

Title	Proposal for Exploratory Work: Private International Law Aspects of Central Bank Digital Currencies (CBDCs)
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Proposal for Exploratory Work: Private International Law Aspects of Central Bank Digital Currencies (CBDCs)

I. Introduction

- 1 In fulfilment of Conclusion and Decision (C&D) No 33 and following the mandate of the Council on General Affairs and Policy (CGAP) in March 2022,¹ the inaugural HCCH Conference on Commercial, Digital and Financial Law Across Borders (CODIFI Conference) was successfully held online from 12 to 16 September 2022. The CODIFI Conference included three tracks of discussions to address matters related to the digital economy, informed by the requests of Members which had responded to a survey distributed by the PB in late 2021. The report of the CODIFI Conference is provided as Annex I to Preliminary Document (Prel. Doc.) No 3A.²
- 2 One of the outcomes of the CODIFI Conference was the conclusion by several experts that further study on the PIL aspects of Central Bank Digital Currencies (CBDCs) is both timely and desirable.³ In response to this input, this Prel. Doc. reports on the PIL implications of CBDCs and seeks a mandate from CGAP to undertake exploratory work on the PIL aspects of CBDCs.

II. PIL Implications of CBDCs

- 3 CBDCs are digital currencies issued by central banks. Token-based CBDCs have been defined as (a) a form of money (b) issued by a central bank (c) whereby the monetary claim on the central bank is incorporated in a digital token and (d) the transfer of the token equals transfer of the claim, (e) without current-account relationship between the central bank and the holder.⁴ CBDCs have gained the attention of governments for their potential as a “new form of money”⁵ to promote policy goals including financial inclusion; reduced transaction costs; resilience of payments in emergency situations; reduced illicit use of money; and increased competition in a country’s payments sector.⁶ A number of central banks are currently piloting CBDCs, with some CBDCs having recently been deployed in jurisdictions around the world. Experts at the CODIFI Conference highlighted the potential for CBDCs to be used in finance, trade and digitised commerce such as cross-border payments, e-commerce, machine-to-machine transactions and smart contracts.⁷
- 4 Questions on the PIL implications of CBDCs have been raised by experts, jurisdictions and States that are currently piloting CBDCs. In response, the Legal Department of the IMF has been studying the development and operation of CBDCs and has drafted a Fintech Note on the Private Law Aspects of Token-Based CBDC.⁸ The Legal Department of the IMF has approached the PB for input

¹ C&D No 33 of CGAP 2022; see also C&D No 38 of CGAP 2021, available on the HCCH website www.hcch.net under “Governance” then “Council on General Affairs and Policy” then “Archive (2000-2022)”.

² “Digital Economy and the HCCH Conference on Commercial, Digital and Financial Law Across Borders (CODIFI Conference): Report”, Prel. Doc. No 3A of January 2023 for the attention of CGAP 2023, available on the HCCH website at www.hcch.net under “Governance” then “Council on General Affairs and Policy”.

³ CODIFI Conference, H.A.M. Hamza, “Digital Economy Redefine / Digital Economy of the Asia-Pacific and MENA Regions”, 15 September 2022; CODIFI Conference, A. Kwan, “Opening Securities”, 12 September 2022; CODIFI Conference, H. Wang, “Digital Economy Redefine / Central Bank Digital Currencies (CBDCs) & Private International Law”, 13 September 2022.

⁴ M. Bechara, W. Bossu, A. Rasekh, C.Y. Tan, A. Yoshinaga, IMF Fintech Note, Private Law Aspects of Token-Based CBDC (First Draft), para. 3.

⁵ *Ibid.*, para. 9. As opposed to account-based CBDC, token-based CBDC have been recognised to legally represent a truly “new form of money” that, per its definition, incorporates a monetary claim on the central bank in a digital token where the transfer of that token equals transfer to the claim and that entails no current-account legal relationship between the central bank and the holder.

