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Dear FCA,

Financial Services Consumer Panel response to FCA CP 25/15: A prudential regime for cryptoasset firms

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's consultation paper on a prudential regime for cryptoasset firms. We are an independent panel that represents the interests of consumers of financial services including both individuals and small businesses. Our focus is on the outcomes and impacts to these stakeholders.

As such, the Panel very much supports the expansion of the FCA's regulatory remit and the FCA's engagement and efforts toward ensuring that there is appropriate cryptoasset regulation. This sector is growing rapidly and must be addressed as it becomes critically important to both individual and small business consumers.

Given that the FCA has global recognition as a regulator that sets high standards, the Panel encourages the FCA to continue with that track record in the context of cryptoasset regulation. The FCA has the opportunity to set a high bar for consumer protection, market integrity/stability, and competition in the UK cryptoasset market. It is this trustworthy environment that will encourage the confidence of consumers, lead to the growth of the sector, and contribute to the growth of the economy.

Long-Term Vision of Prudential Framework

The Panel supports the FCA's long-term vision to review and build a new integrated prudential framework. We believe that this consultation creates

a timely opportunity to inform this review, as it brings into the mix a whole new asset class which has the potential to bring new perspectives from those of traditional finance.

Given the FCA's direction of travel, the Panel believes it is appropriate to first consider the purposes of the prudential framework. This framework received significant attention as a follow-up to the financial crisis of 2007 / 2008, which then led to significant changes in the UK regulatory framework.¹ At the time, the prudential framework was designed to increase market stability, providing greater assurance that firms had the internal financial resources, i.e., capital, to cope with economic stresses, especially those stresses that are unusual. The prudential framework was also designed to ensure that financial resources were available to support an orderly transition if a regulated firm was to fail.

These purposes are still very valid, and the Panel believes that the existing purposes of the prudential framework are critical for protecting consumers when a firm faces financial difficulties or when there is a difficult economic situation / environment. However, the Panel suggests that the FCA might now take a wider view of "prudence" and what it can mean to the capital requirements of regulated financial services firms within its remit. The FCA has already started this journey with the publication of CP23/24: Capital deduction for redress: personal investment firms.² Similar to this approach, as part of the prudential framework, the Panel would like the FCA to consider further incentive mechanisms to motivate good firm behaviour. Providing a means to change a firm's immediate behaviour can be much more impactful than the possibility of enforcement measures down the road.

The Panel also understands that consistency with existing approaches is helpful for existing firms and regulators, and change comes at a cost. However, in alignment with the FCA's long-term vision, the Panel would strongly encourage the FCA, within the context of its 2025 to 2030 strategy³, to make a concerted effort to review and analyse the data it has available to either support or challenge current approaches and to assess risks and opportunities that are on the horizon. Where it determines that critically important data is not available, the FCA should identify the appropriate mechanisms with which to obtain it.

¹ [Financial Services Act 2012](#)

² [CP23/24: Capital deduction for redress: personal investment firms | FCA](#)

³ [FCA launches 5-year strategy to support growth and improve lives | FCA](#)

Clear, easily understood, standard definitions

We believe that it is urgent for all UK authorities and regulators to establish, agree, and communicate with clearly understood standard definitions of the various terms relevant to the cryptoasset sector. Failure to do so is likely to result in confusion, poor decisions, unintended consequences, and negative outcomes. A common understanding is absolutely crucial to consumer protection, both from the perspectives of the regulators and the consumers themselves.

In some cases, the FCA has highlighted the importance of appropriate definitions, as indicated by the footnote in paragraph 12 of the CBA⁴. In this case, the FCA has stated “We avoid using the term “cryptocurrency” as crypto products do not share characteristics with other currencies (used as means of payments, low volatility) and so the term “cryptoasset” is more appropriate.” However, that same paragraph previously notes that “The term “Cryptoassets” refers to a variety of ‘cryptographically secured’ non tangible assets in digital form...” The word “variety” is key here. Lumping all cryptoassets under a single banner also has the potential to be misleading and / or misinterpreted. The underlying technology may be the same, however differing crypto products also have differing characteristics and the perceptions and uses can be very different for each crypto product asset class.

To further underscore the importance of clearly understood standard definitions, and in some contradiction to the FCA’s statement above, paragraph 1.4 of this consultation defines stablecoins as “cryptoassets which seek to maintain their value against a fiat currency (a government issued currency, such as pound sterling or US dollar) by the issuer holding, or arranging for the holding, of fiat currency or fiat currency and other assets. Stablecoins are designed to be stable, money-like instruments...”

