ESTA
The Cash Management Companies Association

Position of ESTA on the draft Regulation on the digital euro (Com (2023) 369 Final)

25 July 2023

(Transparency register number: 850612124598-41)

Summary

ESTA welcomes the proposals for the two Regulations on the e-euro and on the use of the e-euro in countries whose currency is not the euro. However, this is not not from the point of view of the establishment of the e-euro itself, but for what it tells us of the situation of cash and what it implies in relation to the future of cash.

The establishment of an e-euro is a complex process. It is associated with significant risks on financial and monetary stability which will imply, *inter alia*, holding limits and agreement with non eurozone countries and third countries.

The main justification for the e-euro is the weakened monetary anchor resulting from the current situation of cash, the outcome of decades of war on cash, exacerbated by the sanitary crisis. ESTA does not believe that the development of the e-economy is a credible justification for the e-euro, as e-business has been mushrooming in the last 20 years without the help of any CBDC, and does not appear to be hindered by its current inexistence. In addition, payments limits applying to cash and possibly extended to payment in e-euros, as well as holding limits, would not contribute significantly to any further development of the e-economy, at least not where large amounts payments are required (which is where most value is paid).

Because of the necessity of holding limits, the e-euro would only provide a partial monetary anchor and would therefore require to operate jointly with cash to be effective. Therefore, it will be crucial for the success of the e-euro that cash remains available and efficient. The paradox is that e-euro therefore requires a strong defence of cash to work, when it is purportedly meant to overcome the weakened place of cash. ESTA considers that the restoration of the "weakened money anchor" requires a robust defence of cash, regardless of whether the e-euro will be set up or not.

Furthermore, any digital currency will not, by itself, increase the monetary anchor where cash is low, as demand for digital currency will remain weak where cash use is already low. The focus should therefore be to secure a strong place of cash in the eurozone, as the most efficient and most rapid solution to the problem that the e-euro should solve.

The draft Regulation and the various documents attached to it, notably the Impact Assessment, call for a protection of the e-euro against the predatory competition of electronic money providers. This is a welcome acknowledgement of one of the root causes of the decline of cash. Based on this, the defence of cash should also extend its protection from the predatory competition it faces from commercial e-money providers.

ESTA suggests that the defence of cash justifies the establishment of a minimum thresholds of payments of 10 euros, under which only cash payments (and in due course e-euro payments) would be allowed. This legal protection of cash would not only contribute to the "*deprivatisation*" of money in micropayments, but also secure a critical mass of cash in circulation for transactional purposes, which is key to its future. It would be a necessary counterpart for cash to the (legal) monopoly for commercial e-payments deriving from regulations on cash payments limitations and the future e-euro holding limits (which will, indirectly contribute to restrain the ability to pay in digital euro above those limits).

Based on ESTA's analysis of the draft Regulation on the e-euro, the draft Regulation on the Legal Tender of euro cash is a very positive and effective tool to protect cash (see ESTA's position of the draft Regulation) which will need to be adopted urgently and reinforced by adequate measures on relations to sanctions for infringers by Member States. In doing so, it will provide ample time to work on the e-euro and not precipitate its adoption in a way which could be risky and costly.

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I. Introduction

The Commission presented on 28 June 2023 its legislative package which includes the draft Regulation on the codification of legal tender for euro cash, and the two regulations on the establishment of the digital euro (hereafter "*the e-euro*") as a central bank money for the euro area. This position paper refers to the draft Regulation establishing a digital euro. ESTA has also presented a position on the draft Regulation on legal tender.

The proposal for the establishment of an e-euro and the papers related to it are in ESTA's views the best advocacy for putting in place a very robust defence of cash.

The rationale of the adoption of the e-euro is based on a number of observations which ESTA made some time ago for which we urged action to be taken by the EU monetary authorities. The reason motivating the establishment of the e-euro is primarily the "*weakened monetary anchor*" resulting from the reduction of cash in circulation, and particularly cash used for transactional purposes. As ESTA put it, the demise of cash is not happening just by chance: it is provoked. The sanitary crisis only accounts for part of the decrease in cash volumes. During the early days of the crisis, consumers were led to believe that cash could be a vector of contamination, more so than other every day objects or, for example, plastic debit and credit cards. Some stakeholders with vested interests have disseminated the fear that one could be contaminated by cash. As a number of regular cash users are elderly people mostly exposed to the risks of COVID, this also increased fears and anxiety in the elderly that "*one can die for paying in cash*". A massive promotion of contactless payments was organised as "*the safest payment method*" (if only physical shopping could be entirely contactless...) whilst cash was said to be "*extremely dangerous*".[1] No surprise that, as Mr Panetta from the ECB said, COVID was worth "seven years of digitalisation" of payments.[2] Arguably, the main boost brought by COVID to card and mobile payments is their major intrusion into micropayments, which most retailers were not allowing before COVID due to their high costs.

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[1] Mastercard's position paper to the EBA, 20 April 2020, obtained by ESTA through a request for access to document under the transparency Regulation.