⁶ G. Soderberg, M. Bechara, W. Bossu, N.X. Che, S. Davidovic, J. Kiff, I. Lukonga, T.M. Griffoli, T. Sun, A. Yoshinaga, IMF Fintech Note, Behind the Scenes of Central Bank Digital Currency: Emerging Trends, Insights and Policy Lessons, pp. 6-7.

⁷ CODIFI Conference, H. Wang, *supra* note 3.

⁸ M. Bechara, W. Bossu, A. Rasekh, C. Y. Tan, A. Yoshinaga, *supra* note 4, para. 3.

to assist with analyses on the PIL aspects of CBDCs. It is noteworthy that the PIL issues raised in this IMF Fintech Note mirror the same issues raised by experts at the CODIFI Conference, illustrating the global relevance of these PIL considerations.⁹

- 5 For a jurisdiction contemplating the issuance of CBDCs, possible options are to qualify CBDCs as an existing type of hybrid asset or to assign CBDCs a novel *sui generis* property law category.¹⁰ If the former, it has been observed to be unlikely that CBDCs could qualify as one of the main categories of existing hybrid assets, although nothing prevents establishing the category as a new type of hybrid asset under property law and assigning it tangible attributes. If the latter, it would seem possible that a new property law category can be created for CBDCs, although this would raise questions as to whether applications based on technologies adjacent to those that underlie CBDCs would also fall into this new category. This would require further consideration of the legal roles of registries / ledgers and wallets to determine the downstream implications on the holding and evidencing of rights.
- 6 The legal nature of CBDCs might also pose challenges to applying conventional PIL rules.¹¹ Even if rules are found to apply, it is not clear whether every existing rule is fit for purpose. For example, if a CBDC is classified as a tangible-intangible hybrid under a domestic legal framework, the *lex rei sitae* could in theory apply, but it is unclear what the *situs* of a token held on distributed registers and through wallets would be.¹² To support its circulation as money, it will also be crucial that private law rules establish how ownership and other rights in CBDCs can be transferred between economic agents.
- 7 Depending on the chosen model of operation, particularly in relation to cross-border CBDC access by non-residents, central banks may delegate functions to private sector intermediaries.¹³ Banks examining the feasibility of CBDCs have converged on a model that is based on intermediation.¹⁴ Deployment of national CBDCs may also potentially require the use of foreign intermediaries, or intermediaries with worldwide offices; moreover, a user may hold CBDCs of different jurisdictions in the same account. Thus, the PIL implications resemble the intermediation and dematerialisation challenges that informed the development of the *Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (Securities Convention).

III. Areas for Future Exploratory Work

- 8 Given this context, a PIL framework will be needed to enhance the cross-border legal certainty and predictability of CBDCs as a digital version of fiat currency,¹⁵ particularly where digital wallets are created and serviced by intermediary businesses. The adoption of CBDCs should be carefully considered in light of PIL considerations, as the legal certainty of a PIL framework supports the realisation of policy goals that may be pursued in the modernisation of financial systems. These policy goals include financial inclusion; reduced transaction costs; resilience of payments in

⁹ See, for example, CODIFI Conference, H. Wang *supra* note 3.

¹⁰ *Ibid.*, para. 65.

¹¹ *Ibid.*, para. 55.

¹² *Ibid.*

¹³ See generally BIS, Options for access and interoperability of CBDC for cross-border payments at <https://www.bis.org/publ/othp52.pdf>.

¹⁴ G. Soderberg, M. Bechara, W. Bossu, N. X. Che, S. Davidovic, J. Kiff, I. Lukonga, T. M. Griffoli, T. Sun, A. Yoshinaga, *supra* note 6, p. 8.

