

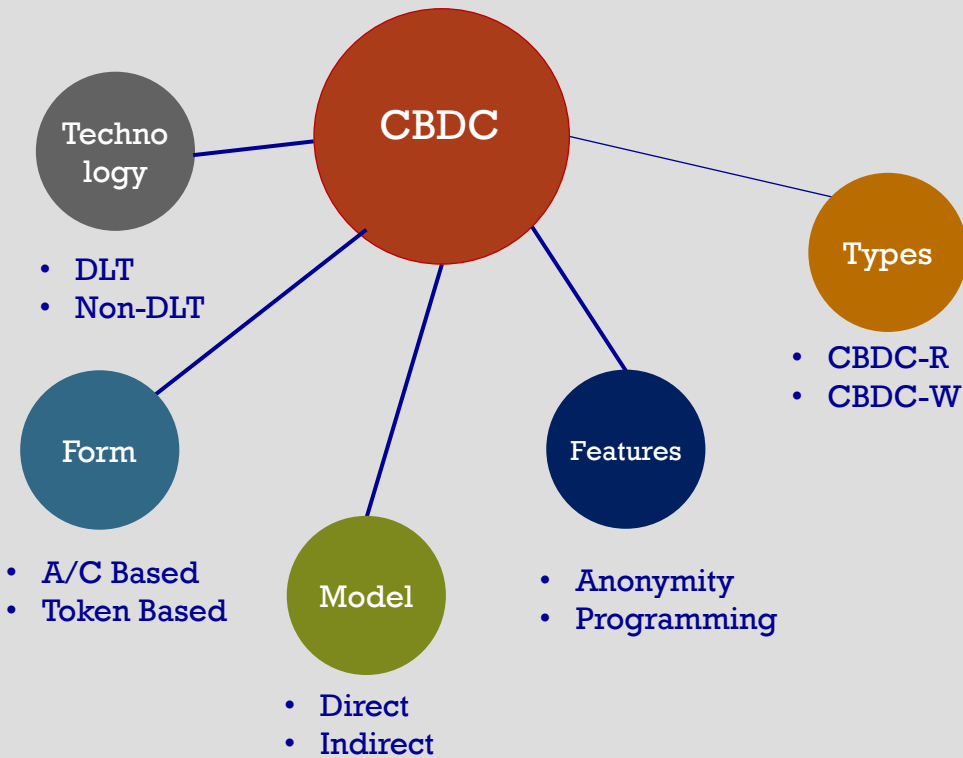


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CBDC: A THREAT OR OPPORTUNITY

Perspective for Banks and Payment Systems

Brief snapshot of CBDC



Reserve Bank of India (RBI) has issued a concept note (“**Concept Note**”) on Central Bank Digital Currency (“**CBDC**”). The above extracts from the Concept Note have stated the short comings of private cryptocurrency in comparison with CBDC. The Concept Note has given the futuristic thinking in relation to CBDC which is going to overhaul the entire payment system in India. The Concept Note issued by RBI is going beyond CBDC vis-à-vis crypto-currency and has shown a vision for various limbs of financial technologies (FinTech).

Important terms and concepts under Concept Note are as under:

- **Types:** The CBDC can be of two form one for retail use (CBDC-R) and other for wholesale institutions (CBDC-W).
- **Model:** The issuance and distribution of CBDC can be done directly by central bank or it can be distributed through intermediaries.
- **Form:** The form of CBDC can be account base like our bank accounts or it can be tokenised where accounts verification would not be required.
- **Technology:** The technology can be distributed ledger (DLT) or conventional which will be centralised (NON-DLT).
- **Features:** The anonymity is like cash transaction total fungible without any trail and given digital nature of CBDC it can be programmed to perform automated function.

“...the inherent design of cryptocurrencies is more geared to bypass the established and regulated intermediation and control arrangements that play a crucial role of ensuring integrity and stability of monetary and financial eco-system.”

