Response to the Bank of England's Discussion Paper

Regulatory regime for systemic payment systems using stablecoins and related service providers

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Sent to: The Bank of England

1. Introduction:

1.1 UK Finance is the collective voice for the UK banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation. We welcome the opportunity to respond to the discussion paper published by the Bank of England on 6 November 2023 on its proposed approach to regulating systemic payment systems using stablecoins and related service providers.

1.2 Given the breadth and diversity of our membership, there are naturally differing views on certain key issues. We have sought to identify more broadly, what those multiple viewpoints are, and where this is relevant to specific issues raised by the Bank of England.

1.3 UK Finance and its members are also providing feedback on other papers published in the context of the UK government's proposals to regulate fiat-backed stablecoins, including:

(a) the FCA's discussion paper on the first phase of its regulatory regime for cryptoassets; and

(b) the Prudential Regulation Authority's Dear CEO letter on innovations in use by deposit-takers of deposits, e-money and regulated stablecoins.

2. Executive Summary

Existing Regulations

Drawing on our responses to previous consultations, UK Finance and its **members support the broad proposal to build upon the existing regulatory/legislative regime for stablecoins used for payments**. Relevant sources are the Electronic Money Regulations 2011 (EMRs), the Payment Services Regulations 2017 (PSRs), and the FCA's Client Assets Sourcebook (CASS).

Definitions

While there is currently no single, uniform definition of a stablecoin, and given the different types of stablecoins on the market, UK Finance and its members believe that there is significant regulatory and market benefit in creating a bespoke definition for a "single-currency payment stablecoin". This also would include distinctions for stablecoins that are being used for wholesale purposes vs retail purposes. Further to this, **definitional clarity will help to outline the differences between e-money, tokenised deposits and stablecoins,** which will allow firms to prepare accordingly as they develop new forms of digital money for payments. UK Finance would be pleased to assist HM Treasury and the FCA in forming such a definition for regulated fiat-backed stablecoins.

Authorisations Regime

Members also expect and hope for an authorisations regime that avoids duplicative applications and reduces the burden on firms participating in stablecoin products and services, where feasible. Furthermore, as the UK moves through its previously described phased approach to cryptoasset regulation, members hope that beneficial authorisation routes are considered for previously regulated firms and those newly regulated firms who wish to acquire subsequent phases of cryptoasset authorisation.

Wholesale considerations

UK Finance and its members appreciate that the proposed regulatory regime is on retail focused, GBP denominated systemic payment stablecoins. We are eager to facilitate discussions with the Bank of England on a wholesale regime and regarding overseas stablecoins.

We believe that the UK's traditional open market approach is key to its international competitiveness and its position as a global financial market. We also believe that the UK regulatory perimeter should be technologically neutral and that the same risk should be subject to the same regulation.

When consideration is given to a wholesale regime and to overseas stablecoins we would encourage consideration of the following:

- Whether business to, as well as in, the UK should be subject to regulation in the first place;
- Use of the overseas person exclusion which provides safeguards proportionate to the activity and UK client or counterparty in its use of "with or through" and a legitimate approach;
- Development of an equivalence regime for cryptoasset service providers who are regulated in another jurisdiction.[1]

Part 1: The Bank's Proposed Regulatory Framework

Q1: Do you agree that, to preserve the singleness of money, systemic payment stablecoins must be fully interchangeable with other forms of money at par?

UK Finance members agree that systemic payment stablecoins should be fully interchangeable with other forms of money at par, this will help to build and maintain confidence in the stablecoin and digital currency ecosystem.

Q2: Do you have views on further requirements that may be needed to ensure the singleness of money when stablecoins are traded in secondary markets?

Stablecoins in their current form represent a transferable claim on the issuer, which renders them akin to a tradeable financial asset with a prevailing market price. Therefore, trading on secondary markets will always mean that there is a bid-ask spread and by implication, exchange rates for tradeable assets may fluctuate away from par.

