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VIA ELECTRONIC SUBMISSION
www.federalreserve.gov/apps/forms/cbdc.

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Money and Payments: The U.S. Dollar in the Age of Digital Transformation

The Electronic Transactions Association ("ETA") respectfully submits these comments to the Board of Governors of the Federal Reserve System ("Federal Reserve") regarding its report on "Money and Payments: The U.S. Dollar in the Age of Digital Transformation" (the "CBDC Report"). In the CBDC Report, the Federal Reserve examined the pros and cons of a potential U.S. central bank digital currency ("CBDC") and requested public comment on whether and how a CBDC could improve the domestic payments system.

As the leading trade association for the payments industry, ETA represents over 500 companies, including banks, payments companies, and fintechs, that provide consumers and small businesses access to safe, reliable, innovative, and effective payments technologies. Our members support the Federal Reserve's ongoing efforts to promote monetary and financial stability, and a safe and efficient payment system, and appreciate the opportunity to share our members' comments and expertise as the Federal Reserve continues to explore this developing area.

In this regard, ETA agrees with the Federal Reserve's view that the key question is whether the benefits of a CBDC would exceed downside risks it may present to households, businesses, and the economy overall. To assess this question, it is important to understand the incredible value and benefits that the current U.S. payments provides to consumers and businesses.

Each year, ETA members make global commerce possible by processing more than $27.5 trillion in purchases and P2P transfers worldwide through the deployment of innovative payment products and services. In the U.S. alone, in 2021, consumers and businesses spent $8.2 trillion in card volume and at least $1 trillion was moved over the largest P2P networks. The infrastructure supporting this system is sophisticated, secure, and fast — processing over 270,000 transactions per minute. The electronic payments system is also reliable — it operates 24/7/365, in the U.S. and around the globe, without interruption. And ETA members are not slowing down; the industry is constantly investing and innovating, creating new financial services and payments products that benefit individuals and small businesses alike.

Accordingly, consistent with the CBDC Report, ETA has long advocated for a federal approach to a CBDC that takes into account potential benefits of the technology while also minimizing any negative or unintended consequences. To this end, ETA has previously published "7 Guiding Principles for CBDC" against which any proposed CBDC should be measured. As the Federal Reserve assesses a potential CBDC it should, consistent with these principles, ensure that any proposal best serves the needs of consumers, furthers financial inclusion, preserves and strengthens the financial system, and ensures that consumers continue to have access to a robust and innovative array of secure banking and payment options.

As explained in our Principles, if the Federal Reserve determines that the benefits of a CBDC outweigh the risks, then ETA strongly encourages the adoption of an "intermediated model," in which the private sector takes the lead in providing the public with digital wallets or other technologies that are used to manage the holding and use of CBDCs. As part of any further consideration of a CBDC, the Federal Reserve should continue to coordinate with public and private stakeholders to address the practical and legal feasibility of implementing a CBDC, and how the adoption of different CBDC design choices might impact operating performance and key policy and economic considerations.

In Section I of these Comments, we provide a general overview of the principles that ETA encourages the Federal Reserve to follow when considering a CBDC and explain how any such CBDC might fit within the existing payments structure, which continues to provide consumers and businesses with safe, reliable, and innovative payments products and services. In Section II, we provide comments in response to several of the specific questions that the Federal Reserve posed in the CBDC Report.

I. GENERAL COMMENTS

A. The Payments Industry Provides Innovative, Safe, Convenient and Cost-Effective Services for Consumers and Business

The payments industry is innovative, dynamic, and competitive, focused on delivering cutting edge products with robust security measures to help consumers connect with merchants, make payments, and move money. Consumers have numerous cost-effective products available for payments, including credit and debit cards, mobile wallets, and ACH payments, among others. The industry continues to innovate, particularly in the area of real-time payments, where the private sector has introduced faster, real-time bank settlement services, and the card networks have developed new push-to-card services. In addition, ETA members are working with the Federal Reserve on FedNow Instant Payments, which will provide instant payments once it is complete.

The resiliency and efficiency of the payments industry was demonstrated during the COVID-19 pandemic when ETA members played a key role helping federal and state government agencies deliver billions of dollars in Payroll Protection Program small business loans, stimulus payments, and other benefits to mitigate economic hardship. As federal and state governments provided stimulus and unemployment payments to Americans struggling with the fiscal impacts of COVID-19, the electronic payments industry was there to facilitate benefits quickly and securely, so people got the help they needed.

