THE INVESTMENT ASSOCIATION

Response to consultation

THE DIGITAL POUND: A NEW FORM OF MONEY FOR HOUSEHOLDS AND BUSINESSES?

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 46% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

- The proliferation of new and emerging technologies will undoubtedly accelerate the UK's movement towards a digitised economy. While the banking and payments section of the economy stretches beyond the IA's central remit, we acknowledge that it is important for the Bank's strategy to evolve and we agree with the Bank's assessment that foresees a future need for retail digital pound. This will ensure that money issued by the Bank remains available and useful in an ever more digital economy.
- The investment industry requires, in the medium term, an on-chain mechanism for digital settlement that is at least as trustworthy and reliable as the settlement systems that investors have historically made use of in traditional, off-chain, markets.
- While the IA has an open mind on the best way to achieve this, it is vital that the solution provides genuine utility across wholesale markets and is able to act as the mechanism for market settlement. We are pleased to be a part of the Bank's co-creation group on Synchronisation to ensure that the connections between RTGS and other ledgers are able to deliver effectively for the buy-side.
- We have not directly addressed the specific questions in the retail-focussed consultation document, but make some general comments about the imperative of wholesale access to central bank money and emphasise the need for further work in this area in order to achieve its potential.
- We suspect that the politicisation of central bank digital currencies will become more prominent in the near- to mid-term, as is the case currently in the US. To ensure that individuals and households continue to trust the Bank as a reputable issuer of currency, particularly over private issuers, we believe that it is important that the Bank proactively shapes public perception by developing a clear and compelling message that instils trust and confidence in the proposals. In particular, effective messaging will be crucial in establishing a foundation of transparency, security, and inclusivity.

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Camomile Court, 23 Camomile Street, London, EC3A 7LL
www.theia.org

Innovation and Operations Unit

@InvAssoc @The Investment Association

General comments

Digital markets

The advent of new technologies, particularly decentralised ledger technology ("DLT"), has enabled the emergence of additional sources of private money, such as cryptocurrencies, stablecoins, and tokenised deposits. In an increasingly digitised economy, household and business demand for privately issued settlement tokens is only likely to increase, particularly if specific tokens issued by banks and/or non-banks are deemed suitable as a means of payment in the future as proposed in HM Treasury's Financial Services Markets Bill.

The IA recognises the adverse impact that the uptake of privately issued settlement tokens may have on the ability of the Bank to pursue its policy objectives, least not price stability and market stability. Therefore, the IA agrees with the Bank of England's ("Bank's") assessment that a retail digital pound will indeed be needed in the future to fulfil its supervisory objectives and maintain individuals' trust in the monetary system.

Furthermore, the IA broadly agrees that a retail digital pound provides a unique opportunity to facilitate innovation in the payments industry. Specifically, we welcome the opportunity for Payment Interface Providers and External Service Interface Providers to provide novel payment, savings and investment services to businesses and households which, in turn, could help to support the UK's retail investment strategy. Nonetheless, we acknowledge that a cost-benefit analysis will be necessary to outline the likelihood and magnitude of retail consumers realising these benefits.

Wholesale usage

Despite our general conceptual support for a retail digital pound, it is the opportunities presented by extending access to central bank money within the wholesale arena that we are most supportive of.

Just as DLT has enabled the proliferation of privately issued settlement tokens, it has also provided the foundations for the tokenisation of financial assets, including securities, bonds, and private equities. Tokenised securities are no longer a new concept. Indeed, they are growing in popularity in major jurisdictions around the globe, with $4-5 trillion worth of traditional assets forecast to be available in tokenised form by the end of this decade[1].

The benefits of tokenised investible assets are well documented and provide multiple benefits for retail and institutional investors. In recent months there have been many examples of digital issuance in the bond market, mainly on the continent. Traditional equities are already an effective market and so the scope for change here is limited. Private assets, however, are a huge largely untapped opportunity and many firms are looking into how tokenisation could unlock these markets by reducing the minimum investment level and opening up new capital for the economy.

Given the opportunities presented by tokenisation, the IA advocates for the use of DLT in capital markets as a means to enhance market efficiency, deliver discernible benefits to investors, and affirm the UK's position as the global hub for investment and financial services. However, with the proliferation of market tokenisation, the industry will require an on-chain mechanism for digital settlement that is at least as trustworthy and reliable as the existing settlement systems that investors have historically made use of in traditional, off-chain, markets.

While it is true that on-chain settlement could be facilitated via privately issued tokens, notably stablecoins, we do not believe that this approach could be viable nor scalable in mainstream markets. Indeed, research undertaken by the Bank of International Settlement[2] has concluded that use of stablecoins as a means of settlement, whether across capital markets or economy more broadly, could jeopardise the "singleness" of

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[1] Citi Group (2023) have forecast that between $4-5 trillion of traditional assets will be tokenised by 2030.
[2] Bank for International Settlement (2023) "Stablecoins versus tokenised deposits: implications for the singleness of money"

money due to the varying creditworthiness of token issuers, as was the case during the era of free banking. Any departure from the singleness of money would not only be inefficient but could also quickly create credit risks that decrease market stability and undermine individuals' trust in money.

To overcome the inherent risks posed by stablecoins as a means of on-chain settlement, tokenised deposits and/or proprietary settlement tokens could be used instead. In this instance, settlement tokens would be used in a way that mimics the practice in the current monetary system of debiting and crediting the account of the sender and receiver respectively, together with concurrent settlement on the Bank's balance sheet. While settlement at the Bank could be processed in keeping with the existing approach of netting, a wholesale central bank digital currency ("CBDC") would be desirable due to its ability to enable atomic settlement and mitigate credit risks during the payment leg of the settlement cycle.

We recognise that at present, the Bank does not envisage a formal digital pound at wholesale level, with the preference to progressing a parallel workstream on an upgraded real-time gross settlement system ("RTGS"). While the IA has an open mind on the best approach to take, it is vital that either solution provides genuine utility across wholesale markets and is able to act as the mechanism for market settlement as outlined above. Regardless of the mechanism, enabling 24/7 settlement of tokenised assets in central bank money is a key objective for the investment industry, in opening up a pathway for the widespread tokenisation of investible assets like bonds, stocks and other securities, as well in enabling tokenised investment funds. We understand that the upgrade programme is likely to deliver a solution sooner than a formal wholesale digital currency would, and so we are pleased to be a part of the Bank's co-creation group on Synchronisation to ensure that the connections between RTGS and other ledgers are able to deliver effectively for the buy-side.

From a slightly different angle, we are also keen to obtain more clarity on the ability of firms to accept the retail digital pound as a form of payment and their ongoing ability to hold it. Noting the intended £20,000 limit for wallet utilisation, it will be important for firms to understand the day-to-day operational mechanics at the point of retail-wholesale interaction. Clearly, firms will need to be able to take a digital pound as a form of payment, but presumably in order to then hold it overnight, for example, it will have to be converted it into commercial bank money. Clarification on the operational mechanics around the retail-wholesale boundary will be appreciated as the proposals are developed.

Outlook and next steps

Going forward, we would like to reiterate the importance of the Bank harnessing consistent and effective messaging that instils public trust and confidence as these proposals develop. We suspect that the politicisation of CBDCs will become more prominent in the near- to mid-term, as we are seeing now in the US. To ensure that UK individuals and households continue to trust the Bank as a reputable issuer of currency, we believe that it is critical that the Bank disseminates effective messaging that enshrines user privacy, security, and inclusivity.