Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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By email: DP-stablecoinpaymentsystems@bankofengland.co.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to the Bank of England and HM Treasury's Consultation on Regulatory regime for systemic payment systems using stablecoins

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

As well as responding to this consultation, the Panel has also responded to the consultation published by the FCA. We have attached a copy of our response within this submission and would kindly request they are read in conjunction with one another. While the Panel's focus is predominately on the work of the FCA, we are responding to the **Regulatory regime for systemic payment systems using stablecoins** because payment systems are the foundational to the financial system and all consumers rely on them in their day to day lives. We wish to ensure that consumers' needs are considered in the development of this Regime.

Any decision on whether and how to regulate systemic stablecoin systems will be very consequential for consumers. We therefore welcome this consultation as another important step in broadening the public conversation about the future of money and payment systems.

The Payment System is crucial for all UK consumers: the ability to safely receive, store and spend a ubiquitously accepted unit of account and medium of exchange is of paramount importance to our society and economy. For this to be achieved, we believe the Payment System, including *all* regulated stablecoins, not just systemic ones, must be guided by the following principles:

- **Accessibility -** All UK consumers must be able to pay and be paid. The system must be accessible to all.

- **Fairness and affordability -** The cost of making payments should not exclude particular consumers, businesses of transaction types. It should not cost more for the poorest to pay.
- **Reliability & resilience -** The Payment System must be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need. The failure of individual providers should not result in consumer losses.
- **Safety, security and consumer protection –** The Payment System must be safe and secure. It should offer protection to consumers, including against fraud and losses resulting from a firm's failure.
- **Transparency –** The costs, risks and protections associated with using different providers and services must be clear and easily understandable. Providers should also offer full transparency about how end users' data is used, by whom and to what end.

Maintaining a consumer focus

We recognise that it is only 'systemic' payment systems using new forms of digital money and related service providers that have been brought into the Bank's regulatory remit by FSMA 2023, that the Bank's regime will apply only when such providers have been recognised by HMT and that this paper specifically considers the regime for such systemic providers. However, we would like to stress our concern with respect to the concept of these 'systemic' boundaries.

It is an undeniable truth that all forms of money are systemic, and all payment systems are systemic to those that hold and use them. The introduction of a regime that addresses only those regulated stablecoins deemed to be systemic to the UK (or likely to become systemic to the UK) – may create a halo effect for and stimulate the emergence of other 'sub-systemic' stablecoins – stablecoins on which consumers begin to depend and which will immediately become systemic to them, albeit perhaps not to the wider system as defined by the Act.

While recognising the boundaries of this consultation and the limits of the Bank's powers in this respect, we would stress the immediate and urgent importance of ensuring that users of any such non-systemic regulated stablecoins will be afforded the equivalent protections as the users of systemic regulated stablecoins. We would stress here that the Sterling system is dependent on consumer trust and consumer trust in sterling itself is dependent on how sterling can be stored and exchanged; it is pivotal that *all* regulated stablecoins do nothing to undermine that trust offering safe storage and redemption and exchangeability at par and on demand.

As the Bank itself states in the paper:

"*to maintain confidence in money and payments, all forms of money should have the same value, be generally accepted as a means of payment and be interchangeable without loss of value with all other forms of money used in the economy."*

We set out our answers to the questions in the consultation in Annex A below.

Yours sincerely,

Helen Charlton

Chair, Financial Services Consumer Panel

Annex A – Responses to questions

Question 1: Do you agree that, to preserve the singleness of money, systemic payment stablecoins must be fully interchangeable with other forms of money at par?

Yes, it is absolutely critical for systemic payment stablecoins to be fully interchangeable with other forms of money at par. Further, we would argue that for systemic payment stablecoins to be additive to the current payment landscape and deliver advantages in terms of cost, convenience and functionality, they would also need to be *freely* and *immediately* interchangeable with other forms of money at par.

Introducing a new type of system for transferring value within the UK economy that adds frictions in terms of speed, convenience or cost would fragment the current sterling payment landscape and undermine uniformity being damaging, not additive to the current set-up. The stability of the UK economy and monetary system relies on this principle.

