THE INVESTMENT ASSOCIATION

Bank of England

By email to: PaymentsInnovationDP@bankofengland.co.uk

30 October 2024

Dear Sir/Madam,

Re: Investment Association response to the Bank of England's Discussion Paper on its approach to innovation in money and payments

The Investment Association (IA) welcomes the opportunity to respond to the Bank of England's (Bank) discussion paper on its approach to innovation in money and payments (DP). In summary, the IA welcomes the Bank's approach to consolidate previous consultations and discussions on the topic of digital money including the future of the use of central bank digital currency (CBDC) in wholesale transactions (wCBDC).

The Bank's approach emphasises the importance of maintaining stability, trust, and confidence in sterling while adapting to new technologies. We agree that this approach is essential for the successful implementation of digital money for tokenisation, a key priority for the investment management sector which will require a reliable and secure on-chain settlement asset. A more innovation-led approach to the future of digital money will enable the UK to remain competitive in the global financial landscape and support the growth of digital markets.

Much of the content of the DP refers to retail payments and associated architecture, on which we have little to contribute. We have instead provided a brief response setting out the considerations of the investment management industry relating to the field of digital money.

Tokenisation of Funds & Assets and the Need for Digital Money

The IA has for some time been working with stakeholders, including the FCA, to establish the regulatory framework for investment funds to utilise distributed ledger technology (DLT) and issue tokens in place of units/shares. Via the Asset Management Taskforce's Technology Working Group, we recently published two reports on fund tokenisation. In the second phase[1], we set out the likely next steps for fund tokenisation including the feature of on-chain settlement. This was informed by our participation in the Bank's Synchronisation co-creation group and argued that widening access to the Bank's RTGS to external ledgers such as those serving funds provided a clear opportunity for innovation as well as the option of utilising the certainty and reliability of central bank funding.

The fund and wider investment management industry will also be significant purchasers and holders of digital securities and other assets making up investment portfolios ('assets') that will utilise a form of digital money for settlement. A digital money solution for on-chain wholesale transactions is critical to the UK financial services industry's competitiveness and for the realisation of the suite of benefits of tokenisation. While we

[1] '*Further Fund Tokenisation*'. March 2024. The Investment Association

have an open mind on the best way to deliver on-chain money, it is vital that any solution provides genuine utility across wholesale markets, can act as the chosen mechanism for atomic settlement and is delivered in a timely manner.

Before advancing our arguments and setting out the needs of the investment management industry, it is important to understand the buy-side's current interaction with central bank money, which is at the heart of the discussion in this DP. Investment or fund managers do not typically use central bank money in their operations aside from an interest in the settlement of wholesale transactions in securities which takes place on their behalf via central securities depositaries.

Indeed, fund settlement, that is, the settlement of fund units/shares transactions between investors and the fund manager, take place almost entirely in commercial bank money (with the exception of a very small proportion handled by CREST). This is true of retail consumers (given the reliance upon retail elements of payment services such as direct debits and debit card subscriptions), but also of lower volume and higher value wholesale transactions by institutions such as pension funds. A visual representation of this is set out in *Appendix 2*.

While the fund and asset settlement legs are currently operating on separate infrastructure there is an opportunity for tokens of each of these to be held, traded and settled on common networks in future. There is therefore an immediate opportunity to combine infrastructure and settlement mechanisms.

Buy-Side Considerations

In light of recent developments and heightened levels of interest in both the fund and asset tokenisation markets in the UK and further afield, the buy-side is keen on an on-chain settlement option that facilitates consistent open market access and the realisation of DLT's benefits. In summary, the investment industry makes the following three considerations:

- *Form of digital money: The buy-side does not currently have a clear preference* on the form of digital money. The industry welcomes the progress of the Synchronisation project and believes it has significant potential to reduce settlement times and increase liquidity and efficiency. We support the Bank's efforts to ensure that an extension of the connections between RTGS and external ledgers can deliver effectively for the buy-side. This proposal, as an upgrade to the current system rather than moving to an entirely new form of digital money, such as a formal wCBDC or stablecoin(s), has the potential to enable smooth on-chain settlement for the industry and can be delivered more quickly than alternatives.

  In the absence of a formal public sector infrastructure solution in the short to medium term, the market is likely to coalesce around private sector solutions. Firms can utilise solutions ranging from tokenised commercial bank deposits to stablecoins including proprietary coins from custodian banks, and other initiatives such as RLN and Fnality. To illustrate the pace of private sector innovation, money market funds (MMFs) are now able to be utilised as a form of money within the retail payment space in the US[2] and Germany[3] as a spending source via debit cards, and tokens of MMFs could feasibly be used as a settlement asset in wholesale transactions. Such innovations highlight the pace of change but are not necessarily going to become available in the UK.