Fragmented approach

Because of the importance of the role of the FCA, the Panel is concerned that the FCA’s efforts to apply regulation to cryptoassets currently appears to be fragmented and does not always give confidence that there is clarity around the holistic picture.

The Panel is concerned that this consultation combines proposals for a prudential regime for stablecoins with what appears to be proposals for a

⁴ [CP25/14: Stablecoin issuance and cryptoasset custody](#)

prudential regime for custody of ALL cryptoassets (most of which are not yet regulated). This is not an intuitive approach, and the rationale for doing so has not been explained. Furthermore, there is concern that a generic custody prudential approach does not consider any specific risks associated with the variety of crypto asset classes. The Panel believes that this particular current effort should only consider custody of stablecoins, with custody of other cryptoassets considered along with associated consultation(s). Therefore, our responses to this consultation assume that custody only pertains to qualifying stablecoins.

The Panel also questions the reasoning behind deferring the assessment of other capital requirements for stablecoins to future consultations. This is likely to lead to significant gaps or significant reconsideration of earlier work.

In addition, there seem to be disconnects between this consultation and CP25/14, Stablecoin Issuance and Cryptoasset Custody, some of which are mentioned in the relevant sections below.

Capital requirements

The Panel takes the position that capital requirements should first and foremost protect consumers and market stability. These primary objectives should underpin all considerations falling within the consultation. Whilst the Panel agrees that the secondary growth objective is important, the Panel also believes that long-term achievement of this secondary objective is fully dependent on the achievement of the FCA's primary objectives.

The Panel recognises that the above discussion presents some new thoughts, which may or may not gain traction. In that light, we also provide some thoughts on the details of the existing proposals in the consultation.

Composition of Capital

The Panel generally agrees with the FCA's proposals relating to the composition of own funds consisting of Common Equity Tier 1, Additional Tier 1, and Tier 2 capital. The assumption that this should be consistent with current application to other regulated firms, as a starting point, makes a degree of sense.

However, given that cryptoassets have not previously been in the regulatory scope, the Panel does not agree with the FCA's position that

stablecoins can be excluded from the deduction from own funds. Once a reasonable period of data demonstrates that there is no deviation from expectations, the deduction could be reconsidered.

The Panel also urges the FCA to closely monitor the potential use or impact of cryptoassets across the capital composition of all firms and to be prepared to take urgent action in the event that any concerns arise in regard to consumer protection and / or market stability.

Furthermore, the Panel notes that the incremental percentages in paragraph 3.14 – 56%, 75%, and 100% have been in place for several years for MiFID firms. The FCA should ensure that these continue to be based on currently valid and fact-based assumptions and analyses.

Permanent Minimum Requirement

The Panel agrees with the concept of a Permanent Minimum Requirement (PMR), as it is an easy-to-understand baseline. However, it is not clear what evidence the FCA has used to determine the amounts proposed in paragraph 4.6. Given that the FCA is equating e-money and stablecoin issuers, the FCA should first look at the perceived effectiveness of the PMR for e-money issuers and custodians, given that there is now some history for the sector⁵ (or to expand to other sectors if needed). Once it is confident that this PMR is appropriate, we recommend that the FCA should perform and document a fact-based analysis between the business models and determine if any adjustment to the PMR for stablecoin issuers and / or custodians is needed to ensure appropriate consumer protection and market stability. The Panel understands the FCA's concerns regarding creating an uneven playing field, but this should not create a weakness in the prudential framework, and the better solution is to address the difference as part of its long-term vision.

Fixed Overhead Requirement

The Panel questions the adequacy and calculation complexity of the Fixed Overhead Requirement (FOR). There are many considerations for a firm that is potentially facing financial difficulties. In this light, resolution may well take longer than three months: payments of fixed overheads are unlikely to be the firm's only current obligations, the firm may incur additional obligations specifically related to its failure, such as retention and severance payments, etc. The Panel also questions whether the cost

⁵ [Risk management and wind-down planning at e-money and payments firms – multi-firm review | FCA](#)

to calculate the FOR is proportionate to any additional value. Therefore, the Panel proposes that the FCA consider changing the requirement to simply consider a period of average total expenses. This determination should, again, be informed by analyses of data available to the FCA.

K-Factor Requirement

The Panel agrees with the FCA's concept of application of a K-Factor requirement to stablecoin issuers, K-SII. As described, this will provide a capital buffer associated with the risks relating specifically to the firm's business activity of issuing stablecoins.