[1]Our members do, have significant concerns regarding HMT's proposal relating to payment arrangers which involves the entirely new concept of the conferral of a regulatory function on a private entity which could well be a competitor to the overseas stablecoin issuer

Intraday deviations from the peg might therefore restrict the ability of stablecoins to serve as a stable means of payment, as payees would only be willing to accept stablecoins in exchange for their goods or services if they have confidence that these stablecoins will maintain their value so that they can be reused in future purchases.

Further consideration may therefore be needed on the role that stablecoin trading on secondary markets may have for price stability and confidence as a stable means of payment, especially if those payments were deemed systemic. The approach should be to maintain the focus on exchange at par (for users) for sterling denominated systemic payment stablecoins.

Part 2: The Bank's Proposed Regulatory Framework

Q3: 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?

We understand the need for a systemic regime focused on UK retail stablecoin payments, and at this stage in the development of systemic payment stablecoins, we would expect those flourishing in the UK market to be sterling denominated stablecoins backed by assets denominated in the same fiat currency.

However, UK Finance and its members are of the view that the Bank (and other regulators) should consider the most likely-to-be-used use cases so the UK economy can best realise the potential of stablecoins. It would be useful for the Bank to work alongside industry to clarify and identify the business models they have in mind.

Members note that stablecoins that are backed by overseas stablecoins or a basket of reference currencies may be subject to additional risks compared to those that are backed by a single currency and consequently may need to maintain larger liquidity/capital buffers to provide for the necessary level of price stability. There was a suggestion to look at the Monetary Authority of Singapore's regime, which allows all G10 currencies to be used to back stablecoins. Furthermore, member research indicates that some small/micro corporates, as well as charities, may be more interested in interacting with different stablecoins than UK retail consumers.

We appreciate the difficulties in creating a regime for systemic stablecoins that are not GBP-denominated; those already in the market currently do not appears close to qualifying for that status. Whilst it currently may seem unlikely that a non-GBP backed stablecoin will become systemic, the fact that the current stablecoin market leaders are denominated in USD means that this should be considered by the Bank as a possibility.

Q4: Do you agree with the Bank's proposed approach to assessing the systemic importance of stablecoins used for payments?

Assessing systemic importance

We would be grateful for further clarity on what it would mean for a stablecoin issuer or participant in a stablecoin payment chain to become "systemic".

We appreciate the difficulties in being able to quantify this and were pleased to hear the Bank's statement and note that to be systemic the disruption to the system would need to impact a lot of people across the UK. It would be useful to know what range the Bank would consider "a lot of people" and whether this range would need to be comparable to the other payment systems that the Bank considers to be systemic.

UK Finance and its members note that the Bank will not judge the systemic threshold solely on quantifying the value of transactions, transaction volumes and tokens in circulation. The Bank provided the example that failure of a stablecoin token, issuer or service provider (e.g. wallet provider) would also need to consider whether other existing stablecoin tokens, issuers or service providers could meet in the market demand in its stead.

We understand that there could be instances where stablecoins are "systemic at launch" due to the consumer network a stablecoin arrangement may have from the outset. Where stablecoin arrangements are overseen by the FCA's regime and could transition to become systemic under the Bank's regime, it would be helpful, in these scenarios, to know how payment chain entities and service providers might be impacted if these stablecoin arrangements were to be designated as systemic and how the two regimes would apply.

The EU's MiCA regulation aims to solve the issue of the systemic threshold by establishing minimum thresholds, however, members noted that these thresholds are very low and could severely impact smaller businesses.

"Systemic at launch"

We note that the Bank does provide additional guidance indicating that certain payment systems could be recognised as "systemic at launch" and this may be the case where, for example, a firm already has a "large user base" which could enable rapid growth in use of their proposed stablecoin. We are interested to get clarity from the FCA on what this may look like

Wallet providers and other payment service providers

In addition to the above, the Discussion Paper explains that certain wallet providers and other digital settlement asset service providers[2] may become systemically important due to reasons beyond their control – for example, where a wallet provider becomes popular with several (non-systemic) stablecoins or where a service provider (e.g. a cloud provider) provides services to several non-systemic stablecoins. Therefore, we would be grateful for further clarity on when this would apply in practice.

