FedFin Client Report

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BIS Finds Ways to Give Nonbanks Payment-System Access, Increase CBDC's Inclusion Impact

Client Report: CBDC12

Executive Summary

As promised, we turn here to an in-depth analysis of a paper from global regulators on whether CBDC contributes to financial inclusion – one of the most vital arguments from those advocating CBDC in the U.S. and in many other nations. The paper is not analytical, as it is based on interviews with nine central banks exploring retail CBDC, but all of those interviewed view CBDC as an effective tool to promote inclusion if designed to do so and the paper also surveys research to back up its findings. It details numerous ways CBDC could prove inclusive, including a first-time assessment of how making certain CBDC aspects programmable and how regtech could permit nonbanks to enter the CBDC payment system without undue risk. The report does not reach any conclusion about CBDC desirability or inevitability, but the central bankers participating in this study see many benefits from retail central-bank services offered by central banks at low prices, using APIs to separate personal from transaction data. The Federal Reserve's CBDC discussion draft does not seek specific comment on these options, instead offering a forum for broad comment on an array of pros and cons for a U.S. CBDC (see FSM Report **CBDC10**).

Analysis

The report first categorizes barriers to inclusion, which include:

- geographic distance from banking centers;
- lack of key tools such as identification methods for individual consumers;
- an "informal" approach to consumer finance lacking effective safeguards;
- large populations with a strong preference for unofficial payments methods;
- market-structure issues (e.g., limited competition, embedded inefficiencies, and low profitability associated with serving excluded groups);
- barriers to access such as low income, rural location, or visual impairment;
- lack of education and financial literacy; and
- low trust in existing financial institutions.

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Given this, CBDC is said to likely increase inclusion, especially for remote regions and digital-payment services that would be insufficiently profitable for private entities, doing so in concert with other efforts (e.g., bringing nonbanks into the payment system, speeding transaction clearing and settlement). The paper describes how inclusion via nonbanks might be achieved without undue risk if programming features limited paying-service provider discretion, suggesting also that lower capital holdings could lead to better pricing and market outreach. Some central banks believe that CBDC acting in concert with other efforts can meet inclusion goals, but several argued for accelerated CBDC implementation, addressing the design issues essential for inclusion. These features include:

- promoting a two-tier architecture akin to that proposed by the BIS for retail CBDC (see *Client Report* **CBDC6**);
- expanding nonbank access to the payment system;
- offering robust, low-cost, public-sector technology (e.g., separating transactions from personal data, ensuring account portability, embedding payments into the internet of things, and better offline connectivity);
- facilitating CBDC enrollment and understanding (e.g., by developing remote interfaces, KYC methodology, etc.);
- fostering inter-operability; and
- obtaining stakeholder buy-in and ensuring consumer privacy. These two design features are considered the most difficult to overcome, although action on pricing and transaction isolation from personal data would resolve at least aspects of them.

The report also notes that CBDC may require nations to pass new law and issue new rules.

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