European CFO Network

Ms. **Christine Lagarde,** *President of the European Central Bank*
Mr. **Fabio Panetta,** *Member of the Executive Board, European Central Bank*
Mr. **Luis de Guindos,** *Vice-President of the European Central Bank*
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Mr. **Andrea Enria,** *Chair of the Supervisory Board of the European Central Bank*

CC to: Ms. Evelien Witlox, *Programme Manager of the Digital Euro, European Central Bank*

21st of July 2023

Dear Madams and Sirs,

The CFO Network, comprising CFOs of the 27 largest banks in Europe, based on our interactions with and publications by the European Central Bank and the European Commission, understands the key reasons expressed for investigating and potentially issuing a digital euro, in particular to strengthen the monetary sovereignty of the euro area.

Properly designed, we believe that a digital version of central bank money could contribute to strengthening public trust in the monetary system.

We are, however, concerned that the introduction of a digital euro –as it is currently discussed– could have major unintended consequences for

- financial stability
- financing the European economy and green transition
- long-term competitiveness of the EU payment ecosystem

In the interest of the overall success of the digital euro, in this letter we would like to express our concerns and propose solutions (as summarized in the following pages).

We hope that you find the views of the CFO Network constructive. As a key stakeholder group in the European banking industry, we support innovation and other developments in our industry provided they are implemented in a manner that promotes financial stability and do not harm the competitiveness of European banks, and ultimately, of the European economy.

We would welcome the opportunity to meet in person and discuss these points in greater detail.

Thank you for your consideration.

Yours faithfully

[redacted]

CONCERNS

1. Loss of stable retail deposits impacts financial stability, banks' liquidity position and regulatory ratios (LCR, NFSR)

A digital euro will mainly be sourced from **banks' retail deposits.** These deposits represent a valuable and stable[1] source of funding. Depending on the effective holding limit for the digital euro, a **very significant share of these most stable deposits may be at risk.** The digital euro could reduce deposits by up to 18% of deposits[2], depending on a bank's business model (or refinancing mix)[3], **impacting liquidity position, regulatory ratios** such as Liquidity Coverage Ratio (**LCR**) and Net Stable Funding Ratio (**NSFR**), funding plans and credit ratings. As a consequence, banks will have to mitigate the impact, by reducing the loan book, increasing the dependence on ECB funding against further collateral (subject to availability and adverse impact on asset encumbrance)[4] or wholesale issuance. This could be very challenging given the size of the wholesale market[5]. It would also require smaller banks to establish wholesale funding programs with the attendant costs.

In case of idiosyncratic stress or rumors on a bank – whether justified or not – the ease of shifting deposits instantly to an ultimate safe haven risks causing or exacerbating bank runs. In times of financial stress, deposits could flow very quickly into the digital euro, regardless of the remuneration and even with negative rates. Moreover, in a situation of market wide **stress**, pressure could mount to lift the holding limit, further undermining the financial stability of the banking sector. The **pressure to lift holding limits** could even occur under normal circumstances, e.g. if other jurisdictions outside the euro area decide on higher holding limits.

2. Loss of stable retail deposits could reduce lending activity and increase cost of credit, especially for more vulnerable customers, and challenge the green transition

Introducing a digital euro that in turn leads to a large-scale reduction of retail deposits would force banks to **shrink their loan books** and **increase the cost of credit** significantly, as low-cost **retail deposits would have to be replaced by expensive wholesale funding.** Additional demand for funding would also likely increase funding costs as the additional wholesale funding needs would be very large compared to the existing debt market.

Consequently, the overall economy will face higher financing costs with negative effects on economic growth. More vulnerable customers, projects and sectors will face barriers to accessing finance. Funding the green and digital transition will be more challenging.

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[1] A large part of stable deposits are covered by deposit guarantee schemes.

[2] For example: 0303-ESBG_response_to_EC_targeted_consultation_on_a_digital_euro.pdf (wsbi-esbg.org) and Central bank digital currency and bank intermediation (europa.eu).

[3] For example: JRC Publications Repository - Central bank digital currency and European banks' balance sheets (europa.eu)

[4] Replacing retail deposits with central bank funding would introduce frictions and policy uncertainty.