[2] Speech of Mr F. Panetta, ECB, "*Cash in time of turmoil*", 15 June 2021. Note that "*digitalisation*" is nothing short of "the weakening of the monetary abchor" of payments, which the e-euro proposal is tasked to address.

As ESTA has shown, the reduction of cash in society is primarily a consequence of the disengagement of commercial banks from cash, which compromises the access to cash by citizens and in turn contributes to the digitisation of payments. As the Impact assessment rightly states, "*Private money cannot replace central bank money as it cannot perform the core functions of central bank money as an anchor of the payments and monetary system*".[3] However, ESTA thinks that there is no need to reinvent the wheel by inventing a digital euro. This is a rather difficult solution compared to defending the one that has always existed: cash.

ESTA has highlighted the causes and the risks on the cash infrastructure of this situation, and in particular on the "war on cash", where cash is subject to a fierce, and often unfair competition from powerful organisations which have alternative, more profitable, means of payment to offer to their customers, and which often publicly denigrate cash.[4] Commercial banks increasingly stop providing cash services. This is their unilateral, cost-based, decision, although they are a central stakeholder of the cash cycle. When doing so, commercial banks overlook their responsibility towards cash and their customers, which is also the duty to provide a public good and a public service to citizens. This service is, moreover, already paid for by their customers as part of the banking fees that financial institutions charge for providing them with a payment account.

This has led to cash dropping to dangerously low levels, triggering the risk of "weakened monetary anchor", which the draft Regulation seeks to address. However, addressing the reduction of cash through the establishment of an e-euro also exposes the monetary and financial system to a number of new risks, such as financial instability and the disintermediation of commercial banks and therefore the reduction of their capacity to fund the economy. None of those risks exist with cash which on the contrary contributes to the stability of the financial system and increases the ability of banks to lend.

Cash is a major factor of the stability of the banking system as cash is what maintain confidence of the public in the financial system which hold their deposits. Commercial electronic money rely purely on the trust of the public, and this trust relies on the "*redeemability*" of commercial e-money into cash (i.e. the conversion of sight deposits at par and on short notice), cash being the only means in the hand of depositors to withdraw their deposits from their bank.[5] As ESTA has stated already, "*Banks should fear the day when the public will consider that cash is becoming so scarce that it will lose confidence in its ability to withdraw its deposits from the bank.*"[6]

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[3] IA, at page 47.

[4] See for example the final report ERPB"s Working group on access to and acceptance of cash, November 2021, which states that "the first obstacle to the acceptance of cash is its image" where the "*perception*" of cash is "*a payment method which is less and less appropriate for modern societies*", "*outdated*", "*not cool*", "*cumbersome*". ERPB final report at page 32.

[5] As the IA states, central bank money provides trust in electronic commercial money (page 47).

[6] ESTA's position to the interim report of the ERPB's working group on access to and acceptance of cash, 10 June 2021.

ESTA believes, however, that a digital euro, even guaranteed by Central Banks, will not be able to provide trust in the same way as cash, because in the public's perception, it will consist of dematerialised money held by private institutions in their name, with the fear that this money will go if the intermediary fails.

I. "*Weakened monetary anchor*"

When looking at CBDCs such as the e-euro, the question might be, as raised by Michelle Bowman from the US FED: "*what is the problem that CBDCs are meant to solve* ?" And the second would then be "*are CBDCs the most efficient way of solving it?*"[7]

I.1 "WHAT IS THE PROBLEM TO SOLVE?"

There are a number of rationales developed in the Impact Assessment for the establishment of the e-euro. We will not comment on those of relevance to the ECB and the Eurosystem (i.e. the "wholesale" use of the e-euro), only those of relevance to business and consumer users of e-euros, as any money is only as good as it is used in society. From that point of view, and according to the Impact Assessment, the primary justification is the "*weakened monetary anchor*" of a declining cash, a trend "*expected to continue*".[8] The corollary consequence is that the crowding out of cash by commercial electronic money is now acknowledged as a stealth "*privatisation"* of money to the sole benefit of the commercial financial sector, a process going against the EU exclusive competence for monetary policy.

The second rationale is arguably related to the increasing place of the e-economy for which cash is not suited as a means of payment. As the Impact assessment puts it, "*Cash, the only current form of central bank money available to the public, alone is not sufficient in the digital age to support the role of public money in the EU's economy*".[9]

We should challenge this as an effective rationale for the e-euro. The e-economy has been able to mushroom without the help of any CBDCs and specific payments instruments have been developed specifically for allowing its development,[10] as well as legislative developments initiated by Member States or the Commission.[11] So the argument of any CBDC being developed to overcome possible insufficient payment innovations required by the e-commerce is hardly credible, and even less so considering that payments in e-euro will be capped, either due to the application of cash payment limitations[12] or indirectly by

[7] Cf " *Considerations for a Central Bank Digital Currency*"; Remarks by Michelle W. Bowman, Member of the Board of Governors of the Federal Reserve System at the Georgetown University McDonough School of Business, Psaros Center for Financial Markets and Policy, Washington, DC 18 April 2023.

