

The Central Bank of Chile's approach to retail CBDC

This document describes the current status of the analysis conducted by the Central Bank of Chile (BCCh) on the eventual issuance of a retail central bank digital currency (CBDC). Since this process is at an early stage, no formal policy decision has been made yet. An internal Working Group (WG) on CBDC is preparing a white paper scheduled for release in early 2022 which will assess and describe future steps on this matter.

The BCCh established the WG with the objective of exploring and proposing a medium- to long-term strategy on digital payments in Chile. Currently, the WG has scoped the internal discussion on retail CBDC. Its first duty is to understand whether there could be a compelling reason for a future issuance of CBDC in Chile. Thus, it has been relevant to assess the current situation of the Chilean retail payment system, looking for possible motivations for a retail CBDC and further designing principles for its eventual implementation.

1. Objectives and considerations for a retail CBDC issuance

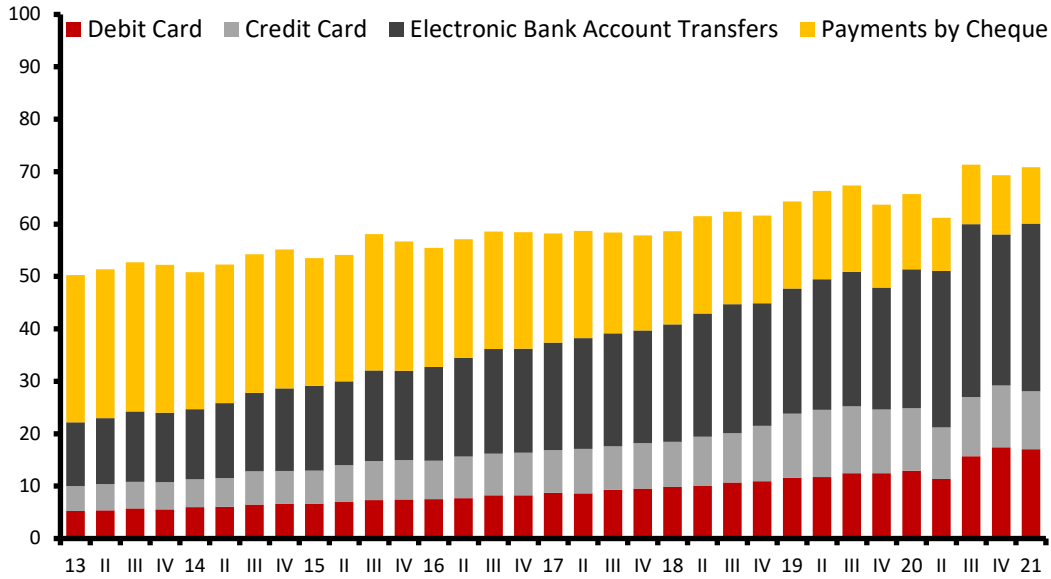
1.1 An overview of the Chilean retail payment system

- The Chilean retail payment system is performing adequately for the level of development of the economy. From the analysis performed, there are no relevant gaps that can be minimised with a CBDC solution.
- A broad view of the local retail payment system can be captured with the following figures:

Non-cash personal payments

As a percentage of GDP

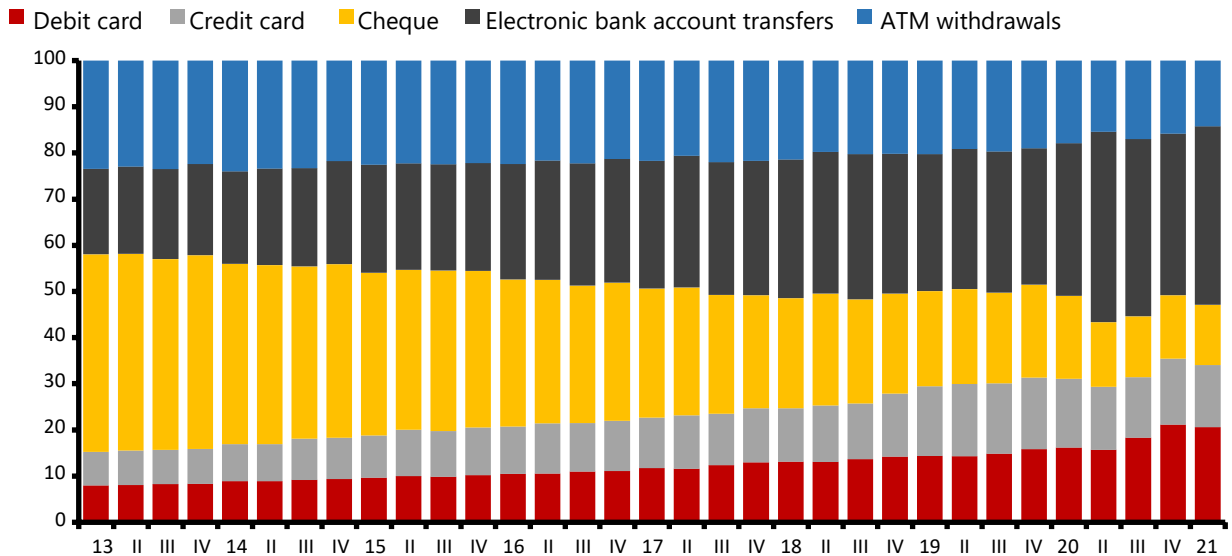
Figure 1



Source: BCCh, with Financial Market Commission data.

Distribution of personal payments

Figure 2



Source: BCCh, with Financial Market Commission data.

