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Dear FCA,

Financial Services Consumer Panel response to FCA Discussion Paper – Regulating Cryptoassets Phase 1: Stablecoins

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's above Discussion Paper.

The Panel supports both the FCA and BoE consulting on the approach to regulating fiat-backed stablecoins, which may be used for payments and the proposed regulatory framework for systematic payments using stablecoins and related service providers. As well as responding to this consultation, the Panel has also responded to the consultation published by the BoE. We have attached a copy of our response within this submission and would kindly request they are read in conjunction with one another.

As stated in our response to the Bank, the Panel has reservations about the development of a 'money' and payments regime which distinguishes between forms of money and payment systems that are systemic and those that are not. All money is systemic to those that hold it, and all payment systems are systemic to those that depend on them. While we recognise that the systemic and prudential risk to the UK will be orders of magnitude larger in the event of a large stablecoin issuer's failure, the existential risk to those consumers who hold their funds in smaller issuers who might fail should not be ignored. There will also be reputational risks to the stablecoin market as a whole, if a non-systemic stablecoin were to fail, as it is unlikely that consumers will understand the difference. We understand that the framework set out by legislation distinguishes between the so-called systemic and non-systemic from a UK perspective, but we would urge the FCA to consider its task in regulating stablecoin issuers from the consumer's perspective.

Under the new regime the consumer will be invited to think of regulated stablecoins – whether they are designated as systemic or not – as

alternatives to cash in wallets or commercial bank money in current accounts. For regulated stablecoins to be usefully considered as such, they need to offer at least the same level of exchangeability, surety and protection as commercial bank money. Any lighter regime designed for the non-systemic issuer must not compromise on these aspects or they will risk undermining consumer confidence not only in the affected stablecoins, but potentially in the money system more widely.

As mentioned in its response¹ to the FCA's Guidance on cryptoasset financial promotions, the Panel would like to underscore that a 'halo' effect may be given to these novel products by regulation which will require careful monitoring. The so-called stablecoins that are in operation today are neither stable, nor useful as payment instruments, nor are they backed and or redeemable in appropriate ways. While some issuers may adapt to the new regulatory framework it is entirely probable – if not likely – that others will not and that other new so-called stablecoin issuers will emerge whether in the UK or overseas. Vigilant monitoring and swift action, alongside consumer education and close cooperation with social media firms, will be required to ensure that such issuers do not use the emergence of a proper regulatory regime to promote products that result in consumer harm.

The Panel would also like to take the opportunity to set out our view of what a well-functioning payments landscape would look like for UK consumers. As in all areas of financial services, we believe payment firms should have a duty to act in the best interest of consumers. The market should also be guided by:

- **Accessibility** – All UK consumers must be able to pay and be paid. The system must be accessible to all. Whilst the Panel appreciate that the FCA anticipate some consumers may not use stablecoins, we would encourage the system to be accessible to all consumers if they choose to make use of stablecoins.
- **Fairness and affordability** – The cost of making payments should not exclude particular consumers and it should not cost more for the poorest to pay.
- **Reliability** – Individual payment systems should be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need. The regulatory regime should address this.
- **Sustainability** – The regulatory regime should be operated on an economically sustainable basis. The failure of individual payment systems (or the regime) should not result in consumer losses.
- **Safety, security and consumer protection** – Individual payment systems must be safe and secure. The regime should offer a

¹ https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_to_fca_guidance_on_cryptoasset_financial_promotions.pdf

minimum level of protection to consumers, including against fraud and losses as a result of failure.

- **Transparency** – Individual payments systems’ costs and protections must be clear and easily understandable. Individual payment systems should offer transparency about how end users’ data is used, by whom and to what end.

In our view, FSCS protection should be in place for Regulated Stablecoins. The FCA itself states that the proposed regime “should enable consumers to buy stablecoins with confidence, and to ensure that they have the legal protections for a money like instrument”. For this, FSCS protection is key.

Please find the Panel’s responses to the questions posed in Annex 1.

Yours sincerely,

Helen Charlton
Chair, Financial Services Consumer Panel

Annex A – Response to consultation questions

Q1. Should the proposed regime differentiate between issuers of regulated stablecoins used for wholesale purposes and those used for retail purposes? If so, please explain how.

The Panel agree that the regime should differentiate between issuers of regulated stablecoins used for wholesale purposes and those used for retail purposes. Retail and wholesale consumers will be using the product for varying uses, and this may impact how they are treated by issuers. Whilst the stablecoins may be similar in each use-case, the processes, controls, communication, literature etc that are associated with an issuer's stablecoins should be different from those used by wholesale and retail users. Retail users should not be able to use wholesale stablecoins directly, to ensure they retain the protections deemed appropriate for retail users.

