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# Fed outlines how banks can live with a CBDC

Article

**The news:** Through a newly issued paper, the Federal Reserve is seeking to start a conversation about creating a US central bank digital currency (CBDC).

**More on this:** The document outlines pros and cons of a CBDC—often nicknamed the **digital dollar**—but stays neutral on whether one should be created.

- A digital dollar would have key advantages over other digital assets, the Fed notes in its paper, stating that it **"would be the safest digital asset available to the general public, with no associated credit or liquidity risk."**

- By contrast, crypto and stablecoins—which are subject to the creditworthiness of whoever backs them—need ways to lower liquidity and credit risks, per the paper.

The central bank is also seeking public comment to continue the dialogue, with a May 20, 2022 submission deadline. It hopes to gather feedback from stakeholders ranging from elected officials to the general public.

**What would a CBDC mean for banks?:** While the Fed states that a US CBDC would be a liability on its own balance sheet instead of on the banks', **it envisions banks playing an intermediary role:**

- The Fed points out that it **lacks statutory authority to offer people bank accounts**. Instead, banks could offer accounts or digital wallets designed "to facilitate the management of digital-dollar holdings and payments."
- Banks could also **pair consumer CBDC accounts with their current frameworks for identity management and privacy.**
- Hanging onto financial institutions as intermediaries **may also improve the prospects of further innovation related to digital dollars.**

Conversely, the Fed cautions that banks may face new risks with a CBDC—and notes that they could be mitigated:

- A digital dollar **could indirectly raise costs for borrowers and reduce the availability of credit**. This is because a US CBDC **could gain usage at the expense of banks' deposits**, which they use to fund their lending, and in turn drive up their funding costs.
- The deposit-substitution effect could be dampened by **limiting holdings of CBDC or ensuring that the digital currency doesn't bear interest.**
- A CBDC **could also make bank runs worse** due to a flight-to-safety scenario, where people pull their funds and place them in a less-risky asset. As mitigation measures, the Fed suggests **capping digital-dollar accumulation over a given time period, plus a broader holdings limit.**

**The big takeaway:** If a digital dollar becomes a reality, banks will likely remain important players in the US financial system due to their technical expertise in account management. If curbs are imposed on CBDC holdings and interest, banks would also become important players within the stablecoin space.

Because both the digital dollar and stablecoins can be used as a store of value and for payments, a digital dollar's lack of credit and liquidity risks gives it a big advantage over stablecoins. However, if the Fed sets limits, bank-backed stablecoins like **USDF** could become the preferred complementary choice because members can leverage their status as FDIC-backed institutions.

The Fed's credibility, plus a digital dollar's simpler distribution and storage models, means account holders are more likely to prefer CBDCs to stablecoins. This would pose a threat to stablecoins like **Tether** that are issued by standalone players like **Bitfinex,** which was fined by the Commodity Futures Trading Commission (CFTC) after the regulator learned that it wasn't fully backed by US dollars.

*To learn about a US CBDC's impact on payments, read our Payments & Commerce team's overview.*

**Financial Institutions' Perceived Uses of Select Cryptocurrencies for Businesses According to Financial Executives Worldwide, Aug 2021**

*% of respondents*

| | Transacting only | Investing only | Both |
|---|---|---|---|
| Ether | 0.0% | 3.4% | 96.6% |
| Stablecoins | 2.9% | 1.0% | 96.2% |
| Bitcoin cash | 4.1% | 0.0% | 95.9% |
| Bitcoin | 3.7% | 3.1% | 93.2% |
| Alternative coins | 0.0% | 7.4% | 92.6% |
| Ripple | 0.0% | 9.7% | 90.3% |

*Source: PYMNTS.com, "Cyptocurrency, Blockchain and Global Business: Assessing the Potential for Multinational Companies and Financial Institutions" in collaboration with Circle, Aug 11, 2021*

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