



The Bundesbank and Electronic Cash

By Christopher Kuner

Attorney-at-Law, Gleiss Lutz Hootz Hirsch & Partners, Frankfurt, Germany

Web: <http://ourworld.compuserve.com/homepages/ckuner>

Email: ckuner@compuserve.com

Christopher Kuner is a US attorney-at-law with the German corporate law firm Gleiss Lutz Hootz Hirsch & Partners in Frankfurt. He is a frequent author and lecturer in Germany and abroad on legal aspects of the Internet, and practices in the areas of electronic banking, cryptography, Internet regulation, and telecommunications law.

The German banking establishment is starting to pay increasing attention to the legal and regulatory problems posed by Internet payment mechanisms such as "electronic cash." Up to now, interest in the subject in Germany has been more theoretical than practical, owing to the cash-based nature of the German financial structure, the halting acceptance of Internet commerce among the German business community, and the German public's scepticism toward new types of payment schemes.

The growth in interest in electronic cash is due to a number of factors, including the increased public interest in the Internet over the past year. However, more important have been the introduction of several competing schemes for prepaid cards, and a pilot project by the Deutsche Bank to offer electronic cash based on cooperation with the Dutch firm DigiCash, which is supposed to begin in early 1997 (see <http://194.175.173.31/wwwforum/ecash/index.htm>).

Germany has been a supporter of the limitations placed on the issuance of prepaid cards in the EU Payment Systems Working Group's Report on Prepaid Cards, such as limiting their issuance to registered banks. Previous comments by directors of the Bundesbank had indicated that these reservations extended to Internet-based payment systems as well. In this regard, the Bundesbank's reservations have been mainly based on three factors:

- (1) security concerns, such as that electronic money could be duplicated by hackers;
- (2) concerns that central banks could lose control over the money supply and thus over monetary policy; and
- (3) concerns related to fraud by issuers, such as that an issuer of electronic cash could go bankrupt and thus the electronic units of value it had issued would become worthless.

On November 28, 1996, Bundesbank director Edgar Meister delivered a speech in Frankfurt which provides the Bundesbank's most detailed and authoritative statement yet on electronic cash and Internet payment issues (an English translation of the speech is available on the Internet at <http://ourworld.compuserve.com/homepages/ckuner>). Meister's comments demonstrate the cautious attitude taken by the Bundesbank in this area.

According to Meister, the Bundesbank sees the various types of electronic payment methods (including prepaid cards, "digital cash" on the Internet, and other such schemes) as holding serious implications for central banks in many areas, including the issuance of money, monetary policy, supervision of cashless payments, and supervision of the banking system. The Bundesbank is concerned that increased use of such schemes could cause it to lose control over traditional techniques for influencing the German economy, and might call for measures such as incorporating electronic money into minimum reserve requirements or, as a last resort, the monopolization of their issuance by the Bundesbank. Meister also expresses concern about the issues of security, liability, and money laundering, and indicates that an upcoming amendment to the German banking law will result in the issuance of what he calls "card money" (e.g. prepaid cards) and "net money" (e.g. digital cash) being limited to banks. Finally, Meister expresses some scepticism about the extent to which such electronic payment methods are likely to find acceptance among the public as substitutes for cash.

The warnings contained in Meister's speech demonstrate the Bundesbank's traditional caution in this area, but raise questions about the effectiveness of the restrictions which Meister discusses. For example, given that there is no effective way for national governments to control message flows on the Internet, it is not clear how restricting the issuance of electronic cash in Germany to chartered banks could be enforced; indeed, attempts at such enforcement on an international scale would likely lead only to insoluble jurisdictional conflicts. Much of Meister's confidence in the government's ability to enforce financial regulation on the Internet is also based on a belief that "net money" will inevitably be converted back into traditional national currencies, which may or may not be true, depending on how quickly and extensively such electronic payment mechanisms are accepted. And while Meister's statements regarding minimum reserve requirements and the monopolization of electronic cash by the German government may only have been hypothetical cases which will likely never come to pass, the fact that he mentioned them at all has understandably unsettled a number of financial institutions potentially interested in offering such payment systems in Germany.

Meister's speech represents a further evolution of the Bundesbank's thinking on the subject of electronic cash, but will not be the last word. It can be anticipated that the Bundesbank will follow the coming pilot projects closely, in order to evaluate the true chances and risks of electronic cash in Germany. While the German position in this area is likely to remain considerably more cautious than that of the Federal Reserve, for example, it is to be hoped that this attitude will be flexible enough not to stifle growth of electronic cash systems.