UK Finance

Financial Conduct Authority's 'Stablecoin issuance and cryptoasset custody' consultation paper (CP25/14)

UK Finance response

July | 2025

Contents

1: Executive summary 4
1.1: Opening remarks 4
1.2: High-level principles 5
1.3: Summary of points raised in our response 6
2: Response to Questions 7

About UK Finance

Representing 300 firms, we're a centre of trust, expertise and collaboration at the heart of financial services. Championing a thriving sector and building a better society.

The financial services industry plays a vital and often underappreciated role enabling individuals, families and communities to achieve their ambitions in a safe and sustainable way – through home ownership, starting a new business or saving for retirement. The sector is fundamental to people's lives, and we are proud to promote the work it is doing to support customers and businesses up and down the country.

Whether it's through innovating for the future, driving economic growth, helping struggling customers amid increases in the cost of living, fighting economic crime or working to finance the net zero transition – the industry is having an overwhelmingly positive effect on the lives of people across the UK and improving the society we live in.

For more information about UK Finance, visit **www.ukfinance.org.uk**.

In developing our submission, UK Finance acknowledges the support of Linklaters and EY.

About Linklaters

Linklaters is a leading global law firm, supporting and investing in the future of our clients wherever they do business. We combine legal expertise with a collaborative and innovative approach to help clients navigate constantly evolving markets and regulatory environments, pursuing opportunities and managing risk worldwide.

For more information about Linklaters, visit **www.linklaters.com**.

About EY

At EY, our purpose is Building a better working world. The insights and quality services we provide help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

For more information about EY, visit **www.ey.com**.

This is UK Finance's response to the Financial Conduct Authority's (FCA) 'Stablecoin issuance and cryptoasset custody' consultation paper (CP25/14). The document was submitted to cp25-14@fca.org.uk.

1: Executive summary

1.1: Opening remarks

UK Finance and its members broadly agree with the approach taken by the FCA in CP25/14 and CP25/15. We recognise the FCA has put an extensive amount of thought into the proposals. Our members believe they are largely effective in delivering the 'responsible' element in the government's 'support the use and *responsible* growth of digital assets'[1] policy ambition. Allowing consumers to redeem their stablecoins into fiat currency at par value helps mitigate the risk of stablecoin innovation impacting the trust and confidence in money. The international stablecoin market was still in an early stage of development when the FCA published its first discussion paper, with the asset primarily used to support cryptoasset trading (or on/off ramping to fiat currencies). Interest in stablecoins has now evolved significantly. It is therefore difficult to determine how 'future proof' the regulatory framework will be over the medium to long-term.

We welcome the revisions made to the proposals that reflect industry's input into the FCA's first stablecoins discussion paper (DP23/4)[2] from November 2023. Whilst we have worked to ensure our inputs towards CP25/14 and CP25/15 are as consistent as possible with UK Finance's response to DP23/4, much of our thinking towards the opportunities and risks of stablecoins has evolved.

There are also wider complex questions around which types of firms should issue stablecoins, and the appropriate measures required to alleviate risks, particularly if a token becomes systemic and falls in-scope of the Bank of England's (BoE) systemic stablecoin regime[3]. Our members therefore find it important to understand the precise interactions between the FCA's requirements for non-systemic stablecoin tokens, and the BoE's requirements for systemic tokens. It's crucial the industry is given enough notice and time to input into the BoE's requirements prior to the wider regulatory framework[4] being finalised.

As highlighted in UK Finance's response to HM Treasury's draft Cryptoassets Order[5], we recognise the regulatory authorities' requirements are dependent on finalised 'level 1' boundaries and carve outs in HM Treasury's secondary legislation. This opened up questions around what proposed requirements in CP25/14 and CP25/15 may change in response to the

[1] HMT: Chancellor speech at Innovate Finance Global Summit 2025.
[2] FCA: Regulating cryptoassets Phase 1: Stablecoins (DP23/4). See UK Finance's response here.
[3] UKF: Response to the Bank of England's Discussion Paper Regulatory regime for systemic payment systems using stablecoins and related service providers.
[4] As laid out in the FCA's Crypto Roadmap.
[5] UKF: UK Finance's response to HM Treasury's 'Cryptoassets Order'.

Cryptoassets Order changing[6]. This has also made it considerably more challenging for firms to engage with these consultation papers. Our members also wished to highlight that the volume of recent FCA consultations, particularly in light of the significant technical detail contained in CP25/14 and CP25/15, has presented some practical challenges for respondents in fully considering and responding to the FCA's prudential proposals. In particular, it would be beneficial for members to have further opportunities to test and model the FCA's proposals, so that they may consider whether the level at which any prudential requirements are set reflects the general principle of regulating risk while ensuring the UK remains internationally competitive. Following the challenges highlighted in relation to HM Treasury's draft Cryptoassets Order and the practical hurdles above, while we have endeavoured to address the key issues arising from CP25/15, current industry feedback may not be as detailed as it might have been under different circumstances.

For next steps, the first priority must be to finalise the Cryptoassets Order, and all other secondary legislative files, including to enable the FCA's Market Abuse Regime for Cryptoassets (MARC) and cryptoassets Admissions & Disclosures (A&D) regime. All requirements so far that have been laid out under the FCA's Crypto Roadmap must then be re-assessed in light of these finalised level 1 boundaries. The BoE must then publish its systemic stablecoins consultation paper. As discussed further below, UK Finance members would also appreciate the ability to re-visit aspects of the FCA's current proposals once any interaction with prudential standards relating to cryptoasset activities proposed by the BoE and Prudential Regulation Authority (PRA) have been made clearer. We would therefore strongly suggest the FCA (with the other regulatory authorities present) conducts an additional informal, shorter and more focused engagement including hosting extensive workshop style sessions with industry participants and trade associations, following finalisation of the legislation and publication of proposals from other regulators.

1.2: High-level principles

Following the above, our members have formulated a set of high-level principles which have underpinned our response to the detailed questions set out.

- **Ensuring safe, resilient and secure products for retail and wholesale users**: Users should feel confident using regulated stablecoins or making informed investment decisions about qualifying cryptoassets.
- **Creating a pro-growth environment for digital assets and money**: We recognise HM Treasury's work to build a regulatory framework that is as internationally competitive as possible to ensure the UK's regulated stablecoin and cryptoasset market supports the government's growth mission. UK Finance members recognise

[6] We outlined the possibility of this challenge in our response to the FCA's 'Regulating Cryptoassets: Admissions & Disclosures and Market Abuse Regime for Cryptoassets' Discussion Paper (DP24/4) (page 8).

there is an opportunity for the UK to carve out areas of market leading activity in digital money and assets, particularly where we can leverage the longstanding role of London as a leading financial centre. Striking a balance with regulatory frameworks so that they attract international investment and do not push activities offshore is critical to job and value creation for the UK economy. The FCA should aim to engender an investment landscape that supports the international competitiveness of UK based stablecoin issuers. This must not, however, come at the expense of customer safety or financial stability.