[8] IA at page 22.

[9] IA at page 13.

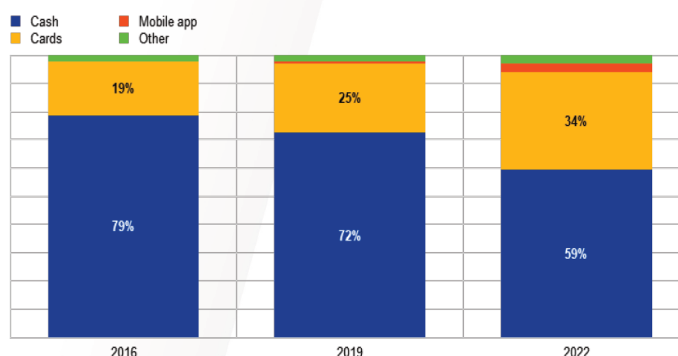
[10] For example, PayPal was initially developed by eBay as an escrow payment system to increase confidence between its members trading on its platform. Other innovations in relation to customer authentication for online trade have also been critical to the mushrooming of e-commerce and the disinhibition of payments on the internet.

[11] E.g. the initial e-Commerce directive (Directive 2000/31/EC of 8 June 2000), and more recently the digital service act, the digital market act.

forthcoming limits in the holding capacity by users for financial stability reasons: the set-up of the e-euro will have no impact above these limits applying either directly or indirectly.

Therefore the main problem that the e-euro is thought to solve is the sharp decline in cash, or, in other words, the stealth privatisation of money by PSPs, which ESTA has raised many times. The solution to the problem might therefore preferably be thought, simply, in the consolidation of cash rather than by reinventing a wheel that may harm cash further without any guarantee that it will be sustainable in the long term. And which in turn, raises a number of serious risks.

According to the European Central Bank's cash use surveys, the decline of cash is continuous and increasing in pace: 79% of all payments were in cash in 2016, then only 72% three years later in 2019 (-7 points), then only 59% (-13 points) another three years later in 2022. This means that the decline in cash has doubled in pace between 2019-2022 compared to 2016-2019: by definition, such a pace is "exponential".



(Source: ECB presentation at the 2023 ESTA Conference in Malta, May 22, 2023).

"*In the Euro area, only 20% of the banknotes today are used for transactional purposes, compared to 35% fifteen years ago*".[13] The question therefore is: how long will monetary institutions continue to watch the decline of cash before taking any serious and robust action to protect it? The response is, it seems, in the e-euro proposal, to which the legal tender proposal is only a "related" proposal. By proposing to address the risk of a weakened monetary anchor in establishing the e-euro, and more specifically by protecting it from anticipated fierce competition from commercial money operators, the EU monetary authorities are in essence stating two important things:

[12] See recital 82: "*While offline digital euro payment transactions have similarities with transactions in cash and should be treated in a similar way in terms of privacy specific holding and transaction limits for offline proximity payments are essential to mitigate AML/CFT risks*,"

[13] ECB working paper No 286, December 2021: "*Central Bank Digital Currency: functional scope, pricing and controls*", Ulrich Bindseil, Fabio Panetta, Ignacio Terrol.

- They acknowledge that central bank money, whether cash until today and e-euro in the future, will be targetted by commercial e-money providers and needs to be protected from their predatory competition;
- They are arguably moving away from their stated "neutrality" to start protecting their own product. This is a very good news, and ESTA suggests that it should also extend to the protection cash, as the preservation of cash is a critical condition for the success of the e-euro, as will be developed below.

I.2 "Are CBDCs the most efficient solution to solve the problem?"

Arguably not, and for the following different reasons.

If the e-euro is meant to address the issue of the "weakened monetary anchor" resulting from diminishing cash, the most obvious solution would be to defend the existing monetary anchor, namely cash, and protect it from unfair and predatory competition. This can be done through other, more specific, measures. It might seem easier to ensure the continuation of an existing form of money which is well-known, well established, well understood by all, and readily available rather than seek to reinvent cash in a digital form. There have been so far numerous papers, reports, working groups, etc. having analysed in detail the issue to solve, and a consensus arises now as to its root causes.

The very nature of the e-euro poses some inherent threats to it: even if transactions and funding or "defunding" will be free of fees for them, consumers are still likely to be required to set up specific accounts to hold e-euros, and acquire specific cards or devices to use their e-euros. All these steps are likely to be subject to fees from commercial financial stakeholders. These costs will therefore have to be benchmarked for the use of e-euros and the question will be whether these kind of stranded costs will be worth the effort at all, for a limited use of e-euros. The precedent might be seen in the various commercial experiences of electronic wallets in the mid 2000, which all failed due to their unease of use and limited purpose compared to electronic debit or credit cards and cash that they were supposed to replace.

