Bank of England

Harriett Baldwin MP
Chair, Treasury Select
Committee
House of Commons
London
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Dear Harriett,

The Government and Bank of England's Response to Treasury Committee report *The digital pound: still a solution in search of a problem?*

HM Treasury and the Bank of England ('the Bank') thank the Treasury Committee ('the Committee') for its report and recommendations on the digital pound.

The Committee's report is very important given the key role of Parliament in scrutinising the work of Government and its agencies. Recognising this, the Government has committed to introducing primary legislation in both Houses of Parliament before any launch of a digital pound, as set out in a letter to the Treasury and Lords Committee chairs in May 2023.[1] Parliament's role going forward will be critical in scrutinising the relevant legislation that would underpin the design and rollout of a digital pound.

The Committee's report is timely; following HM Treasury and the Bank's joint Consultation Paper on a proposal for the digital pound in February 2023, the formal Consultation Response has been published today. The Consultation Response and the Bank's response to the Technology Working Paper take

1 https://committees.parliament.uk/publications/40179/documents/196189/default/

stock of the extensive feedback we received from a range of stakeholders and set out how HM Treasury and the Bank intend to act on that feedback during the design phase.

The core message of the Committee's report, to proceed with care while noting the value of further exploratory work in the design phase, echoes HM Treasury and the Bank's approach to the next phase of work. No decision has yet been taken on whether to introduce a digital pound. The design phase will deepen our understanding of how to design a digital pound that maximises opportunities whilst mitigating risks and aims to develop a robust evidence base to inform a decision later this decade as to whether, or not, to proceed to launch.

The Committee's report highlights the wider indirect benefits for the UK's competitiveness from this work. The process of developing the design for a digital pound over the coming years will present enduring benefits for the UK's digital economy, fostering knowledge-sharing and technical collaboration between the public and private sectors. These efforts are valuable, regardless of whether a decision is ultimately taken to introduce a digital pound.

HM Treasury and the Bank have made a number of further legislative and policy commitments in the Consultation Response document. Many of these commitments speak to the recommendations of the Committee's report:

- The Bank and the Government would not have access to users' personal data – and legislation introduced by the Government for a digital pound would guarantee users' privacy
- The Bank has committed to exploring technological options that would prevent the Bank from accessing any personal data through the Bank's core infrastructure
- The Bank and the Government would not program a digital pound – and legislation introduced by the Government for a digital pound would guarantee this
- The Government has legislated to safeguard access to cash, ensuring that it would remain available even if a digital pound were launched

As the design phase progresses, HM Treasury and the Bank will continue to engage with Parliament and seek input on the design of the digital pound from a wide range of stakeholders. HM Treasury and the Bank have established the CBDC Engagement Forum and Technology Forum, and more recently, an Academic Advisory Group, to seek input from senior figures in industry, civil society and academia. And there would be additional opportunities for stakeholders to share thoughts on a digital pound via further public consultation prior to the introduction of primary legislation by the Government.

Ensuring continued public trust in money and that our modern forms of money and payments meet the evolving needs of users are fundamental responsibilities of the Government and the Bank. Work on the digital pound is in line with HM Treasury's objectives to ensure the stability of the macroeconomic environment and strong growth and competitiveness across all regions of the UK, and the Government's vision for a technologically advanced, sustainable and open financial services sector. Likewise, the digital pound could contribute to the Bank's statutory objectives to maintain monetary and financial stability by acting as an anchor for the wider monetary system, promoting trust and confidence in money and payments. Any decision to launch the digital pound will be based on an assessment of the extent to which the digital pound contributes to these objectives, as well as the wider economic and societal opportunities and risks, and the financial implications of developing and launching a digital pound.

This letter addresses the recommendations made by the Committee to HM Treasury and the Bank, and also responds to other priority considerations highlighted in the report.

<u>Privacy and data protection</u>

TC Recommendation: *We recommend that any primary legislation used to introduce a digital pound does not allow the Government or Bank of England to use the data from a digital pound for any purposes beyond those already permitted for law enforcement.*

HM Treasury and the Bank agree that strong privacy safeguards would be vital if a digital pound were to be introduced. As set out in the 2023 Consultation Paper, neither the Government nor the Bank would have access to users' personal data. Law enforcement would only have access to users' personal information in limited circumstances and where there is a fair and lawful basis – as is the case today. Following feedback from consultation respondents, and in alignment with the report's recommendation, the Government has committed to guaranteeing users' privacy in primary legislation if a digital pound were launched.

HM Treasury and the Bank also understand that there are concerns about how the private sector would use personal data in a digital pound ecosystem. All firms that process personal data in a digital pound ecosystem would be subject to rigorous standards of privacy and would have to comply with UK data protection laws, such as UK General Data Protection Regulation (GDPR), the Data Protection Act 2018 and the Privacy and Electronic Communications Regulations 2003. A digital pound could be privacy-enhancing by design, in order to give users greater control over the use and value of the data held by PIPs. We will explore in the design phase how this could work and will set out in greater detail the regulatory framework that would govern the digital pound.

As part of the 2023 Consultation exercise, HM Treasury and the Bank hosted a roundtable with privacy and data protection experts and within the design phase we will be seeking expert input on the question of privacy through our external forums.