As the Bank itself states in the paper:

"*to maintain confidence in money and payments, all forms of money should have the same value, be generally accepted as a means of payment and be interchangeable without loss of value with all other forms of money used in the economy.*"

Question 2: Do you have views on further requirements that may be needed to ensure the singleness of money when stablecoins are traded in secondary markets?

It is of paramount importance that the regime ensures that systemic payment stablecoins do not in any way undermine the singleness of money within the sterling system. This depends there being no fluctuating exchange rates between different forms of sterling, whatever its form. Any fluctuation between a systemic sterling stablecoin and other forms of sterling would not only undermine confidence in the stablecoin itself and compromise its general acceptance in payments but give rise to fragmentation in the sterling system.

The Bank has stated that it is not minded at present to prohibit systemic payment stablecoins from being traded on secondary markets, and instead to keep a watching brief. It also proposes to require all issuers of sterling-denominated systemic payment stablecoins to ensure that they can be exchanged at par for other forms of money, on demand. The Bank's proposal is consistent with the international standards published in July 2022 by CPMI- IOSCO for payment systems, which state that stablecoins should be convertible into other liquid assets as soon as possible, at a minimum by the end of the day, and ideally intraday.

To ensure the singleness of money in the UK payment system the requirements should go further than those set out in the CPMI-IOSCO paper. Systemic payment stablecoins should be *immediately* and *freely* convertible into other forms of sterling on demand similar to other forms of private money in the sterling system today.

Delays and frictions that make systemic payment stablecoins less immediately interchangeable than existing forms of private money will give rise to a risk of secondary market deviations and undermine the singleness of money.

Question 3: Do you agree that the most likely, and suitable, payment systems using new forms of digital money to become systemic in the UK are sterling-denominated stablecoins which are backed by assets denominated in fiat currency?

The Panel agrees that with the Bank's premise that the most suitable payment systems using new forms of digital money to become systemic in the UK would be sterling-denominated stablecoins. We would add that such stablecoins should also be backed by assets denominated in sterling. It would be a retrograde step if new non-sterling forms of digital money or if new forms of digital money not backed by assets denominated in sterling were to become systemic in the UK. We would encourage the Bank to keep a close watching brief on the emergence of alternatives.

In this regard, we would like to stress our concern with respect to the 'systemic' boundaries under consideration in this paper. We recognise that it is only systemic payment systems using new forms of digital money and related service providers that have been brought into the Bank's regulatory remit by FSMA 2023 and that the Bank's regime will apply only when such providers have been recognised by HMT. However, it is an undeniable truth that all forms of money are systemic and all payment systems are systemic to those that hold and use them. The introduction of a regime that addresses only those stablecoins deemed to be systemic to the UK (or likely to become systemic to the UK) – may create a halo effect for and stimulate the emergence of other 'sub-systemic' stablecoins – stablecoins on which consumers being to depend and which will immediately become systemic to them, but not to the wider system.

While recognising the limits of the Bank's powers in this respect we would stress the immediate and urgent importance of ensuring that users of any such non-systemic regulated stablecoins will be afforded the equivalent protections – or otherwise protected from harm.

Question 4: Do you agree with the Bank's proposed approach to assessing the systemic importance of stablecoins used for payments?

We agree with the overall approach but as set out in our answer to Question 3, we question the underlying premise in the Act that distinguishes the systemic from the 'non-systemic' as any form of money is systemic to those that hold it, and any payment system is systemic to those that use it.

To protect against harms, not just to consumers but to the system itself, it is of paramount importance that a regime addressing 'non-systemic' stablecoin systems and providers is put in place at the same time as any regime addressing their systemic equivalents.

Question 5: Do you agree with the Bank's proposed approach to the regulatory framework for systemic payment stablecoins, as set out in Section 2?

Yes, we support the Bank's proposed approach which aims to regulate systemic payment systems using stablecoins end-to-end– to ensure that risks in the payment chain are comprehensively assessed and controlled for, and do not disrupt the functioning of the payment system. We agree that the entirety of the stablecoin payment chain, and the entities that comprise it, should demonstrate robust financial resources, risk management (including risks arising from the use of third parties), and governance.