Regrettably, the Impact Assessment does not cover at all the expected costs on private users and the possible impact this might have, in relation to their limited ability or desire to hold e-euros. This is, however, a major issue as "*The ability to pay digitally anywhere is one of the basic elements of success for a CBDC*":[14] a widespread merchant acceptance is *the first* condition to the success of the e-euro, which requires a large level of endorsement by consumers. However, the interest in a digital euro will be lower in Member States where consumers already enjoy P2P solutions.[15] That is where the cost vs. benefit to consumers may be challenged.

[14] ECB working paper 286, at page 18.
[15] ECB working paper 286, at page 13.

Similarly, demand for digital currency will be weak in countries where cash use is already low.[16] Therefore, the creation of an e-euro will not, by itself, solve the question of the monetary anchor where cash has gone too low. Cash use will have to be increased first.

In addition, since PSPs and other intermediaries will not be able to charge fees on private use of e-euros, and are subject to capped fees for commercial use (cf Article 17(1) and 17(2)), not least also in consideration with earlier competition cases related to MIFs, the incentive for the intermediaries to engage in the development the e-euro is questionable: why would they like it more than cash, which they did their best to reduce to a minimum in order to maximise the fees from their own cards? This is even more so that intermediaries will not be able to impose other non-digital euro services or products to their e-euro customers (Article 22), with the risk that the cost of providing e-euro service will not be compensated by fees and revenues from other services. Also likely to reduce the attractivity of the e-euro is that it shall not bear interests within the framework of the Regulation (Article 16(8)).

The efficiency of CDBCs to solve the problem should also be assessed under the angle of the risks posed by their establishment. In this regard, the first and most serious risk to stability is linked to an unlimited circulation of e-euros, with the possibility of bank runs happening with just a few clicks before banks and monetary authorities have even time to realise what is happening. Therefore, holding limits will be imposed under the delegated acts of the Regulation. Citizens and businesses will not be able to hold as many e-euros as they wish, as it will be capped most likely to €3,000 (the level under which no serious risk on stability would occur, according to the papers of the JRCs attached to the impact assessment).

This in turn is a serious limitation to the second problem to solve, namely overcoming the "unsuitability of cash as the only money with legal tender for the e-economy", as the cap on holding e-euros will in most cases translate into a payment cap, not withstanding the fact that cash payment limits may apply to payments in e-euros (according to Recital 82).

Therefore, the only critical problem that the e-euro is meant to address is the sharp decline of cash in the euro zone, the causes of which are now well known and formally acknowledged by a number of reports. They have led to legislative measures being adopted in some Member States on cash, and in the EU in the form of the draft Regulations presented on 28 June 2023, namely the draft Regulation on Legal Tender of the Euro Cash (and access to cash) and the two draft Regulations on the e-euro.

Lastly, as is shown by the fact that two proposals for Regulation are presented, it is necessary to address the issue of the distribution and control of the use and holding of e-euros outside the eurozone. This makes the establishment of the e-euro particularly cumbersome as the failure to do it would bear serious risks in relation to the financial stability in the eurozone.

[16] Tanai Khiaonarong and David Humphrey, "*Cash Use Across Countries and the Demand for Central Bank Digital Currency*", IMF working papers WP19/46, March 2019.

No such needs are required in the case of a solution that would primarily focus on a robust defence of cash.

I.3 ALTERNATIVE EFFICIENT SOLUTION

By presenting the draft Regulation on Legal Tender (COM(2023) 364 Final), the Commission just proposed a very efficient solution to protect cash and strengthen the necessary monetary anchor. If correctly implemented, with the relevant delegated acts and appropriate sanctions for failure to comply with it, the draft Regulation on Legal Tender can achieve a lot that the e-euro proposal may not be able to rapidly achieve. It is albeit in a much simpler, cheaper and effective solution than the e-euro. Proportionality calls for all efforts being put into the proposal on legal tender and access to cash.

An additional solution would be to keep a form of monopoly to cash and e-euros in micropayments by implementing a minimum level for any commercial electronic payments, say 10 euros. This could be justified by the soaring costs that small retailers are facing in banking and PSPs fees with the large use of contactless and mobile payments, in addition to the huge societal cost of e-payments.[17] Imposing a minimum threshold for commercial e-payment would also allow to "*deprivatise*" money by securing a reasonable area of exclusivity to central bank money, and secure the critical mass of cash in circulation needed for its sustainability.

If a minimal level of payment is not considered as a suitable solution, an alternative would be to allow retailers to surcharge electronic micropayments for the amount of fees charged by the banks and PSPs, which is currently prohibited by article 62 of the current PSD2.

However, such a surcharge could be allowed in the forthcoming revision of PSD3 presented on 28 June 2023. From a legal point of view, it would be permissible by the mere fact that e-money is not legal tender (only cash is, according to the EUCJ and the draft Regulation) and therefore may be subject to surcharging in relation to its power to discharge from a payment obligation. Reversely, surcharging for cash payments would not be compatible with the definition of legal tender according to the draft Regulation.[18]

These solutions would be compatible with the scope of implementing acts provided in Article 7.3 under article 9.2 or 9.4 of the draft Regulation on Legal Tender.