-RBI’s Central Bank Digital Currency (CBDC)-Futuristic Concept Note

Important Aspects of Concept Note

What is CBDC?

“Reserve Bank defines CBDC as the legal tender issued by a central bank in a digital form. It is the same as a sovereign currency and is exchangeable one-to-one at par (1:1) with the fiat currency.” [CH 2: page 15]

LK Note: CBDC doesn't depend on mining as crypto currency. The entire system is to tokenize the fiat currency in a way that it inherits the decentralised functionality of crypto-currency.

How it is different from current digital money (like Paytm/ Gpay)?

“An Indian CBDC should be able to utilise the current payments infrastructure like UPI, digital wallets like Paytm, Gpay etc. Interoperability between payment systems contributes to achieving adoption, co-existence, innovation, and efficiency for end users.” [CH: 5; pg 35].

LK Note: In simple words, the back end of individual bank account and dealings will change, impacting the efficient transfer and settlement. For example, one may not need a bank

Why is RBI so interested in CBDC?

“Central Banks seek to meet the public's need for digital currencies, manifested in the increasing use of private virtual currencies, and thereby avoid the more damaging consequences of such private currencies.” [CH 3: pg 16]

LK Note: The CBDC features address various concerns of RBI given sudden rise of crypto-currency:

- Sovereign Currency
- Liability in Central Bank's balance sheet
- Accepted as medium of payment
- Freely convertible with fiat cash
- Fungible token to be accepted without bank account
- Cost reduction in issuance and maintenance

Whether CBDC will bring an end to current private payment system operators?

“A CBDC could overcome this barrier and allow private sector innovators to focus on new access services, distribution methods, and related service offerings. Finally, a CBDC might generate new capabilities to meet the evolving speed and efficiency requirements of the digital economy.” [CH 3: page 19]

LK Note: It may bring an end to the current form of payment and settlement but it will open a huge opportunity for private players as de-intermediation will happen. As elimination of inter-bank settlement and guarantee of intrinsic value of CBDC will open a huge innovation opportunity.

What degree of privacy/anonymity would apply and who could hold CBDC?

“...the European Central Bank (2019) has experimented with the concept of a CBDC with elements of programmable money, by which individuals could be allotted a certain amount of ‘anonymity vouchers’ that could be used for small transactions, with larger transactions still visible to financial intermediaries and the authorities, including those responsible for AML and CFT...”[CH 4: pg 28]

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What is the Programmability function for CBDC?

“One interesting application of CBDC is the technical possibility of programmability. This may help in ensuring the end-use which banks have to continuously grapple with across the globe. However, the programmability feature of CBDC needs to be carefully examined in order to retain the essential features of a currency.” [CH 5: pg 34]

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What are the various areas RBI thinks CBDC will be used?

“Further, CBDCs have some clear advantages over other digital payments systems, as it being a sovereign currency, ensures settlement finality and thus reduces settlement risk in the financial system. CBDCs could also potentially enable a more real-time, cost-effective seamless integration of cross border payment systems.” [CH 3: pg 16]

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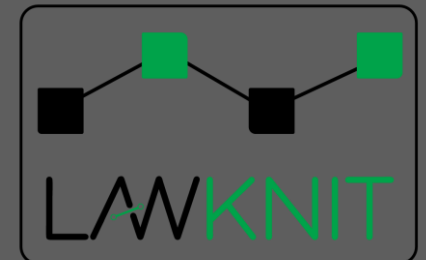
What is offline functionality of CBDC?

“Visa has also proposed an Offline Payment System (OPS). The protocol outlined by Visa allows CBDCs to be directly downloaded onto a personal device, such as a smartphone or tablet. The money is stored on a secure hardware embedded in that device and managed by a wallet provider. The CBDC can be transacted from one device to another device directly without any intermediaries such as banks, payment networks, or payment processors using Bluetooth and Near Field Communication.” [CH 5: pg 34]

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Thank you!

In case of any queries/clarifications, please feel free to reach out to Mr. Arunabh Choudhary at arunabh@lawknit.co



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