Question 6: Do you agree with the Bank's assessment of the risks posed by vertical integration of stablecoin functions? Are there other risks that the Bank should consider based on existing business models? What mitigants could be put in place to ensure that risks posed by multi-function entities are addressed?

Yes, the Panel agree.

Question 7: Do you agree with our approach regarding subsidiarisation of non-UK issuers? Do you agree with our approach to other non-UK elements of the payment chain? What alternative policy arrangements could be used to effectively supervise, oversee, and regulate non-UK systemic stablecoin issuers and other non-UK elements of the payment chain?

We agree that issuers of systemic payment stablecoins should be set up in the UK as subsidiaries in order to carry out business and issuance activities into the UK and with UK-based consumers, both directly and through intermediaries. We also agree that the backing assets and the issuer's capital should have to be held in the UK, subject to UK rules, courts and the UK bankruptcy law and insolvency regime.

We would further stress the importance of backing assets and the issuer's capital also being held in GBP.

Question 8: Do you consider that the Bank's existing binding rules on governance, operational resilience and third-party outsourcing risk management are suitable for systemic payment systems using stablecoins?

Yes, the Panel agree.

Question 9: Do you consider that stablecoin issuers can exercise sufficient control over, and mitigate the risks of, public permissionless ledgers (be it via rule setting and/or the use of innovative solutions)?

No, in our view there needs to be an entity in charge of comprehensively assessing the risks of the entire payment chain on an ongoing basis.

Question 10: How do you consider that existing and emerging stablecoin payment chains operating with a public permissionless ledger may be adapted in order to meet the Bank's expectations and international standards?

NA

Question 11: Do you agree with the Bank's assessment of the important role of backing assets in ensuring the stability of value of the stablecoin?

Requirements on backing assets need to ensure that stablecoins used in systemic payment systems are always stable in value. This is a necessary requirement for money that is used widely as a means of payment in the economy and is fundamental to financial and economic stability.

We agree that a necessary requirement for any form of money used with confidence as a means of payment in the UK economy is that it maintains its value at all times and is interchangeable at par for other forms of sterling-denominated money.

We agree that that the 100% central bank deposits model is most appropriate for systemic payment systems using stablecoins operating in the UK. Like The Bank, our preferred option is for systemic stablecoin issuers to back the stablecoins in issue fully with central bank deposits.

We would stress again here our concern about distinguishing between 'systemic' and the 'non-systemic' as *any* form of money used by the public as a means of payment should have these characteristics, not solely those monies deemed to have 'systemic' importance.

Question 12: Do you agree that the proposed remuneration policy is consistent with systemic stablecoins being used primarily for payments?

We agree that stablecoins used in systemic payment systems should not pay interest to coinholders. This would align the treatment of systemic stablecoins with cash and incentivise the use of stablecoins for payments rather than as a means of investment. We would however caution here that high cash balances in current accounts evidence that not all consumers distinguish properly between renumerated and unremunerated balances. Education will be key to ensuring stablecoins are used for their intended purposes, that stablecoin balances don't balloon and that the provision of credit to the wider economy is not undermined by the emergence of stablecoins.

Question 13: Do you agree with the Bank's proposed requirements on the redemption process, including the role of all firms in the payment chain?

As the Bank recognises, a frictionless redemption process is key. For confidence to usefully be built and maintained in systemic payment stablecoins, coinholders must always be able to redeem their stablecoins into commercial bank money (i.e., bank deposits) at any time and receive the same value as they initially exchanged to obtain the stablecoins (i.e., redeem at par in fiat on demand).

In the Panel's view this means that stablecoins must be redeemable into commercial bank money at least as freely as commercial bank money can currently be exchanged and redeemed – in other words, immediately and without charge.

The Bank however states that such redemptions can be made 'minus any potential fees", later stating that it proposes either to prohibit redemption fees or require "that any redemption fees charged to coinholders reflect the cost incurred by the systemic stablecoin issuer or any other entity providing the redemption service".