To those who might think that it would be unfair to secure a monopoly to cash and e-euros for micropayments, for example under 10 euros, **it would only be the counterpart of a *de***

[17] See for example "*Kosten der Bargeldzahlung im Einzelhandel*", Bundesbank study, February 2019: if time is considered in the transaction costs, cash payment are cheaper up to €19.50; if time is not considered, then cash payments are cheaper up to €50 (see page 67-69)

[18] As legal tender is defined as "*entail[ing] their mandatory acceptance, **at full-face value**, with the power to discharge from a payment obligation*".

***jure* monopoly granted to commercial e-money for large amount payments, through cash payment limitations** (possibly also applying to e-euros) and possible e-euros' holding limits which will make payments above the limited amount unlikely. This solution would help to secure a critical mass of cash and reduce the extraordinary increase of banking and payments fees to small retailers which have been soaring due to the massive intrusion of commercial e-money payments in micropayments, through mobile payment and contactless.

This solution might also avoid precipitating the complex, and somewhat risky, introduction of the e-euro by securing a reliable and permanent "monetary anchor" with the preservation of cash. The future of the e-euro is uncertain and will require a huge amount of work before being operational. It would allow the time necessary to create a robust and flawless e-euro, as rushing the process might lead to costly consequences.

Finally, and most importantly, the introduction of the e-euro will not dispense monetary authorities from putting in place a robust defence of cash, since a critical aspect in the introduction of the e-euro is the many risks on stability that would be generated if users were able to hold it without limits. This means that these risks can only be mitigated if strict limits are imposed. Those strict limits in turn mean that the e-euro cannot be the only central bank money available, as they will weaken the necessary monetary anchor. As a consequence, the mitigation of the risk inherent to the e-euro requires that cash volumes are maintained, and even restored in view of the current low levels of cash which justify the e-euro initiative. This therefore calls for a robust defence of cash, as a condition for the success of the e-euro. Therefore, **a solution to the weakening monetary anchor based on a solid defence of cash does not require the establishment of the e-euro, whilst the establishment of the e-euro necessarily requires the defence of cash** to mitigate the inherent risks of CBDCs. The proportionality principle therefore calls for putting in place a robust defence of cash before going into the massive development of the e-euro.

1.4 Ambiguity as to the preservation of cash in the future

As ESTA has already pointed out a number of times, and lastly when responding to the consultation questionnaire of the ECB in March 2023, there is a damageable lack of clarity as to the future of cash and the willingness of EU monetary authorities to preserve cash beyond the establishment of the e-euro. We understand that the e-euro is meant "*to complement, not to substitute*" for cash (Recital 6). However, cash processing being a volume-driven business, the uncertainty as to the EU desire to restore pre-COVID cash levels post sanitary crisis cast some doubts on the future of cash. In its consultation questionnaire, the ECB raised a number of times the short to medium term question of the sustainability of the cash industry, but did not consider the long-term challenges of the cash industry: the concern seemed to ensure that as least one operator would remain in place for as long as it would be needed, but not beyond that point. As if the main issue was to ensure a smooth operation of cash only as long something else (obviously the e-euro) would be able to take over.

ESTA appreciates that the proposal for a Regulation on Legal Tender of the euro cash, which includes provisions to secure access to cash, is a critical step in the right direction. As developed in our position paper on the draft Regulation on Legal Tender, the main risks inherent to the scheme proposed is that the pace of remedies to deficiencies in acceptance of or access to cash may be too long to intervene to be effective, i.e. before cash falls below its critical mass in a number of countries.

As ESTA stressed, the real issue of cash is that of its infrastructure and logistics: it can be quick to go, but far more difficult to restore once it has fallen below the critical point. Maintaining, as the ECB suggested, a spare capacity (i.e. "excess capacity") of cash handling "just in case", e.g. for the cases of failure of a cash operator in the same market or in a neighbouring country, is simply not thinkable in an environment of fierce competition (even when there is only one operator in place[19]) and low margins.

Cash is at a use-it-or-lose-it turning point. Most citizens are unaware of the situation and whilst they are constantly nudged into using cards or electronic payments, they may not realise until is too late the dire implications of their payment choices, which will put this very freedom of choice in jeopardy.

Therefore, it is critical that a very robust defence of cash is urgently put in place to preserve cash from further damage from commercial electronic money predation.

ESTA notes the words in recital 9 of the draft Regulation that the e-euro, as a direct liability from the ECB and the eurosystem, "*should be issued for an amount equal to the face value of the corresponding liability on the consolidated balance sheet of the European Central Bank and the national central banks of the Member States whose currency is the euro*". ESTA is concerned that its introduction **may result in taking existing cash out of circulation** to accommodate the digital euro without unduly increasing the monetary aggregates, in which case, contrary to Recital 6, e-euros would indeed substitute, at least partly, to cash.