We would add that regulation is imperative to ensure consumer protection and to minimise the risk of consumer harm, which should be the first order concern. The Panel considers that regulation to benefit consumers should not be introduced simply where it could benefit the sector itself. Harm to consumers must be prevented (in line with the FCA's Consumer Duty), and this is particularly the case where there is an asymmetry in either knowledge or power.

The Panel would like to take the opportunity to set out our view of what a well-functioning payments landscape would look like for UK retail consumers. As in all areas of financial services, we believe payment firms should have a duty to act in the best interests of consumers. The market should also be guided by:

- **Accessibility** – All UK consumers must be able to pay and be paid. The system must be accessible to all. Whilst the Panel appreciate that the FCA anticipate some consumers may not use stablecoins, we would encourage the system to be accessible to all consumers if they choose to make use of stablecoins.
- **Fairness and affordability** – The cost of making payments should not exclude particular consumers and it should not cost more for the poorest to pay.
- **Reliability** – Individual payment systems should be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need. The regulatory regime should address this.
- **Sustainability** – The regulatory regime should be operated on an economically sustainable basis. The failure of individual payment systems (or the regime) should not result in consumer losses.
- **Safety, security and consumer protection** – Individual payment systems must be safe and secure. The regime should offer a

minimum level of protection to consumers, including against fraud and losses as a result of failure.

- **Transparency** – Individual payments systems’ costs and protections must be clear and easily understandable. Individual payment systems should offer transparency about how end users’ data is used, by whom and to what end.

Any new regulatory regime for stablecoins must support these ends, not undermine them.

Q2. Do you agree with our assessment of the type of costs (both direct and indirect) which may materialise as a result of our proposed regime? Are there other types of costs we should consider?

The Panel agree with the FCA’s assessment of the type of costs which may materialise as a result of the proposed regime. We would like to echo the point that any additional direct costs which have a material impact on consumers should be made clear and easily understandable for consumers.

Q3. Do you agree with our assessment above, and throughout this DP, that benefits, including cheaper settlement of payment transactions, reduced consumer harm, reduced uncertainty, increased competition, could materialize from regulating fiat-backed stablecoins as a means of payment? Are there any other benefits which we have not identified?

The Panel agree with the FCA’s assessment, but would stress that not all these benefits are guaranteed and nor will they necessarily translate into immediate consumer benefit. Cheaper settlement might be achievable in the long run, but the co-existence of stablecoins with commercial bank money and existing payment systems will involve new and overlapping costs. If and where cheaper settlements are achieved, the reduced costs may not be passed on to consumers. The emergence of new issuers and participants in the payments landscape may immediately lead to competition but owing to the economies of scale and winner-takes-all nature of technology and payments, this competition may swiftly evaporate.

Regulation is imperative to ensure consumer safety and minimise the risk of consumer harm which should be the first order concern. The Panel considers that regulation to benefit consumers should not be introduced simply where it could benefit the sector itself. Harm to consumers must be prevented (in line with the FCA’s Consumer Duty), and this is particularly the case where there is a disparity in either knowledge or

power, which is likely to be the case in the crypto sector, particularly with respect to retail users and investors.

Q4. Do you agree with our proposed approach to regulating stablecoin backing assets? In particular, do you agree with limiting acceptable backing assets to government treasury debt instruments (with maturities of one year or less) and short-term cash deposits? If not, why not? Do you envision significant costs from the proposal? If so, please explain.

The Panel agree with the FCA's proposed approach to regulating stablecoin backing assets and agree that the risks associated with backing assets could, if materialised, impact confidence in the stablecoin and lead to a run on the stablecoin.

In particular, the Panel agree with the requirement for the issuer to constitute and maintain, on an ongoing basis and at all times, a reserve of backing assets equivalent in value to the circulating supply of the regulated stablecoin. This will help issuers achieve prompt redemption and therefore maintain confidence in the asset and its use which is key at a time where consumer trust in financial services, especially investments, is very low. It is therefore vital that consumers receive clear, non-technical and understandable information about the backing assets, including information about the backing asset's stability, sufficiency, constitution and how, and where they are held.

The Panel strongly agrees with limiting acceptable backing assets to the short-term government treasury debt instruments as these typically have low price volatility and therefore provide greater protection and certainty. We would urge the FCA to remain constant on this requirement and not to be persuaded to accommodate other assets when market conditions change.

Q5. Do you consider that a regulated issuer's backing assets should only be held in the same currency as the denomination of the underlying regulated stablecoin or are there any benefits to allow partial backing in another currency? What risks may be presented in both business-as-usual or firm failure scenarios if multiple currencies are used?

The Panel agree that a regulated issuer's backing assets should only be held in the same currency as the denomination of the underlying regulated stablecoin. This is especially important where the stablecoins are being used in the retail market as consumers may not fully understand, or be willing to accept, the potential currency exchange risk which would be present if the stablecoin and backing asset were held in different currencies.

