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Central Bank Digital Currency: Significant Risks Must Preclude Adoption

The Independent Community Bankers of America, representing community banks across the nation with nearly 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing titled: "Digital Assets and the Future of Finance: Examining the Benefits and Risks of a U.S. Central Bank Digital Currency." ICBA believes that clear and significant risks would be derived from the adoption of a CBDC and few if any clearly defined benefits. For the reasons set forth in this statement, ICBA strongly opposes the creation of a U.S. CBDC and urges Congress to oppose this unprecedented and transformative step as well. The policy goals identified in support of a CBDC would best be addressed through alternatives that are readily available in the market today.

ICBA recently filed a comment letter with the Federal Reserve Board of Governors on its public consultation paper, "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," which solicits views from stakeholders on the risks and benefits of a potential U.S. CBDC. The views summarized in this statement are set forth more comprehensively in our comment letter and reflect extensive consultations with community bankers serving rural, suburban, and urban markets in all regions of the United States.

Disintermediation of Community Bank Deposits

The Federal Reserve defines a CBDC as "a digital liability of a central bank that is widely available to the general public." Under the "intermediated" model contemplated by the Federal Reserve, "the private sector would offer accounts or digital wallets to facilitate the management of CBDC holdings and payments. Potential intermediaries could include commercial banks and regulated nonbank financial service providers and would operate in an open market for CBDC services."

Bank deposits are a liability of the issuing bank and reside on its balance sheet. As such, deposits serve as a source of bank lending. By contrast, as a liability of the Federal Reserve, a CBDC, even one that is "intermediated," would not be available to support bank lending. A CBDC would position the Federal Reserve as a direct, advantaged competitor for bank deposits. The Federal Reserve concedes that a CBDC "substitution effect could reduce the aggregate amount of deposits in the banking system, which could in turn increase bank funding expenses, and reduce credit availability or raise credit costs for households and businesses." In other words, a CBDC could create an outflow of deposits from community banks with a direct and adverse impact on credit availability. The risk of this scenario would be accentuated in a financial crisis. Because a CBDC would not have credit or liquidity risk, depositors might "run on the bank" and transfer their balances to CBDC wallets. The digital nature of CBDC would allow these transfers to occur with unprecedented speed, triggering a chain reaction of events that could lead to bank failures.

ICBA strongly objects to any policy change that would disrupt credit availability needed to support consumer spending, home purchasing, business working capital, investment, and hiring. The impact would be especially felt in rural and agricultural communities which are primarily served by community banks. Community banks are small business lending specialists responsible for approximately 60 percent of small business loans. Any policy change that would disrupt community bank deposit availability and the lending that depends on it is an unacceptable risk for communities across America and the economy.

A CBDC Would Be Costly for Community Banks

In the intermediated model, banks would provide a CBDC "wallet" for customers, but CBDC would not fund loans or otherwise serve as a source of bank revenues. Nevertheless, banks would remain saddled with the identity verification, customer service, know your customer (KYC), anti-money laundering (AML), sanctions screening and other compliance burdens associated with maintaining CBDC wallets.

Holding CBDC would create a net cost for community banks, which already operate on narrow margins. Compliance costs may well increase in the future, and sources of non-interest revenue are likely to decline. Today, deposit compliance and operating costs are effectively subsidized by loan interest revenues and non-interest income. Community banks would also be required to make significant technology investments in order to provide CBDC wallet services. Banks would have to offset these costs by charging significant fees.

The compliance costs and technology investments associated with a CBDC would put community banks at a disadvantage relative to larger institutions, creating a less competitive market for financial services. Community banks rely on core providers for technological services that larger institutions maintain in-house. This is an advantage for these larger institutions, and to the extent that CBDC is adopted by consumers, it would shift market share away from community banks and accelerate industry consolidation to the detriment of consumers and small business borrowers. Rural communities served almost exclusively by community banks would be particularly harmed.

The Federal Reserve proposal envisions banks in competition with regulated nonbank financial service providers in an open market for CBDC wallets. This could introduce regulatory arbitrage risk and unfairly advantage these nonbank providers if they are not regulated as stringently as banks.