1.5 UNFAIR COMPETITION

ESTA noted with interest the developments in the Commission Impact Assessment on the need to protect the e-euro from unfair or predatory competition, which might possibly compromise the development of the e-euro. ESTA believes that the Impact Assessment rightly raises those concerns, as the risk is real, as recent developments on cash have shown.

As the Impact Assessment states, "*while the digital euro would offer an additional choice for users, ensuring a level playing field between payments in digital euro and with private*

[19] See ESTA's position on the second implementation report of the Professional Cross-border CIT regulation No 1214/2011 of 16 November 2011, 27 October 2022.

services is important to ensure competition, and maintain and maximise the overall value of payment services for the EU's economy".[20] The e-euro would to some extent compete with private payments solutions. Intermediaries will therefore require "incentives" to distribute the e-euro.[21] Failing this, the development of the e-euro could also be at risk, the same way as cash supply, which is seen as a cost that commercial banks are keen to avoid, regardless of the needs for cash of their customers.

The risks associated with the distribution of e-euros by intermediaries with commercial conflicts of interests (as they are also marketing their own payment instruments competing with e-euros) is such that the draft Regulation regulates fees to be charged to e-euro users. Article 17(1) provides that no fee shall be charged to private users of the e-euro, and fees charged to business users will be monitored and capped to either the cost of providing the service or the fees charged by the intermediaries for "*comparable means of digital payments*", whichever is the lowest (Article 17(2)). This therefore provides for capping fees to a maximum, defined according to the MIF regulation. In fact, this provision **extends the MIF regulation to the e-euro in the eurozone**.

ESTA has two substantial comments on this. First, the draft Regulation acknowledges in effect the potential predatory role that commercial organisations acting as intermediaries could play for the e-euro, and therefore, finds it opportune to protect it against it. Second, ESTA would argue that by doing so, t**he draft Regulation seeks to protect the forthcoming e-euro to the exact same risks that cash has been exposed to in the last decades**, which has led to the dire situation where it is today, and which justifies the proposal for the establishment of the e-euro. Therefore, the need to act to address the "weakened monetary anchor" resulting from the impact of decades of war on cash could also be addressed by protecting cash in a similar way as the Regulation intends to protect the e-euro.

II. Comments on specific provisions of the proposal for an e-euro

II.1 SCOPE OF THE E-EURO

The choice made for the e-euro is to propose it to all operators: central bankers, businesses and consumers/households. This ambitious choice has a number of implications.

The choice could have been to establish an e-euro for "wholesale" monetary purposes only, either between central banks only or within the financial system with commercial banks and PSPs only. This would most likely have had benefits and would probably have avoided a number of risks identified with the e-euro in relation to the erosion of commercial banks deposits,[22] stability, digital bank runs and privacy.

[20] IA at page 33.
[21] ECB working paper 286, at page 20.
[22] IA, at page 181.

By extending it to all, there are a number of risks to be considered:

- by definition, any digital account may be compromised by hackers and cybercrime, exposing the public to cyber fraud. The risk already exists with commercial e-money, and electronic payment fraud is a major curse. However the temptation to hack central bank e-money accounts will generate a further incentive to fraudsters and criminals;
- the e-euro infrastructure may also be the target of cyber attacks of a terrorist nature, exposing the ECB and the Eurosystem more specifically, whether from hostile states, organised crime and/or religious political organisations;
- holders of e-euro, whether legitimate or not, may seek to hold e-euros in amounts in excess of legal holding limits, therefore undermining the stability of the financial system. The controls required for compliance to limits is a serious challenge, particularly in a multi-States area like the Eurozone comprising of 20 states with different administrative cultures.

II.2 Legal tender

Similarly to cash payment limitations in euro countries constituting restrictions to legal tender, holding restrictions in e-euros which are likely to be limited through implementation acts are a restriction to legal tender of the e-euros, notably since deposits limits will make it difficult to make payments above this limit (regardless of reverse waterfall provision which will require to link a non-e-euro account to the e-euro account).

The exception to legal tender based on proportionality (for natural persons and small businesses) expressed in Recital 18 and Article 9(a), is also of concern when it states that the obligation to accept the e-euro would be complied with by operators who are not in a capacity to accept e-euro, but can accept "*comparable digital means of payment*", namely debit and credit cards. This might be seen as tantamount to giving the status of legal tender to commercial e-money, if in relation to these exceptions the obligation to accept e-euros could be legally satisfied when paying by debit or credit card.

The draft Regulation also states in Article 12 that "*Payees of a monetary debt denominated in euro shall accept payments in digital euro according to the provisions of this Regulation, irrespective of whether they accept payments in euro banknotes and coins in accordance with the Regulation* [on legal tender of cash]". ESTA is unsure of the meaning and impact of this language and fears that accepting e-euros might be considered as a good faith reason for not accepting cash. ESTA would caution that this could be a serious flaw in the strength of legal tender, particularly when, as said earlier, the obligation to accept the e-euro would be deemed fulfilled were merchants be allowed to accept "*comparable digital means of payments*" instead. The loophole would be that refusing cash could be justified by the obligation to accept e-euros, which in turn might also be satisfied by accepting comparable digital

payments in small businesses: the shortcut would then be "no cash and no e-euros, only cards".