- **Avoiding unintended consequences for established markets**: Wherever possible, we are seeking to ensure that rules and frameworks for the emerging cryptoasset and stablecoin ecosystem do not unintentionally undermine or cut across well-established and well-regulated market practices and procedures that exist today. This will also help to ensure that traditional market participants enter into this space, e.g. as custodians.
- **Clear definitions and taxonomy**: We continue to advocate for clear definitions and taxonomy and made further specific points on this in our response to the HM Treasury's draft Cryptoassets Order.

1.3: Summary of points raised in our response

Stablecoin issuance questions

Clarity on AML and financial crime

Our members believe that it is critical to provide clarity on AML requirements for stablecoins across all use cases. Strong AML requirements are in the best interests of all market participants. In particular, our members seek clarity on the boundaries of their responsibilities to understand how far 'up the chain' firms need to look. This could also be a very significant issue for custodians of backing assets, so clear guidance on practical implementation is required. If the obligations are uncertain or very onerous, it could result in custodians being reluctant to provide services to stablecoin issuers, or only doing so in exchange for higher fees.

CP25/14 raises Financial Crime questions in terms of Customer Due Diligence requirements[7] and how and when these apply; there are also wider Financial Crime risks to be addressed. Financial Crime considerations need to be baked into the requirements for the design of stablecoins and their custody. This is vital for reducing the risk of fraud and allowing a level of transparency and traceability to support the prevention of financial crime, particularly compliance with developments regarding Financial Action Task Force's (FATF) Travel Rule.

[7] Paragraphs 3.140- 3.143.

How backing asset requirements mitigate risks

We would welcome clarity from the FCA on how its proposed backing asset requirements will help mitigate risks associated with this nascent market. For example, further information on how the 180 days redemption data requirement will help alleviate risks of runs in stressed state scenarios would be welcomed.

More robust prohibition on interest-bearing tokens required

In the current proposals to utilise CASS 16.2.13 to prohibit stablecoin issuers from remunerating token holders with revenue derived from tokens' backing assets, it appears stablecoin issuers would still be permitted to remunerate holders through other sources such as payments by third parties. This appears to allow e.g. stablecoin issuers to pay holders of stablecoins based on other revenues, such as retained profits of the backing asset pools of other stablecoins via lotteries or prizes, account opening bonuses, share reward mechanisms and payment rewards. We would suggest the need for a more robust prohibition scope.

Cryptoasset Custody questions

The FCA currently regulates how firms should hold assets for clients under its rules in CASS 6. In CP25/14, the FCA proposes introducing a separate regime under CASS 17 for firms safeguarding qualifying cryptoassets and/or arranging qualifying cryptoasset safeguarding. We think that the FCA should consider applying CASS 6 to cryptoassets rather than creating a new cryptoasset-specific regime under CASS 17. In the alternative, if the FCA retains a version of CASS 17 separate from CASS 6, we think that cryptoasset custodians who also safeguard and administer investments (e.g. under Article 40 RAO) should be able to opt-in to safeguard qualifying cryptoassets in accordance with CASS 6 (subject to any necessary modifications) (e.g., similar to the opt-in to the CASS 7 client money rules for all of a firm's activities involving client money, where that firm holds client money both in the context of insurance intermediary activities subject to CASS 5 and in the context of investment business subject to CASS 7).

2: Response to Questions

1: Do you agree that the Consumer Duty alone is not sufficient to achieve our objectives and additional requirements for qualifying stablecoin issuers are necessary?

Yes. We agree that there is merit in prescribing specific rules for UK issuers of qualifying stablecoins. Among other things, this will ensure that all qualifying stablecoins issued in the UK share certain features, for example in relation to redemption rights and reserve management. This will serve as a quality differentiator and support the singleness of money agenda.

Whilst we recognise the financial crime mitigation requirements set for stablecoin issuers as outlined in CP25/14, as well as the forthcoming conduct and firm standards consultation paper, some members would welcome further analysis and guidance from the FCA to

understand potential wider financial crime risks associated with these assets, to articulate the FCA's expectations in terms of compliance with existing AML requirements and to determine if further requirements are required. Additionally, we note CP25/14's requirements apply in the context of stablecoin token holders interacting directly with the stablecoin issuer. Our members would therefore welcome further clarity from the FCA on how CP25/14's requirements (on both stablecoin issuers and cryptoasset custodians) exist in the context of UK consumers going to cryptoasset trading platforms (CATPs) to interact, purchase and manage their stablecoin tokens.

2: Do you agree that issuers of multi-currency qualifying stablecoins should be held to similar standards as issuers of single-currency qualifying stablecoins unless there is a specific reason to deviate from this? Please explain why? In your answer please include:

i. Whether you agree with our assessment of how multi-currency stablecoins may be structured, and whether there are other models.

ii. Whether there are specific rules proposed which do not work for multicurrency qualifying stablecoins, and explain why.

iii. Whether there are any additional considerations, including risks and benefits, we should take into account when applying our regulation to multi-currency qualifying stablecoins.

Our members believe that additional requirements are needed for multi-referenced tokens[8]. UK Finance and its members have concerns regarding the implications of singleness of money in relation to multi-currency referenced tokens, particularly regarding the interaction with FX. The FCA should consider rules on the FX spreads for acquisition, redemption, and daily revaluations (mark-to-market). The FCA will also need to consider how multi-currency stablecoin issuers are required to communicate these requirements to customers.

Additionally, multi-currency stablecoins will likely add complexity from a custodian services and capital monitoring, funds exchange and conversion perspective, among other things. We would therefore encourage the FCA to consider restrictions on stablecoin tokens referenced to a basket of currencies until appropriate measures to protect against risks can be put in place.

3: Do you agree with our proposals for requirements around the composition of backing assets? If not, why not?

[8] We understand that there are two interpretations of the scope of the term "qualifying stablecoin" as defined in Article 88G of HM Treasury's draft SI. In our view the definition is limited to stablecoins which "reference a fiat currency". We view references to "other assets" in Article 88G as referring to the backing assets that issuers hold. As such, based on the current draft SI, it is our understanding that the FCA will not be able to impose rules in relation to multi-currency stablecoins, on the basis that they will not fall within the UK's regulatory perimeter. Our answer to this question therefore assumes that the SI will be amended to include multi-currency stablecoins within the regulatory perimeter.

