

Digital Euro

Setting the course for the future of our
monetary system

Position of the National Association of German Cooperative Banks (BVR) 10/2022



National Association of German
Cooperative Banks



Foreword

Digital Euro – Setting the course for the future of our monetary system

The introduction of the digital euro can make an important contribution to securing Europe's digital and monetary independence. This is absolutely to be welcomed in view of current geopolitical challenges. However, its introduction also represents a fundamental change of course that will not only shape our payments system for decades to come but may also have significant consequences for financial and monetary policy, as well as the real economy. The form it will take should therefore be carefully considered.

The design of the digital euro raises numerous questions, some of which affect and may have a lasting impact on the foundations of the business model of banks. As part of the German banking industry, we would therefore like to be involved in the process of introducing the digital euro at an early

stage and to highlight the opportunities and risks. We, the German Cooperative Financial Network, want to ensure that we can continue to fulfil our tasks of financing SMEs and providing them with credit in the future.

Greater political discussion and monitoring of the topic are urgently needed in view of the European Central Bank's (ECB) ambitious timetable for introduction of the digital euro. According to ECB President Christine Lagarde, the digital euro could be in circulation as a means of payment as early as 2025; its design is to be defined as early as autumn 2023. In addition, if it is equipped with the essential features of cash, such as anonymity and privacy protection, it can act as a digital complement to cash and represent an important step on the path towards the future of payment transactions.

In this paper, we highlight the risks to the banking industry and real economy of introducing the digital euro and show ways to shape it and create an innovative monetary system, whilst preserving the important function of banks.



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The introduction of the digital euro requires fundamental decisions to be made

In order for the many economic opportunities of the digital euro to come to fruition, the form it will take is of crucial importance. To put it simply, two versions are under consideration: A **bearer version**¹ (like cash) and an **account version** (like today's bank accounts).

▪ "Bearer version"

The digital euro could be issued by the ECB as digital cash in the form of tokens. The banking industry could obtain these like cash and issue them to citizens in wallets – analogous to the dispensing of cash at ATMs. The digital euro as a token could enable largely anonymous payments; in principle, it is the equivalent of cash in the virtual arena and would ideally also be usable offline. The digital nature of the digital euro allows it to be equipped with features such as a limit (maximum holding amount, analogous to a full wallet), so that money laundering and other disadvantages of cash can be effectively countered.

▪ "Account version"

The ECB could also circulate the digital euro conventionally via accounts. The balances would then be held either directly in private ECB accounts or held in trust, as off-balance-sheet items, in accounts at private banks. This form is a copy of today's bank accounts under the label of the ECB and would therefore rank alongside the services previously offered competitively by commercial banks, without enabling any benefits in terms of economic efficiency. Furthermore, it would be in direct competition with the money currently held in current accounts (giro money) and in the form of other deposits by companies and households at banks. Yet these deposits are the basic prerequisite for supply of credit to the economy, i.e. to all consumers and companies.

In the current debate, there are increasing indications that the ECB is leaning strongly towards an "account version" in its deliberations. This could

lead to a **fundamental restructuring of the monetary system.**

Considering the economic effects of the digital euro

The ECB has already clearly stated that the digital euro should in principle be held and used by citizens free of charge. Whether it will also become an attractive form of money storage or even investment is yet to be decided; negative interest rates or caps for consumers are possible measures to limit this. Clarification of these issues is urgently needed, as otherwise the introduction of accounts for holding the digital euro may have serious negative consequences for the banking industry and real economy without providing any innovative benefits.

1. Flexible credit supply is important for the economy

If the ECB were to make the digital euro an attractive and safe investment, there would be the threat of a significant transfer of funds from conventional bank deposits to the digital euro. Depending on the conditions set by the ECB or in the event of a crisis of confidence, many customers could withdraw their funds from bank accounts at short notice and convert them into digital central bank money.



Scenario analyses by the ECB have illustrated that, if there were no limit on use, around **€7,500 billion**, or around 50 percent of the total customer deposits of banks in the euro area, could be switched to the digital euro.

A massive shift in bank deposits would primarily hit the lending capacity of those banks whose focus is on the deposit and lending business for the real economy. At the same time, the digital euro in this form would exacerbate the crisis as the ability to lend would be significantly impaired for the entire financial sector – precisely when it is needed most. Therefore, it must be ensured that banks will continue to have a stable deposit base in the future to be able to provide a stabilising supply of credit in the economic cycle.

¹ A bearer instrument is characterised by the fact that the person who owns it can also directly dispose of the value. The transfer can be made directly between two parties,

without the involvement of a third party. This can be implemented in the form of a "token" (technical term).

However, the ECB's scenario analyses do not constitute a complete impact analysis. They only consider one part of the impact, namely in relation to the supply of liquidity to banks. It must be taken into account that further effects will also have an impact on the earnings side, which may additionally worsen regulatory ratios and thus also long-term lending possibilities.

2. Low financing costs support investment activity

The impact on the real economy of massive transfers of funds from bank deposits to the digital euro would be striking. If the possibilities for credit and money creation by the banking industry were to be drastically restricted, the financing options of the economy and private households would deteriorate significantly. In terms of compliance with liquidity requirements, more and more banks would reach the regulatory ceilings and would no longer be able to adequately fulfil their economic role.

If the supply of credit were to tighten, there would be a tendency for interest rates to rise, which in turn would lead to a decline in investment. The digital euro could thus unintentionally become a brake on investment. That would be a catastrophic result, especially in view of the urgently needed investments in climate protection and digitalisation.