[5] 1tr of potentially lost deposits are significant compared to the size of outstanding debt securities for euro area banks of around 4tr (Macrobond, ECB: Euro area 19, MFI, Debt securities)

3. Risks to the long-term competitiveness of the EU payment ecosystem

Finally, we believe that a digital euro – as planned by the ECB project and defined in the legislative proposal by the European Commission – will severely **hamper innovation and reduce competition** in the European payment industry:

A fully-fledged front-to-back payment solution provided by the ECB, connected with a legal obligation for banks to distribute the digital euro via the ECB solution, will cause the payment industry to de-prioritize much needed innovation. This includes existing and future strategic initiatives to make the EU payment ecosystem more competitive in the global context.

In addition, the legislative proposal gives the ECB the sole legal mandate to define standards governing digital euro payment services. This neglects the core competencies of the private sector to understand market trends and customer needs, which would ensure successful adoption.

We would like to highlight that the EU payment industry has delivered significant innovation in the past years and established a well-functioning digital retail payment ecosystem. Existing and upcoming instant payment solution will complete this work as a key foundation for competitive and EU-built payment solutions based on SEPA instant credit transfers.

Solutions like Bizum in Spain as well as the recently launched multi-country European Payment Initiative (EPI) are just a glimpse of what is to come in the next several years for the benefit of the EU single market and the independence of EU payment solutions. A digital euro roll-out as currently planned would crowd out the efforts of the private sector. Moreover, there is a significant risk that they compromise each other's success. In this case, international payment schemes will further increase their market share in the EU, elevating the risk of locking EU customers into their global networks.

We observe that the design of the digital euro is driven by the political ambition to establish a common and independent EU-wide payment solution. We, however, strongly believe this should not be the core purpose, but the digital euro should rather be designed as a new form of money with only cash-like functionalities that will be integrated into existing payment wallets.

Beyond retail payments, and as outlined by the Bank for International Settlement in June 2023, monetary systems as a whole must ensure to remain the core anchor of economies[6]. New technologies and new forms of money challenge central banks and commercial banks alike. On-going initiatives for the use of wholesale central bank digital currencies (wCBDC) have the potential to significantly improve cross-border payments and capital markets processes. We must focus on being ready for this future to serve as pillars of stability and resilience.

[6] Press release: BIS builds out "game-changing" blueprint for the future monetary and financial

PROPOSED SOLUTIONS

A digital euro should have a specific and stable holding limit, be cash-like and not bear interest

To reiterate our initial statement: a digital euro could strengthen the monetary sovereignty of the euro area and contribute to retaining public trust in the monetary system. To ensure that the digital euro becomes a key pillar of central bank money while maintaining financial stability and preserving the crucial role of commercial bank money, the CFO network proposes the following approach:

- **A specific and stable holding limit.** This limit should be based on the amount of cash payments that most consumers make during a certain period and the amount of cash consumers typically carry in their wallets (e.g. 500-1.000 euro).

  The decision on holding limits should only be made after a **specific and detailed impact assessment** – drawing on bank level data through a Quantitative Impact Study (QIS) -- has been undertaken by the Eurosystem, providing a full picture of the consequences for banks' balance sheet and liquidity management.

  A **transaction limit and overall volume limit** for funding/reverse waterfall on wallets would further constrain deposit outflows. The funding/reverse waterfall mechanism forces banks to fund/defund the wallet when the transaction exceeds the holding limit. There is currently no limit on the number or size of transactions discussed which might lead to increased liquidity fragmentation[7]. Transaction limits for fraud management should be established in any case.

- **No remuneration.** To emulate cash and avoid asymmetries with cash, the digital euro should not bear interest under any circumstances, as stated in the European Commission's legislative proposal.[8]

- The ECB project should revise its approach to the digital euro infrastructure by focusing on establishing a digital euro as a new form of **digital unit of account** on a **settlement platform** and providing **access for intermediaries** to build payment solutions on top.

- The EU co-legislators, in the **legal framework**, should allow credit institutions to have the **option** to distribute the digital euro either via **existing payment solutions** or via the **ECB-built front-end.**

- The legal framework should ensure **pan-euro area interoperability** on the basis of a jointly public-privately governed digital euro scheme rulebook.

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[7] The details of these prefunded Dedicated Cash Accounts (DCA) have still to be determined.
[8] 230628-proposal-digital-euro-regulation_en.pdf (europa.eu)