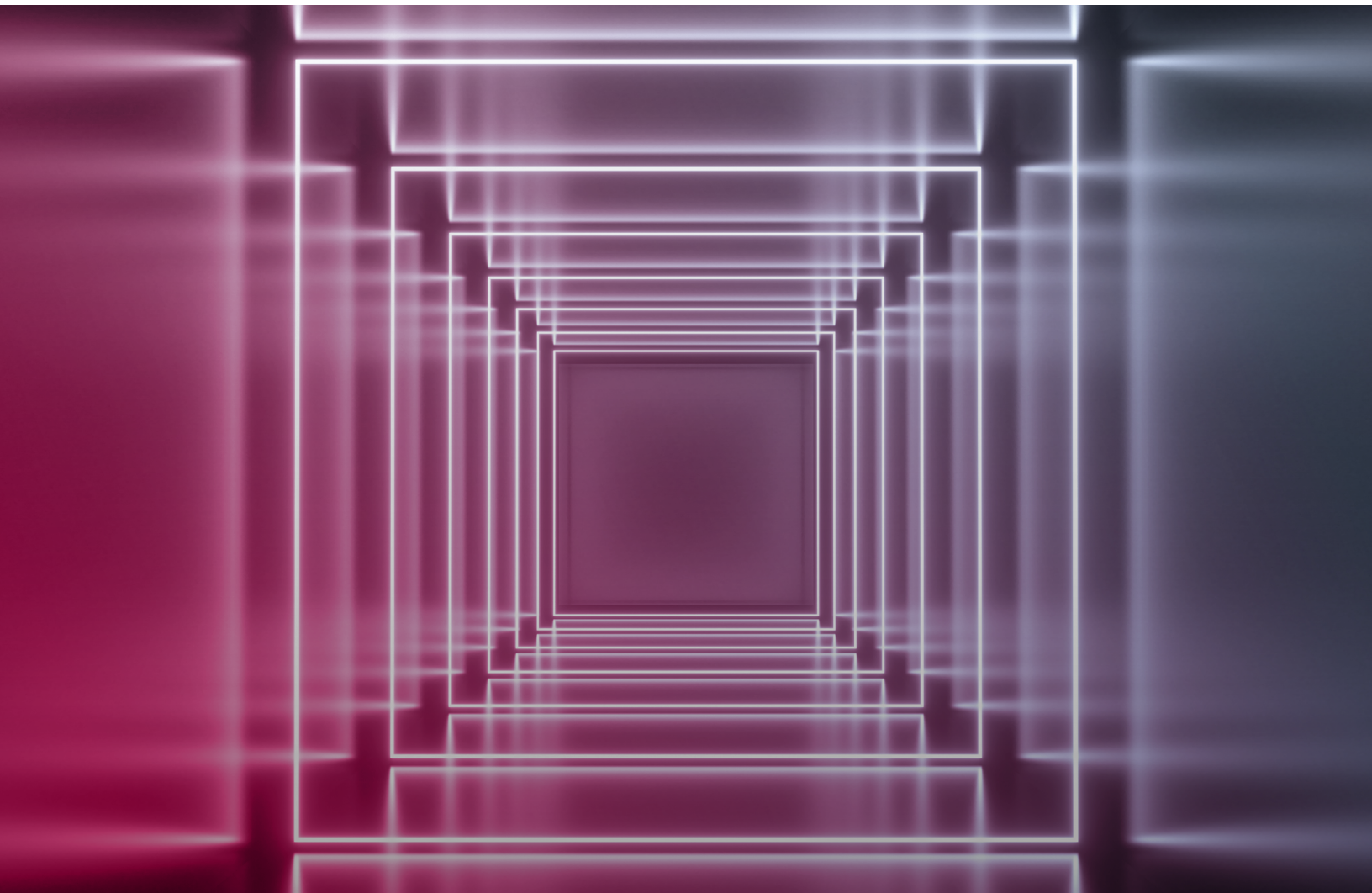


# CAPCO | DIGITAL

## THE FUTURE OF PAYMENTS THROUGH DIGITAL CURRENCIES

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Individual consumers have grown increasingly comfortable with digital currencies through the rise of well-known cryptocurrencies, such as Bitcoin and Ether, along with the e-commerce shift and continuous growth in digital banking. However, many major traditional financial institutions have been hesitant to incorporate or adopt digital currencies thus far.