Q5: Do you agree with the Bank's proposed approach to the regulatory framework for systemic payment stablecoins, as set out in Section 2?

UK Finance members have expressed some concerns about the business model changes that would need to come into effect should a stablecoin issuer move from the FCA's regime into the Bank's systemic perimeter.

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[2] Under s.182 BA09 (5A) a "DSA service provider" is a person who provides one or more services in relation to a payment system that includes arrangements using digital settlement assets where—

(a)the person creates or issues the digital settlement assets involved in the payment system,
(b)the person provides **services to safeguard, or to safeguard and administer**, digital settlement assets including their private cryptographic keys (or means of access),
(c)the person is directly involved in any of the activities mentioned in paragraphs (a) or (b),
(d)the person is a digital settlement asset exchange provider,
(e)the person sets rules, standards, or conditions of access or participation in relation to the payment system, or
(f)the person **provides any service that facilitates, or supports, a transfer of money or digital settlement assets to be made using the payment system**, **including any infrastructure provider** in relation to the system.

Removing interest spread models would impact existing business models and may have unintended consequences. The transition for firms going from the FCA to the Bank's (and FCA) respective regimes would be difficult given how far apart they seem to be. Prohibition of redemption fees and earnings through interest could cause commercial concern to those firms issuing stablecoins, such that they may avoid becoming classified as systemic.

Furthermore, businesses operating models that do not perform lending services or generate revenue from interest on deposits would also be impacted by the regime. UK Finance and its members are of the view that these business models should also be assessed against the proposed framework. Some current business models exist where firms provide transaction banking services, custody, safeguarding accounts, payments, and FX, etc. Such firms don't lend or trade and therefore their risks could be deemed significantly lower. For such models, the current proposals would seem overly constrictive. Overall, UK Finance members are keen to explore the implications of the potential cliff-edge between the Bank and the FCA regimes.

Obligations on a systemic payment operator

Separately, whilst members generally agree with the Bank's approach to ensure a robust regulatory oversight of entities that play a critical or systemic role in a stablecoin payment chain, the responsibility of maintaining the payment chain should not be solely placed on one entity within the chain.

Despite recognising the roles played by third party service providers, under the Bank's proposals the recognised payment system operator would still need to perform the role of the 'systemic risk manager' across the entire chain. This approach effectively means that the payment system operator would become responsible for the risks that may arise from the entire ecosystem and assumes a level of control over independent third parties that the payment system operator may, or may not, have a direct contractual relationship with.

We would therefore urge the Bank of England to reconsider the feasibility of how one single entity will be able to effectively risk manage an entire payment ecosystem if those risks and activities are beyond the control of that entity.

In addition, it would also be helpful for industry participants to understand in more detail the Bank's expectations for the delineation of responsibilities that the issuer, payment system operator, and other entities in a stablecoin payment chain are expected to fulfil. In particular, it would be helpful if the Bank could set out its expectations for the payment system operator's responsibilities for the entirety of the payment chain with regards to other entities and service providers that may also play a role, especially when it comes to the provision of technical support and infrastructure.

Control over blockchain

Further, Members are concerned that this proposal would amount to a requirement to have effective control over key aspects of a blockchain, which may not be feasible in practice (see our response to Question 9 for details). There is a concern that firms would have to create a separate private blockchain which can be fully monitored and controlled, which will be very costly and time consuming in light of the operational costs and time involved in the development of a blockchain.

Q6: 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?

UK Finance are of the view that the Bank's assessment of the risks posed by vertical integration of stablecoin functions is sensible and would help with conflicts of interests as well as any risks posed for the entities themselves and for the ability of coin holders to redeem their tokens.

However, requiring an issuer to form a legal entity that is organisationally separate from other entities in its group will require a transitional period to implement and might change its business model, as the new entity will need to develop financial and operational autonomy, as well as comply with new, more stringent operational / governance requirements than previously implemented.

