

Examining the issuance of a Canadian CBDC

Key Industry Positions



August 22, 2022

Executive Summary

With the rapid rise of digital currencies and significant advances in the technology supporting financial services, Finance, OSFI, the Bank of Canada (BoC) and other federal authorities are working to understand the potential impact these innovations may have on the financial sector. Policy makers, regulators and international standard-setters have voiced concerns surrounding the growth of cryptocurrencies, including stablecoins, as they relate to the potential impacts on the broader financial system. To some extent, these developments have accelerated work by central banks around the world, including by the BoC on the potential issuance of a Canadian central bank digital currency (CBDC).

In February 2020, the BoC released a [contingency plan](#) that outlines the BoC's intention to build the capacity to issue a cash-like CBDC should the need to implement one arise. While issuing a CBDC is not a foregone conclusion, the BoC identified two scenarios that may prompt it to act: a tipping point where the acceptance of cash sharply declines, and the potential widespread adoption of alternative digital currencies. Beyond the key policy considerations outlined in the contingency plan, the BoC is also examining potential distribution models and technical considerations for such a currency. These include examining the role of the private sector (e.g., the respective roles of banks and non-bank entities) and the potential impacts on the broader ecosystem. Most recently, Budget 2022 announced a forthcoming legislative review of digital money by Finance, including an examination of potential CBDC issuance.

If a retail CBDC were to be issued in Canada, there could be 'wide-reaching implications for the economy, the financial system and the Bank of Canada's operations'.¹ While there may be some potential benefits to issuing a retail CBDC, the policy objectives for issuing it must be clearly established and verified in light of the risks to the stability of the financial sector. Most notably a key risk arising from the issuance of a retail CBDC is the potential impact on bank deposit disintermediation, including repercussions for banks' source of funding and their ability to provide credit. Depending on its design and technical aspects, a retail CBDC also gives rise to concerns surrounding privacy, financial crimes and the security and resilience of the overall CBDC system. All of these elements must be addressed to maintain trust in the financial sector.

¹ As cited in Press, J. (2022, January 3). Federal documents hint at sweeping economic impact from Bank of Canada "digital loonie." The Globe and Mail. <https://www.theglobeandmail.com/business/article-federal-documents-hint-at-sweeping-economic-impact-from-bank-of-canada/>

The potential benefits of a CBDC to address concerns about the widespread adoption of alternative digital currencies and cross-border payments inefficiencies warrants further examination. The regulatory landscape for cryptocurrencies, including stablecoins, continues to evolve in Canada and abroad. Expanding the regulatory perimeter to address these digital money innovations, as Canadian federal authorities are contemplating, coupled with ongoing enhancements to the Canadian payments ecosystem, could alleviate the BoC's concerns surrounding the broad adoption of alternative digital currencies. We also believe there are many policy alternatives beyond CBDCs that should be considered to enhance efficiencies of cross-border payments. To this end, we support the BoC's ongoing collaboration with international partners, including collaborating with Financial Stability Board (FSB), to address inefficiencies of cross-border payments.

With the above in mind, the CBA has identified key policy considerations that we believe the BoC should take into account as it continues its work on the potential issuance of a CBDC in Canada. They are:

- **The reason to issue a retail CBDC must be clearly established and the risks and benefits to the financial sector carefully assessed.** The public policy objectives set out by the BoC in the contingency plan should be carefully assessed against other public policy goals. A retail CBDC should not undermine the trust that Canadians have in the financial system, nor should a CBDC be viewed as a panacea to address policy issues to which other alternative solutions may already exist or could be addressed by the private sector. Moreover, the BoC should ensure the issuance of retail CBDC does not impede or restrain innovation and competition in the financial sector.
- **Stability of the financial sector should not be undermined by the issuance of a retail CBDC.** Ensuring a stable and efficient financial system is a core function of central banks and it is crucial that the potential disintermediation risks that may rise as a result of a retail CBDC, including the impact on bank lending, are addressed. While preliminary BoC research suggested that DSIBs could withstand the potential negative effects on net income and liquidity if a retail CBDC were introduced, we believe the potential impact on banks' deposits is understated and warrants further consideration. Particular attention should be paid to assessing those risks that may be exacerbated in times of financial stress, and potential long-term implications to deposits. Potential mitigants should also be evaluated (e.g., limits on holdings) to deter deposit flight, including their effectiveness and whether implementing these controls would undermine the perceived benefits of introducing a CBDC in the first place (e.g., constraints could limit demand/uptake).
- **A retail CBDC should not undermine ongoing projects, like payments modernization, that are currently in development.** Canada is in the process of modernizing the clearing and settlement systems and building a new platform for retail payments (the Real-Time Rail), which will provide Canadians with faster, more efficient and more secure payment options. We are confident these investments will result in a better payments infrastructure in Canada. If the BoC were to issue a CBDC, the associated technology should not compete with private sector solutions and should be interoperable with future payments systems and their underlying technology.
- **Commercial bank solutions, together with effective regulation and oversight of alternative digital currencies, could be effective in addressing the BoC's concerns surrounding the displacement of the Canadian dollar.** Canada's payments system is realizing the benefits of collective efforts and

