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The Distributed Ledger
Blockchain, Digital Assets and Smart Contracts

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Centralising Cryptocurrencies: What's Next for the UK's Digital Pound?

Responses to the joint Bank of England and HM Treasury consultation paper on a "digital pound" are in, with over 50,000 submissions in total. The scale of feedback shows significant interest in a discussion which could pave the way for wide-reaching reform of the UK payments sector. Both the Bank of England and HM Treasury have indicated that it is too early to decide whether to introduce a digital pound. That said, they also concluded "it likely that a digital pound would be needed in the future", so there is a sense that this is a question of how and when and not if.

In their latest joint publication on 25 January 2024, the Bank of England and HM Treasury share a summary of feedback received and set out their next steps in the digital pound project (Response Paper). The overarching message is that: (i) the proposed design of the digital pound as set out in the consultation paper of February 2023 is seen as "reasonable" and "well-grounded"; and (ii) further preparatory work is required as part of an on-going "design phase" of the digital pound.

What Is the Purpose and Proposed Design of the Digital Pound?

The Bank of England and HM Treasury set out their vision of a digital pound in the Consultation Paper. Within that, they identified two primary issues which a digital pound may help address:

- **Risks to the uniformity of money.** The on-going decline in the use of cash, coupled with the continued emergence of digital currencies provided by private issuers (*e.g.*, financial institutions or tech firms), increases the risk that the UK's payment space may become fragmented, with a material portion of transactions undertaken in different units of account which may not be readily convertible to pound sterling. This potentially undermines the ability to maintain price stability centrally through monetary policy, and may also restrict the ability of UK authorities to effectively regulate large portions of the UK payments system.
- **Risks to competition in payments.** Regulators have acknowledged that the current concentration within the payments sector presents a long-term risk to competition, and that Big Tech firms may exploit entrenched market power, which could worsen consumer outcomes.

It is thought that a digital pound could support uniformity of money by offering a digital currency which maintains access to central bank money (reducing the incentive to use non-sterling alternatives), while supporting innovation and competition through an open platform from which the private sector can develop future digital services.

The proposed model for the digital pound set out in the Consultation Paper comprises the following components:

- **The platform model and public-private partnership.** The digital pound would be issued by the Bank of England, with its value equal to its cash equivalent in pound sterling. While the Bank of England would provide the central infrastructure (including a core ledger), the private sector would provide the interface between the Bank of England and users (*i.e.*, by providing wallets and other services).
- **Data protection and privacy.** A digital pound would be private (and subject to privacy and data protection laws) but would not be anonymous in the interests of preventing financial crime. "Payment interface providers" (*i.e.*, wallet providers) would identify and verify users, but any personal data would be anonymised before sharing with the Bank of England for the purposes of maintaining the core ledger.
- **User experience for households and businesses.** It is expected that users (whether or not in the UK) would access their wallets through smart devices and smart cards for everyday payments (online, in-store and person-to-person), though there would be a limit on the size of holdings for an initial period. The digital pound would be seamlessly exchangeable with other forms of money and, like a banknote, would not automatically accrue interest.

Key Issues Raised in the Responses

Responses to the Consultation Paper covered a range of issues. Overall, respondents from a cross-section of industries supported the proposed design given the objectives of the digital pound project. However, there were calls for an open debate and active engagement with stakeholders, and the feedback highlighted a range of themes, including these:

The Declining Use of Cash

Concerns have been raised that the introduction of a digital pound may further accelerate the declining use of cash. In particular, there have been calls for the government to legally protect access to cash. The Response Paper makes clear that the digital pound is intended to complement and not replace cash, and reaffirms the commitment of the Bank of England and the government to maintaining access to, and meeting demand for, cash. It is noted that this commitment is already enshrined in existing legislation and industry-led initiatives.

A Mixed Payment Ecosystem

While there has been support for a mixed payment ecosystem, in which cash co-exists with other forms of digital currencies (whether a digital pound or other private digital payment), some respondents flagged the challenges that such competing demands may place on existing payments infrastructure, requiring greater coordination and prioritisation of payments initiatives and resources. The Response Paper notes that the future success of a digital pound "would depend on close collaboration with the private sector."

The Platform Model and Public-Private Partnership

Feedback shows support for the platform model, with the Bank of England providing the core infrastructure (*i.e.*, the ledger) and payment interface providers hosting "pass-through" wallets (but not holding funds directly). But there have also been calls for clear and fair regulation of such intermediaries, and greater clarity as to how the existing regulatory frameworks may need to be expanded to cover a digital pound. Questions have also been raised as to whether there is a viable business model for payment interface providers. The Bank of England and HM Treasury have committed to prioritise efforts to better understand the associated costs and revenues and potential business models for such providers.

Maintaining Privacy

There was broad support of proposals to restrict the Bank of England's and government's access to personal data arising in connection with a digital pound. Many respondents expressed concern that users' privacy rights would nevertheless be breached for surveillance purposes. Whilst the Response Paper reiterates that a digital pound would *not* be anonymous in light of the need to fight financial crime, it said that any legislation introduced for the digital pound "would guarantee users' privacy", and it commits to exploring technological options to restrict the Bank of England accessing personal data through the core infrastructure.

In-Scope Payments

Prioritising in-store, online and person-to-person payments has been broadly supported, though some respondents have raised further use cases, including payments between individuals and governmental organisations, such as taxes, reliefs, subsidies and pensions.

Programmability of Payments

There was mixed feedback on programmability features in a digital pound (*e.g.*, smart contracts allowing automated payments where specified conditions are met). For those in favour, the view was generally that programmability should be implemented as a service by private intermediaries, and not as a function of the core ledger operated by the Bank of England. According to the Consultation Paper, this is a view shared by the Bank of England and HM Treasury, which have also confirmed that automated payments would be subject to "a stringent and robust regulatory framework and always require user consent."

Next Steps for the Digital Pound

We are still in the "design phase" of the digital pound project, and a decision on whether to commence the "build phase" is not expected until 2025 or 2026. The Bank of England and HM Treasury maintain that it is not practicable to focus on more than one model, and so the intention is to focus resources on the proposed model set out in the Consultation Paper, given its overall endorsement by respondents.

The design phase is expected to have four key workstreams:

- **Experimentation and proofs of concept:** establishing the technological feasibility of the various design choices.
- **Blueprint:** developing a comprehensive blueprint of the digital pound architecture.
- **National conversation:** undertaking a programme of engagement with stakeholders.
- **Assessment:** evaluating the costs and benefits of a digital pound.

If a decision is taken to proceed with a digital pound and move to the build phase, a prototype would first be developed, based upon the final blueprint, in a simulated environment, after which live pilot tests would commence. It will be Parliament, however, that has the final say and the government has committed to introducing primary legislation before launching a digital pound. That process is expected to trigger further public consultation, so there are a few more hurdles to go before the digital pound becomes a reality.