II.3 "WATERFALL" AND "REVERSE WATERFALL" CLAUSES

As ESTA stated during the various processes of public consultation on the e-euro, a key issue is the fate of payments received in e-euros which would come in excess to the holding limit ("waterfall") or the need to convert more e-euros than the holding limit would allow in order to make a payment ("reverse waterfall"). Article 13(4) provides for these situations. Whilst the "reverse waterfall" case is rather straightforward (i.e. a conversion from non-e-euro deposits into e-euro for effecting a specific payment), the waterfall case raises a more complicated situation. Article 13(4) provides that the excess in e-euro shall be automatically "defunded" on a linked non-e-euro account. The first consequence will be that the e-euro will be cumbersome to operate without a linked non-e-euro account.

However, nothing seems to be said about what happens to the defunded e-euros, and what their status becomes. Do "waterfall" e-euros simply become commercial scriptural euros, or are they kept as e-euros on another specific e-euro account? If they survive as e-euro, where will they go, and on whose account? And if not, will they be written off as e-euros and simply become commercial euros? Article 13(4) says nothing on this and neither do its related recitals 36 and following. This is critical, as monetary policy being an exclusive competence of the EU, this implies that the emission of e-euros is an exclusive competence of the ECB (as stated in Article 4). This also means that the *destruction* of e-euros is also an exclusive competence of the ECB. However, nothing is said in the draft Regulation on the destruction of e-euros.

The waterfall clause also has a serious drawback in relation to the very purpose of the draft Regulation which is to provide a Central Bank guaranteed e-payment instrument: in case a payment is received which leads to exceeding the maximum holding limit (which triggers the waterfall system), this means that only part of the payment would indeed be guaranteed by Central Bank's money, i.e. the part that fits within the payee's holding limit, not the part of the payment beyond this limit. This defeats the very purpose of any CBDC.

II.4 PRIVACY AND DATA PROTECTION

The Regulation provides that only very limited data related to the use of e-euros will be kept, and this excludes any transaction-related data, which shall not be retained by intermediaries, not even the ECB or national central banks (Article 37(2)). The idea is to make it as private as cash.

However, the very nature of e-activities of any kind is that they always leave a digital trace: data will be generated. Prohibitions to use this data may be imposed by law, but there are always two conundrums : the risk of operators not complying with the law, in an environment where "data is the new oil". Or a change of circumstances leading to a change of the law, for specific, overarching reasons that may subsequently appear, where data will then be used, possibly also retroactively.

This issue has been put in very unambiguous terms by the UK Parliament, in response to a Bank of England report on a digital Pound. "*To prevent their use in large-scale criminal activity, any CBDC system could not support anonymous transactions in the same way that cash can be spent anonymously. While there are design options that would provide some privacy safeguards, technical specifications alone may be insufficient to counter public concern over the risk of state surveillance.*"[23] As the UK Parliament concludes, any institution launching a CBDC may be drawn into "*very controversial debates*" on privacy.

II.5 HOLDING LIMITS

As said earlier, the need to restrict the ability of economic operators to hold e-euro is a serious limit to the role and function of the e-euro. ESTA understands that these limits are critically important to the stability of the monetary and financial system, which is precisely why an e-euro cannot fulfil the same core functions that cash does, as it bears inherently a major risk that the imposition of holding limits are meant to mitigate.

However, as explained in the Impact Assessment, central bank money is key to generating trust in commercial e-money by virtue of its "*redeemability*", as stated above. The stability of the financial system is fuelled by the trust of depositors that anyone will be able to withdraw their deposits from their bank at any time (obviously not everyone at the same time). Nevertheless, the confidence that anyone can withdraw their deposits from the financial system, should they so wish, is critical to the stability of the system.[24]

The e-euro could, in theory, fulfil this role and generate trust. However the mere existence of holding limits will compromise its ability to generate trust, as the level of these limits (likely 3,000 e-euros, according to the JRC's papers) will be much too low for that (compared for example to the 100,000-euro "haircut" guaranty under the financial stability provisions). This is particularly so as the public may have difficulties accepting e-euros considering the hurdles to using them in comparison to the level to which they will be able to hold them (see section I.2 above). Therefore, the e-euro might not be in a position to generate trust as cash does, precisely because of its holding limits.

[23] "*CBCDs: a solution in search of a problem*" Report from the UK Parliament, 13 January 2022, response to the Bank of England report on a digital pound.

