that need it the most.

Similarly, a CBDC does not appear to be necessary to support the role of the U.S. dollar internationally. While many countries have experimented with a CBDC, many have focused on a wholesale model, something not contemplated by the Federal Reserve’s discussion paper. In addition, many have pulled these experiments back as the costs of implementation have become apparent. The Federal Reserve notes that the dollar’s status as the global reserve currency is driven by 1) the strength and openness of our economy, 2) the depth of our financial markets, and 3) the trust in our institutions and rule of law.

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[3] A “direct” CBDC means a liability of the central bank held directly by a member of the public, unlike a commercial bank deposit, which is a liability of the commercial bank owed to its customer.
[4] A “wholesale” CBDC means a CBDC designed for use among financial intermediaries only.
[5] The account standards are available here: https://2wvkof1mfraz2etgea1p8kiy-wpengine.netdna-ssl.com/wp-content/uploads/2020/10/Bank-On-National-Account-Standards-2021-2022.pdf. *See* Written Testimony Submitted to the U.S. House Committee on Financial Services, House Subcommittee on Consumer Protection and Financial Institutions. Hearing on “Banking the Unbanked: Exploring Private and Public Efforts to Expand Access to the Financial System,” (July 21, 2021), Submitted by David Rothstein, Senior Principal, Cities for Financial Empowerment Fund, available at: hhrg-117-ba15-wstate-rothsteind-20210721.pdf (house.gov); Accounts – BankOn (joinbankon.org); The Bank On National Data Hub: Findings from 2020, available at: bankonreport_2020findings.pdf (stlouisfed.org).

The risks associated with issuing a CBDC are often downplayed but are real and likely to undermine any possible benefit that a CBDC would have. Most importantly, every construction of CBDC requires moving funds from banks to the Federal Reserve. According to the Federal Reserve "A widely available CBDC could serve as a close substitute for commercial bank deposits or other low-risk assets such as government MMFs and Treasury bills. A shift away from these assets could reduce credit availability or raise credit costs for households, businesses, and governments."[6]

In effect, a CBDC will serve as an advantaged competitor to retail bank deposits that will move money away from banks and into accounts at the Federal Reserve where the funds cannot be lent back into the economy. These deposit accounts represent 71% of bank funding today. Losing this critical funding source would undermine the economics of the banking business model, severely restricting credit availability increasing the cost of credit, and causing a slowdown of the economy. ABA estimates that even a CBDC where accounts were capped at $5,000 per "end user" could result in $720 billion in deposits leaving the banking system.

With respect to financial stability, the Federal Reserve notes, "Because central bank money is the safest form of money, a widely accessible CBDC would be particularly attractive to risk-averse users, especially during times of stress in the financial system. The ability to quickly convert other forms of money—including deposits at commercial banks—into CBDC could make runs on financial firms more likely or more severe. Traditional measures such as prudential supervision, government deposit insurance, and access to central bank liquidity may be insufficient to stave off large outflows of commercial bank deposits into CBDC in the event of financial panic."

The only solution proffered to solve this fundamental problem has been a limit on the value of CBDC that anyone can hold – effectively limiting it to consumers. But this use case undermines practically every use case for CBDC, as it means that it cannot be used for commercial purposes, and that any retail holder will have to hold a bank account as well, in case the limit is exceeded.

Given the high stakes, it is important we get this right, which is why the joint trades support the Federal Reserve's thoughtful and considered approach. The Federal Reserve's discussion paper takes a balanced view of the opportunities and risks associated with issuing a CBDC in the United States.

The recent Executive Order on Digital Assets[7] places an increased focus on CBDC. While much of the executive order calls on federal agencies to assess the expanding marketplace of digital assets before recommending new rules, we are concerned that it clearly directs federal agencies to begin pursuing a central bank digital currency even before determining if a U.S. CBDC is actually 'in the national interest' as the order also requires. Secretary Yellen recently commented

[6] Federal Reserve Board, Financial Stability Report at 44 (May 2022), https://www.federalreserve.gov/publications/files/financial-stability-report-20220509.pdf.
[7] https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/

on this work, noting that "issuing a CBDC would likely present a major design and engineering challenge that would require years of development, not months."[8]

It also seems worth noting that proponents of a dollar CBDC frequently note enthusiasm in other countries, and the potential for a "CBDC gap." However, the Bank of Canada has sidetracked its CBDC effort, noting that it does not see a compelling need for one. Likewise Australia, where the central bank governor noted of CBDCs that "we have not seen a strong public policy case to move in this direction, especially given Australia's efficient, fast and convenient electronic payments system." In the U.K., the Lords Economic Affairs Committee recently found that none of the witnesses who came before the committee (including the Governor of the Bank of England) was able to make a convincing case for a retail CBDC, and concluded that the introduction of a CBDC could pose significant risks.

