India's Central Bank outlines Digital Rupee known as CBDC

~Sumat Singhal

In month of October beginning, India's central Bank i.e. Reserve Bank of India has issued the Concept note on Central Bank Digital Currency and it has calibrated its strategy for introducing a full-scale central bank digital currency (CBDC).
Lets discuss about CBDC, its objective, benefits, challenges and way forward-

What is Central Bank Digital Currency (CBDC)?
Consider CBDC as a digital form of a paper currency and not like cryptocurrencies because it operate in a regulatory vacuum. CBDCs are legal tenders issued and backed by a central bank.
It is the same as a *fiat currency** and is exchangeable one-to-one with the fiat currency.

**A fiat currency is a national currency that is not pegged to the price of a commodity such as gold or silver.*

The digital fiat currency or CBDC can be transacted using wallets backed by *blockchain**.
It is believed that Retail CBDC can provide access to safe money for payment and settlement as it is a direct liability of the Central Bank

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**Block chain is a form of public ledger, which is a series (or chain) of blocks on which transaction details are recorded and stored on a public database after suitable authentication and verification by the designated network participants. The block chain is not only about the cryptocurrency but is actually a pretty reliable way of storing data about other types of transactions, as well. In fact, blockchain technology can be used in property exchanges, bank transactions, healthcare, smart contracts, supply chain, and even in voting for a candidate.*

Model for issuance and management of CBDC

- ✓ There are two models for issuance and management of CBDCs viz. Direct model (Single Tier model) and Indirect model (Two-Tier model). A Direct model would be the one where the central bank is responsible for managing all aspects of the CBDC system viz. issuance, account-keeping and transaction verification.

- ✓ In an Indirect model, central bank and other intermediaries (banks and any other service providers), each play their respective role. In this model central bank issues CBDC to consumers indirectly through intermediaries and any claim by consumers is managed by the intermediary as the central bank only handles wholesale payments to intermediaries.

  The Indirect model is akin to the current physical currency management system wherein banks manage activities like distribution of notes to public, account-keeping, adherence of requirement related to know-your-customer (KYC) and anti-money laundering and countering the terrorism of financing (AML/CFT) checks, transaction verification etc.

Objectives to issue CBDC:

- The main objective is to mitigate the risks and trim costs in handling physical currency, costs of phasing out soiled notes, transportation, insurance and logistics.
- It will also discourage people away from cryptocurrencies as a means for money transfer.
- Easier Cross-Border Payments: It could also be used for cross-border payments, it could eliminate the need for an expensive network of correspondent banks to settle cross-border payments.
- CBDC is aimed to complement, rather than replace, current forms of money and is envisaged to provide an additional payment avenue to users, not to replace the existing payment systems.

Challenges:

- CBDC may have a potential for disintermediation in the financial system resulting from loss of deposits by banks, impeding their credit creation capacity in the economy. Also considering that physical cash does not carry any interest, it would be more logical to offer non-interest bearing CBDCs.
- The shift to CBDC can impinge upon the bank's ability to plough back funds into credit intermediation and if the Reserve Bank of India (RBI) places no limit on the amount that can be stored in mobile wallets, weaker banks may struggle to retain low-cost deposits.

How it is different from existing mobile wallet payment system?

Whenever a new payments technology is introduced, questions are raised on its differences and advantages over existing payment systems.

When considering CBDC versus mobile money, CBDC is said to be different from any other type of payment instrument including mobile money, card payments, or electronic funds transfers.

Lets try to understand few difference between CBDC and Mobile wallet

- **Issued by the Central Bank**

CBDC is a national digital currency issued by the central bank that is expected to replace or coexist with fiat money and hold the same value. Mobile money, on the other hand, utilizes existing commercial banking-based accounting to manage customer wallet balances based on exchange with cash or lines of credit and loans.

- **Liability of the Central Bank**

CBDC is somewhat a direct liability on the central bank as it is the main issuer of the currency, whereas mobile money is the liability of commercial banks and other authorized financial institutions. Although some implementation approaches propose that CBDC can be implemented in either an indirect or hybrid form, its liability still remains on the central bank.

- **Universally Accessible**

Universal accessibility remains an unresolved dilemma when it comes to implementing CBDC. The word universal is limited to the demographic nature of the population of a country, and while cash is accessible to people of all ages, both CBDC and mobile money have accessibility limitations.

For example, mobile wallets are subject to Know Your Customer (KYC) age limitations where some age groups are restricted from creating wallets. However, it is expected that new regulatory frameworks will provide the means for CBDC to be universally accessible at the national level.

- **Peer-to-Peer Nature**

There is no single payment mechanism or type of money that is peer-to-peer today except for commodities, cash banknotes and coins, unauthorized cryptocurrencies and stable coins. CBDC is expected to be designed as another peer-to-peer model that provides similar mechanisms for exchanging cash banknotes and coins between the senders and receivers of CBDC.
On the other hand, mobile money, card payments and electronic fund transfers require the presence of intermediary issuing and acquiring banks, financial institutions, or Payment Service Providers (PSPs) to authorize and validate the payments.

Way Forward

- The introduction of CBDC has the potential to provide significant benefits such as reduced dependency on cash, reduced cost of RBI due to lower transaction costs, and reduced settlement risk.
- It would possibly lead to a more robust, efficient, trusted, regulated and legal tender-based payments option.
- There are associated risks, no doubt, but they need to be carefully evaluated against the potential benefits.
- It would be the RBI's endeavour, as we move forward in the direction of India's CBDC, to take the necessary steps which would reiterate the leadership position of India in payment systems

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