[24] See notably F. Seitz and M. Krüge " *The blessing of cash*"; International Cash Conference 2017 – War on Cash: Is there a Future for Cash? 25 – 27 April 2017

II.6 Use of the e-euro outside the eurozone

The cross border use of the e-euro may have some interest but comes at a risk. The risks are those of financial stability in case of asymmetrical cross border holdings of e-euros, of the transmission of shocks and crisis due to an increased linkage between economies: "*CBDC creates a new international arbitrage condition that links together interest rates, the exchange rate and the remuneration of the CBDC. [….] This leads to stronger exchange rate movements in response to shocks in the presence of a CBDC – foreign agents rebalance much more into CBDC than they would into bonds*".[25]

The establishment of the e-euros therefore requires the setting of rules related to the distribution of the e-euro outside the eurozone to prevent risks being imported from other countries. This is not required in the case of cash, which therefore does not expose the Eurosystem to this risk. It therefore adds to the complexity of the establishment of the e-euros, compared to a solution which would primarily seek to robustly defend cash.

Conclusion: The e-euro, "a solution in search of a problem"?

ESTA welcomes the proposal for a Regulation on the establishment of the e-euro, however, not for what it brings but for the reasons which justify it, namely the awareness of a "*weakening monetary anchor*". This awareness is also the consecration of the impact of decades of war on cash. Instead of embarking on a robust defence of cash, the choice appears to be to reinvent the wheel and create a new form of cash.

The difficulties in the establishment of the e-euro are not to be underestimated. The risks associated with it are also considerable. To quote a famous British Prime Minister: "*Don't argue the matter, the difficulties will argue for themselves*".

The difficulties are twofold: those needing to be overcome in order to establish the e-euro, and those which will need to be overcome once it is established. The latter are arguably more critical than the former as they might put the entire stability of the monetary and financial system at risk. From a proportionality point of view, it is therefore questionable if the e-euro is the most efficient solution as a remedy to the sharp decline of cash, rather than putting in place a robust defence of cash.

The draft proposal on legal tender (and access to cash) presented on 28 June 2023 is by contrast a very appropriate response which needs to be further strengthened through its implementation acts. If sanctions to be put in place by Member States are appropriate and deterrent enough, it will play a substantial role in ensuring that the monetary anchor of central

[25] "Ferrari, M., Mehl, A. and Stracca, L. (2020), "*The international dimension of a central bank digital currency*", VoxEU, 12 October", quoted in ECB working paper 286, December 2021.

bank money is not weakened further, but also restored, which is the purported objective of the e-euro proposal.

The uncertainty of CBDCs is such that, for example, the Swedish Central Bank has announced that it is stopping work on the e-krona, as it fails to see a "*sufficient social need*" for it,[26] whilst it continues to look at the technicalities of the e-krona. Similarly, in the US, the FED is currently working on two questions before progressing on the e-dollar: "*what is the issue to be solved with it?*" and "*what current frictions exist or may emerge in the payment system that only a CBDC can solve or that a CBDC can solve most efficiently?*".[27] These questions are highly relevant to the digital euro proposed which is why ESTA started this position paper by raising them.

This converges towards the conclusion of the UK House of Lords Economic Affairs Committee:

> "*We took evidence from a variety of witnesses and none of them were able to give us a compelling reason for why the UK needed a central bank digital currency. The concept seems to present a lot of risk for very little reward. We concluded that the idea was a solution in search of a problem.*"

Therefore, whilst there may a be a temptation to let cash continue to decline in the longer term as the e-euro might at some point take over,[28] ESTA would urge putting in place a robust defence of cash as cash may reach its critical mass level sooner than expected and in any case before the e-euro may be up and running and before it might be able to substitute for it. Therefore ESTA suggests that it may be necessary to:

- Restore cash levels as quickly as possible and put in place a robust defence of cash, as in any case the e-euro will not be able to operate without cash;
- Look at competition issues related to the fierce competition of private/commercial providers of electronic payment solutions and prevent unfair competition against cash from commercial e-money operators, in a similar way the draft Regulation intends to protect the e-euro from their unfair competition;
- Establish through delegated/implementation acts a minimum threshold for commercial electronic payments of €10, under which only cash (and e-euros in due course) payments would be allowed. This is critical to secure a critical mass of cash in circulation. Alternatively, impose surcharging on electronic payments under this threshold in order to cover the business and societal costs of micropayments in commercial electronic money;
- Secure very rapidly the adoption of the draft Regulation on Legal Tender and access to cash, which is urgently needed.

[26] https://www.riksbank.se/en-gb/payments--cash/e-krona/

[27] Cf " *Considerations for a Central Bank Digital Currency*"; Remarks by Michelle W. Bowman, Member Board of Governors of the Federal Reserve System at the Georgetown University McDonough School of Business, Psaros Center for Financial Markets and Policy, Washington, DC 18 April 2023

[28] As ESTA pointed out to the ECB in the 2023 consultation process which took place on the "concentration" of the CIT industry, in relation to the continuity of the cash cycle.

This would allow enough time to thoroughly look at the needs and challenges of the e-euro.

ESTA hopes that these comments will be of interest and remains available to develop them further.

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