In addition to developing innovative payment methods, ETA member companies continue to advance the global flow of commerce while delivering affordable financial tools and services that meet the needs of underserved consumers. A goal of ETA member companies is to continually enhance the electronic payments and financial ecosystem so that it is accessible for all consumers, while ensuring that their transactions can be completed securely, efficiently, and ubiquitously. A key driver to achieving such a system is the development of new technologies that allow traditionally underserved consumers to access financial products and services.

Expanding the ability to access the financial system not only empowers consumers to take control of their financial well-being, but also creates a more resilient and inclusive economy. Just a few examples of the ways that the payments industry has expanded access to financial services include:

- Open Finance – Open finance provides consumers with the full picture of all their finances and allows any company to use financial data, with the consumer's consent, to generate new products, services, and use cases for their customers.

- Prepaid Products – For millions of consumers, including those with limited or no access to traditional financial accounts, prepaid products provide cost-effective, convenient, and innovative payment options.

- Peer-2-Peer Payments – Transformative P2P technology is changing the way individuals exchange money with each other, by enabling the secure, instantaneous transfer of money via mobile applications.

Taken as a whole, the retail payments system works extremely well; consumers and businesses have numerous options for safe and reliable payments. It is therefore critical that the Federal Reserve continue to take policy positions (such as with respect to a CBDC) that recognizes the important role that the private sector plays in providing access to safe, reliable, and cost-effective payments services.

B. Any CBDC Should Take into Account ETA's Principles

As the Federal Reserve moves forward with exploring a CBDC, ETA encourages the Federal Reserve to consider carefully potential downside risks along with the potential benefits, particularly given that the adoption of a CBDC would have a dramatic impact on the U.S. financial infrastructure and broader economy.

Most proposals envision CBDC to be a direct substitute for cash using the same underlying technology as cryptocurrency. While all electronic payments are cash substitutes to some degree, a CBDC would be issued, maintained, and settled by the Federal Reserve. The CBDC would be transacted P2P, but since it lacks physical form, the transfer would be recorded to a digital ledger (possibly using blockchain technology).

Regardless of its final design, the adoption of a CBDC would have a profound impact on the U.S. economy and the existing financial infrastructure. In light of this, ETA believes there is a common set of principles against which any proposed CBDC should be measured. As the federal government assesses a potential CBDC, it should carefully consider these principles and ensure that any proposal best serves the needs of consumers, furthers financial inclusion, preserves and strengthens the financial system, and ensures that consumers continue to have access to a robust and innovative array of secure banking and payment options.

As policymakers and the Federal Reserve consider implementing a CBDC, ETA supports a CBDC that advances these 7 guiding principles:

1. Innovation: Continual investment in innovation is at the heart of past, present, and future improvements to the financial ecosystem — enabling new capabilities, strengthening cybersecurity and consumer protection, increasing efficiencies, and expanding access to financial services. Any public sector engagement with the financial sector, including the deployment of a CBDC, should serve as a catalyst and a platform for continued innovation.

2. The Right Tool for the Job: Policymakers should compare the suitability of a CBDC with existing systems and other ongoing improvements to payments infrastructure — such as real-time payments systems — to find the approach that best fits their country's transactions needs.

3. Private Sector Participation: Expanded financial inclusion, ongoing payments innovation, and the efficiency of national and international payment flows all depend on vibrant private sector competition in payments. A CBDC should seek to preserve those functions and minimize effects on the broader financial system through a two-tiered ecosystem that includes the private sector in its design, piloting, and distribution.

4. Interoperability: Any CBDC would be introduced into an established, robust, well-functioning payments ecosystem. Ensuring interoperability between a CBDC and other forms of national and international payments systems is necessary to avoid weakening existing mechanisms and harming consumers and businesses. Any CBDC must be able to interoperate seamlessly across the existing landscape.

5. Open Acceptance: Consumers will be more likely to adopt a CBDC if it can be used on existing acceptance infrastructure and is supported by known and identifiable payment methods (e.g., in-person and online) that are linked to the user's existing devices and accounts. To be useful to consumers, any CBDC would need to take advantage of existing acceptance networks and acceptance infrastructure to allow any merchant that accepts cards to also accept the CBDC.

6. Consumer Protection: A CBDC should require a framework of standards and rules that safeguards the privacy and security of every transaction, protects consumers' interests, and gives consumers the confidence necessary for in-person and online transactions. It should also ensure that consumers understand those protections and how they may differ from those offered by other payment methods.

7. Regulation Tailored to the Risk Profile of the Participant: Entities engaging with a CBDC should be subject to regulation that is tailored to the activities and risks that they pose due to their position in the payments ecosystem. Appropriate regulation should consider potential harm to consumers as well as safety, soundness, and financial stability risks.