- According to the figures, the retail payment system has an adequate level of digitisation. There are several means of payment available to end users. Although an estimate of the use of cash for retail payments cannot be made from the figures, it is manifest that cash withdrawals from ATMs are declining.
- Even if overall financial inclusion in Chile from a comprehensive perspective can be improved, there is a significant level of access to basic financial products and

digital payments. The Chilean state-owned bank, BancoEstado, offers a bank account with a debit card linked to each citizen's identification number. In 2020, there were 1.08 active credit and debit cards for each citizen and 45% of these cards were issued by BancoEstado, which represents 63% of the adult population. Historically, this type of bank account has been mainly used for withdrawals from ATMs, but in recent years BancoEstado has offered innovations to its users related to payment methods, which has increased their use for transactions. This view is consistent with various financial inclusion reports made by the Financial Market Commission in which this idiosyncratic bank account is declared as a relevant financial product for accessing the Chilean banking system.¹

- With regard to fast payments, since 2008 payments by direct transfer from bank accounts have been seen by users as instant payment, 24x7, although there are some internal post-payment bank processes.
- In recent years, the regulatory framework for card issuers has been modified to open up access to the payment system to more and/or different participants. With these changes, non-bank financial institutions can issue prepaid cards and receive deposits from individuals for the exclusive purpose of completing payments.
- There are competition challenges within the payment system and some difficulties related to the implementation of the four-part model for payment card networks. A committee, with members including the Financial Market Commission and the BCCh, has been appointed by law to determine the maximum exchange fee to be paid from acquirers to issuers of payment cards, an innovation that is intended to boost competition, among other goals.
- The Government has sent a bill to Congress known as the "Fintech Law" that includes topics such as the introduction of open banking and regulation for stablecoins. In addition, the BCCh has issued a public consultation on a regulation to incorporate payment service providers and retail payment processors into the regulatory perimeter, endorsing the implementation of low-value payment clearing houses.

1.2 Drivers of CBDC issuance

The WG has been exploring whether there are relevant reasons that could incentivise a potential CBDC issuance in Chile. The WG is currently confident about the following motivations.

Homogeneity of public money and commercial bank money

- The main methods of payment are cash, physical money issued by a central bank, and demand deposits, digital money offered by banks. Both are denominated in the same unit of account and have a 1:1 guaranteed conversion.
- In the absence of demand for cash, there must exist another instrument issued by a central bank that should homogenise the value of any other commercial bank money. This gives a guarantee of the acceptance of all means of payment offered by the banking system.

¹ See www.cmfchile.cl/portal/estadisticas/617/articles-38692_doc_pdf.pdf.

- The central bank is the only agent that could ensure that there is an asset in the economy that links bank deposits and bank transactions to the value of the national fiat currency. Therefore, it could be a commitment from the public sector to provide this instrument to the local financial system and to the public. Currently, this instrument is cash. Then, in a scenario where the use of cash as means of payment decreases substantially, the BCCh would be prepared for this new reality.

Efficiency and resilience of the financial system

- If the CBDC issuance originates with the objective of developing a new payment infrastructure with redundancy as a criterion of resilience, the CBDC could strengthen the quality of the retail payment system.
- In addition, the new infrastructure of the CBDC system could stimulate more activity from private agents to innovate and offer new payment solutions.

CBDC as a platform for a digital economy

- The challenge of being prepared to act properly for future scenarios of disruptive changes in payments is a relevant driver for an eventual CBDC implementation. In these terms there is a case for CBDC as a new digital payment platform which could provide access to central bank digital money, becoming the basis for new – and hitherto unseen – payment solutions. In this case a CBDC could leverage future innovation in payments of private and public agents and enhance the system.
- The potential massive use of cryptocurrencies, even a foreign CBDC, as a local means of payment could severely impact financial stability and the transmission of monetary policy. In Chile there is public confidence in the local currency (it is used as a unit of account, store of value and means of payment), so currently this concern is not a priority. However, in conjunction with other measures a properly designed CBDC could help to mitigate this type of risk in the future.

2. Basic design principles for CBDC

- In CBDC, an appropriate design is relevant due to potential consequences for payment systems, financial policy, and monetary policy transmission. Therefore, it is important that design decisions are aligned with the BCCh mandate and authority, and the policy objectives derived from it.
- Furthermore, design considerations depend on the main objectives to be addressed and the associated costs. Hence, design considerations from jurisdictions with which Chile has commercial and financial relations are particularly relevant.
- The WG has been evaluating an initial list of principles for a potential CBDC issuance in Chile, having as a central principle “do no harm” to the financial system, as several central banks have already stated. Despite the BCCh being at an exploration stage, the following principles have been raised by the WG:
 - a) **Enhance the payment system.** CBDC should be complementary to cash. It should be designed as a “good means of payment” and not as

a store of value per se. Some design decisions could include for CBDC holdings not to earn interest and/or limiting the amount of CBDC held in digital wallets, the underlying idea being not to disintermediate the banking system.

- b) The WG is considering a **preference for an indirect model**, such as the hybrid model or the intermediated model, within the two-tier architecture options. Since a (retail) CBDC is registered as a liability for a central bank, a relevant design choice is defining whether the BCCh should interact directly with end users or not. In general terms, as it does today, the BCCh should exclusively manage the issuance of money, and it should not necessarily be responsible for the entire distribution process. In this scenario the BCCh would externalise all functions and responsibilities that the private sector and other authorities already perform. For instance, the private sector could manage the CBDC distribution to end users and all onboarding and compliance obligations such as know-your-customer (KYC) policies.
- c) **Interoperability level.** As mentioned, a CBDC should improve the system; therefore, in achieving this goal, a Chilean CBDC should not create a segmented payment system outside of the current system. The challenge is that greater integration among different systems could be more costly and complex and it is not clear that potential benefits derived from full interoperability in the system would offset its cost. There is a trade-off on how much interoperability the BCCh should implement for a proper CBDC design.