The Bank goes on to recognise that redemption fees, particularly disproportionately high redemption fees, could create frictions across the redemption process as coinholders may seek to avoid fees by selling their stablecoins in the secondary market. During times of stress, this could increase the risk of stablecoins trading away from par value, which may exacerbate run risk and spread financial instability.

The Panel's view is that there needs to be absolute clarity and certainty: fees should be prohibited in their totality if a frictionless redemption process is to be put in place and redemption guaranteed at par.

The Panel also has concerns on the proposed timing of stablecoin redemptions. The Bank proposes to require systemic stablecoin issuers to process redemption requests by the end of the day on which a valid redemption request is made, "and in real time wherever possible".

If the stablecoin redemption process is truly to be frictionless we would argue that redemptions need to be executed at least as fast as existing commercial bank payments.

Question 14: Do you have views on requirements on redemption fees, or prohibiting these, to minimise any frictions across the redemption process?

As set out in our answer to Question 13, redemption fees should be prohibited in their totality.

Question 15: Can you identify any issues with the requirements on systemic stablecoin issuers and other relevant firms within a payment chain to cooperate and support the appointed administrators with a view to facilitating redemption or payout in the event of a firm failure?

The more complex a payment chain and the more parties involved in any redemption and/or pay out process, the greater the likelihood of issues and delays arising in the event of a firm failure.

It will be of paramount importance that issuers and other relevant firms within payment chains maintain robust, up-to-date recovery and administration plans and that their record-keeping and reconciliation processes are impeccable if delays are to be avoided. Their plans and records and reconciliation processes should be tested and audited on an initial and ongoing basis.

Question 16: Do you agree that issuers should have access to customer information to be able to fulfil redemptions in the case of the failure of an entity providing the customer interface, eg a wallet provider and/or to facilitate a faster payout in insolvency?

Yes, we agree that issuers should have access to customer information in order to fulfil redemptions. Clear rules governing access should be put in place and permissions granted *ex ante* to ensure their proper usage and smooth functioning.

Question 17: Do you have views on the Bank's proposed safeguarding regime being centred on two key features (statutory trust in favour of coinholders; and safeguarding rules)?

We agree with the Bank's proposed safeguarding regime and support its proposal to use the Legal Trust model over giving coinholders proprietary claims against the issuer and above the Debt model which would give coinholders on unsecured debt claims. We would stress however that for the Trust model to work properly, organisational controls, record keeping, reconciliation, segregation and ringfencing will all need to be executed properly and promptly. These must all be inspected and audited on an initial and ongoing basis and failures in these aspects must not be tolerated.

Question 18: Do you think there are any other features that need to be reflected in the safeguarding regime for systemic payment stablecoins?

Speed and certainty of payout are key. Stablecoins purport to variously offer a more convenient, faster and accessible form of money; for that to be the case the speed, convenience and accessibility need to survive firm failures. Consumers holding stablecoins should be paid out and be able to access their balances in the event of firm failures at least as swiftly as they would in the event of a bank failure where they are covered by the Financial Services Compensation Scheme – ie within seven days in most cases. Given that Stablecoins effectively seek to offer alternatives to wallets and current accounts, which carry funds which consumers need immediate access to, it is vital that a time-stamped schedule be hardwired into these arrangements.

Question 19: Do you agree with the requirements for stablecoins owned by the issuers held in treasury wallets?

Yes, the Panel agrees that issuers should be required to comply with safeguarding rules so as to fully back *all* stablecoins held in treasury wallets.

Question 20: Do you consider that the capital requirements would effectively mitigate risks that may result in a shortfall in the backing assets or that can threaten the ability of issuers to operate as a going concern?

We agree that issuers of stablecoins used in systemic payment systems should hold additional capital against other risks that may result in a shortfall in the backing assets or that can threaten the firm's ability to operate as a going concern.

Question 21: Do you have views on the approach (including any existing or bespoke methodologies) that should be considered for calibrating capital requirements?