Q7: 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 support the Bank's approach that issuers of systemic payment stablecoins should be set up in the UK as subsidiaries to carry out business and issuance activities into the UK and with UK-based consumers, both directly and through intermediaries. We agree that, where FMIs operate across borders, the Bank should seek co-operation between authorities in different jurisdictions. Given the nature of regulated payment stablecoins, we might expect markets to continue to develop and for central banks and other authorities to continue to monitor them and their regulation and oversight.

UK Finance members are also requesting clarity on which parts of the stablecoin payments chain (that are not issuers) would be included in scope. It seems, due to the principle of the need to ensure continuity of services in case of entity failure, that many types of firms within the stablecoin payments chain may need to have an established presence in the UK. This seems particularly true of exchanges, wallet providers and custodians.

Subject to the territorial scope of the FCA regime, there may be certain stablecoin issuers that will be required to establish a new subsidiary and transfer its business to that new subsidiary when moving from the FCA to the Bank's stablecoin regime. We are keen to hear whether the Bank has any proposals on easing this transition process.

Part 3: Requirements for the transfer function

Q8: 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?

The current rules provide a good framework, which appears suitable for systemic payment systems using stablecoins.

Q9: 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)?

Permissionless blockchains

It may be difficult to design the means by which a stablecoin issuer could exercise sufficient control over the public permissionless ledger itself. This is because public permissionless ledgers are by definition not subject to the control of a single party: their development is open source, and anyone can access the ledger and use it to access or share information.

Providing a trusted environment for all parties interacting with the ledger used for the transfer function would help realise the full potential for stablecoins to be used as payments. This can, for example, be provided under an alternative model for overseeing stablecoin payment arrangements through the creation of a set of scheme rules to govern the interactions between network participants and enable a range of protections for consumers and businesses. This is akin to existing rules for card and real-time payment networks, with the scheme rules governing who can participate in the payment chain as well as the roles and responsibilities of its participants.

There is future potential for the development of consensus and design mechanisms of blockchains that can allow for public blockchains to be managed in a controlled manner. To do this an issuer may need to create its own blockchain solution. Even then, the stablecoin issuer would either need to hold a majority of the tokens or would need to issue governance tokens and hold a majority of these. Regardless, by not accounting for public permissionless ledgers, the Bank may be at risk supporting an increased fragmentation of different kinds of ledgers and may also hinder innovation in the space.

The benefits of public permissionless ledgers are the ability for a firm to use a pre-built blockchain to assist with the transfer function of the stablecoin. This saves significant costs to a firm rather than the need to develop its own blockchain and may help with interoperability with other solutions where required. Blockchains can be utilised to make interacting with other tokenised forms of regulated money easier and it may be useful for the Bank of England to consider these use cases.

Q10: 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?

Whilst the use of permissionless chains presents governance challenges, the Bank may want to consider leaving room for innovation and solutions.

UK Finance members are of the view that a firm using public permissionless ledger may, if then designated as systemic, need up to 18 months to completely change the ledger it uses for the transfer and recording of transactions to meet the required standards, should the Bank decide to exclude public permissionless ledgers from its regime. If a stablecoin issuer leverages an existing public permissionless blockchain to record the stablecoin token transactions prior to reaching the systemic threshold, then it would be unlikely for the issuer to make sufficient changes to the blockchain for its stablecoin to remain compliant with the Bank's regulatory regime and would need sufficient time to make such changes.

Providing a trusted environment for all parties interacting with the ledger used for the transfer function may help to realise the full potential for stablecoins to be used as payments. This can, for example, be provided under an alternative model for overseeing stablecoin payment arrangements through the creation of a set of scheme rules to govern the interactions between network participants and to enable a range of protections for consumers and businesses. This is akin to existing rules for card and real-time payment networks, with the scheme rules governing who can participate in the payment chain as well as the roles and responsibilities of its participants.

Part 4: Requirements on backing assets and restrictions on remuneration for the issuance of stablecoins used in systemic payment systems

Q11: Do you agree with the Bank's assessment of the important role of backing assets in ensuring the stability of value of the stablecoin?

UK Finance members agree with and appreciate the important role of backing assets in ensuring the stability of value.