**Digital currencies** can be divided into three categories, including Central Bank Digital Currencies (CBDCs) which are centralized and regulated by a nation's central bank but have not yet developed in all geographies. The other two categories, Stablecoins which link to FIAT underlying currencies such as USD and EUR, along with native digital currencies – commonly known as cryptocurrencies, such as Bitcoin and Ether, are both decentralized and more prevalent across markets.

Early native digital currencies laid the foundation for developments within the industry, and thus far have been primarily used for retail purposes, including investing and payments. In an increasingly digitized era, and accelerated by COVID-19, digital adoption has rapidly gained momentum as the distribution of physical cash is expensive and less demanded. The underlying technologies of digital currencies, including blockchain, have matured to the point of mass distribution and uncertainty in markets and institutions further pushes the adoption of digital currencies as a payment method as well as investment hedge. With increased adoption and regulation, it is expected that digital currency usage will expand heavily beyond the initial use. Cryptocurrencies have already exemplified how blockchain can be used securely for payments and, as digital currencies grow, it is expected that blockchain will expand and become a standard across digital payment types.

## DEVELOPMENTS IN CRYPTOCURRENCY WILL CONTINUE DRIVING INNOVATION

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Besides the advancements in Internet of Things (IoT), digital currencies are expected to expand heavily beyond retail purposes and become a standard form of B2B payments. Further, retail and corporate users can leverage well-established digital currencies to transfer funds across borders without third-party banks and their associated fees. Governments and central banks may also heavily benefit from the expansion of digital currencies. These currencies can decrease the cost and ecological footprint of monetary systems with a reduction in cash distribution, extend

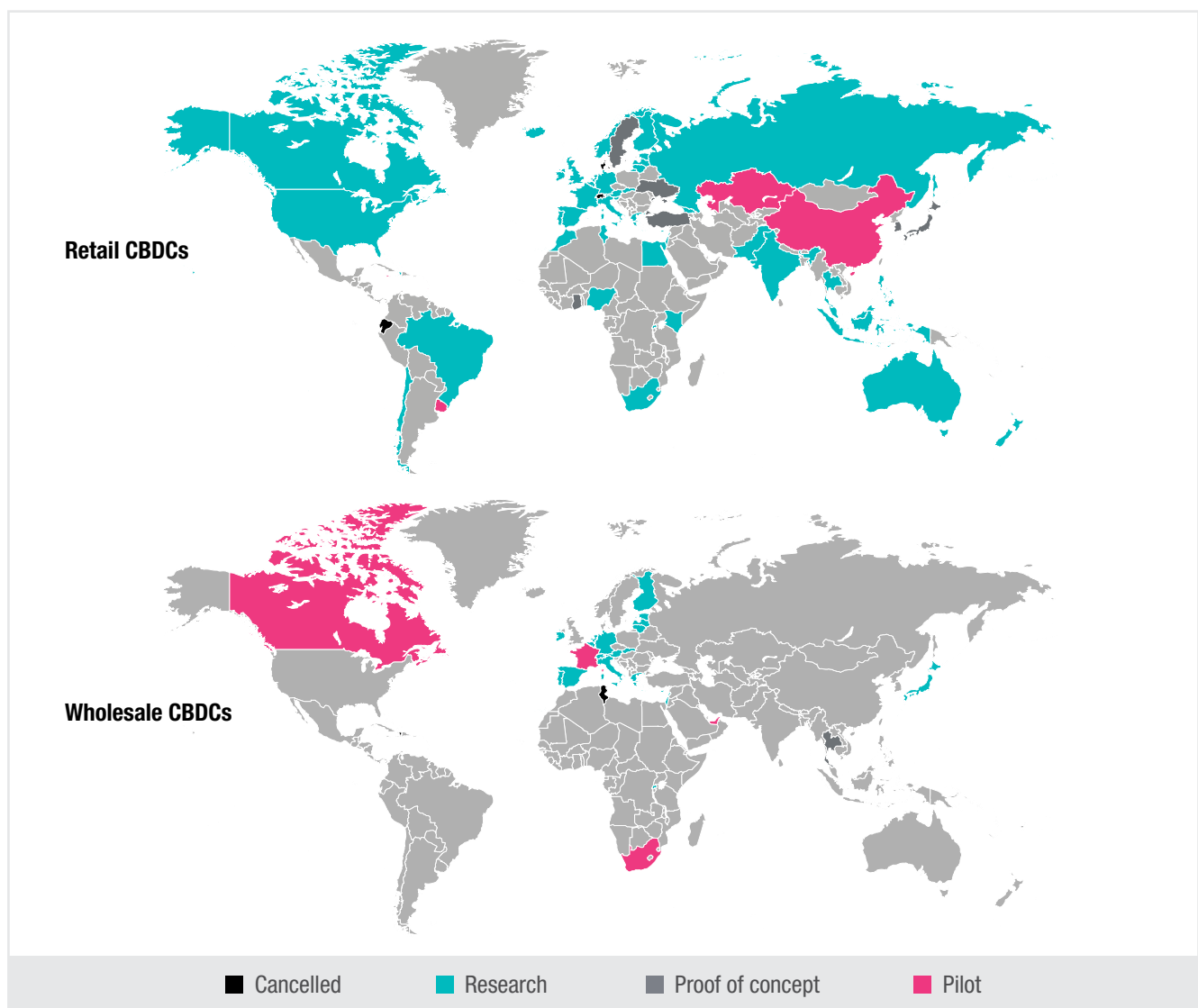
monetary policy toolkits, provide an alternative to cash if usage continues to decline and increase payment system resiliency in the case of extreme events.