Yes, our members broadly agree with the proposals, including expanding the type of (non-core) permitted backing assets. However, as outlined below, we would like to propose some wider questions around how the backing asset composition requirements connect to how stablecoins may be used in the future, and whether they appropriately address the potential associated opportunities and risks. We have formulated commentary on both the wider policy aims of HM Treasury and the FCA, and the technical provisions around question 3.

Assessing the risks

There are wider questions around what type of firms will be permitted to issue stablecoins, and how they may be categorised once their business has scaled (or designated as 'systemic' under the BoE's systemic stablecoins regime). Members would urge the FCA to maintain the distinction between deposit-taking credit institutions, e-money institutions and the new regulatory category of stablecoin issuers that the proposed regime will create. This is important context to assessing what backing asset pool type is appropriate to the business model, and how risks can be mitigated.

There is also the question of where yield-bearing stablecoins may fall in the scope of the wider regulatory framework (including HM Treasury's draft Cryptoassets Order), and the potential knock-on economic risks posed by these issuers offering higher yields for investors compared to deposit-taking credit institutions. Allowing stablecoin issuers to issue yield-bearing stablecoins also has the potential to blur the boundaries between stablecoin issuers and deposit-taking credit institutions. As such, the FCA should carefully consider the clarity of distinction between stablecoin issuance and full banking regulations. In addition to considerations regarding the products that stablecoin issuers can produce, our members also find it important that consistent compliance and risk management standards apply across all types of issuers. This is particularly important regarding Know Your Customer (KYC), Anti-Money Laundering (AML), and Counter-Terrorist Financing (CTF) obligations.

AML

It would be helpful for the regulators to clarify the AML responsibilities of custody providers when receiving backing assets held in trust by the issuer for unidentified beneficiaries. We note this is in relation to the challenge outlined in paragraph 3.127 regarding market participants exchanging ownership of stablecoin tokens on the secondary market (peer-to-peer).

MMFs

It would be helpful to permit a broader range of money market funds (other than limiting the category to PDCNAVs) to be held as expanded backing assets in addition to other assets listed, in line with other jurisdictions such as Singapore.

Tokenised/DLT based assets as backing assets

In view of the core principle of taking a technologically neutral approach, members would like to assume that eligible backing assets will be recognised as such irrespective of the form they take, provided that they retain the regulatory characterisation of the underlying asset. For example, where a gilt is an eligible backing asset, members are of the view that a digital gilt should be too (be it a digitally native gilt or an existing gilt that has been tokenised), assuming

that its regulatory characterisation remains the same. Members believe that clarity in that regard will support industry.

ODDR

Our members consider that 5% should operate as a minimum threshold. We think that there are grounds for increasing this to take into account periods of market stress, and members would like to see further detail from the FCA on how such stressed scenarios have been factored into the FCA's calculations on this. Members also note that relying on liquidity arrangements may be fine in normal circumstances but might not be reliable during periods of market stress as firms may be unable to support such arrangements (even with financial penalties) and/or such agreements may limit the appetite for further liquidity to be provided by the credit institution in question, or market peers. We would welcome further engagement with the FCA to determine the best technologically neutral percentage[9], particularly in context to CP25/14's CBA assessment.

4: Do you have any views on our overall proposed approach to managing qualifying stablecoin backing assets? Particularly: i) the length of the forward time horizon; ii) the look-back period iii) the threshold for a qualifying error.

UK Finance and its members recognise the FCA's detailed workings to develop specific proposed metrics for how stablecoin issuers manage backing assets. We would welcome further engagement with the FCA to understand how specific metrics will help mitigate the potential risks associated with stressed scenarios. We note these requirements will be an important part of ensuring stablecoin products are as safe and resilient as possible.

180 days redemption data requirement

UK Finance and its members would welcome further detail from the FCA regarding its workings behind setting the lookback period to '180 days'. Some members suggest that the FCA should also consider the incorporation of some form of stressed circumstances. This is on the basis that BAU redemption rates may be extremely low but may experience significant spikes in times of stress. We would also welcome sight of the FCA's economic workings regarding the 90 days[10] timeframe for expanding tokens' backing asset pools.

Issuing more than one 'Qualifying stablecoin product'[11]

We note that issuers are required to segregate their backing pools per stablecoin product and that stablecoin products are defined by reference to fungibility. Regarding issuers that issue more than one stablecoin product, to determine their fungibility we would suggest the issuer should assess:

[9] For example, in relation to the 'CE21 liquidity requirement' in the FCA's Handbook primarily for MiFID activities.

[10] Section 16.2.35 of CP25/14's proposed amends to CASS.

[11] Paragraph 3.87.

- The ability of a token holder to exchange the qualifying stablecoin with another qualifying stablecoin product at par (and with no exchange costs) with the issuer.
- The use of the same pool of backing assets, same management processes, same issuance processes for a group of qualifying stablecoins.

We note the complexity of this challenge faced by stablecoin issuers, given that market participants may treat an individual stablecoin token as fungible or not, regardless of its technical connection to the backing asset pools of the wider stablecoin product offering from the same issuer and would therefore encourage the FCA to provide clear guidance on how issuers should address this.

Prohibition of interest revenue to token holders
CASS 16.2.13 provides that firms are not permitted to pay interest, income or any other benefit accruing from or in connection with the backing asset pool to the holder of a qualifying stablecoin. Currently 16.2.13 R only prohibits remuneration arising from the backing asset pool, and does not seem to prohibit remuneration from other sources, such as payments by third parties. This would appear to allow stablecoin issuers to pay holders of stablecoins based on other revenues, such as retained profits of the backing asset pools of other stablecoins via lotteries or prizes, account opening bonuses, share reward mechanisms and payment rewards.

There is a significant risk therefore that the current approach may prove ineffective in achieving the FCA's policy aims. We would suggest the need for a more robust prohibition scope and one that aligns with the prohibition on electronic money issuers[12]. This prohibition is not tied to safeguarded funds/assets but rather explicitly prohibits awarding interest in respect of the holding of electronic money; or any other benefit related to the length of time during which an electronic money holder holds electronic money.

5: What alternative ways would you suggest for managing redemption risk, which allow for firms to adopt a dynamic approach to holding backing assets?