U.S. policymakers are coming to the same conclusion. In June, 2021, then Vice Chair for Supervision Randal Quarles suggested that CBDCs were an unfortunate fad like "parachute pants" that would be "puzzling or embarrassing" in hindsight. [9] Similarly, Federal Reserve Governor Christopher Waller called CBDC "a solution in search of a problem."[10]

Lastly, and perhaps most importantly, we believe that legislation is required to authorize the Federal Reserve and the Treasury Department to change the nature of our nation's currency.[11] Just as Congress acted to authorize the abandonment of gold backing for the currency in 1933, it would need to act now to convert our nation's currency from paper to digital form. The requirement of Congressional action is all the more important given the profound consequences for the nature of our economy, and the role of government in it.

We look forward to engaging with the Federal Reserve, Treasury Department, and other policymakers as they consider the important questions raised in this discussion paper.

Sincerely,

American Bankers Association[12]
Bank Policy Institute[13]
Consumer Bankers Association[14]

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[8] https://home.treasury.gov/news/press-releases/jy0706
[9] https://www.federalreserve.gov/newsevents/speech/quarles20210628a.htm
[10] https://www.federalreserve.gov/newsevents/speech/waller20210805a.htm
[11] https://bpi.com/legal-authority-to-issue-a-u-s-central-bank-digital-currency/
[12] The American Bankers Association is the voice of the nation's $24.0 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.9 trillion in deposits and extend $11.4 trillion in loans. Fed Comment Letter.
[13] The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans and are an engine for financial innovation and economic growth. Fed Comment Letter.
[14] The Consumer Bankers Association is the only national trade association focused exclusively on retail banking. Established in 1919, the association is now a leading voice in the banking industry and Washington, representing members who employ nearly two million Americans, extend roughly $3 trillion in consumer loans, and provide $270 billion in small business loans.

Credit Union National Association[15]
National Association of Federally-Insured Credit Unions[16]
National Bankers Association[17]
The Clearing House[18]

cc: Members of the House Financial Services Committee

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[15] The Credit Union National Association, Inc. (CUNA) is the largest trade association in the United States serving America's credit unions and the only national association representing the entire credit union movement. CUNA represents over 5,000 federal and state credit unions, which collectively serve over 130 million members nationwide. CUNA's mission in part is to advocate for responsible regulation of credit unions to ensure market stability, while eliminating needless regulatory burden that interferes with the efficient and effective administration of financial services to credit union members. Fed Comment Letter.

[16] The National Association of Federally-Insured Credit Unions advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 130 million consumers with personal and small business financial service products. NAFCU membership is direct and provides credit unions with the best in federal advocacy, education and compliance assistance. Fed Comment Letter.

[17] Since 1927, The National Bankers Association has served as the leading trade association for minority depository institutions (MDIs). Our members include Black, Hispanic, Asian, Pacific Islander, Native American, and women-owned and -operated banks across the country, all working to help low and moderate-income communities who are underserved by traditional banks and financial service providers.

[18] The Clearing House Association, L.L.C., the country's oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than $2 trillion each day Fed Comment Letter.

MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
Washington, DC 20515

PATRICK McHENRY, NC
RANKING MEMBER

May 18, 2022

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Chairman Powell:

We appreciate the Federal Reserve's (Fed) work on a U.S. Central Bank Digital Currency (CBDC) and the issues raised by its discussion paper, "*Money and Payments: The U.S. Dollar in the Age of Digital Transformation*."[1] As the Fed considers its next steps, we believe it is necessary to first understand the problems a CBDC would solve. Moreover, we believe the Fed should understand whether the benefits of a CBDC outweigh the risks to commercial banks, the existing payments system, and consumers. Last year, Committee Republicans released a set of principles to guide our review of a potential CBDC. These principles coalesce around many of the questions to which the Fed is seeking comment. As the Fed moves forward, we believe it should focus on the issues outlined below.

1. *Identifying the inefficiencies in the U.S. payment system, and whether a CBDC solves them, including whether a CBDC increases greater access to banking services for traditionally unbanked and underbanked communities.*

In its paper, the Fed suggests that a CBDC could provide a safe, digital payment option for households and businesses, particularly as the payments system continues to evolve and results in faster payments across national borders.[2] However, the paper fails to identify the current payment system inefficiencies a CBDC will address. We believe the Fed should first identify the challenges presented by the current payment system infrastructure and whether those challenges are best addressed by a CBDC. Separately, the Fed should analyze the intended scope of uses and potential users of a CBDC, including any barriers preventing prospective users from access and intended use. The analysis should also include a comparison of a CBDC to the forthcoming FedNow Service and the current and anticipated private sector payment mechanisms.