Such a requirement would eliminate currency risk between the coin and its backing assets as well as trading, settlement and liquidity risks. This said, were a non-sterling stablecoin to be issued in the UK, this requirement would mean it has to be backed by a foreign currency. That currency would either need to be held in the issuing country (and exposed to jurisdictional and legal risks) or held in the UK (and exposed to credit risk). These risks will need to be made explicit by issuers of any non-Sterling stablecoins.

Q6. Do you agree that regulated stablecoin issuers should be able to retain, for their own benefit, the revenue derived from interest and returns from the backing assets. If not, why not?

The Panel agree that regulated stablecoin issuers should be able to retain, for their own benefit, the revenue derived from interest and returns from the backing assets. However, we would caution that issuers whose business models rely heavily on returns from their backing assets will chase yield at the expense of safety. The proposed requirements on backing assets being limited to short term same-currency government debt will undoubtedly come under pressure when interests fall, and such business models come under pressure. This pressure will need to be resisted if consumers are not to be put at undue risk. Issuers should be required to stress test their business models to ensure they can withstand a fall-off in these returns especially given the current market conditions.

The Panel note the FCA's consideration that regulated stablecoin issuers should not be permitted to pay income or interest to consumers which is in line with current market practice. The Panel agree with the FCA's assumption that this may be perceived as unfair to consumers, especially in the event that interest rates continue to remain high and/or increase significantly, however it could help set a clear distinction between stablecoins and bank deposits.

The usefulness of this distinction will rely on consumer understanding and awareness which will require a significant educational effort. The high balances that consumers maintain in unremunerated current accounts clearly indicates that consumer understanding about the difference between different types of bank accounts is low.

We would note here that there has been a rise in 'crypto savings accounts' which allows consumers to earn interest on digital assets deposited if the consumer agrees to lend these deposits – the Panel see this as an area which could give rise to consumer confusion and therefore harm. It is vital that the FCA ensures consumers understand the difference between such accounts.

Q7. Do you agree with how the CASS regime could be applied and adapted for safeguarding regulated stablecoin backing assets? If not, why not? In particular:

- i. Are there any practical, technological or legal obstacles to this approach?**
- ii. Are there any additional controls that need to be considered?**
- iii. Do you agree that once a regulated stablecoin issuer is authorised under our regime, they should back any regulated stablecoins that they mint and own? If not, why not? Are there operational or legal challenges with this approach?**

We agree that regulated issuers should be required to reconcile internally and externally and value their backing assets on at least a daily basis. The Panel considers that as stablecoins will be promoted and/or described as secure, it is vital that the backing assets are secure and protected from all eventualities. In designing the rules on backing assets, thought will need to be given to how to prevent any contagion that could occur, if stablecoins use other stablecoins as part of their backing assets.

We also agree that there should be a CASS oversight officer responsible and accountable for such reconciliation and operational activities. The Panel agree with how the CASS regime could be applied and adapted for safeguarding regulated stablecoin backing assets. In particular, the Panel agree that the FCA should introduce a requirement to ensure each coin's backing assets are segregated from one another in order to guard against contagion risks across coins and prevent cross-contamination of coins should assets become 'value shocked'.

In relation to issuers minting and holding their own coins, the Panel agree that these should be backed by the issuing firms. This is vital so that in the event of a hack, unbacked regulated stablecoins would not be able to enter the crypto ecosystem.

Q8. We have outlined two models that we are aware of for how the backing assets of a regulated stablecoin are safeguarded. Please could you explain your thoughts on the following:

- i. Should regulated stablecoin issuers be required to appoint an independent custodian to safeguard backing assets?**
- ii. What are the benefits and risks of this model?**
- iii. Are there alternative ways outside of the two models that could create the same, or increased, levels of consumer protection?**

The Panel agree that regulated stablecoin issuers should be required to appoint an independent custodian to safeguard backing assets so long as this does not reduce the protections available to consumers compared to the model where the issuer holds the backing assets.

This should however be done on a consistent basis, meaning that either all issuers should be required to appoint independent custodians or none are permitted to do so. The Panel believe that a consistent approach to this is necessary in order to ensure consistency for consumers but also to allow the FCA to effectively monitor firms' compliance and transparency post implementation.

An independent custodian model should, if governed appropriately, further reduce the impact on consumers and markets from insolvency of an issuer. It will also act as an additional layer of oversight and accountability which could help protect the integrity of the stablecoin framework and increase consumer confidence when purchasing or using regulated stablecoins.

The Panel are however alive to the potential issues and harms consumers may face if a custodian fails. Currently, there is a lack of a clear regulatory framework which could result in uncertainty that would likely cause consumer harm through delays in the return of assets, extra costs or a loss of their assets. The Panel would encourage the FCA to undertake stress testing exercises with issuers to identify how robust their plans are in the instance that their custodian fails or enters an insolvency process. Equally custodians should battle test their own plans, individually and on a sectoral basis. Custodians should also be required to keep client accounts separate from their own funds.

