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Winter 2023

Wholesale Central Bank Digital Currency (CBDC) and UK Economic Security Policy Briefing

In September 2023, The University of Manchester hosted delegates from government, the private sector and academia to examine the potential ramifications of adopting a RLN on UK economic security.

They found that a UK Wholesale CBDC (or more accurately UK participation in a Regulated Liability Network [RLN]) **presents a viable and important opportunity to improve the competitiveness of the UK's financial services industry at limited cost or risk to the UK taxpayer.** As well as benefiting the financial services sector, there is also significant potential economic security benefit related to the more effective regulation of financial markets through the adoption of a UK RLN.

Background

- In the past two-years, the potential adoption of Wholesale CBDC (or Regulated Liability Network - RLN) for interbank transfers and securities transactions been the focus of attention both within the UK government and internationally.
- Rather than Retail CBDC, which would change how individuals access money, a RLN refers specifically to money used exclusively within the financial sector.
- Currently, wholesale payments represent approximately 98% of payments made through the Bank of England's Real-Time Gross Settlement (RTGS) system – as opposed to approximately 2% for retail transactions.
- **There are approximately £720 billion of RTGS transactions daily in the UK and the international market is commensurately larger still.**
- However, these systems are relatively slow, lack transparency for participants, and expensive.

Key developments in RLN (Regulated Liability Networks):

- A UK RLN would represent **a significant technological upgrade** to the current systems that facilitate these transactions by combining asset and liability digital ledgers.
- **The RLN structure is designed to ensure interoperability** so that banks don't need to use the same type of blockchain to transfer tokens between them.
- Proponents of a UK RLN highlight its **potential for reducing transaction costs, improving settlement times**, and allow for holistic, real-time monitoring of transactions.
- Central to a UK RLN's effectiveness is the application of digital ledger technology to overcome challenging siloing effects in existing financial systems that are expensive, inefficient, and more difficult to monitor because of their interdependent but not connected ledgers.
- **The underlying technology required for a UK RLN already exists** (in various different forms) and has been piloted both in the UK and internationally.

Private pilots, too, have demonstrated the viability of the technology, notably ongoing work in the Citi-SETL sandbox in a US-UK collaboration.

- Key outcomes from these projects have been the demonstration of Wholesale CBDC/RLN in enabling **faster payments, atomic settlement** (whereby both sides are settled simultaneously), and **safer more accessible transactions**.
- Most designs for a UK RLN propose maintaining existing API standards and protocols, enabling a relatively easy adoption and interoperability.
- From a regulatory perspective, considering that data regarding wholesale transactions are already shared with multiple counterparties and regulators, **privacy issues do not apply**.
- **The UK adoption of a RLN is time sensitive.**
- It is highly likely that digital ledger technology will be adopted internationally for clearing and settlement functions, and **the UK will benefit from participating in the development of international standards**.

The adoption of a RLN will affect whether the UK maintains or grows its position as global financial centre versus losing out to more nimble competitors

- The UK's large financial services sector offers scale and a depth of expertise in understanding and operating international, cross border, complex, multi-currency ledgers. This means that **the UK holds several advantages for adopting and benefiting from a RLN, but also faces greater risks from lagging behind**.

Despite outstanding questions about the specifications of a UK RLN, the different legal and technical aspects examined in recent pilots do not fundamentally change its potential impact regarding UK economic security.

Key Findings and Recommendations

The University of Manchester workshop in September 2023 made assessment of the repercussions of the adoption of a UK RLN and reached the following conclusions:

1. "Wholesale CBDC" is an unnecessary misnomer that limits effective policy discussion and is often conflated with "Retail CBDC" – **a more useful term would be Regulated Liability Network (RLN) that uses Digital Ledger technology**.
2. An RLN represents a significant improvement over existing systems for international clearing and settlement and the UK. **There is considerable evidence that its adoption will benefit the UK's financial services sector**.
3. UK adoption is time-sensitive and **there is a significant risk of loss of market share if competitors launch an attractive RLN first**. However, the UK will benefit from developing its RLN collaboratively with trusted international partners and contributing to the development of common international standards.
4. The clearest economic security benefits for the UK adoption of a RLN are in its applications in real-time financial monitoring and regulation. This represents **an important opportunity to build further resilience into the financial system** and allow for more dynamic and targeted interventions in the future.
5. However, while the adoption of a RLN will benefit the UK's financial services sector, there is limited evidence to indicate it will provide additional value for the wider UK economy and/or UK innovation.

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