

The Federal Reserve And Central Bank Digital Currencies

August 20, 2020

Overview

Federal Reserve Board Governor Lael Brainard outlined the Federal Reserve's ongoing research and work on central bank digital currency (**CBDC**) in a [recent speech](#). She described several interesting new and ongoing initiatives that are being pursued by the Federal Reserve System. First, to further the Federal Reserve's understanding of CBDC, the Federal Reserve Bank of Boston is collaborating with researchers at the Massachusetts Institute of Technology to build and test a hypothetical central bank digital currency. The Federal Reserve will publish the results of this study, along with any codebase developed through the effort.

Second, the purpose of its research is to "assess the safety and efficiency of digital currency systems, to inform [the Federal Reserve's] understanding of private-sector arrangements, and to give [the Federal Reserve] hands-on experience to understand the opportunities and limitations of possible technologies for digital forms of central bank money." The Federal Reserve acknowledged that before it would consider issuing CBDC, it would first engage in significant policy and legal analysis to determine the implications of such an issuance.

The Federal Reserve will also continue to collaborate with the [CBDC coalition of central banks](#) to share lessons learned, conduct joint experiments, and integrate expertise in an effort to improve the efficiency of cross-border transactions, as well as address threats related to cybersecurity, fraud and money laundering.

CBDC around the World

The Bank of Canada, Bank of England, Bank of Japan, European Central Bank, Sveriges Riksbank and Swiss National Bank, along with the Bank for International Settlements, (together, the **Coalition**) have committed to collaborating with each other as they assess CBDC use cases, design choices, and emerging technologies. In addition to the Coalition, a number of foreign central banks have announced that they are researching or testing use cases on CBDC:

- **China (DCEP)**
- **France**
- **South Korea**
- **Turkey**
- **South Africa**
- **Saudi Arabia**
- **UAE**
- **Israel (e-shekel)**
- **Cambodia**
- **Ecuador**
- **Ukraine (e-hryvnia)**
- **Thailand**
- **Uruguay (e-peso)**
- **The Bahamas (Sand Dollar)**
- **Eastern Caribbean Currency Union (DXCD)**
- **Marshall Islands (SOV)**
- **Brazil**
- **Norway (e-krona)**
- **Denmark (e-krona)**
- **Iceland (rafkrona)**

Notably, China, which is not a member of the Coalition, is the furthest along in the development of its digital yuan, DCEP. A group of Chinese state-operated banks have conducted internal tests of a digital

currency wallet designed specifically for DCEP. Further, China announced that it would soon roll out DCEP for full-scale testing in Hong Kong's Greater Bay Area.

Key Takeaways

The recent announcement is a notable shift in the Federal Reserve's messaging related to CBDC. In a December 2019 [hearing before the House Financial Services Committee](#), Treasury Secretary Mnuchin stated that both he and Chairman Powell were in agreement that there was no need for the Federal Reserve to issue a digital currency in the next five years. However, over the course of this year, the Federal Reserve [announced](#) that it was collaborating with other central banks in the Coalition to advance its understanding of CBDC, and the Federal Reserve has now launched a formal CBDC research initiative. Given the rapid pace with which China is implementing DCEP, the acceleration of the Federal Reserve's efforts to research CBDC is no surprise.

Before implementing CBDC, the Federal Reserve, like other central banks, would need to address many open issues. Whether and how it decides to pursue CBDC will depend upon key design choices, the extent to which the Federal Reserve accounts are direct or indirect and the participation of the financial sector. Chief among the issues requiring attention from the Federal Reserve are cyber security, which is discussed in the announcement, and risk governance and compliance, which are not. Regarding legal issues, the validity of legal tender is discussed in the announcement, but many other legal topics such as the allocation of risk for a cyber breach, the exact contours of the finality rules, BSA/AML and data privacy for consumers have been left for a later day. That said, the Federal Reserve is right to start with core design choices on the technological framework.

Useful Resources

CBDC is a new and complex topic that also brings with it necessary discussions about the nature of money, including private money creation. For those interested in a deeper dive, here are eight articles and white papers we have found useful to get up to speed on the topic:

- [Paul Wong & Jesse Leigh Maniff, Federal Reserve, *FedNotes Comparing Means of Payment: What Role for a Central Bank Digital Currency?* \(August 13, 2020\)](#)
- [Margaret E. Tahyar & Howell Jackson, *Fintech Law: The Case Studies – Digital Currencies*, 205-27 \(August 6, 2020\)](#)
- [Jemma Xu & Dan Prud'homme, London School of Business Economics, *China's digital currency revolution and implications for international business strategy*, \(August 2020\)](#)
- [Bank of England, *Central Bank Digital Currency: opportunities, challenges and design* \(March 12, 2020\)](#)
- [Bank for International Settlements, *Investigating the impact of global stablecoins* \(October 2019\)](#)
- [Tobias Adrian & Tommaso Mancini-Griffoli, International Monetary Fund, *The Rise of Digital Money* \(July 2019\)](#)
- [Morgan Ricks, John Crawford, & Lev Menand, Federal Reserve, *FedAccounts: Digital Dollars* \(June 7, 2018\)](#)
- [Bank for International Settlements, *Central Bank Digital Currencies* \(March 2018\)](#)

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