Submission

to the

Reserve Bank of New Zealand

on the

Consultation Paper: *Digital cash in New Zealand*

26 July 2024

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following eighteen registered banks in New Zealand are members of NZBA:

- ANZ Bank New Zealand Limited
- ASB Bank Limited
- Bank of China (NZ) Limited
- Bank of New Zealand
- China Construction Bank
- Citibank N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Industrial and Commercial Bank of China (New Zealand) Limited
- JPMorgan Chase Bank N.A.
- KB Kookmin Bank Auckland Branch
- Kiwibank Limited
- MUFG Bank Ltd
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited

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Introduction

4. NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand – Te Pūtea Matua (**RBNZ**) on the Consultation Paper: *Digital cash in New Zealand* (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

5. We believe that a number of topics canvassed in the Consultation Paper would benefit from further consideration, as set out in detail below.

6. In summary, this submission captures NZBA's views on:

   6.1. Timing and implementation for the development of CBDC, considering ongoing work programmes

   6.2. Fraud, scams and digital identity

   6.3. Possible impact on the banking system and financial stability

   6.4. Wholesale vs retail use of CBDC

   6.5. Privacy and anonymity

   6.6. Credit risk

   6.7. Financial inclusion

   6.8. Reliability and resilience

   6.9. Competition and innovation

   6.10. The risk to NZD from cryptocurrencies

7. We note that the RBNZ has requested responses to some specific questions in the Consultation Paper, for example, questions 8 – 10 on strategic design. It is not possible to provide feedback on questions around strategic design without further detailed information on the proposed development and delivery of CBDC, including in relation to the matters listed at paragraph 6 above. We consider that significant work on the proposal and engagement with industry is required before decisions around strategic design are taken.

8. Finally, we also note that the proposal to introduce CBDC is a significant one, and we do not feel that the justification for this introduction has been clearly articulated. For example, the use cases outlined in the Consultation Paper are much broader, in our view, than the harms which it is intended to solve (for example, financial inclusion and threats to monetary sovereignty). Many of the use cases may well be delivered by

other regulatory reforms and industry initiatives already underway, such as Next Gen Payments and confirmation of payee.

Significant programmes of work are already underway across industry

9. We support the policy objectives that the RBNZ is seeking to deliver through CBDC. However, we submit that the proposed timeline for developing CBDC is not realistic.

10. There is significant transformational work underfoot across the banking sector to modernise the payments system and core bank systems. Key examples of such work includes ISO20022, front end switch replacement, core system transformation and fraud and scams mitigation (including confirmation of payee). In our view the industry should remain focused on the delivery of these as a priority. Development of a CBDC within the timeframes proposed would divert essential bank resources away from these critical projects.

11. In addition, the case has not been sufficiently made to justify the development of retail CBDC functionality within the timeframes contemplated. The Consultation Paper does not sufficiently articulate the immediate likelihood and degree of risk to monetary sovereignty to warrant launching a CBDC, nor does it consider a wide range of other programmes of work, such as Open Banking, Confirmation of Payee, and Digital Identity.

12. We submit that the following three conditions are necessary to ensure the successful delivery and adoption of CBDC by industry and consumers:

    12.1. The RBNZ should start by identifying a small number of compelling use cases and ensure there is a clear value proposition to encourage the uptake and transition to CBDC. RBNZ should validate use cases by way of a cost-benefit analysis to ensure that CBDC will provide a clear value proposition as compared to existing and developing payment options. Without this, it is unlikely the technology will benefit from continued investment and innovation.

    12.2. Industry participants must have an achievable and commercially viable pathway for delivery of CBDC. If RBNZ proceeds with its preferred design positioning, the industry will be required to make a significant level of upfront and ongoing investment to ensure CBDC can be accessed by the public and integrated into market facing acceptance devices and processes (ranging from POS terminals, to e-commerce gateways and online billing systems). The scale of consumer demand needs to be of a sufficient level to ensure a return on investment which is sustainable over time. Without this, there is a risk of underinvestment and a lack of innovation, noting:

        12.2.1. The recent example of declining investment in and use of EFTPOS, which was driven by a lack of revenue to support it.

12.2.2. That investment may not be sustainable through bank profits, as under these proposals, the RBNZ could be removing access to bank margins and system funding (discussed further below at paragraph 15 below).

12.3. CBDC must be delivered within realistic timeframes, with proportionate implementation requirements for entities of different sizes and scales, that take into account the prioritisation of other policies and industry initiatives.

13. While we support the key policy objectives that have been outlined (such as financial inclusion and promoting competition and innovation), we believe that the RBNZ should consider whether other policy initiatives (such as amending AML / CFT regulations to promote financial inclusion, or introducing regulation of crypto currencies) or industry initiatives could deliver the same objectives more quickly and in a less costly way.