Q12: Do you agree that the proposed remuneration policy is consistent with systemic stablecoins being used primarily for payments?

Many UK Finance members have concerns about the current remuneration proposals which are perceived to be too constrictive and require the firms to make high investments without any corresponding return on investment. At present, it is unlikely that any stablecoin issuers would be 'systemic at launch'. Accordingly, it is more likely that a stablecoin issuer would possibly meet the systemic threshold at some late point and move into the Bank's regulatory perimeter. The differences between the FCA and the Bank's proposals and the effect this would have on a firm's ability to generate revenue, would potentially create an unintended consequence of a firm doing its upmost to avoid systemic designation.

Another suggestion from members was whether the Bank would consider that any assets backing the stablecoin over the initial 100% could be used to generate interest. This could help firms meet the requirements about redemption risk and also allow for a small proportion of the backing assets to generate revenue for the firm.

Further to this, UK Finance members foresee that, should the regime proposals from the Bank stay the same, there could be an unintended consequence that stablecoins (effectively backed by Bank of England deposits) could be perceived as more secure in times of crisis than commercial bank money. UK Finance raised similar concerns to the Bank during the Digital Pound consultation phase. There has since been further published research evidencing the risks of deposit flight during times of stress, and the consequent impacts on financial stability and credit creation.[3]

Full backing by central bank deposits (which does not have interest being paid on the deposits) would make a systemic stablecoin economically equivalent to a synthetic CBDC. This could present the same possible financial stability risks we see with CBDC – a central bank-backed stablecoin may be perceived as a 'safer' asset. We acknowledge limits may mitigate this risk.

Furthermore, having a regime that would effectively make systemic stablecoins economically equivalent to a CBDC, could create one of two possible unintended consequences. Either it could deter firms from creating a systemic stablecoin as they know the Digital Pound may become a preferred mode of retail payment, or that the systemic stablecoins would be more prevalently used than the Digital Pound, which may not be an ideal outcome in terms of the effort and resource that will be required across the ecosystem to implement it (if such a decision is made).

Part 5: Other requirements for the issuance of money used in systemic payment systems

Q13: Do you agree with the Bank's proposed requirements on the redemption process, including the role of all firms in the payment chain?

[3] For example, https://www.ebf.eu/ebf-media-centre/copenhagen-economics-study-on-the-impact-of-a-digital-euro-on-financial-stability-and-consumer-welfare/

From the Bank's proposals, it seems that it is the responsibility of the issuer to ensure the entity providing the customer interface is compliant with the Bank's regime. It would be helpful for the Bank to suggest ways in which a stablecoin issuer would conduct such a process – for example, by confirming whether this process would be conducted through an independent auditor or through the issuer's own checks?

Q14: Do you have views on requirements on redemption fees, or prohibiting these, to minimise any frictions across the redemption process?

From a consumer perspective, lower costs for redemption are likely to be welcomed, and for the majority of retail consumers there is an expectation of 'free' payments. However, in the context of the Bank's model for systemic stablecoin issuers, it would be difficult to see where issuing firms would be able to make revenue under these proposals. Whilst UK Finance members agree with the premise that redemption fees should not be disproportionally high, if the backing asset proposals remain the same then it is foreseeable that redemption fees will likely need to be charged to coinholders.

A further unforeseen consequence could occur if a systemic stablecoin entity must begin to charge fees to make up for not earning revenue off of backing assets – this may dissuade consumers from using the stablecoin and opting instead to use a regulated non-systemic stablecoin or even a non-regulated stablecoin.

We note the Bank's statement that a pause may be needed for financial stability reasons, which we agree is a pragmatic approach. Issuers and other parties may identify other options to minimise friction for the Bank to consider.

Gas fees

We would like to know how the regime proposes to account for gas fees that are chargeable at redemption and whether these can be deducted directly from the amount being redeemed. It is unclear how the regime would deal with these fixed costs and requiring a stablecoin issuer to pay the amount will only make it more difficult for them to operate.

Q15: 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?

Q16: 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?