  The wide range of innovation is producing variety in payment optionality, but there is also a risk of creating fragmentation in the market, as recently outlined by the BIS[4].

- *Commitment and a clear indication on timelines*: We hold a less cautious view on the likely scale of future adoption than the Bank. Currently, 134 countries are exploring CBDCs, and the size of the tokenised

[2] WisdomTree Prime® Unveils New Earn-Until-You-Spend Functionality with Money Market Fund October 2024
[3] UnitPlus. Accessed October 2024
[4] Tokenisation in the context of money and other assets: concepts and implications for central banks October 2024 Bank for International Settlements

assets market is forecast[5] to rise as high as $30 trillion by 2034, with certain jurisdictions exploring a launch in the next 2 years[6]. On the *funds* side, multiple tokenisation projects are in progress or have been implemented recently, particularly within the MMF sector. We therefore see a more urgent need for a commitment from the Bank on its delivery of one or more versions of a digital money solution. As the market activity on tokenisation grows and with it, the use of digital money across jurisdictions, we urge the Bank to set out a clear roadmap on when it plans on making these available.

- *Unintended expansion of regulatory ambit*: Transactions in investment funds are within the purview of the FCA and of only limited interest to the Bank. Any utilisation of CBDC, including via the Bank's Synchronisation project, could potentially alter the current restricted prominence of the investment management sector in relation to the Bank. Should there be any conditions or requirements attached to this utilisation, we will be keen to ensure these arrangements are proportionate and appropriate to the level of involvement.

Given the growing interest in digital assets, the pace of global developments and the tokenisation of funds and assets, there is a very real prospect of public sector innovation in this space being outpaced by the private sector. Therefore, some of the risks outlined in the DP could be realised due to a lack of a timely and accessible solution for wholesale market transactions relating to the fund sector.

Yours faithfully

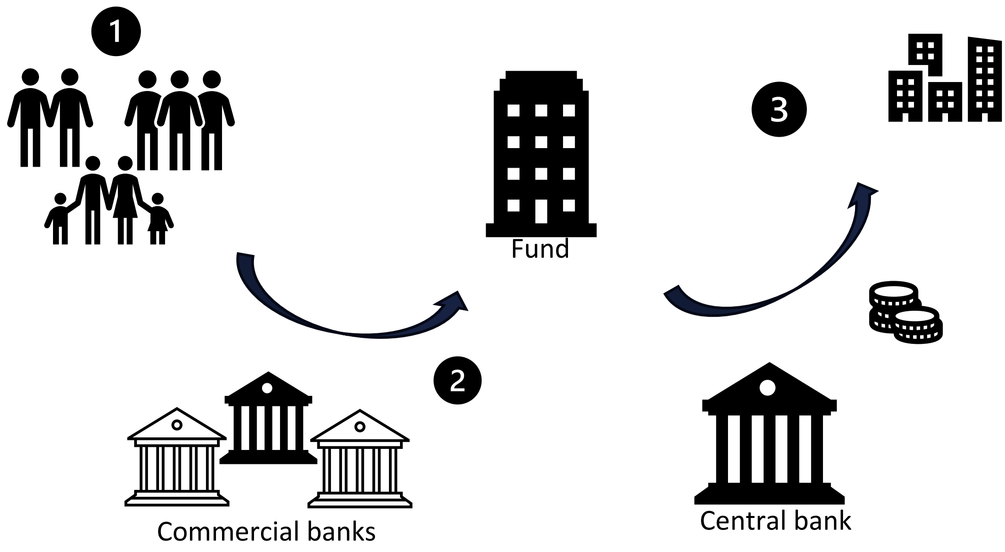
John Allan
Head of Innovation and Operations Unit

[5] Standard Chartered and Synpulse. June 2024
[6] Progress on the preparation phase of a digital euro - First progress report June 2024. European Central Bank

Appendix 1: About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.1 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 49% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Appendix 2: Cashflow between retail / real economy and wholesale capital markets



1. Investors in investment funds, including direct and intermediated retail consumers, but also institutions and pension funds, subscribe to the fund.
2. Settlement to the fund in return for fund units/shares is facilitated by payment through commercial bank money, predominantly through UK payment architecture including bacs direct debit, debit card, faster payments but also cheques. Settlement in the other direction, when divesting, can also take place through bacs direct credit or CHAPS. A very small proportion of settlement, via CREST, utilises central bank reserves via the CREST Participant arrangement.
3. Investment funds use these subscriptions to purchase holdings in securities and other investment assets through the capital markets in the UK and overseas. These are settled via a CSD and almost always in central bank money.