Frauds and scams and digital identity

14. The Consultation Paper refers to better scams and fraud protection as being one of the appeals of CBDC. It is not clear how CBDC would provide better fraud and scam protection, particularly in light of the focus on protecting users' privacy (with the goal being that CBDC is as private as cash) and instant payments without the ability to clawback payments inadvertently made to scammers. If anything, we consider CBDC may heighten the risk posed by fraud and scams as it will not benefit from existing fraud monitoring technology. The effective management of fraud and scams is essential to the success of CBDC, and is another reason to take time and care in its development and implementation.

Possible impact on the banking system and financial stability

15. The consultation paper does not address financial stability risk in any meaningful way. If RBNZ is to progress these proposals any further it must engage the industry on key issues such as funding and liquidity, ratings, exposure to offshore funding market disruptions, exposure to risk of rapid withdrawals and consequential risk management and mitigation parameters for CBDC. In particular, further analysis needs to be carried out on what impact CBDC could have on accelerating bank runs, for example if consumers respond quickly to rumours of a bank's financial stress by transferring private money into CBDC. These risks will need to be carefully balanced against the scale and nature of benefits that CBDC will deliver.

16. The RBNZ has stated that it does not have evidence that demand for CBDC will reach high levels, however it is possible that this could change quickly if for example Government agencies started adopting CBDC to stimulate uptake.

17. We strongly oppose the idea that RBNZ pays interest on CBDC. This could divert liquidity that the market needs for investment capital or could drive up real interest rates when the macroeconomic settings do not require this. It is possible that, if

interest is paid by RBNZ on CBDC, consumers move from investment products offered by financial institutions, leading to less liquidity in the current market. To compete with this shift, financial institutions may need to offer more interest to attract investments, in turn pushing up interest rates where there is no apparent macroeconomic reason to do so.

18. Additionally, we believe that the case for a CBDC is to provide a new payment instrument that facilitates payments. Paying interest on CBDC could arguably bring the RBNZ into the realm of providing a savings product, thus confusing the value proposition that CBDC should deliver. CBDC must be configured correctly to avoid system wide unintended consequences.

Wholesale use cases are where the most value is likely to exist

19. We believe that there are more compelling use cases for an appropriately designed wholesale CBDC to improve efficiency in and deepen wholesale cross border trade. A wholesale CBDC could play a transformative role in this space, which represents commercial opportunities and value propositions which would justify the investment required.

20. This is consistent with the approach taken by other OECD central banks (including the Reserve Bank of Australia) which have reservations about the benefit that a retail CBDC could deliver and accordingly have concluded that for the time being they will focus on wholesale use cases for a CBDC.

21. In our view, New Zealand should follow the example of Australia in developing a proof of concept in the wholesale market, which will likely avoid the regulatory complexities associated with retail.

Privacy and anonymity

22. One of the biggest benefits of physical cash is that it is private by nature, entirely anonymous and leaves no trace.

23. In contrast, the identity of persons using CBDC, and their transactions will be recorded (albeit subject to appropriate data governance and restrictions) by third party providers. While we agree that there are ways to design a degree of privacy into CBDC, CBDC can never ensure the same level of privacy as physical cash and accordingly we do not believe that it is correct to characterise CBDC as entirely private. For this reason, we submit that CBDC is unlikely to appeal to users of cash who strongly value the full anonymity and privacy that physical cash offers.

24. There is also tension between how privacy can be reconciled with the requirements to meet AML/CFT obligations in the context of CBDC. We would expect that ensuring compliance with AML/CFT obligations (particularly, transaction monitoring), would require close monitoring of any user's use of CBDC which would be counter to the

notion of “privacy”. We submit that further thought and analysis is required in this regard.

Credit risk

25. We query whether, in the presence of a fit for purpose banking supervision regime (and in light of the Deposit Takers Act, the Depositor Compensation Scheme and uplift to banks’ capital requirements), there will be significant benefit offered by CBDC in terms of reduced credit risk.

26. Most consumers are satisfied with the banking system[1] and therefore we question whether this is a benefit that would carry significant weight for individuals when deciding to transition their money from the banking system to CBDC. It is also unclear that CBDC will be preferable to other well-established forms of digital cash that are already available.

27. In this regard we refer to the findings of the Reserve Bank of Australia in the context of exploring the merits of a retail central bank digital currency in Australia. The report suggests that “*the average consumer attaches no value to the added safety of a CBDC. This is consistent with bank deposits in Australia already being perceived as a safe form of money, and physical cash issued by the RBA continuing to be available as an alternative option*.” [2]

Financial inclusion

28. NZBA submits that the key drivers of financial exclusion such as appropriate identification and address verification may not be addressed with CBDC (given that the identification of users will be verified before they can use CBDC). CBDC is unlikely to appeal to those who are reluctant to use technology in the first place or are digitally excluded, and this could lead to further exclusion of these groups from the financial system.