Q9. Do you agree with our proposed approach towards the redemption of regulated stablecoins? In particular:

- i. Do you foresee any operational challenges to providing redemption to any and all holders of regulated stablecoins by the end of the next UK business day? Can you give any examples of situations whether this might be difficult to deliver?**
- ii. Should a regulated issuer be able to outsource, or involve a third party in delivering, any aspect of redemption? If so, please elaborate.**
- iii. Are there any restrictions to redemption, beyond cost-reflective fees, that we should consider allowing? If so, please explain.**
- iv. What costs associated with our proposed redemption policy do you anticipate?**

The need to redeem in a timely manner that is easy for consumers to execute is key to ensuring market stability and the integrity of stablecoins. It is vital that any redemption policies are clearly communicated to consumers. The Panel would encourage the FCA to undertake consumer testing in this area to identify the 'consumer mood' on the use of third parties and to gain insight into instances where a firm was unable to provide redemption by the end of the next UK business day – such research would provide direct insight into consumer views and experiences, whereas some firms may be reluctant to share their consumer feedback with the regulator due to concerns about regulatory action.

The Panel agree that a regulated issuer should be able to outsource or involve a third party in delivering redemption. This should however be at no extra cost to the customer looking to redeem. If the FCA finds that this cannot be done without passing on the cost to consumers, it should look to undertake a cost benefit analysis of issuers' use of third parties. If this does not derive a benefit for consumers, issuers should not be allowed to involve a third party.

Any third party that is involved should follow GDPR rules and other applicable rules and should be able to satisfy both the issuer and the FCA that they are operationally resilient and will be able to deal with any potential hacks/data breaches in a way that does not cause harm for consumers. Such issuers would need to clearly disclose the process and associated terms and conditions to customers in a clear manner and the Panel agree with the FCA's additional requirement that the full redemption policy must be clearly disclosed and accessible on the regulated stablecoin issuer's website at all times.

Issuers involving a third party should also be able to satisfy the FCA that they have a plan/strategy they can execute in the event the third-party collapses or fails. The Panel would also encourage the FCA to ensure firms understand that even if a firm uses a third party, the legal redemption claim, and any corresponding liability, would remain on the regulated stablecoin issuer at all times.

Q10. What proof of identity, and ownership, requirements should a regulated stablecoin issuer be gathering before executing a redemption request?

The Panel agree with the FCA's proposal that regulated stablecoin issuers should be required to carry out customer AML checks when dealing with customers directly at redemption if it is the issuer's first point of interaction with those customers – however, this must be executed in a timely manner. The Panel also support redemption requests received from unhosted wallet owners requiring AML checks at the point of redemption.

Customers should be able to show proof of identity and ownership of the stablecoin to the issuer ahead of any redemption request being approved. Issuers should have some responsibility in ensuring they are dealing with the owner of the stablecoin, in order to reduce fraud and scams.

Q11. Do you agree with our approach to the Consumer Duty applying to regulated stablecoin issuers and custodians? Please explain why?

The Panel strongly agree with the FCA's approach to the Consumer Duty applying to regulated stablecoin issuers and custodians. Given that many issuers and custodians might be new to the FCA regime, and the Consumer Duty has itself only recently been introduced, it will be important for the FCA to ensure that issuers and custodians properly understand their responsibilities and obligations before entering this market.

Q12. Do you consider that regulated stablecoins should remain as part of the category of 'restricted mass marketed investments' or should they be captured in a tailored category specifically for the purpose of cryptoasset financial promotions? Please explain why.

The Panel believe that regulated stablecoins should be categorised differently from other forms of crypto tokens, in order for FCA financial promotion rules to reflect their purpose and new regulatory status. However, while the financial promotion rules should reflect the proposed function, the Panel considers that restrictions on who can buy and use Stablecoins should remain in place unless the new regime ensures there are strong regulatory protections for consumers using Stablecoins, including access to the FOS and the FSCS.

The Panel considers that crypto tokens, including stablecoins, should not be named, labelled or categorised as 'investments' as this sets the wrong expectation and understanding. This is especially the case for Stablecoins, as these are intended to mirror the value of the backing currency and are specifically not an 'investment'. The rationale for Stablecoins is that they will stay in lock step with the currency they are linked to, so that they can be used as part of the payments system. Therefore, there should be no expectation that they will appreciate in value (in local currency terms). Furthermore, this DP proposes that any interest is retained by the issuer and prevented from being passed on to the coin owner. As Stablecoins are designed specifically not to appreciate in value and will not pay any interest, it is appropriate for Stablecoins to have a different classification to other forms of crypto tokens for financial promotions purposes. However, this does not mean that Stablecoins are entirely without investment risk. Specifically, under some circumstances it

might be possible for market forces to break the peg between the Stablecoin and the currency it mirrors. Therefore, whether consumers need to have had financial advice before purchasing a Stablecoin, and the extent of any risk warnings, will depend on the strength of the protections that are put in place.