We have diverging views on this from our members. Some members oppose the FCA's proposals to permit stablecoin issuers to adopt more flexible backing asset requirements in respect to question 5. As outlined in our response to question 3, there needs to be a clear distinction between deposit taking credit institutions and stablecoin issuers and flexibility in managing backing assets should be an area of differentiation. However, other members are of the view that precluding flexibility for sophisticated issuers to deploy financial techniques in managing their redemption risk may run the risk of those sophisticated issuers deciding to move their business offshore.

[12] Regulation 45, EMRs 2011.

6: Do you think that a qualifying stablecoin issuer should be able to hold backing assets in currencies other than the one the qualifying stablecoin is referenced to? What are the benefits of multi-currency backing, and what risks are there in both business-as-usual and firm failure scenarios? How might those risks be effectively managed?

The majority of our members think this should not be permitted. This is on the basis that the use of backing assets in different currencies to the stablecoin introduces additional FX risk and it is likely that the costs/risks this creates are not proportionate to the benefits, and that ultimately exposure to this greater range of risks may reduce confidence in these firms. This may also introduce additional contagion risk between the UK and other jurisdictions (e.g. if a UK issuer is able to use US Treasuries in their backing assets).

However, some members are of the view that if an issuer is sophisticated enough to manage the FX risks then they should be given the flexibility to maintain backing assets in different currencies if the portfolio is appropriately hedged so it achieves a GBP exposure. This is linked to the answer given to question 5.

7: Do you agree that qualifying stablecoin issuers should hold backing assets for the benefit of qualifying stablecoin holders in a statutory trust? If not, please give details of why not.

Whilst our members broadly agree with the FCA's policy aims around a statutory trust arrangement helping to enable the safety and soundness of token holders' assets, they find it challenging to comment on the direct operational implications of a statutory trust arrangement as the terms have not been published.

Additionally, there is the question of when flexibility may be needed if a UK statutory trust arrangement is not recognised in another jurisdiction. Some members are of the view that statutory trust arrangements should be applied to all issuance activities as it ensures all token holders have equivalent protections, including those involving overseas sub-custodians, whilst others welcome a more outcomes-based approach to these arrangements that give token holders equivalent protections. We would welcome further engagement with the FCA on what this flexibility would look like for overseas sub-custodians utilised by stablecoin issuers to ensure protections for token holders are maintained. One example of this flexibility could be that the default is that a statutory trust will apply. However, if issuers utilise arrangements involving an overseas element that will not recognise a UK statutory trust, then firms should be given flexibility to put in place an alternative arrangement that achieves the same level of protection for stablecoin holders.

Further to the above, members are keen for the FCA to consider the following:

Terms not yet clear

The precise impact of requiring a statutory trust will not be clear until the terms of that trust are known. It would be helpful to have a chance to provide more substantive input once the draft terms have been published. In an ideal world, the scope of the terms of the trust should be as limited as possible and require record keeping and be limited to those trustee duties that cannot be contracted out of under the Trustee Act.

Fiduciary duties of issuer
Paragraph 3.86 suggests that issuers should be subject to "well established fiduciary duties", however, in practice, it is possible to limit these significantly in a commercial environment where there is a common law trust. The FCA should be careful about extending fiduciary duties beyond the duty to segregate and keep accurate records. In the instance that the 'statutory trust' safeguarding arrangement is taken forward, some of our members have discussed that the most effective approach would be for the FCA to align any safeguarding arrangement in CASS 16 with the terms of the statutory trust in CASS 7 and provide a clear policy rationale for any deviations in form and content between the respective statutory trusts, e.g., if deemed necessary, for securities or repo transactions.

Access to custody services
Similarly, custodians may be put off providing services in circumstances where they have no regulatory backing supporting their having a security interest, lien or right of set-off in order to recover debts owed to them by clients. Under CASS 6.3.6A(1)(a) a firm may have a security interest, lien or right of set-off over clients' safe custody assets which it may exercise to recover debts that relate to the provision of services to one or more clients. A similar provision is not included in the new CASS rules for cryptoasset custodians. Members have also raised the following questions on which they would be grateful for further consideration from the FCA:

- Where a credit institution holds a portion of backing assets for an issuer's backing asset pool on a bare trust, what would the relevant deposit protections be on these assets?
- How would these protections apply to unidentifiable beneficiaries?[13]

8: Do you agree with our proposal that qualifying stablecoin issuers are required to back any stablecoins they own themselves? If not, please provide details of why not.

Our members have different views on this issue. Some members support the approach outlined by the FCA, suggesting operational challenges and complexities around backing issuer-owned stablecoin tokens do not appear to be significantly challenging to warrant revising the proposal, while other members believe that issuers having to back any

[13] As discussed in response to question 3.

stablecoins they own themselves will pose real operational challenges, and consequently disagree with this proposal.

The members who do not support the proposal consider that if issuers are able to demonstrate that the stablecoins are effectively restricted from entering into circulation, the issuer should be able to hold the operational tokens on for its own account on an unbacked basis. They suggest testing the assumption that requiring stablecoins held by the issuer to be fully backed addresses hacking risks generally, as opposed to only some hacking risks, as it seems that a hack of the minting process in the smart contract would not be addressed by this requirement, which undermines the policy rationale. Some members are of the view that an issuer may choose to hold stablecoins in both backed and unbacked formats, provided that unbacked stablecoins are not fungible with backed ones. This is also relevant to paragraphs 3.133 and 3.134.

Some members suggested the FCA should build out its thinking further on this question, due to a level of uncertainty around the complexity of backing issuer owned stablecoin tokens.

Additionally, members have noted the following:

- Risks around hackings (as outlined above) exist as a wider challenge facing the UK's developing regulatory framework and should be addressed in technical operational requirements such as in the relevant smart contract functions. This could be covered in the operational resilience requirements as set out in the forthcoming conduct and firm standards consultation paper.
- The requirements outlined could increase regulatory overhead for stablecoin issuers and it is not clear that this has been quantified in the CBA assessment.

9: Do you agree with our proposal to require third parties appointed to safeguard the backing asset pool to be unconnected to the issuer's group?

The majority of members consider that:

- If a firm is subject to CASS, the firm should be able to use affiliated entities to safeguard both cash and non-cash assets, as to require otherwise risks such issuers using less well-regulated entities than those that are already subject to robust regulatory rules.
- If a firm is not subject to CASS, the firm should be required to use an unconnected bank to safeguard cash assets but should not be required to use an unconnected custodian to safeguard non-cash assets. This approach is consistent with existing (and planned future) requirements on e-money and payment institutions and would therefore be a technologically neutral approach.