A CBDC Would Risk a Consumer Privacy Backlash

A CBDC would require a public record of all transactions conducted in CBDC to be maintained by the central bank. ICBA believes that consumers would be strongly resistant to using a digital asset that undermines their financial privacy. For this reason, a CBDC would not be an effective means of drawing more Americans into the banking system – a benefit proponents claim for the proposal. Surveys of unbanked households consistently show that financial privacy is a primary reason they choose not to use the banking system.

In addition to concerns about granting the federal government visibility into consumer transactions, a CBDC would create an irresistible target for criminal hackers and rogue states. A CBDC would depend on the Federal Reserve to serve as a hub, validating all transactions between CBDC wallets. A breach of the Federal Reserve's cybersecurity could disrupt or misdirect countless transactions, inflicting financial harm on consumers and damaging the credibility of the CBDC and potentially the dollar as well.

FedNow℠ Is an Imminent and More Viable Solution

ICBA does not believe that the benefits claimed for a CBDC withstand scrutiny. As noted above, it is an implausible means of reaching the unbanked. ICBA's comment letter to the Federal Reserve argues against other supposed benefits, such as supporting the global dominance of the dollar. We address here the claim that a CBDC is needed to modernize the U.S. payments system and ask Congress to consider alternatives for payments modernization currently being implemented.

CBDC proponents argue that more competition is needed in the payments system. There is a wealth of evidence that demonstrates the U.S. has a diverse and highly competitive payments system today, with significant consumer choice. Safe, efficient Federal Reserve and private-sector interbank payment systems exist now that offer increased transaction speed and reduced costs. The FedNow service, launching in 2023, will enable financial institutions of all sizes to provide safe and efficient instant payment services in real time and around the clock. FedNow will provide many of the benefits of alternative payments rails without the risk and will accomplish many of the stated goals of a CBDC.

In public comments addressing unequal access to the financial system, Nellie Liang, Treasury Undersecretary for Domestic Finance, said that FedNow "will be low cost to users. Because FedNow relies on the banking system, there already are safeguards for consumers and businesses."[1] With the impending introduction of FedNow instant payment services, increased Same Day ACH adoption, and The Clearing House's introduction of Real Time Payments (RTP®), Americans are enjoying faster transactions clearance and can expect further innovations to be built upon these rails. ICBA urges policymakers to give FedNow a chance to succeed in advancing payments modernization. The launch of a CBDC, if adopted, will be many years away. A decision at this time to establish a U.S. CBDC would be premature. FedNow must be given a chance to work and be evaluated in the market before a CBDC is considered.

The Volatility of Unregulated Stablecoins Must Not Drive Adoption of a CBDC

Recent market developments have shattered the pretense of stablecoin stability. Tether and Terra have both lost their peg to the dollar. They are anything but a stable source of value and must not be viewed by consumers as the equivalent of bank deposits. ICBA urges policymakers to develop a consistent regulatory definition and framework

[1] https://home.treasury.gov/news/press-releases/jy0673

for stablecoins to protect consumers and the safety of the financial system.

However, a CBDC must not be viewed as an alternative to privately issued stablecoins nor a substitute for their regulation. There is no binary choice between a CBDC and stablecoins. A CBDC will neither outcompete stablecoins out of existence nor solve the regulatory challenges and systemic risks presented by privately issued stablecoin arrangements.

The Role of Congress

The Federal Reserve promised in its report not to move forward "without clear support from the executive branch and from Congress, ideally in the form of a specific authorizing law." Federal legislation would be required to establish the roles and responsibilities of the various stakeholders—including the Treasury Department, Federal Reserve, and the private sector. Congress would need to exercise its authority to preclude any actions that would disrupt the stability of the economy and inject safety and soundness risks to the financial system. Congress must not be sidelined in a policy choice with such far reaching, and potentially damaging, significance.

Closing

Thank you for convening today's hearing to highlight the significant stakes in any creation of a CBDC. ICBA urges the members of this committee to carefully consider ICBA's objections to a CBDC as expressed in this statement and more fully in our recent comment letter to the Federal Reserve.