The Panel considers it will be important to undertake consumer testing, before introducing any new regime, in order to assess consumer understanding, including of any risks they will be taking as a result of using Stablecoins. The financial promotions regime for Stablecoins should then be designed to maximise benefits to consumers and ensure they fully understand what is involved.

For the reasons stated elsewhere, the Panel does not consider that it is appropriate to differentiate between systemic and non-systemic Stablecoins in setting regulations. The Panel is particularly keen to ensure that all Stablecoins (regardless of their status) will need to comply with the FCA's financial promotions rules. This will help promote consumer trust and prevent consumer misunderstanding.

Q13. Should individual client wallet structures be mandated for certain situations or activities (compared to omnibus wallet structures)? Please explain why.

Yes, individual client wallet structures should be the norm. Client assets should be strictly segregated from the firm's through ownership and wallet labelling. Records need to be tightly maintained so that there is a clear and accurate record of each customer's individual holdings at any given time.

Q14. Are there additional protections, such as client disclosures, which should be put in place for firms that use omnibus wallet structures? Are different models of wallet structure more or less cost efficient in business-as-usual and firm failure scenarios? Please give details about the cost efficiency in each scenario.

Client omnibus wallet structures should be permissible if and only if: Firm assets are segregated from client assets; Customer records are tightly maintained so that the issuer has a clear and accurate record of each customer's individual holdings at any given time; that such records can be accessed and understood and acted on immediately in insolvency; that full risk disclosures are made to consumers.

Q15. Do you foresee clients' cryptoassets held under custody being used for other purposes? Do you consider that we should permit such uses? If so, please give examples of under what circumstances, and on what terms they should be permitted. For

example, should we distinguish between entities, activities, or client types in permitting the use of clients' cryptoassets?

The Panel is not supportive of the FCA permitting the use of clients' cryptoassets being used for other purposes.

Q16. Do you agree with our proposals on minimising the risk of loss or diminution of clients' cryptoassets? If not, please explain why not? What additional controls would you propose? Do you agree with our proposals on accurate books and records? If not, please explain why not.

The Panel agree with the FCA's proposals on minimising the risk of loss or diminution of clients' cryptoassets. It is vital that cryptoasset custodians have adequate organisational arrangements to minimise the risk of loss or diminution of clients' cryptoassets due to misuse, fraud, poor administration, inadequate record-keeping, use of assets as part of money laundering, illicit activities, or negligence. Custodians should also have their policies and procedures reviewed regularly and amended as required, this includes the skills and expertise of their employees which aligns with current requirements applied to custodians in traditional finance.

Through distinguishing the assets held for one client from cryptoassets held for any other client and from the firm's, issuers and custodians are able to maintain records in a way that ensures their accuracy and that they may be used as an audit trail.

The Panel would support an approach where the FCA have a 'line of sight' from the consumer to the issuer including any firms responsible for custody, redemption services etc and that the FCA ensures that all parties involved in this end-to-end process have the right processes, controls and disclosures in place to ensure adequate consumer protection.

Q17. Do you agree with our proposals on reconciliation? If not, please explain why not? What technology, systems and controls are needed to ensure compliance with our proposed requirements?

The Panel agrees with the proposals on reconciliation.

Q18. Do you consider that firms providing crypto custody should be permitted to use third parties? If so, please explain what types of third parties should be permitted and any additional risks or opportunities that we should consider when third parties are used.

Allowing the use of third parties could result in risks to controls and governance, however the Panel agree with the FCA that these can be

mitigated by having strict due diligence requirements on cryptoasset custodians.

Q19. Do you agree with our proposals on adequate governance and control? If not, please explain why not? What (if any) additional controls are needed to achieve our desired outcomes? What challenges arise and what mitigants would you propose?

The Panel agrees with the proposals on adequate governance and control and would encourage the FCA to work with the industry to identify challenges and innovative mitigants to such challenges. The Panel also agree with the proposal of requiring custodians of all sizes to report information on their clients' cryptoasset holdings to the FCA on a monthly basis.

Q20. Should cryptoasset custodians undertaking multiple services (e.g., brokers, intermediaries) be required to separate custody and other functions into separate legal entities?

Custodians should be required to take whatever steps are necessary to protect consumers, which is likely to include using separate legal entities to ensure stablecoins can be managed and maintained adequately and issues in any one (or more) stablecoin do not have a contagion effect on others.