The minority of members consider that:

- Mandating a non-affiliated custodian introduces a layer of independence, helping to mitigate correlated failure risks between an issuer and custodian. While this does not represent the majority of member views, we wanted to represent this minority view too.

10: Do you consider signed acknowledgement letters received by the issuer with reference to the trust arrangement to be appropriate? If not, why not? Would you consider it necessary to have signed acknowledgement letters per asset type held with each unconnected custodian?

Yes. Most members agree that signed acknowledgement letters from a third-party bank/custodian that the relevant assets are backing assets, part of a trust and that the third-party bank/custodian does not have, or waives, certain rights it might otherwise have over the assets are appropriate, and note that they are standard practice, and in many ways simplify things.

We also acknowledge that FCA mandates the use of prescribed acknowledgement letters in the other contexts in CASS where the FCA has established a statutory trust over client funds, namely in the relevant client money rules in CASS 7, 11 and 13. As a result, most members are supportive of the principle that stablecoin issuers should be required to obtain a signed acknowledgement letter from relevant third-party bank/custodian for the backing assets (which is separate from any other legal documentation which governs the relationship between the issuer and relevant third-party bank/custodian).

Finally, to the extent the FCA retains its proposed acknowledgement letters in CASS 16 Annexes 1 and 2, members generally agree that FCA should align the templates with the existing acknowledgement letter templates in CASS 7 Annex 2R, CASS 11 Annex 1, and CASS 13 Annex 1, or that the FCA should clearly explain the policy rationale for any substantive difference between these templates. For example, paragraph (f) of the existing acknowledgement letter templates (in CASS 7, 11 and 13) contemplate that the current/deposit account provider to the CASS firm (i.e. the third-party bank that accepts the relevant client money on deposit from the FCA-regulated investment firm, debt management firm or claims management firm) may obtain a contractual right to retain sums recorded to that current/deposit account until any properly incurred charges or liabilities owed to the account provider, and arising from the operation of the account, are satisfied. By contrast, a cash/securities account provider to a qualifying stablecoin issuer (i.e. the third-party bank/custodian that has accepted on deposit/into custody the relevant cash or securities comprising the issuer's backing assets pool) would appear to be required to waive any similar contractual right of retention over the assets under paragraph 6 of the proposed acknowledgement letter templates (in CASS 16). The policy rationale for this difference in treatment of the same third-party account provider services to an FCA-regulated firm under CASS 7, 11 and 13 versus under proposed CASS 16 is unclear. As is the position for the services banks provide CASS firms under CASS 7, 11 and 13 today, we expect that third-party banks and custodians may decline to open backing funds/asset accounts, to accept money on deposit or take securities into custody, for a qualifying stablecoin issuer if the bank/custodian

is not allowed to retain an amount equivalent to any sums owed to it from the operating that account at least on the failure of the issuer (as the account holder).

However, some members suggested that firms could be able to achieve a similar outcome to having an acknowledgement letter through the underlying custody agreement, for example if the custody agreement notes that assets are backing assets (and subject to a trust) and that the custodian is required to notate this in its records. They suggest that firms should have a choice of whether they utilise an acknowledgement letter (based on an FCA template) or use an alternative method provided that the key points are documented.

We do note that in the context of payment services a number of firms have experienced challenges or delays in obtaining acknowledgement letters. If this were to also occur in the context of stablecoin issuance, we would encourage the FCA to consider how this may affect the policy aims of CP25/14.

AML considerations are also relevant to the safeguarding arrangements. In particular, what are the AML and KYC requirements for firms when holding assets on trust for beneficiaries Can firms expect clear T&Cs and disclosure requirements on this? In respect to paragraph 4.36, some members have suggested that enhanced CMAR reporting requirements should be required for tokens, keys, public, private, etc in line with paragraph 4.39.

11: Do you agree with our proposals for record keeping and reconciliations?

In general, yes. There is already a substantial industry that provides daily mark-to-markets and margin/collateral adjustments. Our members consider this requirement to be technologically neutral with requirements in traditional finance and payments. The approach will also be an important way for stablecoin issuers to build the trust that token holders will need to have in their assets.

12: Do you agree with our proposals for addressing discrepancies in the backing asset pool? If not, why not?

Our members broadly agree with the proposals for addressing discrepancies. Some raised the possibility of over-segregating, noting that over-segregation is required in other regulatory regimes such as the CFTC regime for cleared derivatives and allowing for over-segregation could potentially alleviate the operational burden on firms. We note that this is not an option the FCA has historically adopted as this is not permitted in the context of CASS, but the point is raised as this may simplify operational burdens on issuers.

We would however support the FCA pursuing further thinking (in context of the CBA assessment) to how over-segregation may affect issuers' abilities to address market threats, including possible runs on tokens.

13: Do you agree with our proposed rules and guidance on redemption, such as the requirement for a payment order of redeemed funds to be placed by the end of the business day following a valid redemption request? If not, why not?

The majority of our members agree with the wider policy aim and ambition set by the FCA regarding redemption, and as noted in our response to DP23/4. Many members view it as helpful to align the expectations for payments orders associated with redemption with the general 'D+1' requirement set out in regulation 86(1) of the PSRs 2017 that fall on the e-money and payments industry more broadly in the UK. It is also felt this requirement gives clarity and confidence to customers.

Members discussed whether these requirements could be relaxed further for smaller issuers but ultimately there was not sufficient support for this proposal.

14: Do you believe qualifying stablecoin issuers would be able to meet requirements to ensure that a contract is in place between the issuer and holders, and that contractual obligations between the issuer and the holder are transferred with the qualifying stablecoin? Why/why not?

We agree that issuers should be under contractual obligations to holders of stablecoins that they issue. Members note that there are a number of means by which this can be achieved under English law that are used in the securities market, with a fallback option being for the issuer to execute a deed poll in favour of holders. Members are also keen to note the following:

Contractual relationship

We would expect the contractual relationship to be unilateral as it would not be customary to impose obligations on holders that are enforceable by the issuer. Where a holder of a stablecoin is required to take certain steps, such as satisfying KYC obligations or providing account information, these requirements would be expressed as conditions to the issuer's obligations.

Negotiability status of stablecoins

Whether a stablecoin has negotiable status as a matter of English law (such that each a bona fide purchaser for value takes free of any defects in title of the transferor) may depend on whether the instrument has acquired that status through the courts' recognition of a mercantile custom of treating them in that way. Various factors can contribute to that conclusion. It would be helpful if the FCA could craft its rules with this in mind and in a way that would support the conclusion that qualifying stablecoins issued by UK issuers under English law are suited to acquiring negotiable status in this way.

