November 19, 2019

The Honorable French Hill
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Thank you for your letter dated September 30, 2019, requesting the Federal Reserve’s views on the development of a central bank digital currency.

As your letter notes, a number of central banks are actively exploring central bank digital currency options, and the Federal Reserve is monitoring these developments closely. Further, while we are not currently developing a central bank digital currency, we have assessed and we continue to carefully analyze the costs and benefits of pursuing such an initiative in the U.S. Overall, we observe that characteristics that make the development of central bank digital currency more immediately compelling for some countries differ from those of the U.S. For example, in some countries there has been a rapid migration by consumers away from cash, while demand for cash in the U.S. remains robust. Conversely, in some countries, central banks are considering issuing central bank digital currency because there are not otherwise fast and reliable digital payment services widely available. The U.S. payments landscape is highly innovative and competitive, with many such options available for consumers. Moreover, in the U.S. context, issuing a central bank digital currency for general use would raise important legal, monetary policy, payments policy, financial stability, supervision and operational questions that need to be considered carefully. Nonetheless, the Federal Reserve will continue to analyze the potential benefits and costs of central bank digital currencies.

The following are responses to the enumerated questions included in your letter.

1. Is the Federal Reserve exploring the development, or actively developing, a U.S. Dollar digital currency?

2. What plans is the Federal Reserve making to respond if digital fiat currencies or their private sector equivalents begin to gain traction?
In response to questions 1 and 2, the Federal Reserve is not currently developing a U.S. dollar central bank digital currency (CBDC), but continues to carefully evaluate the costs and benefits of issuing a general purpose CBDC, defined as a new type of Federal Reserve liability that could be held directly by households and businesses. As described below in the response to questions 4 and 5, there are a number of challenges and risks entailed in issuing general purpose CBDC for widespread use.

In analyzing the potential costs and benefits of general purpose CBDC, we are carefully monitoring the activities of other central banks to identify potential benefits that may be relevant in the U.S. context. To date, our observation is that many of the challenges they hope to address do not apply to the U.S. context including disuse of physical cash, narrow reaching or highly concentrated banking sectors, or, poorly developed payment infrastructure, more generally. In addition to the developments at other central banks, we are also tracking private sector initiatives. We are, for example, scrutinizing the Libra initiative closely and are in active dialogue with other regulators domestically and globally.

We also continue to conduct our own research related to general purpose CBDC, including conducting small-scale research-oriented technology experiments aimed at giving us hands-on experience to better understand the opportunities and limitations of possible technologies behind general purpose CBDC. These efforts position the Federal Reserve to be able to react more expeditiously to rapid developments in this arena.

3. What legal, regulatory, or national security issues would prevent the Federal Reserve’s development of a U.S. Dollar digital currency?

Before the Federal Reserve could contemplate developing and issuing a general purpose CBDC, several significant legal questions would have to be addressed. In addition to an underlying question of authority, there are many unanswered questions about the legal status of general purpose CBDC, such as whether it would constitute legal tender, and how the rights and obligations of participants in such a system would be determined. The Federal Reserve would also need to consider many policy implications for developing and issuing a general purpose CBDC, such as the potential impact on monetary policy, financial structure, financial stability, and other technological and security risks.

4. What benefits or detriments do you see the Federal Reserve incurring as a result of developing a U.S. Dollar digital currency, especially as it relates to upholding its mandates and policy goals?

A general purpose CBDC would raise important policy, operational, and, as mentioned above, legal questions. From a policy perspective, general purpose CBDC raises questions on a number of levels. If it is designed to be financially transparent and provide safeguards against illicit activity, a general purpose CBDC could conceivably require the Federal Reserve to keep a running record of all payment data using the digital
currency—a stark difference from cash, for instance—and something that raises issues related to data privacy and information security.

The specific design of a general purpose CBDC, for example, whether it pays interest or whether there would be limits on supply, would impact how a general purpose CBDC interacts with monetary policy. To date, we have not identified potential material benefits of general purpose CBDC to the implementation of monetary policy relative to our existing tools.

In terms of financial stability, offering an option for the public to quickly, and at a relatively low cost, reallocate liquidity from the private sector to the Federal Reserve in potentially unlimited size entails the risk of exacerbating runs from private markets when these markets experience a stress episode.

Lastly, a general purpose CBDC would raise many operational challenges that would need to be addressed. These include increased exposure to cyberattacks, the need to potentially open and provide service to accounts which could number in the hundreds of millions, and questions associated with alternative technologies being able to achieve the reliability, integrity, and scalability as central bank systems in use today.

Alternatively, we are assessing whether general purpose CBDC would lead to safer, less expensive, faster, or otherwise more efficient payments. As noted above, many of the challenges that general purpose CBDC could potentially address do not apply to the U.S. context including disuse of physical cash, narrow reaching or highly concentrated banking sectors, and poorly developed payment infrastructure, more generally. The U.S. payments landscape is highly innovative and competitive, with many fast, reliable digital options available for consumers. It is not yet clear what additional value a general purpose CBDC could provide in the U.S.

5. What market risks, if any, do you see in the development, or failure to develop, a national digital currency?

The provision of general purpose CBDC could potentially replace private-sector financial service provision with public-sector provision. For example, banks’ provision of credit and other services to households and businesses could be profoundly impacted by a general purpose CBDC, depending on its design. Similarly, the present diversity of payment service providers, both bank and nonbank, may be affected by the issuance of a general purpose CBDC. While the Federal Reserve fosters the safety and efficiency of the payment system by offering interbank payment services, direct provision of payment services to households and businesses would represent a major change. The FedNowSM Service is being developed to permit banks of every size in every community across the country to be able to provide real-time payments to their customers, but it will not entail the Federal Reserve serving those customers directly.
6. Please provide a description of any salient design features that would have to be considered or specified by Congress for the development of a U.S. Dollar digital currency (e.g., access and transfer mechanisms for such currency, the degree of anonymity of transaction vis-à-vis the central bank, parameters of a potential pilot program, and any cyber or other operational considerations)?

There are a number of potential policy choices or design features that would have to be considered for the development of a general purpose CBDC. These choices include, but are not limited to: what parties general purpose CBDC would be available; whether general purpose CBDC would pay interest and, if so, at what rate. A determination also would need to be made as to how the outstanding stock of a general purpose CBDC would be governed and whether transacting in CBDC would require the use of a Federal Reserve payment system. Moreover, consideration would need to be given to whether the ownership of and transactions made with general purpose CBDC should be anonymous, akin to cash ownership and transactions, or traceable by the Federal Reserve. Furthermore, a decision regarding which technology solution or solutions would best support CBDC implementation would also need to be made.

I hope you find this information helpful. I look forward to continuing our dialogue on this important issue.

Sincerely,

[Signature]

Irene H. Ravel