Q21. Are there any practical issues posed by requiring cryptoasset exchanges to operate a separate legal entity for custody-like activities? Specifically, please could you explain your thoughts on the following:

- i. Would these issues differ between institutional and retail clients?**
- ii. What would be the operational and cost impact?**
- iii. What are the benefits to clients of cryptoasset exchanges prefunding trades? Can these be achieved if there is legal separation of entities?**
- iv. Would separating custody and exchange functions impact the way clients' accounts are managed and structured (in omnibus and individual client wallets)?**
- v. Do you agree that the conflicts of interest we have identified exist? Are there other conflicts of interest we should consider?**
- vi. Are there alternative ways to ensure the same level of consumer protection?**

Custodians should be required to take whatever steps are necessary to protect consumers, which is likely to include using separate legal entities to ensure stablecoins can be managed and maintained adequately and

issues in any one (or more) stablecoin do not have a contagion effect on others.

Q22. What role do you consider that custodians should have in safeguarding client money and redemption? What specific safeguards should be considered?

The Panel believe that retail consumers should be given a choice as to whether they would like a custodian to safeguard their money and undertake the redemption process for them. Whilst custodians are beneficial for consumers, some consumers may choose to opt out of using a custodian.

For consumers who do choose to use a custodian, it is imperative that the custodian maintains its obligation to the client and acts in their interest. Any additional costs will need to be communicated to consumers in a clear and non-technical manner.

Alongside the above, it is vital for custodians to establish a robust network of systems and controls to prevent the loss or diminution of client assets.

Q23. Do you agree that our existing high-level systems and controls requirements (in SYSC) should apply to the stablecoin sector? Are there any areas where more specific rules or guidance would be appropriate?

The Panel agree that the existing high-level systems and controls requirements in SYSC, should apply to the stablecoin sector.

We would request that any specific rules or guidance focuses on what a well-functioning payments landscape would look like for UK consumers. Any specific rules or guidance should be guided by the following:

- **Accessibility** – All UK consumers must be able to pay and be paid. The system must be accessible to all. Whilst the Panel appreciate that the FCA anticipate some consumers may not use stablecoins, we would encourage the system to be accessible to all consumers if they choose to make use of stablecoins.
- **Fairness and affordability** – The cost of making payments should not exclude particular consumers and it should not cost more for the poorest to pay.
- **Reliability** – Individual payment systems should be robust and reliable with appropriate redundancy measures in place to ensure continuity of service in case of need. The regulatory regime should address this.
- **Sustainability** – The regulatory regime should be operated on an economically sustainable basis. The failure of individual payment systems (or the regime) should not result in consumer losses.

- **Safety, security and consumer protection** – Individual payment systems must be safe and secure. The regime should offer a minimum level of protection to consumers, including against fraud and losses as a result of failure.
- **Transparency** – Individual payments systems’ costs and protections must be clear and easily understandable. Individual payment systems should offer transparency about how end users’ data is used, by whom and to what end.

Q24. Do you agree with our proposal to apply our operational resilience requirements (SYSC 15A) to regulated stablecoin issuers and custodians? In particular:

- Can you see how you might apply the operational resilience framework described to your existing business (e.g. considering your important business services and managing continuity)? Please set out any difficulties with doing this.**
- What approach do you take when assessing third party-providers for your own internal risk management (such as responding to, testing and managing potential disruption)?**
- Are there any minimum standards for cyber security that firms should be encouraged to adopt? Please explain why.**

The Panel strongly agree with the FCA’s proposal.

Q25. Do you agree with our proposal to use our existing financial crime framework for regulated stablecoin issuers and custodians? Do you think we should consider any additional requirements? If so, please explain why.

Stablecoins may appeal to fraudsters and scammers as they will be more money-like than cryptoassets and especially if they are perceived to be any less policed than commercial bank money.

The Panel agree that it is of utmost importance that financial crime rules are applied to issuers of regulated stablecoins and custodians just as they are in the traditional financial sector. The regulated stablecoin sector should not develop into a dark channel for money laundering, scams and fraud.

Q26. Do you agree with our proposal to apply our existing Senior Managers and Certification Regime to regulated stablecoin issuers and custodians? In particular:

- Should we apply the current SMR and requirements to issuers and custodians of regulated stablecoins? Are there**

- additional SMFs or requirements needed to capture the nature of regulated stablecoin business services?**
- ii. **Should we create additional criteria to determine when the 'enhanced category' of the regime should apply to regulated stablecoin issuers and custodians?**
 - iii. **Should we apply the current certification functions and requirements to regulated stablecoin issuers and custodians? Are there any additional functions needed to capture the nature of regulated stablecoin issuers and custodians business services?**
 - iv. **Do you agree that we should apply the existing Conduct Rules to regulated stablecoin issuers and custodians?**

The Panel believe that both solo and dual regulated stablecoin issuers/custodians should be required to comply with both the FCA's regime and the Bank of England's Code of Practice. The Panel note that the FCA are only considering firms that would be solo regulated by the FCA and therefore agree that issuers and custodians should be captured by the 'Enhanced' category. The Panel would encourage the FCA to be diligent at the gateway to ensure the appropriate SMR rules are applied to the relevant firms remembering in particular that as issuers of regulated stablecoins they will be participating in the UK payments' system – the most systemic part of the financial services industry and (potentially) serving all sorts of consumers. Their responsibilities should be clearly understood at the gateway.