15: Do you agree with our proposed requirements for the use of third parties to carry out elements of the issuance activity on behalf of a qualifying stablecoin issuer? Why/ why not?

Yes, our members broadly agree that permitting stablecoin issuers to utilise third parties (with the appropriate safeguarding requirements between the issuer and token holders) to support the issuance activity makes sense. Members note this aligns with the approach taken in the EMRs 2011.

However, in this context some members noted the current market practice around issuers utilising third parties for functions outside the issuance activity, such as for market-making. UK Finance members will seek to develop thinking on this issue (including whether stablecoin issuers utilising market-making activities is consistent with stablecoins being used as money-like instruments) in the forthcoming conduct and firm standards consultation paper.

16: Do you agree with our proposals on the level of qualifications an individual needs to verify the public disclosures for backing assets? If not, why not?

Yes. Requiring stablecoin issuers to utilise external qualified individuals to verify public disclosures (and publish the results) is an important part of building sound regulated products for consumers.

17: Do you agree with our proposals for disclosure requirements for qualifying stablecoin issuers? If not, why not?

In general, yes. However, the current proposals for disclosure of the number of stablecoins and the value and breakdown of backing assets on the basis of when this data becomes inaccurate could lead to complexity. The FCA does not appear to include parameters around the degree of inaccuracy or the frequency, which could lead to significant deviation across the market as well as a high frequency of updates being driven by immaterial changes in the value of backing assets.

Furthermore, we would suggest that the FCA sets out more specific requirements for a more a granular disclosure of the type of assets in the backing pool. Currently the FCA requires that this disclosure gives a value and percentage by the type of asset. It is unclear exactly what granularity is meant by the asset type e.g. whether this just means "Cash" and "Short dated sovereign bonds", or if there should be a breakdown by the issuing sovereign and the remaining tenor on the bond. Including this degree of breakdown would be helpful to support trust in the stablecoin and support the singleness of money.

We would also point towards our thinking on disclosure requirements for issuers of unbacked cryptoassets and cryptoasset trading platforms (CATPs) as outlined in response to DP24/4[14]. Whilst the CP25/14 proposals apply to token holders going to issuers directly, there is the scenario of consumers going to CATPs for information about a stablecoin product. As such,

[14] UKF: UK Finance response to DP24/4.

requirements between the Admissions & Disclosures (A&D) and CP25/14 should address this challenge to ensure consumers access consistent information across these different firms.

18: Do you agree with our view that the Consumer Duty alone is not sufficient to achieve our objectives and additional requirements for qualifying cryptoasset custodians are necessary?

We agree that the Consumer Duty alone is not sufficient to achieve the FCA's objectives in this context. Prescribing specific rules for custodians of qualifying cryptoassets is appropriate to ensure alignment with existing rules for custodians of other financial assets, consistent rules apply for all types of customers (not just retail consumers), and to ensure clarity on the FCA's expectations for firms operating in the cryptoasset market.

Clear regulatory requirements that address segregation of assets, record-keeping, and governance arrangements are essential to minimise risk to customer assets and ensure that assets will be available to satisfy customer claims in the event of a custodian's insolvency. We support the introduction of a tailored regime for cryptoasset custodians that reflects the unique operational and legal characteristics of digital assets, while maintaining the standards of asset protection expected in financial markets.

Members have noted that from their perspective it is imperative that custodian liability can only be to the customers/clients that they deal with directly, where loss is a result of the custodian's actions only. Similarly, custodians cannot have AML/KYC obligations to end users that they do not have visibility of, e.g. end-users interfacing with other cryptoasset service providers.

Additionally, we note that CP25/14 requirements apply in the context of stablecoin token holders interacting directly with the stablecoin issuer. Our members would therefore welcome further clarity from the FCA on how the CP25/14 requirements (for both stablecoin issuers and cryptoasset custodians) exist in the context of UK consumers going to cryptoasset trading platforms (CATPs) to interact, purchase and manage their stablecoin tokens.

19: Do you agree with our proposed approach towards the segregation of client assets? In particular:

i. Do you agree that client qualifying cryptoassets should be held in non-statutory trust(s) created by the custodian? Do you foresee any practical challenges with this approach?

ii. Do you have any views on whether there should be individual trusts for each client, or one trust for all clients? Or whether an alternative trust structure should be permitted.

iii. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet?

iv. Do you foresee any challenges with these rules with regards to wallet innovation (eg the use of digital IDs) to manage financial crime risk?

Applying existing custody rules to cryptoassets

The FCA currently regulates how firms should hold assets for clients under its rules in CASS 6. In CP25/14, the FCA proposes introducing a separate regime under CASS 17 for firms safeguarding qualifying cryptoassets and/or arranging qualifying cryptoasset safeguarding.

We think that the FCA should consider applying CASS 6 to cryptoassets rather than creating a new cryptoasset-specific regime under CASS 17. This approach would:

- ensure closer alignment between the rules that apply to traditional financial assets and those that will apply to cryptoassets;
- make it easier for firms that hold both traditional financial assets and cryptoassets to comply with the regimes;
- reduce operational costs for those firms complying with both regimes;
- avoid confusion in relation to which regime should apply to cryptoassets which are specified investments, such as security tokens15; and
- avoid the risk that new rules or guidance in CASS 17 might cut across well-established practices under CASS 6.

We acknowledge that it would not be appropriate for cryptoasset custodians to be subject to all the requirements under CASS 6. We think a tailored application of the rules could be designed, such as exists for trustees and depositaries. For cryptoasset custodians, CASS 6 could, for example, disapply the rules on the registration and recording of legal title and instead impose additional requirements focused on protecting means of access (such as private keys). Other rules would apply to both traditional financial assets and cryptoassets, including reconciliation requirements, rules on third-party arrangements and general requirements to protect clients' assets and have adequate organisational arrangements in place.

In the alternative, if the FCA retains a version of CASS 17 separate from CASS 6, we think that cryptoasset custodians who also safeguard and administer investments (e.g. under Article 40 RAO) should be able to opt-in to safeguard qualifying cryptoassets in accordance with CASS 6 (subject to any necessary modifications) (e.g., similar to the opt-in to the CASS 7 client money rules for all of a firm's activities involving client money, where that firm holds client money both in the context of insurance intermediary activities subject to CASS 5 and in the context of investment business subject to CASS 7)[16]. The objective would be (as we understand was/is the policy rationale for the CASS 7 opt-in under the existing CASS 5 client money rules) to ensure relevant firms subject to both regimes are not required to duplicate their CASS supervisory, compliance and audit arrangements twice for the same activity (e.g., protecting client assets).