If the Federal Reserve decides to move forward with a CBDC, one of the underlying themes of these principles is the need for a clear regulatory framework that facilitates the modern payments infrastructure in administering CBDCs in a way that protect consumers and drives economic benefits.

C. The Private Sector is Best Positioned to Administer CBDCs Consistent with Existing Market Structures

If the Federal Reserve moves forward with a CBDC, the program should be structured to model after the existing intermediated system, and designed to take into account the expertise and input of the private sector. This is one of the key design requirements given that central banks generally lack experience in implementing and administering the various day-to-day functions required for a nationwide retail payments service. In the case of a CBDC operated exclusively by a central bank, the central bank would be required to maintain and update all aspects of the payments and banking system. Accordingly, in ETA's view, the potential benefits of a CBDC can only be realized through an intermediated model that includes the private sector in its design, piloting, and distribution.

With an intermediated model, the private sector would take the lead in providing consumers and businesses with access to the CBDC, whether through digital wallets or other technologies. In this model, consumers would access their CBDC at a bank or fintech, likely through a digital wallet-type service. One of the key benefits of this model is that it does not require the central bank to provide retail banking services. As recognized by the Bank for International Settlements, a "natural split in any tiered CBDC system would be for the central bank to be responsible for the core of the system to the extent that they could steer the system to deliver policy goals and a safe and efficient payment system. Multiple private entities would then act as intermediaries, competing and offering choice within an ecosystem to drive innovation and efficiency."[1]

This approach makes economic and practical sense because the private sector is in the best position to manage the various functions necessary to administer CBDCs – ETA's members, for example, already facilitate the provision of numerous safe, innovative, and convenient payments products and services. The payments industry has decades of experience in managing functions such as anti-money laundering compliance, customer service, dispute resolution, privacy protection, cybersecurity, and the deployment and updating of technology on a regular basis. If a CBDC is adopted, the private sector has the tools, experience and proved track record needed to assist consumers in accessing, using, and transferring funds in a safe and reliable way.

II. Responses to Specific Questions from the CBDC Report

<u>CBDC Benefits, Risks, and Policy Considerations</u>

1. What additional potential benefits, policy considerations, or risks of a CBDC may exist that have not been raised in this paper?

The Federal Reserve's paper identifies many of the key benefits, policy considerations, and risks presented by the potential adoption of a CBDC. As discussed throughout these comments, the most critical factor is for the Federal Reserve to design a system that (a) continues to leverage private

[1] https://www.bis.org/publ/othp42_system_design.pdf

industry and supports interoperability in order to ensure broad adoption, innovation, and efficiency for users, and (b) protects user privacy while balancing the need to combat money laundering and other similar risks. In support of these broad goals, key considerations of a CBDC should include "(i) continued access to central bank money, (ii) resilience, (iii) increased payments diversity, (iv) encouraging financial inclusion, (v) improving cross-border payments (vi) supporting privacy and (vii) facilitating fiscal transfers."[2]

2. Could some or all of the potential benefits of a CBDC be better achieved in a different way?

If the Federal Reserve decides to move forward with a CBDC, ETA submits that the only way to achieve the potential benefits of a CBDC are by designing a system that supports the concepts set forth in ETA's Principles. The ultimate design of a CBDC will have a significant impact on the extent to which it provides additional benefits for consumers and businesses. On one extreme, the Federal Reserve could adopt a model in which it is interfaces with end-users. ETA and its members do not support this approach because it would place the Federal Reserve in the difficult (if not untenable) position of operating the entire system, would limit the potential for future innovation, and would disintermediate the existing financial sector in a way that would ultimately harm consumers. The better approach, in ETA's view, is an intermediated solution—again, if the Federal Reserve ever issues any CBDC at all—where the CBDC represents a direct claim on the central bank, but onboarding and real-time payment services would continue to be operated by private intermediaries (e.g., banks and fintechs,) through the two-tier model similar to how it is done today. An intermediated approach would allow the Federal Reserve to leverage existing payment infrastructures and the ongoing private innovation, while also minimizing operational risk for the Federal Reserve.

3. Could a CBDC affect financial inclusion? Would the net effect be positive or negative for inclusion?

ETA's members support the goal of providing universal financial inclusion. In this regard, the payments industry continues to advance the global flow of commerce while delivering affordable financial tools and services that meet the needs of underserved consumers. A goal of ETA member companies is to continually enhance the electronic payments and financial ecosystem so that it is accessible for all consumers, while ensuring that their transactions can be completed securely, efficiently, and ubiquitously. The payments industry continues to innovate in this area, whether through the development of prepaid cards, buy-now-pay-later, or other technologies, like cryptocurrency and stablecoins.