The Panel also agrees with the concept of applying a K-Factor requirement to capture the risks relating to firms acting as custodian of stablecoin assets.

However, the Panel has two concerns about both of these proposals. First, the FCA should be transparent about the source of the data and analyses it used to determine the K-SII of 2%, and the FCA should also do the same to verify that .04% is the right metric for the K-Factor for stablecoin custodians.

Second, the calculations of K-SII and K-QCS appear to be quite complex. Whilst the FCA notes that firms should have the data required, there is a cost associated with ongoing calculations and their validation. It is unclear that these costs are included in the Cost Benefit Analysis. The Panel is mindful that costs are likely ultimately to be passed on to consumers, so ensuring that the resource required is commensurate with the outcome is important. Even if the calculation of the relevant K-Factor results in a higher capital amount, the overall cost to the firm could be less; therefore, this should be part of the analysis to determine the appropriate calculation approach.

This consultation does not appear to have considered the stablecoins that are owned by the issuer, which was discussed in CP25/14, Stablecoin Issuance and Cryptoasset Custody. We believe that this is critically important and refer the FCA to the Panel's response to question 8 of that consultation for further attention.

Liquid Assets Requirement

The Panel understands and agrees that stablecoin firms must hold an appropriate amount of liquid assets to ensure consumer redemptions can be made on a timely basis and to support a wind-down process if

necessary. However, we aren't convinced that the FCA has demonstrated that the proposals in this consultation are adequate and appropriate for this purpose. We would like greater transparency as to the analyses and modelling that justifies these amounts. This should include both historic events and an attempt to model plausible future events. It should also consider the impacts that broader availability of stablecoins might have on the ecosystem.

For the Basic Liquidity Asset Requirement (BLAR), we would question the view that one month of fixed expenses is adequate, especially in a scenario of economic stress for the sector. We do not understand the reasoning for including only 1.6% of the total amount of guarantees provided to clients.

For the Issuer Liquid Asset Requirement (ILAR), although the FCA has provided an extensive explanation of price risk in the backing pool in paragraphs 5.15 to 5.26, the Panel would like to better understand the expected calculation methodology and its timing in a period where the stablecoin has become "de-stabilised"⁶. We also believe that it is important to clearly state that the credit rating of the backing asset is included as a consideration in the calculation, as this seems to be an increasing risk, even for government debt.

Whilst the Panel generally agrees with the list of assets (and exclusions) that are defined as core, additional clarity should be provided within an evolving cryptoasset landscape. Some of these core assets already may be or may become digitised in the near future, e.g., Central Bank Digital Currencies and money market funds. How will these cryptoassets be treated in the context of the BLAR and ILAR?

For further detail relating to backing assets, please refer to the Panel's response to question 3 of CP25/14, Stablecoin Issuance and Cryptoasset Custody.

We also note the FCA's discussion of the Backing Asset Composition Ratio (BACR) and the On-Demand Deposit Requirement in CP25/14, but that neither was mentioned in CP25/15. Although they are for different purposes, they do have implications for the calculations of liquid assets. Therefore, they should be included when considering liquidity requirements for prudential purposes. We are of the view that the BACR is a particularly informative metric. Please refer to the Panel's response to question 5 of CP25/14 for further information.

⁶ [Stablecoins: A Deep Dive into Valuation and Depegging | S&P Global](#)

Concentration Risk

The Panel understands the dilemma that concentration risk poses to stablecoin issuers, as by definition, the backing assets of the stablecoin are likely to be restricted to asset classes and / or issuers. However, as noted in paragraph 6.4, the Panel agrees with the FCA that firms must monitor and control all sources of concentration risk, including in their backing asset pool as well as across the business.

Furthermore, given that accumulated concentration risk across all stablecoin firms could pose a risk to market stability, the Panel believes that the FCA should develop a regular reporting mechanism for these firms to inform the FCA of their concentration risk. This reporting should specifically address any risk associated with the broader concentration risk across independent custodians; firms must report relevant data to the FCA. The FCA should monitor this data for potential systemic risks and act accordingly.

Other Prudential Requirements

We note the FCA's intention to publish, at a later date, a further consultation addressing other prudential requirements that will apply to stablecoin issuers and custodians. As noted earlier, the Panel believes that this is a sub-optimal approach. Given that stablecoins are a relatively new asset class and there is likely to be a lack of familiarity with the concepts and the details, contributors to consultations need to have an understanding of the total picture before assessing the FCA's proposals and making recommendations. The FCA must also be in a position to convey all of the information in a joined-up manner. Deferring what is likely to be the more complex components of the prudential requirements, e.g., the Internal Capital Adequacy and Risk Assessment, creates a significant risk of wrong decisions being made or material rework being required.