The European Commission estimates that additional investment of **€350 billion per year** will be needed in Europe by 2030 for climate protection alone. That figure does not take into account investments in digitalisation, improvements in efficiency of the economy and reinvestment. A large part of that activity is performed by the private sector and is mainly financed in the form of loans (from banks and savings banks).

3. Maintain the narrow monetary policy mandate of the ECB

In the event of massive transfers of funds from bank deposits to the digital euro, banks would lack a granular basis for refinancing that is stable over time. The interbank market is also likely to dry up, as the decline in deposits is likely to extend across all banking groups.

To enable banks to refinance nevertheless, the ECB would have to offer long-term refinancing facilities

on a massive scale. The banks would then be directly dependent on the central bank and the conditions set there.

The result would be an enormous concentration of power at the ECB and a fundamental change in its role in the monetary and financial system. Monetary policy decisions would have a much more direct impact on the banking industry and the financing conditions of the economy and thus on the economy as a whole. The step towards a form of ECB economic government would not be far off. The legitimacy of independence of the ECB – an important basis for ensuring price stability – would be called into question if the ECB's mandate were to be extended significantly.

4. Do not introduce a parallel system to the existing payment transactions

The intervention in the payment transactions infrastructure, which is run on competitive lines, would be even greater if the ECB were to design the digital euro not only as a **means of payment**, but also as its own **payment system**.

With an account-based digital euro that supports all payment types, the ECB would become a one-stop payment provider for consumers and companies – with the service, by definition, free of charge in the same way as the free use of cash. Compared with private providers, banks and payment service providers, this would be a distortion of competition through a service run by the sovereign, without a market failure having occurred.

As a result, private investment in the further development and operation of alternative solutions would decrease massively. The choice for consumers would deteriorate and the experience that banks and financial service providers have in dealing with customers and risks, in their intermediary role, would not be drawn on. As a result, the payment transactions sector would be hampered in terms of both investment and innovation. The announcement of an account-based digital euro by the ECB alone is likely to lead to a decline in the financial sector's willingness to invest in customer-oriented European solutions, as any form of investment could be counteracted by the digital euro.



Digital Euro: What form should it take?

The digital euro should be designed as a bearer instrument. In this form, it would be a useful addition to the existing means of payment and would transfer the advantages of cash to the digital world. As the equivalent of the familiar cash, it should enable simple and anonymous payments in the digital arena.

- This can best be achieved with a "token version", which – amongst other things – ensures the greatest possible anonymity for payments and remains useable, for example, even in the case of internet and power outages.
- Only a one-time registration of the wallet would be required in this case to implement the important limitation (to counter money laundering, threat to the monetary system etc.).
- Rules on interoperability on a technological basis can also ensure that wallets are compatible across Europe. The transfer of money and thus the greatest possible security of being able to pay with the digital euro would increase the confidence of citizens, allowing the digital euro to be accepted and for its digital benefits to reach their full potential.
- However, should the ECB decide in favour of an "account version," clear access restrictions must be defined in order to limit the negative economic effects. Central to this is the introduction of a low holding limit in the form of a "full wallet" (500 euro), so that the digital euro does not become an investment. The holding limit should remain stable over time, for example by mandating it by law and linking adjustments to consumer price trends.

In any case, any proposal for designing the digital euro must be geared to key societal needs. These include the protection of privacy, a high level of resilience with regards to payment transactions – for example, through offline capability – and the agreement that payments will be anonymous, with

adequate money laundering prevention and avoidance of economic collateral damage. These goals require a low holding limit per citizen.

It must be made clear: The introduction of the digital euro is an important step towards securing Europe's digital and monetary sovereignty. It is pivotal to setting the course for the further development of the monetary system in the age of digitalisation. It is crucial that the design of the digital euro is carefully considered. It is not only a technical decision in terms of payment transactions, but also a fundamental political decision on the future interaction of the central bank and commercial banks (equivalent to the state and the private sector) in the economy.

Before the final planning and introduction of the digital euro, detailed impact studies are therefore necessary that show the effects of the introduction of the digital euro on the financing of private households and companies and thus on our entire economic area. This also requires a sound analysis of the extent to which the banking industry will be able to continue performing its role in the monetary system in the future.

Similarly, close monitoring by the euro area member states and clarity concerning the mandate of the ECB are urgently needed. After all, currencies thrive on the trust that citizens and economic players at home and abroad place in them – and this is all the more true when it comes to transferring cash to the digital arena. The banking industry is ready to enhance its proven role in retail payments and the financing of private households and companies within the framework of the digital euro and to invest in appropriate solutions that guarantee customer benefits.

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National Association of German Cooperative Banks (BVR)

The BVR is the central association of the cooperative banking industry in Germany. These banks include nearly 800 cooperative banks, Sparda banks, PSD banks, banking institutions for churches and other special institutions such as the Deutsche Apotheker- und Ärztebank (German Bank for Pharmacists and Physicians). The President of the BVR is Ms Marija Kolak. The other members of the Board of Managing Directors are Dr. Andreas Martin and Daniel Quinten. The BVR represents the interests of the Cooperative Bank Financial Network throughout Germany and internationally. Within the Group, the BVR coordinates and develops the joint strategy of the local cooperative banks.

It advises and supports its members in legal, tax and business management matters. The BVR also operates two institutional protection schemes. These are: the wholly-owned subsidiary “BVR Institutssicherung GmbH”, which represents the officially recognised deposit guarantee scheme and the voluntary “BVR protection scheme” – the oldest bank protection scheme in Germany. The BVR is active in Berlin, Bonn and Brussels. Information on the BVR and its topics may be obtained via politik@bvr.de or under +49 (0)30 2021 1605 or at the Website www.bvr.de.



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