[15] We acknowledge that CP25/14 does not cover specified investment cryptoassets and that the FCA will consider the custody of these cryptoassets in a future consultation paper.
[16] CASS 7.10.3R and CASS 5.1.8G.

Requirement to safeguard as trustee

Some members are of the view that the requirement to safeguard qualifying cryptoassets as a trustee should be reframed as guidance under which the FCA clarifies its expectations without imposing a trust structure. We recommend the FCA takes a more outcomes-based approach, which will achieve the same goals without the need to be restrictive and prescriptive. While enforceable property rights are important for client asset protection, particularly in insolvency scenarios, there may be alternate legal structures that can achieve this protection.

CASS 6 does not require custodians to hold traditional financial assets on trust for their clients. The operation of law and market practice, supported by the FCA's rules on segregation, record-keeping and reconciliations, help protect the client's ownership rights. In practice, custodians tend to hold assets on trust (either express or implied). We think a similar approach can be applied to cryptoassets, where the objective is ensuring customers can assert proprietary interests over assets and have those interests protected and enforced under applicable law following a custodian's insolvency.

In CP25/14, the FCA proposes introducing an explicit requirement to hold cryptoassets on trust (CASS 17.3.2 R). We acknowledge that the FCA is not proposing to impose a statutory trust, under which the FCA would specify the terms of the trust, but does set out several conditions which firms must meet.

We disagree with this approach because it:

- is likely to lead to unforeseen consequences in the future in a rapidly evolving areas;
- does not align with existing rules for traditional financial assets;
- risks read-across to well-established practices under CASS 6;
- imposes unnecessary operational costs on cryptoasset custodians, such as the expectation that custody agreements are executed by deed;
- limits flexibility, including for overseas custodians whose local legal and regulatory structures may offer alternative structures for protecting clients' cryptoassets[17][18]; and;
- risks creating confusion about the treatment of specified investment cryptoassets. Where cryptoassets are held under a trust, we support the FCA's approach to allow one trust for all clients (as opposed to individual trusts for each client). This omnibus approach offers operational efficiencies and is consistent with the general position

[17] Based on HM Treasury's Draft Cryptoassets Order, non-UK firms may be in the scope of the UK regulatory regime where they provide safeguarding qualifying cryptoassets and specified investment cryptoassets on behalf of UK consumers.

[18] This flexibility is also granted to the custody of assets in traditional finance by overseas firms (dependent on sound local legal and regulatory structures).

under English law that a global trust may be identified in favour of all relevant clients, each holding a pro-rata share in the trust property.

Allowance for gas fees

When firms hold certain types of cryptoassets for clients, they may also need to hold additional cryptoassets in the same wallet to cover transaction costs e.g. gas fees on the Ethereum network.

We think the FCA's rules should allow cryptoasset custodians to hold a certain amount of qualifying cryptoassets belonging to the firm in client wallets so that they can cover transaction costs. This approach is consistent with established practices in traditional asset custody where custodians may hold small amounts of their assets for the purpose of facilitating transactions involving client assets. We note that this is something the FCA plans to consider as part of a future consultation.

20: Do you agree with our proposed approach towards record-keeping? If not, why not? In particular, do you foresee any operational challenges in meeting the requirements set out above? If so, what are they and how can they be mitigated?

References to claim

In CP25/14 the FCA proposes requiring firms to keep client-specific qualifying cryptoasset records which specify, among other things, the nature of the client's claim against the firm in respect of the qualifying cryptoasset (CASS 17.5.4 R). According to the FCA, a firm may record the client's claim against the firm as being a beneficial interest under a trust for which the firm is the trustee or a claim for the return of the relevant qualifying cryptoasset.

We question whether "claim" is the appropriate terminology in the context of a trust structure, or otherwise, where the client has proprietary rights in relation to the cryptoassets held by the custodian. In such cases, the client's rights are more accurately described as beneficial entitlement. By using the word "claim", the draft rules could be interpreted as characterising the client's right as a personal one against the relevant firm. We encourage the FCA to reconsider how these rights are described in its rules in order to more accurately reflect the legal nature of the relationship and the protection that the CASS rules are intended to provide.

Additionally, in draft CASS 17.5.2R, the FCA proposes that a custodian must keep such records as necessary to enable it at "any time and without delay" to distinguish assets held for one client from assets held for another and for asset held for clients from assets held for the firm. Draft CASS 17.5.3R states such records must be accurate "at all times". While we appreciate this drafting mirrors the equivalent internal recordkeeping standard in CASS 6 for financial assets, UK Finance members would welcome clarity around how "at any time and without delay" and "at all times" would apply to cryptoassets. For example, a traditional custodian would not typically be expected to update its independent internal records over the weekend, especially if such records are independent of the DLT ledger in which the relevant assets are recorded. In the context of cryptoassets, a wallet may receive an 'air drop' where

tokens are paid into a wallet without instruction from the wallet holder, which would require investigation by the custodian prior to updating books and records.

21: Do you agree with our proposed approach for reconciliations? If not, why not? In particular:

i. Do you foresee operational challenges in applying our requirements? If so, please explain.

ii. Do you foresee challenges in applying our proposed requirements regarding addressing shortfalls? If so, please explain.

Timeframes for resolving shortfalls

In CP25/14 the FCA proposes requiring cryptoasset custodians to decide whether to resolve any shortfall "immediately".

The equivalent rule in CASS 6 requires firms to "promptly" investigate the reason for the discrepancy and resolve it "without undue delay". This investigation and resolution may take more than one day.

It is impracticable for firms to make a decision about resolution immediately without having sufficient time to investigate the shortfall. We think that the timeframes for the cryptoasset shortfall regime should align with the existing rules under CASS 6. This would allow firms more flexibility to investigate and resolve shortfalls which may be required when dealing with complex digital asset custody arrangements that may involve multiple wallets, sub-custodians, or technological challenges unique to distributed ledger technology.

Treatment of shortfalls

Proposed CASS 17.5.145(3)(a) would allow a firm to resolve a shortfall itself by "using its own resources". We would suggest, similar to the position established in CASS 6.6.54R, that relevant cryptoasset custodians be explicitly allowed in the rules to cover a relevant shortfall by segregating their own assets and money as client assets (e.g., subject to CASS 6, 7 or 17 as applicable) and the firm's own assets should not need to be the same type or kind of qualifying cryptoasset (for which it may not be possible for the custodian to source at the time of the shortfall, e.g., due to liquidity).