In order for a CBDC to further financial inclusion, the following should be taken into account:

- The CBDC should support the two-tiered payment system, which can support broad adoption through enrollment and education on CBDC.

[2] https://www.bis.org/publ/othp42_system_design.pdf

- The CBDC should support interoperability, including with existing domestic and international payment instruments like bank transfers, payment cards, and other similar technologies.

- The CBDC should protect privacy to the greatest extent possible to encourage broad use and adoption.

5. How could a CBDC affect financial stability? Would the net effect be positive or negative for stability?

A significant policy risk involving the adoption of CBDCs is the potential negative impact on bank lending and credit availability. Under the current two-tiered banking model, banks hold deposits for depositors, but are not required to maintain the entire amount of the deposit on hand. This system of fractional reserve banking provides borrowers with access to safe, low-cost deposit services, while also allowing banks to increase their ability to lend funds to consumers and businesses. The implementation of a CBDC could negatively impact the fractional reserve banking system and the corresponding benefits, particularly if the CBDC is designed in a way that encourages the move of bank deposits to the Federal Reserve. This would reduce access to credit and have a substantial impact on the U.S. economy and monetary policy.

Similarly, a Federal Reserve CBDC could allow consumers to make equivalent electronic transactions without the need for a bank account. Banks would need to offer higher interest rates and improved services to induce consumers to deposit their funds rather than leaving them in the form of CBDC. In this respect, a CBDC could lead to volatility in deposits or even a long-term reduction in deposits, which, in turn, would likely negatively impact bank lending the provision of financial services.

Finally, it is important that any CBDC be designed with resiliency as a key characteristic. To be successful, a CBDC must guarantee the availability and usability of funds. One of the reasons the current payments system has been so successful is that private industry offers consumers multiple safe and efficient payments options. A key way to ensure resiliency is for any CBDC to work as an intermediated system and leverage private industry, including by supporting interoperability between a CBDC and other forms of national and international payments.

6. Could a CBDC adversely affect the financial sector? How might a CBDC affect the financial sector differently from stablecoins or other nonbank money?

A poorly designed CBDC might adversely affect the financial sector in a number of ways, all of which would ultimately have a negative impact on consumers and businesses that rely on having access to safe, efficient, and innovative financial services. As a starting point, any CBDC that does not include private sector participation risks losing the innovation that is critical to ensuring improvements to the financial ecosystem. In addition, while stablecoins and certain other private developments have been designed with interoperability and the private sector in mind, a CBDC that shuts out the legacy private sector would negatively impact a core aspect of the U.S. economy, with the potential for significant disruption.

And, as noted, the adoption of a CBDC could negatively impact the fractional reserve banking system and the corresponding benefits, particularly if the CBDC is designed in a way that encourages the move of bank deposits to the Federal Reserve. This would reduce access to credit and have a substantial impact on the U.S. economy and monetary policy.

7. What tools could be considered to mitigate any adverse impact of CBDC on the financial sector? Would some of these tools diminish the potential benefits of a CBDC?

The best– way to mitigate any adverse impact of CBDC on the financial sector is for the Federal Reserve to design a system that includes the private sector in its design, piloting, and distribution. This approach is also the only approach that has a realistic chance of achieving the numerous potential benefits offered by CBDC.

9. How might domestic and cross-border digital payments evolve in the absence of a U.S. CBDC?

The payments industry has and will continue to drive innovation in the absence of a U.S. CBDC. The payments industry is innovative, dynamic, and competitive, focused on delivering cutting edge products with robust security measures to help consumers connect with merchants, make payments, and move money, including via credit and debit cards, mobile wallets, ACH payments, and even cryptocurrencies. The industry continues to innovate, particularly in the area of real-time payments, where the private sector has introduced faster, real-time bank settlement services, peer-to-peer payments, and the card networks have developed new push-to-card services. Further, with or without a CBDC, the private industry continues to develop and explore use cases for private stablecoins, which offer some of the same potential benefits as a CBDC.

Many of these services are evolving to operate even more efficiently at the cross-border level, and new technologies are being tested and developed that may further facilitate efficient cross-border transactions, such as stablecoins and cryptocurrencies. In this regard, however, cross-border transactions are naturally more complex. Some of these challenges would apply to a U.S. CBDC in that it would need to be designed for interoperability with other CBDC systems.