Q27. Do you agree with our consideration to apply our Principles for Businesses and other high-level standards to regulated stablecoin issuers and custodians? Are there any particular areas you think we should apply detailed rules regarding information to (other than those for backing assets set out in Chapter 3)?

The Panel agree with the FCA's consideration to apply Principles for Business and other high-level standards to regulated stablecoin issuers and custodians. We are very supportive of firms being subject to the Consumer Duty.

The Panel would encourage detailed rules/guidance in relation to retail consumer disclosures in order to ensure they are clear and free of technical jargon. The Panel considers that the FCA should use consumer testing to inform the disclosure rules for Stablecoins, in order to maximise their effectiveness.

Q28. Do you consider that we should design more specific conduct of business rules to regulated stablecoins issuers and custodians? In particular what approach should we take to applying rules on inducements and conflicts of interest management to regulated stablecoin issuers and custodians?

The Panel agree with the FCA's consideration to apply Principles for Business and other high-level standards to regulated stablecoin issuers and custodians. We are very supportive of firms being subject to the Consumer Duty.

The Panel considers that managing conflicts of interest will be very important and there should be clear rules that will prioritise consumers' interests.

Q29. Do you agree that the dispute resolution mechanisms provided in traditional financial services (i.e., the application of the DISP sourcebook and access to the Ombudsman Service) should be applied to the business of regulated stablecoin issuers and custodians? Have you identified any gaps or issues in relation to dispute resolution? Please explain.

The Panel agree that the dispute resolution mechanisms provided in traditional financial services should be applied to the business of regulated stablecoin issuers and custodians. This will not only be in the interest of consumers but will ensure the FCA advance its consumer protection objective as it is vital that consumers are able to access dispute resolution mechanisms when things go wrong.

Based on current market practices, consumers are unlikely to have a direct relationship with a regulated stablecoin issuer and therefore may direct any complaint to a service provider with whom they are directly engaged. The Panel would encourage the FCA to consider this potential issue further, as the FOS is only able to consider complaints between a consumer and service providers with which they have a direct relationship. The Panel strongly agree that customers of regulated stablecoin issuers and custodians should have access to the FOS. By doing so, instances of harm can be resolved promptly and effectively.

Q30. Do you agree that the FCA should not be proposing to extend FSCS cover to the regulated activities of issuing and custody of fiat-backed stablecoins? If you do not agree, please explain the circumstances in which you believe FSCS protection should be available.

The Panel understand the FCA's view that compensating consumers where they have chosen to engage in higher risk services or products (which may be appropriate in some, but not all, circumstances) may create the wrong incentives among consumers and firms.

However, as the FCA states, regulated fiat-backed stablecoins will be money-like and will be able to be used as a means of payment for goods and services in the UK. The FCA further states that stablecoins might usefully be used in cross-border transactions (particularly for remittances)

and that unbanked adults might want to use fiat backed stablecoins for payments. In other words, as the FCA recognises, consumers of all kinds might wish to use stablecoins in everyday contexts – for paying, receiving and storing money. These activities are everyday financial activities in which consumers *have* to engage; they are not elective or sophisticated financial activities and services that enable them should not be provided on a higher risk basis. To the extent the FCA envisages that *all* consumers should have access to regulated fiat-backed stablecoins *and* that they be considered, positioned and/or marketed as being money-like, the Panel believes that they should have FSCS cover and all the sureties that commercial bank money deposits and payments receive.

The Panel does **not** agree with the FCA’s proposal of not extending FSCS cover to the regulated activities of issuing and custody of fiat-backed stablecoins. We would question what safeguards a consumer has should the firm or custodian enter insolvency and whether a typical consumer would understand the differences in FSCS protection for (as an example) retail investments vs stablecoins. Indeed, the fact that stablecoins would not be positioned as investments, means that the key risk to consumers would be firm failure which the Panel would expect to be covered by the FSCS.

The Panel believe that in the circumstance of a firm failure (which results in consumers being unable to make use of their stablecoin holdings and therefore suffer harms) or the failure of a custodian, FSCS protection should be available.

In our view, FSCS protection should be in place for Regulated Stablecoins. The FCA itself states (1.21) that the proposed regime “should enable consumers to buy stablecoins with confidence, and to ensure that they have the legal protections for a money like instrument”. For this, FSCS protection is key.