For a consumer to redeem their token, they would either need to redeem with the issuer or sell the stablecoin token on the secondary market. To ensure market stability with the stablecoin it would be beneficial to create proposals that would allow for the ease of redemption at par even in the case of firm failure. Should consumers sell their systemic stablecoin token on the secondary market, this could affect the price and potentially de-peg from the 1:1 ratio. Accordingly, it would seem sensible that in the instance of the entity providing the customer interface (such as a wallet service) failing, it should facilitate redemption by providing information about the customer to the issuer. This should only be done however once a redemption request has been made and the entity providing the customer interface has failed. It is important to note that this may depend on the contractual relationship between the entities, but members are of the view that, where an entity providing the consumer interface fails, the bank would need to put in place requirements to try ensure redemption remains as swift as possible.

Part 5: Safeguarding

Q17: 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)?

UK Finance members are of the view that the proposals to segregate backing assets are sensible. Some members believe that it would be beneficial to firms to be able to earn some interest from the backing assets. Members believe that the optimal solution might be one that would both preserve stability but also allow for firms to earn on their backing assets.

UK Finance members welcome the statutory trust proposal (which places clients' assets held by a safeguarding firm on 'statutory trust' for the sole benefit of those clients) over the debt model (which grants stablecoin holders an unsecured debt claim against issuers for the par value of their stablecoin holdings). It is also logical that the Bank and the FCA adopt this same model in its respective regimes.

Q18: Do you think there are any other features that need to be reflected in the safeguarding regime for systemic payment stablecoins?

We note the Bank's reference to reporting, audits, and notification, and agree this makes sense, provided that the frequency of reporting, etc. is not unduly burdensome on firms.

Q19: Do you agree with the requirements for stablecoins owned by the issuers held in treasury wallets?

UK Finance welcomes the proposals to require stablecoin issuers who hold their own stablecoin tokens to store these in proprietary/treasury wallets that are separate from stablecoins that have been purchased by consumers and are therefore in circulation.

The Bank is also proposing that these stablecoins held by a stablecoin issuer (i.e. in a separate proprietary wallet) should be fully protected at all times in accordance with relevant safeguarding rules. Similarly to the proposals for consumers' stablecoins, some members believe that it is overly onerous to require a firm to fully back another set of its own assets without the ability to earn any value / interest from the backing assets. This may dissuade systemic stablecoin issuers from holding a great amount of its own stablecoins. On the one hand, given recent crypto failures, this seems a sensible approach. However, the nuance is in how blockchain operations work: an issuer may need to hold a significant amount of its own stablecoin, or a cryptoasset that is native to the blockchain it is using, in order to remain compliant and have strong governance over the blockchain.

Part 5: Capital Requirements

Q20: 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?

UK Finance members are of the view that there should at least be capital requirements ensuring that reserve assets account for the risks associated with stablecoins (such as operational, cyber, technical, and those relating to mass redemptions of a stablecoin).

However, beyond this, regulators should not adopt overly punitive measures that would restrict a firm's ability to invest its own business and therefore stifle innovation. The Bank would need to consider what an Issuer can hold as capital requirements and whether the level required, may impact their ability to operate.

Q21: Do you have views on the approach (including any existing or bespoke methodologies) that should be considered for calibrating capital requirements?

Member firms would appreciate further guidance on what are considered high quality and highly liquid assets.

Q22: 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?

UK Finance agree that this is a sensible approach and its mirroring with the FCA's approach is useful. Stablecoin issuers must have the appropriate capital/liquidity buffers to maintain their peg, ensure they can make consumers whole at par in a timely manner, have appropriate supervision and proposals in place to prevent fraudulent or illicit activity (comingling funds, accuracy in audits and attestations), adequate disclosures and transparent reserve management and audits to ensure the adequacy of backing assets.

Q23: Do you have views on the range and quality of the assets issuers would be required to hold to mitigate shortfall risks?

UK Finance members are of the view that capital reserves could be made up of high-quality liquid assets (HQLA). However, commercial paper and repo agreements should not be included in the calculation.

