

## **Yves Mersch: The role of cash - customer retention and tie to the citizen**

Contribution by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, to The Banker, 1 September 2017.

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There is much talk about the demise of cash. But to paraphrase Mark Twain, reports of its death are an exaggeration. Cash remains popular. A crucial point for banks to understand, since respecting clients' needs and wishes is a precondition to ensuring their loyalty and support. This not only applies to the relationship between private banks and their clients, but also between central banks and the public, where cash provides a tangible daily link. I will discuss each in turn.

### **Private banks: cash is a means of customer retention**

The banking sector is confronted with low profitability as well as high and increasing competition from other banks and non-banking start-ups, so-called fin-techs. In this environment, customer retention is pivotal to staying in business: if your customer is not satisfied, he most likely will not stay your customer. Therefore, it is important to ensure that customers' interactions with banks can be carried out in a way that satisfies the customers the most.

Take the use of cash and the growing shift to newer payment systems. There is a wide and ever increasing supply of non-cash payment systems available, such as credit cards, electronic payments, portable wallets and mobile phone payments to name but a few. As more people adapt to new payment options, banks' established business models can be disrupted. Banks need to remain agile and endeavour to meet their customers' evolving desires.

In this context, some see major business opportunities arising from abolishing cash, by eliminating the high storage, issuance, and handling costs that the financial industry currently faces. Customers would benefit, too, as they would no longer need to carry wads of cash or search for ATMs.

But this assumed increase in convenience would come at a cost. There are a wide range of legal, governance and operational questions that need to be considered carefully before switching away from cash. Just as cash has a number of technological safeguards to protect from counterfeiting, innovative payment systems require significant safeguards to protect individuals from theft and from loss of personal information. That protection of personal information extends to ensuring the ability of law-abiding citizens to maintain their anonymity and addressing legitimate concerns surrounding the use of Big Data for personal profiling.

Most importantly, empirical evidence suggests that the lobbying to abolish cash fails to respect the will of the people: cash remains popular. Recent research for the ECB finds that 80% of transactions at point of sale are in cash. Even adjusting for the value of transactions, cash still accounts for the majority. Indeed, the demand for cash currently outstrips the growth in nominal GDP.

Banks should see such developments as a positive opportunity to engage with customers, without actively pushing them away from cash where it remains their preference. Enabling customers to manage their finances in the manner that most appeals to them encourages loyalty and supports customer retention.

### **Central banks: cash is a link to the citizen**

Central banks face similar questions. They are confronted with proposals to abolish cash and replace it by digital variants. But this, too, has implications for their relationship with their ultimate

clients – the general public.

Central banks have issued cash since their inception. For cash to carry out its roles as a medium of exchange and store of value, the public has to have trust in its integrity. And for monetary policy to be effective, trust in the central bank and support by the citizens is required.

To maintain that integrity and protect the currency from counterfeiters, central banks have not only adopted innovations at the cutting edge of printing technology, but actively driven innovation in that area. The ECB's recent €50 note – issued earlier this year – is no exception, incorporating an enhanced range of security features.

But the technological developments mentioned earlier have also encouraged more radical ideas, including the abolition of cash. Some argue in favour of overcoming the restrictions on monetary policy arising from the zero lower bound, others aim at undermining illicit activities by eliminating their preferred means of payment.

I am sceptical about these arguments.

First, central banks worldwide implemented various unconventional measures during the past decade which were effective in meeting the challenges of low inflation. Negative nominal interest rates have worked, without triggering a flight to cash, especially when combined with other unconventional measures. Still, while it might be feasible to set extreme negative rates in a theoretical model, I wonder how the public would react. Not only would such rates be deeply unpopular, there may be unintended changes in behaviour that would dampen their effectiveness.

As the Bank for International Settlements recently found, there seems to be an independent role for nominal interest rates in the transmission process, regardless of the level of real rates. Monetary policy transmission could be weakened by the headwinds that may arise in the aftermath of balance sheet recessions. Likewise, inherent non-linearities could kick in when interest rates are persistently low and may dampen their impact on spending.

The law-and-order case for banning cash also wilts under scrutiny. By acting as a store of value and a means of payment, cash fulfills an important social function for many honest citizens. Would anyone suggest forbidding cell phones because criminals use them? Harming the law-abiding majority in order to punish a misbehaving minority is a step too far.

Last but not least, cash is the only central bank liability available to the public. Digital claims against central banks already exist – commercial banks and some other types of institutions hold them in the form of deposits. But private citizens have no access to them.

Although electronic payments provided by the financial industry are used by private customers, these methods are based on commercial bank money. From the perspective of the citizen, a liability vis-à-vis the central bank is more valuable than one vis-à-vis a commercial bank, not least because of the different credit risks. Bank deposits and other commercial bank liabilities are highly protected, but they are not absolutely risk-free. A central bank, however, can never become illiquid and can always honour its liabilities.

Cash therefore maintains a tangible link between the general public and the central bank, a tie which is important for maintaining trust between the two.

But cash could be digitalised, too, given recent technological advances such as the Distributed Ledger Technology, or DLT, a variant of which is used for Bitcoin. Central banks could stop issuing cash and shift to just providing an electronic claim on the central bank. In principle, the introduction of central bank-issued digital currency or digital base money (DBM), as I have called it, would be much easier and potentially less expensive than ten years ago.

But the challenges go beyond the technological sphere. Would DBM involve each individual having an account at the central bank, or instead a decentralised system where each individual has an electronic wallet and the central bank is unaware of transactions that take place? Either solution could be implemented using distributed ledger technologies, but the set-up would be quite different in each scenario.

A further important question is whether DBM would be remunerated (as excess central bank reserves held by commercial banks currently are) or not, like cash. Either option has implications for household behaviour. Should DBM not be remunerated and the deposit facility rate be negative, as it is now, commercial banks may try to circumvent the regulations by setting up non-bank subsidiaries, which could in turn affect the efficacy of monetary policy.

In any case, DBM would require significant safeguards to protect individuals from theft and from loss of personal information. In addition, any potential DBM solution needs to be assessed against some high level principles, including: (1) technological safety, (2) efficiency, (3) technological neutrality and (4) freedom of choice for users of means of payments.

The different options have potential impacts – both positive and negative – that need to be studied and considered carefully. Only when the best way of designing DBM has been identified, can it be decided if DBM for non-banks should be introduced at all. The most important question for the ECB is whether introducing DBM would affect our ability to honour our mandate. Adopting untried technology that ultimately proves unreliable could seriously endanger public trust in the currency and in the central bank.

## **Conclusions**

There are valid reasons for maintaining cash, from the perspective of commercial banks and central banks alike.

Given the widespread desire to use cash, banks should facilitate rather than obstruct customers in using their preferred method of payment. Time will tell how the use of cash will evolve once instant payments are introduced in the near future.

For central banks, cash is a tool to build trust. Cash provides the general public with direct access to central bank money. For an independent institution like the ECB, maintaining that link is important, which is why we place great emphasis on ensuring people's continued trust in cash.