Q31. Do you agree with our proposed prudential requirements for regulated stablecoin issuers and custodians? In particular, do you agree with our proposals on any of the following areas:

- i. Capital requirements and quality of capital**
- ii. Liquidity requirements and eligible liquid assets**
- iii. Group risk**
- iv. Concentration risk**
- v. Internal risk management**

The Panel believe that regulated stablecoin issuers and custodians should be required to have adequate financial resources. The Panel agree that any additional requirements should achieve the following outcomes for consumers and markets:

- Enable firms to remain financially viable
- Enable a firm to be able to afford to put right any harm that it causes
- Enable an orderly wind-down without causing undue economic harm to consumers or the integrity of the UK financial system

Q32. Do you agree with applying the existing CASS rules on post failure treatment of custody assets to regulated stablecoin issuers and other firms holding backing assets for regulated stablecoins, as well as CASS pooling events? If not, why not? Are there any alternative approaches that should be considered? If so, please explain.

The Panel agree with applying the existing CASS rules on post failure treatment of custody assets to regulated stablecoin issuers and other firms holding backing assets for regulated stablecoins, as well as CASS pooling events.

Q33. Do you agree with our thinking on how the CASS rules can be adapted for returning regulated stablecoin backing assets in the event of a firm failure or solvent wind-down? If not, why not? Do you foresee the need for additional protections to ensure prompt return of backing assets to consumers or otherwise reduce harm in firm failure (e.g., strengthening wind-down arrangements, a bespoke resolution regime)? If so, please explain.

The Panel agree with the FCA's thinking on how the CASS rules can be adapted for returning regulated stablecoin backing assets in the event of a firm failure or solvent wind-down.

Q34. Do you agree with the proposed overall approach for post failure trading? If not, is there anything else that should be considered to make the approach more effective? If so, please explain. Are there any arrangements that could avoid distribution of backing assets in the event an issuer fails and enters insolvency proceedings?

The Panel agree with the proposed overall approach for post failure trading.

Q36. Do you agree that this approach to integrating PSR safeguarding requirements and custody requirements will secure an adequate degree of protection for users of stablecoin payment services?

The Panel agree that the FCA's proposed approach to integrating PSR safeguarding requirements and custody requirements will secure an adequate degree of protection for users of stablecoin payment services but only if safeguarding rules are strictly followed, segregation is

maintained, and record keeping is kept up to date. This must be scrupulously monitored. We would like to see surety of the timing of the return of safeguarded customer funds after insolvency. And the FSCS should apply per our earlier observation.

Q37. Do you agree that the custody requirements set out in chapter 5 should apply to custody services which may be provided by payment arrangers as part of pure stablecoin payment services?

The Panel agree that the custody requirements set out in chapter 5 should apply to custody services which may be provided by payment arrangers as part of pure stablecoin payment services.

Q38. Are there additional risks or opportunities, not considered above, of different stablecoin payment models that our regulation of payment arrangers should seek to tackle or harness?

The Panel note the FCA's assumption of the proposals within the Discussion Paper having no direct impact on the digitally excluded population and older consumers as they are presumed unlikely to use fiat-backed stablecoins. Whilst we agree with this, things may change. The Panel would request the FCA monitor usage and where applicable, consider consumer education in order to ensure consumers understand the risks and opportunities associated with using stablecoins. The risk of cementing and furthering exclusion is also not to be ignored particularly given that that issuers will likely target the most attractive (ie the more solvent and digitally literate) parts of the population, leaving the rest under-served.

Q39. What are the potential risks and benefits of the Treasury's proposal to allow overseas stablecoins to be used for payments in the UK? What are the costs for payment arrangers and is the business model viable?

In the Panel's view all regulated stablecoins need to offer the same suite of consumer protections for any regulated stablecoins to be in any way additive to the UK payments landscape. We cannot envisage how it would be possible for an overseas stablecoin to offer such protections. The introduction of regulated overseas stablecoins would therefore be misleading and confusing as well as fraught with currency, opacity, credit, operational, regulatory, jurisdictional and insolvency risks.

Q40. What are the barriers to assessing overseas stablecoins to equivalent standards as regulated stablecoins? Under what circumstances should payment arrangers be liable for overseas stablecoins that fail to meet the FCA standards after approval, or in the case where the approval was based on false or incomplete information provided by the issuer or a third party?

Allowing overseas stablecoins to be used for payments in the UK may bring benefits for greater consumer choice, however the Panel is concerned that this may carry various practical issues for implementations, creates risks for consumers and could threaten market integrity. The Panel agree that each overseas stablecoin would need to meet equivalent standards. This would ensure that consumers will continue to have an appropriate degree of protection in place.