Part 5: Limits and other requirements (e.g. business models)

Q24: 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?

UK Finance members agree that limits are likely to be needed for systemic payment system stablecoins, and certainly would be useful to have set limits at the start of the regime. There are significant practical implementation and challenges that UK Finance and its members highlighted in our response to the Digital Pound consultation.

Should a systemic stablecoin be purely backed by Bank of England deposits that cannot be remunerated, then this would be economically equivalent to a synthetic CBDC. As this could present the same financial stability risks that we see with CBDCs then holding limits could help to mitigate this risk.

We acknowledge and understand the dilemma between "wide usability" and risks to financial stability and disintermediation and are keen to continue to support HMT and the Bank in helping achieve this balance. It is also the case that different parts of the financial system may be impacted differently. For example, building societies could be uniquely impacted by the Digital Pound (and potentially systemic stablecoins) due to the Nature Limit within the Building Societies Act, and some legislative change for the Act may be required alongside any introduction of the Digital Pound.

Q25: Do you have views on the use, calibration and practicalities of limits?

We encourage the Bank to continue to engage closely with industry on the use and practicalities of holding limits. The different limits outlined could be used depending on what aspects of the market need greater oversight and management.

To note, in a bear market, consumers may want to transfer their unbacked cryptoasset into a secure digital asset as seamlessly as possible (i.e. a systemic stablecoin). Should there be limits on how much of a stablecoin token a consumer can hold, then it may influence a consumer from transferring to a non-regulated stablecoin. As the systems mature it is possible that it may become easier to apply limits in a more nuanced way (for example, limiting certain type of large transactions in certain circumstances, if warnings are triggered).

Q26: Do you have other views on the Bank's proposals for requirements for systemic stablecoin issuers, as set out in Section 5?

Q27: Considering the requirements for issuers in Sections 4 and 5, how might models need to change in order to retain commercial viability from those in the market today?

We refer again to our earlier points noting the challenges that may result from the delta between the FCA and BoE proposals, which would significantly impact commercial viability when transitioning from a regulated non-systemic and systemic stablecoin as well as what we see in the market today.

Part 6: Requirements for wallet providers

Q28: 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?

We agree that it will be essential for custodial wallet providers to deliver against the outcomes set out in Table 6.2. and reduce the risks to coinholders.

Q29: 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)?

It should be important for the Bank to note that there are significant innovations that are currently being developed such as self-sovereign identity and zero-knowledge proofs (ZKPs) that may ensure transaction validity without revealing sensitive information.

Q30: 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?

We believe that systemic off-chain ledgers should be subject to the same requirements that are applicable to systemic payment systems and welcome the need to ensure the operator of the ledger is in line with operational risk management rules.

Part 7: Requirements applicable to other service providers

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

UK Finance members welcome the Bank's approach to regulating service providers to those operating in a systemic stablecoin payment chain. UK Finance members are also conscious that firms should not come under unnecessary dual regulation or under scope of multiple regimes that would lead to firms incurring high costs when trying to comply with multiple regimes at the same time.

Like other systemic payment systems, systemic stablecoin payment chains may also rely on a broader set of service providers to support the issuance, transfer and/or store of value functions, without issuers directly performing them. Depending on the scale of the risks posed and activities performed, these service providers may also come into the Bank's remit in various ways or be recognised as a "critical third party". Therefore, it would be helpful if the Bank and HM Treasury provided clarity on which firms would come under scope of the critical third-parties regime and the Bank's proposed Code of Practice.

We appreciate that business models and use cases may vary, therefore it may be helpful to industry participants to understand in more detail the Bank's expectations for the delineation of responsibilities that the Issuer, Operator, and third-party entities are expected to fulfil. As previously mentioned in our answer to Question 5; it would be helpful if the Bank could set out its expectations for the payment operator's responsibilities for the entirety of the payments chain, and where other service providers and entities may also need to play a role, especially with regards to the provision of technical support and infrastructure. Again, this would help participants undertake their own due diligence requirements should they wish to consider their potential involvement as use cases evolve.

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.