Monetary policy considerations

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

A digital pound would be intended as a means of payment, rather than a savings product, meaning it would be unremunerated like cash. A non-remunerated digital pound would be less likely to compete with bank accounts as a way to hold savings, reducing the potential impacts on the banking sector – a concern that was raised by the Committee.

Remunerating the digital pound, either with positive or negative interest rates, to make monetary policy more effective is not a motivation for issuing the digital pound, which is aligned with the approach being taken by most other jurisdictions internationally. Monetary policy is mainly implemented by setting the interest rate – the Bank Rate – on deposits held at the Bank overnight by commercial banks and other eligible firms. The Bank has undertaken analysis on the possible impacts of a digital pound on monetary policy, and in the Consultation Paper on the digital pound the Bank acknowledged that a digital pound that pays interest could directly influence the pass-through of Bank Rate changes to banks' savings rates for retail customers, therefore impacting monetary policy. However, there is uncertainty about the knock-on effects of this.

For these reasons, a digital pound would be unremunerated at launch. Any decision to revisit the approach to remuneration after the digital pound is introduced would be preceded by a review with full consultation.

Costs

TC Recommendation: *To ensure transparency around the costs incurred, we recommend that the Bank of England reports expenditure on the digital pound as a separate line item in its annual report and accounts from 2024 onwards.*

The Bank acknowledges the Committee's request for transparency around the costs incurred in the development of the digital pound. Costs on CBDC are currently reported in the Bank's Annual Report in combination with our broader portfolio of fintech work.
Additionally, in line with procurement law and the Bank's procurement policy, procurement costs related to CBDC are publicly available. We are committed to transparency around our CBDC work, including on costs, and will consider the appropriate reporting mechanism going forward.

Assessment

TC Recommendation: *We recommend that the Government and Bank of England set out in more detail, as soon as possible, the criteria they will use to inform that final decision [on whether to launch a digital pound].*

HM Treasury and the Bank agree that a balanced, transparent and rigorous approach is required to assess the case for a digital pound, to explore the benefits, costs, opportunities and risks of issuance from a neutral stance.

The decision to launch a digital pound will consider the fundamental factors noted in the Committee's report.

The assessment would look at the contribution of the digital pound to the objectives of the Government and the Bank. In particular, ensuring that where appropriate, central bank money remains available and useful in an ever more digital economy, continuing to support UK monetary and financial stability, and providing a public platform for private-sector innovation, promoting further competition, efficiency and choice in payments.

The assessment will cover both economic and societal opportunities and risks, and the direct financial implications of developing and maintaining the digital pound. It will be informed by a strong base of evidence, and will be forward-looking, recognising that the digital pound, if launched, would be part of a future payments landscape.

The criteria that will inform the decision as to whether to proceed to build the infrastructure, along with the wider assessment framework, are being developed as part of the design phase of work. HM Treasury and the Bank remain committed to engaging with Parliament and reporting on progress throughout the design phase, including on the development of the assessment framework and the decision-making criteria. HM Treasury and the Bank also plan to engage stakeholders, including industry, academics, and civil society in the development of this analysis in order to ensure that the assessment is as robust as possible.

Other issues

While the report made four explicit recommendations, it also highlighted other considerations related to the design of the digital pound.

On **limits,** the Committee concluded there may be merit in a more cautious approach of a lower initial limit on individual holdings than the proposed £10,000-£20,000 limit to reduce the risk of large-scale outflows from bank deposits. Having reviewed the consultation feedback, views on the appropriate level of limits on individuals' digital pound holdings ranged widely. HM Treasury and the Bank are minded to proceed at this stage with a proposed holding limit in the range of £10,000 to £20,000, at least during the introductory period. HM Treasury and the Bank remain open to revisiting the bounds of this range if new information came to light, and will continue to analyse the impact of limits and engage with industry on this issue. It is worth noting that the risks of fast and disorderly outflows of deposits from the banking sector already exist in today's digital payments landscape and will continue to exist irrespective of the digital pound. We will use regulation to continue to manage these risks.

The report also advocated for **financial inclusion** initiatives, including the option for offline payments and continued support to those that rely on cash.

Tackling financial exclusion is a priority for HM Treasury and the Bank. To inform work on financial inclusion, we have established a working group of expert stakeholders, reporting to the digital pound Engagement Forum on the issue of offline payments, and their potential benefits and technical feasibility.

The working group will report to the Engagement Forum by the end of this year, and its findings will be published on the Bank's website. The Bank will also conduct experiments to explore how those who are more digitally excluded would still be able to use the digital pound.

A digital pound would complement, not replace, cash. The Government and the Bank have a clear commitment to maintain access to cash for those who want to use it. In recognition that cash continues to be important for many, the Government legislated in 2023 to provide the Financial Conduct Authority (FCA) with powers to protect access to cash across the UK, including access to free services for individuals. The FCA is currently consulting on how it plans to protect access to cash and has said publicly that it expects that its new regulatory framework will come into effect by summer 2024.

The issues the Committee have highlighted will be given careful consideration throughout the design phase and in any future assessment of a potential digital pound. HM Treasury and the Bank would like to thank the Committee for its report and look forward to further engagement with Parliament.

Yours sincerely,

BIM AFOLAMI MP
ECONOMIC SECRETARY TO THE TREASURY

SARAH BREEDEN
DEPUTY GOVERNOR FOR FINANCIAL STABILITY