### **Current Adoption Across Institutions**

Global institutions have slowly begun shifting toward researching and developing centralized currencies, such as CBDCs and Stablecoins. A notable step forward in digitizing a national currency has come from China, piloting its own centrally owned

digital currency. This contrasts Western economies of Europe and North America where such innovation has received less support at the national level. Instead, alternatives to volatile digital currencies arise, such as Stablecoins; cryptocurrencies pegged against a reserve of a central currency (USD/Euro). Central banks have begun conducting research in deploying digital euro/dollar infrastructure together with commercial banks on blockchain networks. The European Central Bank (ECB) is focusing on retail payments and considering a two-year investigation period in July 2021, and a potential system go-live in 2026-28.

It is also important to note the difference in adoption thus far between retail and wholesale CBDCs. Retail CBDCs are issued for individual retail and corporate consumers, while wholesale CBDCs are issued for financial institutions to use as reserve deposits with central banks. Globally, the development of retail CBDCs have outpaced wholesale CBDCs.



CBDC Tracker (<https://cbdctracker.org/>)

## Implementation Opportunities

While central banks across the globe investigate and trial digital currencies, privatized options and technology are readily available for institutions and groups to easily create new digital currencies, Stablecoins backed by FIAT or otherwise, all outside the control of central authorities. The emerging ecosystem of payment options, cryptocurrencies, and Stablecoin options remain valuable even alongside potential CBDCs, complementing rather than competing with central banks.

The incentives for Central Banks to adopt digital currencies are increasingly relevant. Digitizing national and international economies, expanding monetary policy toolkits, and remaining relevant against increasingly prominent non-centralized digital currencies, like Bitcoin and Ether, are all factors at the forefront of banks' agendas. In addition to the driving need to stay competitive, CBDs and digital currencies enable greater resiliency in payment systems while decreasing costs and ecological footprints of these systems.

The influence of blockchain technology and digital currencies continues growing, and payments processes increase in efficiency. Financial services institutions are at a crucial inflection point to adapt to new technologies and the upcoming challenges of digital currency products and services. Institutions that fail to innovate and shift their offerings lose not only growth opportunities, but potentially risk falling behind or being displaced. End-to-end payments and legacy systems are being replaced and will require support from institutions to not only adapt to changes such as CBDCs, but proactively prepare for a world of blockchain based transactions. The capabilities for innovation are increasingly critical as digital currencies provide heightened standards of transparency, efficiency and reduced bureaucracy. Regulations and data security will also be evolving, and digital transformations will only become increasingly necessary yet challenging for financial services.

## HOW CAPCO CAN HELP

Adopting digital currencies and blockchain solutions will help financial institutions evolve given the shift within the payments space. Capco understands the end-to-end effect of these new payment methods and can utilize our expertise to help define strategies and extend business models. Our expertise allows us to help clients understand the potential business case, offerings and synergy opportunities to ensure institutions make informed decisions on investments in this area.

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## ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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