¹⁵ Fiat currency or fiat money is defined as the money issued and backed by a government, valuable for its status of legal tender rather than its backing by another commodity. See I. Asmundson and C. Oner, IMF Back to Basics: What is Money? (2012).

emergency situations; reduced illicit use of money; and increased competition in a State's payments sector.¹⁶

- 9 One possible way forward is the development of a system of applicable law rules based on the Securities Convention. The treatment of intermediated holdings in the Securities Convention could be adapted to accommodate systems of intermediaries that provide CBDC wallets. This may also account for situations where intermediary businesses operate in jurisdictions with no local CBDC framework.
- 10 The primary PIL rule of Article 4(1) of the Securities Convention supports an express choice of law agreement between the account holder and the relevant intermediary. The parties' choice of law will be effective only if the relevant intermediary has, at the time of the agreement, an office (or an office of a third party acting for the relevant intermediary) in the selected State that serves certain specified functions relating to securities accounts, or that is otherwise engaged in a business or other regular activity of maintaining securities accounts.¹⁷ Thus, the party autonomy allowed through the choice of law is tempered with this "reality test"¹⁸ concerning the office; the choice must also meet with the intermediary's consent, as well as regulatory and practical considerations.¹⁹
- 11 This framework provides benefits beyond those provided by the Place of the Relevant Intermediary Approach (PRIMA) rule, another potential rule for the applicable law in an intermediated asset. The framework of the Securities Convention takes into consideration the constraints of locating an account at one place with precision, and in so doing guarantees the necessary *ex ante* legal certainty and predictability with regard to the applicable law. Given the argument that both approaches are similar in that they look to a single relationship between the account holder and the intermediary as the critical connecting factor,²⁰ the advantage offered by the Securities Convention is that it contains clear rules that enable parties to determine the applicable law at low cost and up front at the time of entry into the transaction.²¹
- 12 Possible PIL questions to consider in relation to the development of CBDCs include:
- Applicable law: In the case of cross-border circulation, what is the law applicable to CBDCs?
 - Jurisdiction: Which court has jurisdiction in relation to intermediaries?
 - Recognition and enforcement: How will judgments in CBDC systems be recognised and enforced in different jurisdictions?
- 13 CGAP is invited to consider mandating the PB, in partnership with relevant Observers and subject-matter experts, to study the PIL aspects of CBDCs in light of developments in technology, application, and pilot programmes. This study is proposed to comprise an initial exploratory phase focused on monitoring new developments such as the PIL implications of evolving legal frameworks of CBDC pilot projects and the possible involvement of intermediary businesses. Within this exploratory phase, Members of the HCCH may be requested to provide inputs regarding developments relevant to the questions listed above, and any other matters, as appropriate. The PB will also consult with relevant subject-matter experts and Observers for input to the study. The

¹⁶ G. Soderberg, M. Bechara, W. Bossu, N.X. Che, S. Davidovic, J. Kiff, I. Lukonga, T.M. Griffoli, T. Sun, A. Yoshinaga, *supra* note 6, pp. 6-7.

¹⁷ This limitation on the choice of governing law in the account agreement is known as the "qualifying office test".

¹⁸ CODIFI Conference, S. Bariatti. "Reasons to Join the HCCH Securities Convention", 13 September 2022.

¹⁹ C. Bernasconi and C. Sigman (2005), "Myths about the Hague Convention Debunked", *International Financial Law Review*, pp. 31-32.

²⁰ M. Ooi (2019), "Rethinking the characterization of issues relating to securities", *Journal of Private International Law*, Vol. 15, Issue 3, p. 582.

²¹ C. Roodt, "The Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary: The Hague Securities Convention", 18 *South African Mercantile Law Journal* 83 (2006), at p. 96.

PB will report to CGAP at its 2024 meeting with outcomes and proposals for next steps. CGAP may also want to consider the possibility of mandating preparations by the PB for an online colloquium on this topic.

IV. Proposal for CGAP

14 The PB invites CGAP to note the issues described in this Prel. Doc. in relation to the PIL aspects of CBDCs. Having in mind the limited resources at the PB and the work programme assigned to the International Commercial, Digital and Financial Law Division, the PB proposes the following Conclusion and Decision for CGAP's consideration:

CGAP mandated the PB, in partnership with relevant subject-matter experts and Observers, to study the PIL implications of CBDCs. The PB will report to CGAP at its 2024 meeting on the outcomes of this study, including proposals for next steps. CGAP also mandated the PB to prepare for and organise an online colloquium on this topic.