In a speech delivered earlier this year, Vice Chair Lael Brainard discussed critical changes and advancements within the U.S. financial system. These advancements are largely a result of private sector innovation. Specifically, Vice Chair Brainard emphasized that "some of these innovations hold considerable promise to reduce transaction costs and frictions, increase

[1] *Money and Payments: The U.S. Dollar in the Age of Digital Transformation,* Federal Reserve Discussion Paper, (Jan. 20, 2022) *available at* https://www.federalreserve.gov/newsevents/pressreleases/other20220120a.htm.
[2] *Id.*

competition, and improve financial inclusion."[3] As part of the Fed's next steps, it should closely examine how a CBDC removes inefficiencies in cross-border payments and understand how these solutions compare to existing and anticipated alternatives.

Separately, some stakeholders have advocated for the Fed to issue a CBDC to foster greater financial inclusion in the United States. To that end, the paper alludes to the difficulties unbanked individuals may experience paying minimum balance fees or distrust of banking institutions so much so, they avoid them altogether. However, it is unclear how a CBDC solves this problem.

As the paper acknowledges, the share of unbanked individuals has recently declined in the United States and without a CBDC. Moreover, the share of adults without a smartphone is nearly three times higher than the unbanked rate for U.S. households.[4] Please explain how a CBDC would increase financial inclusion. We are particularly interested in how financial inclusion would be broadened given the current levels of technological adoption and the outlays required by individuals to use a CBDC.

2. *Private Sector Must Lead the Way in Innovation*

The Fed has historically supported responsible private sector innovation. Future digital currency policies must continue to promote private sector innovation and foster competition. Potential regulations for emerging payment technology should seek to target the specific uses and activities and mitigate discrete, identified potential risks. Policies should not disallow or regulate the underlying technology.

Committee Republicans believe stablecoins, if issued under a clear regulatory framework, hold promise as a potential cornerstone of a modern payment system. Transacting in stablecoins has the potential to be a more efficient, faster, and less expensive payment option than what currently exists. These benefits would extend to the very consumers and small businesses a CBDC purports to help. Thus, we request the Fed provide a detailed analysis on any potential impact to the stablecoin market of a CBDC. The analysis should cite to any impact on competition and innovation that may result from a CBDC. This information will help Congress evaluate whether a CBDC and privately issued stablecoins can coexist within the payment system and ensure that innovation within our payments system continues apace.

3. *Impact on Monetary Policy Implementation and the Role of the Federal Reserve*

The Fed ensures that the United States has a safe, flexible, and stable financial system. As noted in the paper, a CBDC could impact monetary policy and interest rate control by altering the supply of reserves in the banking system and the long-term size of the balance sheet. A CBDC could also impact credit markets and involve the Fed in products and services that are traditionally reserved for retail banking institutions. Furthermore, expanding central bank activity

[3] *Preparing for the Financial System of the Future,* Federal Reserve Vice Chair Lael Brainard, (Feb. 18, 2022) *available at* https://www.federalreserve.gov/newsevents/speech/brainard20220218a.htm.
[4] Pew Research Center: Mobile Fact Sheet (Apr. 7, 2021), *available at* https://www.pewresearch.org/internet/fact-sheet/mobile/.

into retail banking is likely to result in increased politization of the Fed. This in turn raises serious concerns with respect to the Fed's ability to effectively perform its monetary and regulatory functions.

We request a detailed analysis on the possible impact of a CBDC on the Fed's monetary policy tools and decision-making. The analysis should evaluate whether a CBDC could result in adverse unintended consequences for monetary policy implementation; assess whether a CBDC facilitates the use of unconventional monetary policy tools (including negative interest rates) that the Fed has previously rejected or require a balance sheet that is politically unsustainable. We also request that the Fed examine any implications for financial stability through bank runs that may result from transfers of commercial bank deposits into CBDC accounts, as referenced in the paper.

4. *Ensure Privacy and Security*

The paper states "the analysis [completed] to date suggests that a potential U.S. CBDC, if one were created, would best serve the needs of the United States by being privacy-protected, intermediated, widely transferable, and identity-verified."[5] The Fed has acknowledged that ensuring adequate security for a CBDC would be challenging. Further examination is needed regarding how the Fed will balance privacy rights and transparency, particularly as it relates to deterring criminal activity and when anti-money laundering concerns are present. It is critical that we fully understand the potential impact a digital currency will have on Americans' civil liberties and privacy rights before any legislative action is considered.

Chair Powell, we understand this is the first step in an extensive discussion with Congress, the public, and other stakeholders. We look forward to continuing to work with you as Congress contemplates both the risks and benefits of a potential CBDC.

Sincerely,

Patrick McHenry
Ranking Member
Committee on Financial Services

Ann Wagner
Vice Ranking Member
Committee on Financial Services

[5] *See* Federal Reserve Discussion Paper, Money and Payments: The U.S. Dollar in the Age of Digital Transformation, supra note 1.

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cc: The Honorable Lael Brainard, Vice Chair, Federal Reserve
The Honorable Michelle W. Bowman, Governor, Federal Reserve
The Honorable Christopher J. Waller, Governor, Federal Reserve