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25th June 2023

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Dear Sirs,

Addendum on 'central bank money' to our response to the survey connected to the Bank of England's 'The digital pound: Consultation Paper' of February 2023

This is an addendum to our response, dated 11th May 2023, to the Consultation Paper for the 'Britcoin' central bank digital currency (CBDC) project.

Its subject is under what conditions the 'digital pound' can be considered as 'central bank money', and can have the effect of ensuring 'ongoing retail access to central bank money'.

This phrase is used to denote a main purpose and value of CBDC in the publication by the Bank for International Settlements entitled 'Central bank digital currencies: ongoing policy perspectives – May 2023'.

Since the Bank of England provided the secretariat for this publication, I presume that you are fully familiar with it, and were possibly even the author of it.

Physical cash is the payment means that provides current retail access to 'central bank money'.

The main conditions for the 'digital pound' to fulfil the purpose stated in the BIS document are that it must be exchangeable for the other forms of UK 'central bank money' instantly and **at par**.

There can be no delay in settlement: settlement must be in real time.

Settlement must also be in full and with finality: there can be no deductions-from-face-value between the act of the tendering of the 'digital pound' by a payer and the settlement of the full value to the payee, and there can be no possibility of a reversal of the payment without the agreement of the payee.

The three forms of 'central bank money' and the definition of 'at par' in relation to each of them are:

- government debt – 'at par' means at face value adjusted (i) for any change in the yield-to-maturity on such debt between its date of issuance and the date of the trade (or, in the case of variable-rate debt, any change between the current coupon and the yield now prevailing from the trade date to the next date at which the coupon will be re-set), and (ii) for interest accrued between the most recent coupon payment and the trade date;
- cash – 'at par' means at face value;
- a credit balance on an account at the central bank – 'at par' means at face value.

A distribution model like exists in the Visa and Mastercard systems – involving one or more deductions along the way like 'interchange fees' and/or 'scheme fees' or however they are described – is incompatible with 'central bank money'.

Settlement of Visa and Mastercard payments involves a delay: a merchant, when accepting a card payment, receives a guarantee of future payment, against which the merchant feels comfortable in releasing goods or performing a service. The settlement follows 2 or 3 business days later, minus all of the deductions.

If deductions-from-face-value and non-instant settlement were to be features of the 'digital pound' when it was eventually put into production, the 'digital pound' could not be said to be a 'central bank digital currency', because it would not be a 'central bank currency', and its labelling as a 'central bank currency' would be a misrepresentation.

A subsidiary point is that the 'central bank money' must never become subject to the interventions of intermediaries whose currency is 'commercial bank money', such as:

- by intermediaries identifying flows amongst their clientele that could be netted: every order to pay the 'digital pound' must create accounting entries for the full amount at the Bank of England, in the same way that a client's order for an exchange-traded financial instrument must be passed across the floor of the exchange and not offset at the level of the client's broker against equal-and-opposite orders the broker has received from other clients;
- by intermediaries becoming a legal party to any payments using the 'digital pound'. The contractual situation for physical cash must be preserved: banks, ATM operators, security carriers and so on are involved in its distribution, but they are not parties to its usage between a payer and a payee.

The blurring of parameters around 'central bank digital currency' can be attributed to the participation of the European Central Bank, with their 'digital euro' project, in the discourse being carried out by the world's central banks.

The ECB website contains the following definition of 'central bank money':

What is central bank money?

The money that we at the ECB create is called central bank money. The cash in your wallet or purse is central bank money. In fact, banknotes and coins are currently the only kind of central bank money available to the public.

Central bank money is also called public money because it is issued by a public institution – the central bank – and is therefore backed by the public sector.

This is a misleading definition, but fits with the flawed structure of the euro in which there is on the one hand no genuine 'central bank money', but on the other hand the ECB and the Eurosystem have admitted all manner of assets to their list of ones eligible for monetary and payment operations that fail the definition, even if the obligor under many of them can be classified as a 'public institution'.

'Central bank money' is a liability of a sovereign country in its own currency, of which it is the sole user. While one of its three forms (government debt) is a direct liability of the government treasury, the other two - cash and a credit balance on an account at the central bank – must be subjected to a reinsurance mechanism to make these direct liabilities of the central bank become the indirect liabilities of the government treasury.

Within that structure 'central bank money' is free of CREDIT RISK because the sovereign country has powers available to it that ensure it need never default – e.g. the sovereign country is able to instruct its central bank to print more money in its sovereign currency to pay its debts as they fall due.

'Central bank money' is by definition 'backed by the full faith and credit' of all tax-liable entities – natural and non-natural legal persons – in the country of the currency and the central bank concerned.

The euro fails a number of the tests of having any 'central bank money', like no reinsurance mechanism between the ECB and member state government treasuries for cash and for balances on ECB accounts (let alone for one member state government to be responsible for the balances on accounts at the national central bank of a different member state), that none of the member states are the sole user of the currency, and that none of the member state governments can instruct either their own national central bank or the ECB to issue currency so as to avoid a default. It was necessary to set up the European Stability Mechanism to address this last point.

For further explanation of the flaws in 'euro central bank money', please refer to any of these publications:

(i) R Lyddon, *The shadow liabilities of EU Member States, and the threat they pose to global financial stability'* (The Bruges Group, 2023, ISBN 978-1-8380658-9-8);

(ii) B Reynolds, D Blake and R Lyddon, *Managing Euro Risk: Saving Investors from Systemic Risk* (Politeia, 2020, ISBN 978-1-9163575-1-8);

(i) Reynolds, Barnabas, 'Plain Sailing for the ECB? Look out for the rocks!', *Politeia*, 2023 - https://www.politeia.co.uk/plain-sailing-for-the-ecb/

It serves the interests of the ECB that 'central bank money' be far more widely defined than I have done. The ECB's definition has in effect been extrapolated from its decisions to admit such a wide range of securities to its eligible list. It does not serve the UK's interests to accept – either within the 'digital pound' project or elsewhere – the ECB's wider definition. It risks tainting the UK's precious commodity – our genuine 'central bank money' in pounds sterling.

If there is to be a 'digital central bank currency' in pounds sterling, this precious commodity must pass between payers and payees in real time, in full, and intact as 'central bank money'. Deductions-from-face-value, a settlement delay and a role for intermediaries in its usage will taint and debase it. As a result the distribution model for the 'digital pound' cannot be one based on the principles of the Visa and Mastercard ecosystems.

BL/23.6.23