29. We would support deeper analysis of why people remain unbanked to determine whether CBDC is likely to overcome these root causes. In this regard the industry is committed to addressing the needs of those who are currently excluded from the banking system and is willing to work with the RBNZ to identify the key drivers behind financial exclusion and the most effective way to address these.

Reliability and resilience

30. The purported resilience benefits (such as CBDC as a back-up and offline availability in the event of natural disasters) rely on the large-scale adoption of CBDC in the appropriate places. It is unlikely that these benefits will be realised if the adoption of

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[1] As noted in the Consultation Paper at page 23.
[2] Valuing Safety and Privacy in Retail Central Bank CBDC (rba.gov.au)

CBDC is not widespread. It is therefore essential that detailed analysis and projections of consumer demand in various demographics is carried out to ensure that CBDC will in fact be supported by consumer demand, which will increase the likelihood of the stated resilience benefits being realised.

31. We note that there are a number of other regulatory initiatives already underway which are also aimed at lifting the resilience of New Zealand's payments infrastructure (such as the Financial Markets Infrastructure Act, and the Department of the Prime Minister and Cabinet's work on Critical Infrastructure Resilience). We think that appropriate calibration of these existing policy settings is a more targeted, beneficial and cost-effective way of addressing resilience issues within the payment system.

Competition and innovation

32. We support the RBNZ's objective of increasing competition and innovation. However, we submit that the best way to promote competition and efficiency is through industry led initiatives rather than the creation of a costly and entirely new payment system which may not have widespread adoption. This could divert investment and resources and crowd out other payment innovations with stronger value propositions. Accordingly, it is essential that detailed validation of the use cases and consumer demand for CBDC is undertaken to justify this level of investment and to ensure that industry efforts to enable CBDC produce a return on this investment.

33. We believe that RBNZ should also consider whether, in the immediate term, there are less costly means of achieving the competition and innovation objectives that the RBNZ has stated. In this regard we refer to both industry and regulatory initiatives aimed at promoting competition and innovation such as those referred to in the consultation paper to improve access to both the "front end" and the "back end" of the payment system.

34. Given this, we query whether there is net benefit in the creation of an entirely new payment system aimed at achieving similar objectives, in particular because the consumer demand, purported benefits and value propositions are not immediately clear.

35. Separately, we note that private entities in New Zealand have issued stablecoins in New Zealand backed 1:1 with the NZD and some of the major banks in Australia have done the same with the AUD. It is possible that a major NZ bank could issue an NZD stablecoin with some of the same blockchain based functionality the RBNZ is proposing for a CBDC if there was a clear market demand.

36. In this regard, it is worth referring to the Australian experience. The Reserve Bank of Australia undertook a trial of a CBDC last year, with the outcome that it was unclear the introduction of a CBDC would deliver compelling benefits. The report on the trial stated that:

"*[I]t is possible that many of the benefits linked to the pilot CBDC could be achieved in other ways, including through privately issued forms of digital money such as tokenised bank deposits or asset backed stablecoins. In other words, in a number of use cases, it was not clear that CBDC was exclusively required to achieve the desire economic outcomes. Some combination of other forms of private digital money, wider access to RBA settlement accounts balanced and enhancements to existing payments infrastructure may have also yielded improvements over current practices. There is considerable scope for further research in this regard*."[3]

The risk to NZD from cryptocurrencies

37. Even if cryptocurrencies were to overcome existing issues with public trust, volatility and poor functionality, it is not clear that they would present a challenge to monetary sovereignty, or that CBDC would address this risk. In terms of the emergence of alternative currencies, there are two possible scenarios:

    37.1. **NZD-denominated stablecoin** would work in the same way as commercial bank liabilities, and regardless of the rate of adoption, the RBNZ would retain its ability to determine NZD interest rates.

    37.2. **Non-NZD denominated assets,** such as Bitcoin or a USD-denominated stablecoin, face significant challenges to widespread adoption, as users could be exposed to exchange rate risk as long as some of their interactions (wages and salaries, purchases, savings or borrowings) are still NZD-denominated. The greater challenge would likely be if there was a widespread abandonment of the NZ dollar. However, in the few instances overseas where such a shift has occurred, the cause has generally been that the local currency has been seriously mismanaged, resulting in hyper-inflation. In this situation, a CBDC is unlikely to address the fundamental problem of a loss of trust in the central bank itself. We refer to Ecuador's dinero electronico which has failed, and Nigeria's e-Naira which is struggling, both for this reason.

[3] https://www.rba.gov.au/payments-and-infrastructure/central-bank-digital-currency/pdf/australian-cbdc-pilot-for-digital-finance-innovation-project-report.pdf, page 6