investments banks have made to enhance the general efficiency and convenience of payments. We believe with the increased convenience today and with planned future enhancements, the likelihood of widespread adoption of stablecoins remains low in Canada in the near term. If this scenario, however, were to change, we believe increased regulation and oversight of stablecoins could address many of the risks associated with stablecoins and alleviate the BoC's concerns about the displacement of the Canadian dollar. Unlike (non-bank) stablecoins issuers at this time, commercial banks are subject to strict regulatory requirements in addition to being covered by deposit insurance and subject to comprehensive consumer protection regulation. To this end, we support the FSB's views that no stablecoin project should begin operations until the applicable oversight risks and challenges are adequately addressed. Domestically, we encourage the BoC to collaborate and coordinate with Finance on the financial sector legislative review focused on the digitalization of money and maintaining financial sector stability and security.

- **A retail CBDC system must strike the right balance between protecting Canadians' privacy and preventing financial crimes.** A potential CBDC system presents a dichotomy between privacy and preventing financial crimes, which could risk Canadians' trust in a CBDC system. Given the concerns around financial crimes, it is unlikely a Canadian CBDC will be able to offer the same level of anonymity and privacy as physical cash. Assessing whether the right balance between safeguarding privacy of consumers and the appropriate level of transparency to deter financial crimes (which entails disclosure of information to adhere to regulatory expectations) can be achieved is a critical aspect of the BoC's contingency planning efforts. Evaluating different business models and technical considerations can determine the degree of privacy of a CBDC and will be an integral part of this research. If Canadians do not trust a Canadian CBDC, or perceive the BoC does not adequately address privacy concerns, public adoption of a CBDC could be negatively impacted.
- **Ensuring the resilience of a CBDC system in Canada is paramount to maintain the trust Canadians have in the financial sector.** Beyond potential compromises to an individual's CBDC holdings, a CBDC ecosystem could be a high-value target to threat actors. Operational resilience and the implementation of cybersecurity controls and safeguards should be foundational elements of a potential CBDC system. Like existing payments systems in Canada, all stakeholders should apply the highest standards of security and data protection, including the entities involved in the issuance and distribution of a potential Canadian CBDC. A significant failure in CBDC infrastructure could have a negative impact on the financial sector. The notion that a CBDC would enhance resilience of the payments landscape by acting as an alternative payment method, even with offline capabilities, seems overstated because traditional payments systems have been designed around risk management, resilience and developing contingency (e.g., PFMI, recovery and resolution regime) to mitigate against the risks of potential outages.
- **The issuance of a CBDC is one of many policy alternatives that could be considered to enhance cross-border payments.** Addressing the pain points related to cross-border payments is a complex issue that banks are working to address in coordination with public and private stakeholders. Developments in real-time payments systems, adoption of ISO 20022 standards, implementation of solutions by SWIFT, as well as addressing interoperability, are just some examples of the ways in which the impediments related to cross-border payments can be addressed. We support the BoC's work with other central banks and

through the FSB to address the inefficiencies associated with settlement and cross-border payments within the current system, including by addressing the role of central banks in the process to alleviate efficiency concerns.

- **The potential issuance of a CBDC should be considered as part of the broader policy discussions impacting the financial sector.** The banking industry is already undergoing considerable change through initiatives like payments modernization and the increasing digitalization of the sector. In addition to regulatory oversight of new entrants, we encourage the BoC to take a holistic approach when assessing the impact of CBDCs on banks, in conjunction with other policy initiatives that are currently impacting the banking industry and/or are likely to have an impact in the future (e.g., open banking/consumer-directed finance and changes to regulatory guidance relating to both financial and non-financial risks). Given the cross-functional nature of this issue, we are pleased to see collaboration and coordination between the BoC and other authorities domestically and abroad to ensure a well-coordinated and holistic approach.

As the digitalization of the financial sector continues to evolve, the CBA and our members are committed to working with the BoC and other stakeholders to explore the policy issues and considerations raised in the BoC's contingency plan.

Our industry stands ready to engage the BoC and its government partners as it assesses the impact of a digitalization of money to the stability, integrity and security of the financial sector while at the same time promoting an environment that fosters competition and innovation to ensure Canada's financial sector is in a strong position to harness the benefits of a digital and data-driven economy.