We agree with the Bank's proposal to require that issuers clearly identify risks that can lead to a shortfall in the backing assets, including any operational risks such as fraud or mismanagement, and the costs of distributing assets to coinholders. However, we would caution here that operators have consistently underestimated these risks leading to undercapitalisation. Furthermore, and as the Bank acknowledges, the novelty of the industry and consequent unavailability of historical data, means that estimating the capital requirements may be more challenging than usual. The Bank should closely scrutinise issuers' assumptions and stress-test these on an initial and ongoing basis.

Question 22: Do you have views on the requirement to hold reserve assets in a statutory trust, to ensure that stablecoins are fully backed and the backing assets are duly protected and available to satisfy coinholders' redemption requests at all times?

Yes the Panel fully supports this requirement.

Question 23: Do you have views on the range and quality of the assets issuers would be required to hold to mitigate shortfall risks?

We have reservations about the proposal that that the reserve assets, should *not* need to meet the same standards as backing assets. To be truly useful and act to protect consumers against the risk of shortfalls, reserve assets need to offer liquidity, price stability and accessibility even in times of stress. History has repeatedly shown that the search for yield leads to improbable assumptions about asset quality and liquidity and, as recent events have very clearly reminded us, market risk is a very real risk and even so-called high-quality, highly liquid assets, can suffer from rapid pricing dislocations and liquidity crises. As the Bank itself states in Section 5.5, operational incidents [can] cause a sudden and material shortfall in backing assets. In such instances the only assets there is any recourse are the reserve assets so it is vital they be liquid, stable and accessible. In the Panel's view to offer a proper degree of protection, reserve assets should be held in central bank deposits.

Question 24: Do you agree that, at least during a transition, limits would likely be needed for stablecoins used in systemic payment systems, to mitigate financial stability risks stemming from large and rapid outflows of deposits from the banking sector, and risks posed by newly recognised systemic payment systems as they are scaling up?

Yes, we strongly support limits during the scale-up period (and potentially beyond it).

Question 25: Do you have views on the use, calibration and practicalities of limits?

Imposing Holding Limits would seem the most sensible initial option, however we would recommend the Bank keep vigilant and keep its options open to impose other limits, if and when stablecoin usage scales.

Question 26: Do you have other views on the Bank's proposals for requirements for systemic stablecoin issuers, as set out in Section 5?

No.

Question 27: Considering the requirements for issuers in Sections 4 and 5, how might business models need to change in order to retain commercial viability from those in the market today?

NA

Question 28: Do you agree with our proposed expectations for custodial wallet providers for systemic stablecoins (including when provided via exchanges) and how we propose applying them in a systemic stablecoin payment chain?

Yes, we agree with the proposed expectations for custodial wallet providers. We would refer the Bank to our answer to the FCA. We also support the Bank's proposal to monitor when and whether custodial wallet providers warrant recognition by HMT as service providers and to directly regulate the entities if and when they are recognised.

Question 29: Do you consider that unhosted wallets could operate in a way that the systemic stablecoin payment chains can meet the Bank's expectations (including for the issuer to deliver against the Bank's requirements set out in this Discussion Paper)?

No we do not believe that systemic stablecoin payment chains could operate or operate with unhosted wallets *and* meet the Bank's expectations and requirements, including those related to redemptions, holding limits as well as AML checks.

Question 30: Do you agree with the Bank's proposal to regulate off-chain ledgers operated at systemic scale under the same requirements otherwise applicable to systemic payment systems?

Yes we agree with this proposal.

Question 31: Do you agree with the Bank's approach to regulating service providers to firms operating in systemic stablecoin payment chains?

Yes we agree with this approach.

Question 32: The Bank will have due regard to the public sector equality duty, including considering the impact of proposals for the design of the regulatory framework for systemic payment stablecoins on those who share protected characteristics, as provided by the Equality Act 2010. Please indicate if you believe any of the proposals in this Discussion Paper are likely to impact persons who share such protected characteristics and, if so, please explain which groups of persons, what the impact on such groups might be and if you have any views on how any impact could be mitigated.

NA