12. How could a CBDC provide privacy to consumers without providing complete anonymity and facilitating illicit financial activity?

If the Federal Reserve decides to move forward with a CBDC, the Federal Reserve should implement a framework of standards and rules that safeguards the privacy and security of every transaction, protects consumers' interests, and gives consumers the confidence necessary for in-person and online transactions. It should also ensure that consumers understand those protections and how they may differ from those offered by other payment methods. If the Federal Reserve moves forward with a CBDC, the centralized approach (as opposed to an intermediary-focused

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approach) presents a greater risk of potential surveillance, leading to abuse of user privacy interests.

One of the benefits of a CBDC that incorporates the private sector is that the financial industry has significant experience in protecting user privacy while also combatting fraud and other illicit activity. The financial sector has spent years implementing policies, procedures, and safeguards to protect user privacy pursuant to various federal, state, and international laws, including, for example, the Gramm-Leach-Bliley Act, the California Consumer Privacy Act, and the European Union's General Data Protection Regulation, among others. At the same time, the financial sector is on the front lines battling fraud, terrorist financing, and other illegal financial activity through the implementation of due diligence, monitoring, and reporting systems. While the payments industry is subject to various legal requirements, such as those under the Bank Secrecy Act, the industry has voluntarily implemented numerous additional tools and safeguards to combat potential fraudulent financial transactions.

With the benefit of decades of expertise, ETA members have developed effective due diligence programs to prevent fraudulent actors from accessing payment systems, monitor the use of those systems, and terminate access for network participants that engage in fraud. Working with its members and industry and government stakeholders, ETA has published various guidelines that provide underwriting and diligence best practices for merchant and risk underwriting, including the "Guidelines on Merchant and ISO Underwriting and Risk Monitoring" and "Payment Facilitator Guidelines." These documents provide industry with underwriting and diligence guidance, including information on anti-fraud tools, security, and related issues.

For example, when it comes to card data protection, the payments industry took the lead in developing the Payment Card Industry Data Security Standard ("PCI-DSS") for handling the safety of cardholder data. The PCI-DSS sets forth requirements designed to ensure companies that process, store, or transmit credit card information maintain a secure environment for such data. In addition, the PCI-DSS establishes a framework for implementation of the data security standards, such as assessment and scanning qualifications for covered entities, self-assessment questionnaires, training and education, and product certification programs.

And, of course, the payments industry continues to refine tools for monitoring and analyzing payment data for suspicious activity. With improvements in machine learning and artificial intelligence, payments companies are gaining additional tools for identifying suspicious patterns in transaction data. These are just some of the tools that the payments industry has developed in recent years to fight fraud, protect consumers, and ensure the integrity of the payments ecosystem. These efforts have been remarkably successful in reducing fraud while ensuring that consumers have access to fast, reliable, and safe payment options.

17. What types of firms should serve as intermediaries for CBDC? What should be the role and regulatory structure for these intermediaries?

If the Federal Reserve decides it is necessary to implement a CBDC, ETA encourages a two-tiered system that relies on banks, and fintechs, to serve as intermediaries with the primary responsibility for interfacing with consumers and businesses that use the CBDC.

In line with the Federal Reserve's expressed views, ETA agrees that any regulations for fintechs that are given access to serve as an intermediary of a potential CBDC should be tailored to the activities and risks that they pose and be evaluated on their risk management and operational capabilities, including a standard set of core protections and requirements such as considering potential harm to consumers as well as safety, soundness, and financial stability risks in the ecosystem. Furthermore, the Federal Reserve should provide on-going oversight to ensure risk profiles have not changed materially, and risk management structures, and operational capabilities remain adequate. For additional guidance, please refer to ETA's comments submitted in Docket No. OP-1747, "Guidelines for Evaluating Account and Services Requests."

19. Should a CBDC be designed to maximize ease of use and acceptance at the point of sale? If so, how?

If the Federal Reserve decides to move forward with a retail CBDC, the CBDC should be designed to work efficiently at the point of sale. The key to the successful implementation of a CBDC is ensuring interoperability, which will facilitate broad adoption, coordination with existing and alternative payment methods, and ensure the potential for future innovation. Without interoperability and coordination with legacy systems (or future non-CBDC systems that may be implemented), there is a risk of both low adoption and fragmentation between various closed loop systems, all of which would negatively impact user acceptance and system viability.

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We appreciate the Federal Reserve's focus on this important issue and the opportunity to submit comments. If you have any questions or wish to discuss any issues, please contact Scott Talbott, Senior Vice President, Government Affairs, stalbott@electran.org.

Respectfully submitted,

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