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National Association of Federally-Insured Credit Unions

September 13, 2023

The Honorable French Hill
Chairman
Committee on Financial Services
Subcommittee on Digital Assets,
Financial Technology and Inclusion
United States House of Representatives
Washington, DC 20515

The Honorable Stephen Lynch
Ranking Member
Committee on Financial Services
Subcommittee on Digital Assets,
Financial Technology and Inclusion
United States House of Representatives
Washington, DC 20515

Re: Tomorrow's Hearing – Digital Dollar Dilemma: The Implications of a Central Bank Digital Currency and Private Sector Alternatives

Dear Chairman Hill and Ranking Member Lynch:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) regarding tomorrow's hearing on a central bank digital currency (CBDC). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 138 million consumers with personal and small business financial service products. NAFCU appreciates your work to ensure the United States financial system remains competitive and up to date with the most recent technological systems, and we would like to share the perspective of credit unions in advance of your hearing.

The Federal Reserve should not proceed with the development of a CBDC at this time. The hypothesized benefits of a CBDC are difficult to pinpoint given the lack of specific policy direction in current proposals. Moreover, many of the speculative benefits associated with a CBDC, such as greater payments efficiency or financial inclusion, can be achieved through less costly and more reliable alternatives: the existing financial sector infrastructure of credit unions or the Federal Reserve's own payment systems.¹ Despite recent appraisals of various CBDC use cases by different Federal Reserve Banks, many questions remain unanswered. CBDC design features necessary to achieve cash-like functionality come with serious tradeoffs that could negatively impact credit unions and pose broader financial stability risks. In some cases, those tradeoffs are difficult to anticipate because underlying regulatory policies—such as what balance to strike in terms of protecting consumer privacy, or how to guard against retail deposit substitution—are not yet developed.

¹ Speech by Governor Christopher J. Waller, CBDC: A Solution in Search of a Problem? (August 5, 2021), available at <https://www.federalreserve.gov/newsevents/speech/waller20210805a.htm>.

Offering CBDC directly to consumers through government accounts would constitute a radical expansion of the Federal Reserve's mission and involvement in the economy, and NAFCU strongly discourages any model for issuing CBDC that relies upon such an arrangement. Even in an intermediated model, where financial institutions act as providers of CBDC accounts, there is a risk that CBDC would displace commercial bank money, and the Federal Reserve has acknowledged that this substitution could "increase bank funding expenses and reduce credit availability or raise credit costs for households and businesses."² Credit unions would also be affected. Even if the Federal Reserve were to design CBDC to be non-interest bearing or impose limits on individual balances, CBDC could still be seen as a safe haven in times of crisis and this would have serious consequences on the liquidity of financial institutions, especially credit unions, if consumers substitute commercial deposits for CBDC.

One oft quoted claim is that a CBDC would promote adoption of faster or cheaper payments. Not only is CBDC redundant as a payments rail given that the Federal Reserve is already pursuing development of FedNow, a real-time settlement service, but also the allocation of compliance responsibilities to financial institutions would likely complicate, rather than complement, existing private and public sector payments innovation. The real-time speed of CBDC payments coupled with any policy directive to anonymize certain transactions to preserve end-user privacy could give rise to unique fraud risks. Financial institution intermediaries such as credit unions would assume these risks if consumer CBDC transactions are subject to the Electronic Fund Transfer Act (EFTA) and Regulation E. The involvement of nonbank intermediaries as facilitators of CBDC payments could also give rise to complex error resolution procedures that could divert resources away from other payments channels. It is also unclear how credit union intermediaries will recoup the costs of consumer compliance functions. Regulation E compliance is expensive on its own, but implementing Bank Secrecy Act/anti-money laundering oversight, cybersecurity controls, and potentially new technology to accommodate an anonymous layer of CBDC transactions would overburden credit unions that are already struggling under the weight of excessive regulation.

A CBDC would also pose serious privacy concerns. Some of the purported benefits of a CBDC require tradeoffs that could erode either consumer privacy or the auditability of transactions.³ While a maximalist view of CBDC often asserts that preserving both the anonymity and auditability of transactions can be achieved at a technical level, the lack of tangible details makes evaluation of costs and benefits of proposed solutions and their associated tradeoffs difficult.⁴ Privacy concerns would also do nothing to address the Subcommittee's goal of increasing

² Federal Reserve, Money and Payments: The U.S. Dollar in the Age of Digital Transformation, 17

³ See Federal Reserve Bank of Boston and Massachusetts Institute of Technology Digital Currency Initiative, Project Hamilton Phase 4-5 A High Performance Payment Processing System Designed for Central Bank Digital Currencies, (February 3, 2022).

⁴ See *id.* at 5 ("Equally, clear public policy objectives and product design decisions are required to inform the appropriate technical design for the system.")

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financial inclusion, as trust and privacy are some of the most often cited concerns of traditionally underserved populations.

Finally, NAFCU expects that future enhancements to cross-border digital payments will be driven by industry-led investments that are not dependent on the introduction of a U.S. CBDC. NAFCU anticipates a similar outcome for domestic payments now that the FedNow Service has launched and offers instant settlement. A CBDC is not the answer to increasing transaction speed or achieving the regulatory harmonization needed to improve cross-border payments. While new technology may hold promise for improving speed or efficiency, it is doubtful a new central bank liability is needed to achieve those goals.⁵

NAFCU expects that the net costs of a CBDC will exceed the benefits, and that administration of a CBDC will distract from the Federal Reserve's dual mandate of achieving both stable prices and maximum sustainable employment. Accordingly, the Federal Reserve should not proceed with further development activities at this time. Additionally, the Federal Reserve should not allocate resources towards investigating hypothetical models of CBDC until it has identified clear regulatory parameters, with the input of Congress and key stakeholders, that are the necessary foundation for understanding CBDC design limitations and tradeoffs.

We thank you for the opportunity to share our thoughts in advance of tomorrow's hearing on a CBDC. Should you have any questions or require any additional information, please contact me or Chad Adams, NAFCU's Senior Director of Legislative Affairs, at 703-842-2265.

Sincerely,



Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Subcommittee on Digital Assets, Financial Technology and Inclusion

⁵ Speech by Governor Christopher J. Waller, "The U.S. Dollar and Central Bank Digital Currencies" (October 14, 2022), available at <https://www.federalreserve.gov/newsevents/speech/waller20221014a.htm>.