The RBI Launches the Retail Digital Currency

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Summary

The Reserve Bank of India has launched a pilot project for the use of retail digital currency. The digital currency will initially be issued through selected banks in 13 cities. The digital currency bears all the characteristics of fiat money, and users can transact it through digital wallets. It will help to reduce operational costs involved in physical cash management, foster financial inclusion and provide for all uses like any private virtual currency without the associated risks. The pilot has been launched to test the system's robustness so that further pilots can be commissioned based on learnings from the present launch.

While launching the Central Bank Digital Currency (CBDC – e₹-R) for the wholesale segment on 1 November 2022, the Reserve Bank of India (RBI) announced that it will launch the pilot in digital currency for the retail segment in a month. On 1 December 2022, the RBI officially launched the pilot phase of the CBDC for retail users. The digital Rupee is a digital form of currency notes issued by a central bank that can be used in contactless transactions.

The project will cover select locations and banks in a closed user group comprising participating customers and merchants. The pilot will initially cover the four cities of Mumbai, New Delhi, Bengaluru and Bhubaneswar, where customers and merchants can use the digital Rupee (e₹-R), also called the e-Rupee. In the first phase, four banks, namely, State Bank of India, ICICI Bank, Yes Bank and IDFC First Bank, in four cities across the country will be involved in the controlled launch of the digital currency. Four more banks will be added to the list in the next phase – Bank of Baroda, Union Bank of India, HDFC Bank, and Kotak Mahindra Bank. Consequently, the service will be extended to Ahmedabad, Gangtok, Guwahati, Hyderabad, Indore, Kochi, Lucknow, Patna and Shimla.

The RBI has clarified that the e₹-R will be in the form of a digital token that represents a legal tender. It will be issued in the same denominations as paper currency and coins and distributed through intermediaries – the banks. Users will be able to transact with the e₹-R through a digital wallet offered by the participating banks and stored on mobile devices. Transactions can be both person-to-person and person-to-merchant. Payments to merchants can be made using QR codes displayed at merchant locations.

The e₹-R will offer features of physical cash like trust, safety and settlement finality. As in the case of cash, it will not earn any interest and can be converted to other forms of money, like deposits with banks. The regulator has stated that the e₹-R is interchangeable one-to-one at par with the fiat currency and is the same as sovereign currency. However, it is different in that it is not made of paper (or polymer). It is a fungible legal tender for which holders need not have a bank account. The CBDC will appear as a 'liability' (currency in circulation) on the RBI's balance sheet.

Quite like the affirmation made by the Governor of the RBI on fiat paper currency to pay the bearer the equivalent value of the currency note denominated on the face, the e₹-R will also be in the form of a digital token. In this way, the e₹-R represents a claim on the central bank, effectively functioning as the digital equivalent of a banknote that can be transferred electronically from one holder to another. The token CBDC is also a bearer instrument like a banknote – whoever holds the tokens at a given time will be presumed to own them.

Thus, in effect, the retail e-Rupee will be an electronic version of cash and will be primarily meant for retail transactions. It will be potentially available for everyone's use – the private sector, non-financial consumers and businesses – and will be able to provide access to safe money for payment and settlement, as it will be the direct liability of the central bank. It will be as anonymous as paper money. All the relevant laws applicable to traditional cash will also apply to new-age money. A major factor in favour of digital currency is that with one click of a computer, digital currency can be transferred to any bank branch in any remote corner of the country. As against this, physical currency requires transporting cash under adequate security precautions – a process which may take days to move from one city to another. The evolution of digital money will depend on the extent of innovation in the start-up and financial technology eco-system and the kind of channels it opens up using the e-Rupee as the base.

The RBI had earlier clarified that the key motivations for exploring the issuance of the e₹-R include reduction in operational costs involved in physical cash management, fostering financial inclusion, and bringing resilience, efficiency and innovation in the payments system. Further, the use of digital currency is expected to add to the efficiency of the settlement system and boost innovation in the cross-border payments space. It will also provide the public with uses that any private virtual currencies can provide without the associated risks. The RBI has repeatedly flagged concerns over money laundering, terror financing and tax evasion with private cryptocurrencies like Bitcoin and Ether. Introducing its own e-Rupee has been seen as a way to bridge the advantages and risks of digital currency.

The RBI has launched the pilot programme to test and assess the robustness of the entire process from the creation, distribution and retail usage of the digital Rupee in real time. Based on the lessons learned from this pilot, the RBI can evaluate other aspects and uses of the e₹-R token and architecture in further pilots.

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