Firm and FCA Requirements

The Panel strongly believes that adherence to FCA principles (especially the Consumer Duty), the Senior Managers and Certification Regime (including Conduct Rules), and implementation of good systems and controls are essential for the long-term viability of any firm. Any stablecoin issuer or custodian seeking authorisation must be able to demonstrate that these regulatory standards have been embedded into their firm culture.

The FCA must have the required resources to make the appropriate assessment at the authorisation gateway. Furthermore, the FCA must have sufficient supervisory resources to proactively supervise all authorised stablecoin issuers and custodians, regardless of size, until such time as there is comfort that these firms are demonstrating the right culture and clearly adhering to the high regulatory standards expected of UK firms.

The FCA should further incentivise firms that are adhering to high standards with lower capital requirements. Although not without challenges, in addition to levying capital requirements for poor firm practice, the Panel believes that applying incentives that reduce capital for good firm practice is an approach that also should be considered. This is aligned with the FCA's direction of devoting more effort toward problem firms and less to firms that demonstrate that they are "doing the right thing." This should better serve consumers, outcomes-oriented firms, and the growth of the economy.

The Panel also believes that it is critical that consumer investors in stablecoins have appropriate access to FSCS protections; therefore, in addition to capital requirements, the FSCS levy for stablecoin firms should consider any greater risks of stablecoin firm failure. Not only will this protect investors against unanticipated market issues and / or potential firm failures, but it should also serve to provide additional confidence in the sector, which is also likely to enhance the perception of stability, furthering growth in the sector.

Yours sincerely,

Chris Pond

Chair, Financial Services Consumer Panel

Annex

Question 1: Do you have any comments on our proposals for the definitions and types of, and deductions from, regulatory capital that CRYPTOPRU firms should use to calculate their own funds?

Please see the cover letter for the Panel's response.

Question 2: Do you have any views on our proposed requirements for deductions from CET1 capital, in particular cryptoassets held by firms which they have issued or are in control of the supply of?

Please see the cover letter for the Panel's response.

Question 3: Do you have any comments on our proposed overall approach on the Own Funds Requirement (OFR), and the detailed provisions of the specific components: (i) PMR, (ii) FOR, (iii) K-SII, and (iv) K-QCS?

Please see the cover letter for the Panel's response.

Question 4: Do you have any views on the items to be deducted from total expenditure when calculating the FOR, are there any others that may be relevant for cryptoasset firms and if so, why?

Please see the cover letter for the Panel's response.

Question 5: Do you agree with our proposal that the value of qualifying cryptoassets appointed by or to a third party custodian for the purposes of safeguarding must be included in the measurement of QCS? If not, how else would you suggest that the risk of potential harm from the use of third parties is mitigated?

Yes, the Panel agrees that stablecoins appointed by or to a third-party custodian for the purposes of safeguarding must be included in the measurement of QCS.

Question 6: Do you agree with our proposals on the basic liquid asset requirement (BLAR)?

Please see the cover letter for the Panel's response.

Question 7: As part of the BLAR, can you identify any circumstances where the provision of guarantees provided to clients by firms might apply to cryptoasset custodians or qualifying stablecoin issuers?

The Panel is not in a position to respond to this question.

Question 8: Do you agree with our proposals on the issuer liquid asset requirement (ILAR) to address price risk when government

debt instruments are held in a backing pool (either directly, or indirectly in connection with certain funds and repo/reverse repo transactions)? If not, please explain why you do not agree with specific aspects and what alternative solutions would you suggest?

Please see the cover letter for the Panel's response.

Question 9: Do respondents consider that the foreign exchange risk for qualifying stablecoin issuers described in paragraph 5.22 needs to be addressed through minimum requirements, for example would a specific capital charge be appropriate?

The Panel believes that foreign exchange risk for qualifying stablecoin issuers should be addressed through minimum capital requirements, as this could have a material impact on the issuer's financial position.

Please also refer to the Panel's response to question 6 of CP25/14, Stablecoin Issuance and Cryptoasset Custody, for further information.

Question 10: Do you have any comments on the proposal for monitoring and control of concentration risk? Please provide suggestions for any specific clarifications that you feel may be helpful.

Please see the cover letter for the Panel's response.