Shortfall notifications

CP25/14 proposes requiring firms to notify the FCA and clients about shortfalls in certain circumstances. This includes where shortfalls are not resolved before the next business day's cryptoasset reconciliation and where the firm concludes that neither it nor a third party is responsible for resolving the shortfall.

By comparison, the equivalent notification requirements in CASS 6 are limited to:

- for FCA notifications, where firms are unable, or materially fail, to take the required steps for the treatment of shortfalls, and;

- for client notifications, where the firm has concluded that someone else is responsible for the shortfall and the shortfall remains unresolved, in which case the firm must "consider whether it is appropriate to notify the affected client of the situation".
- We think that the notification requirements for the cryptoasset shortfall regime should align with the existing rules under CASS 6. This would reduce the operational burden on firms, especially those who custody both qualifying cryptoassets and traditional financial assets. Aligning the regimes would also promote consistency and clarity for market participants.

In any case, we expect that cryptoasset custodians will also be subject to the FCA's Principles[19]. These require firms to, for example, pay due regard to the interests of customers and treat them fairly, pay due regard to the information needs of their clients, and appropriately disclose to the FCA anything the FCA would reasonably expect notice of.

Timeframes for shortfall notifications

CP25/14 proposes requiring firms to notify the FCA and clients about shortfalls immediately. The notification must set out, among other things, the reasons for the shortfall, the number of clients affected and the timeframe for resolving the shortfall.

It is impracticable for firms to make these notifications immediately. There is no corresponding timeframe for similar notifications under the existing CASS 6 regime. We think that the existing flexibility under CASS 6 should also apply to the cryptoasset shortfall regime.

By comparison, the FCA's proposed operational incident reporting regime (CP24/28[20]) would require initial incident reports to be made "as soon as is practicable" after a crystallised operational incident has breached a threshold. Adopting a similar approach to cryptoasset shortfall notifications would allow cryptoasset custodians more flexibility to respond to shortfalls appropriately, and promote consistency and clarity for market participants.

Materiality of shortfall notifications

There is no materiality threshold for the shortfall notification requirement under CASS 17. This means that cryptoasset custodians would need to send notifications to the FCA and clients in relation to discrepancies relating to very small amounts of cryptoassets. This would be operationally challenging, both for firms and for the FCA, and potentially confusing for clients. We suggest that these rules are subject to materiality or a *de minimis* threshold.

22: Do you agree with our proposed approach regarding organisational arrangements? If not, why not?

We do not have any comments on this question.

[19] The application of the Principles to regulated cryptoasset activities will be the subject of a future FCA consultation.
[20] FCA: Operational Incident and Third Party Reporting (CP24/28).

23: Do you agree with our proposed approach regarding key management and means of access security?

Although members broadly agree with the principle of ensuring adequate protection of the means of access, the proposed CASS 17.4.5R requiring 'adequate organisational arrangements' is likely to be interpretated broadly by auditors, which could have the unintended consequence of extending the CASS audit to the entirety of a firm's IT security arrangements and control environment. This is also duplicative of CASS 17.2.3R. UK Finance members suggest the scope of this rule should be more narrowly defined.

24: Do you agree with our proposed approach to liability for loss of qualifying cryptoassets? In particular, do you agree with our proposal to require authorised custodians to make clients' rights clear in their contracts?

Yes.

25: Do you agree with the requirements proposed for a custodian appointing a third party? If not, why not? Do you consider any other requirements would be appropriate? If not, why not?

No. Our members do not see any reason for the FCA to adopt an approach for regulating the appointment of third parties to safeguard client assets that differs substantively between CASS 17 and CASS 6.

Alignment with CASS 6

CASS 17.6.6(2) R requires crypto custodians to take into account several factors when selecting, appointing and reviewing sub-custodians. The corresponding provisions in CASS 6 are set out as guidance for firms to follow (CASS 6.3.2 G). We think that the regime for appointing third parties under the cryptoasset regime should align with CASS 6.

Overly restrictive conditions

We think that the conditions for appointing third parties to safeguard cryptoassets (CASS 17.6.3 R) are disproportionately restrictive and inconsistent with established principles for customer asset protection in traditional financial markets.

The necessity condition

The necessity condition requires firms to conclude that the appointment of the third party is and remains "necessary" for the firm to fulfil its own obligations to safeguard qualifying cryptoassets. This is a high bar. Many of our members believe there is no justification for it needing to be necessary, when it can simply be beneficial, either to the commercial viability, availability, performance etc.

According to the FCA, a firm must be satisfied that there are sufficiently compelling reasons for which it is not possible for the firm to undertake the safeguarding qualifying cryptoassets

activity entirely by itself. With no regard to costs or operational challenges, it will always be theoretically possible for the firm to make sufficient adaptations to perform the activity by itself. This approach fails to recognise that cryptoasset custodians use specialised third parties to improve risk management processes e.g. key sharding and multi-party computation methods. As a minimum, we suggest that the references to "possible" in CASS 17.6.4 R are replaced by "practicable".

We would suggest that the necessity condition should be removed, or a clear explanation provided as to why this requirement is needed for cryptoasset custody but not for traditional asset custody.

The best interests condition

The best interests condition requires firms to conclude that the appointment of the third party is and remains in the best interests of its client(s).

There is no equivalent explicit requirement in the CASS 6 rules on appointing third parties. We think that the regime for appointing third parties under the cryptoasset regime should align with CASS 6.

It should be permissible when it is beneficial to the custodian, so long as it does not lead to worse outcomes for clients. This current restriction will reduce competition and raise costs for both firms and customers.

Assuming that cryptoasset custodians will be subject to the FCA's Principles, the best interests rule will apply to firms in any event. Adding this explicit condition could create confusion about how far firms need to go to meet the standard of compliance required.

Board approval

Every time a cryptoasset custodian proposes to appoint a third party it must first be approved by the firm's governing body. The outcome of periodic reviews of a firm's selection and appointment of a third party must also be approved by the firm's governing body.

There is no equivalent for this requirement in the existing CASS rules. We think that the regime for appointing third parties under the cryptoasset regime should align with CASS 6.

Requiring board approval of these arrangements raises practical challenges for large international businesses that may need to appoint multiple specialised sub-custodians to effectively manage different aspects of digital asset custody. This may discourage these firms from offering services (which seems counter to the aim of the FCA to encourage mature players into the market). We think that it would be appropriate for the FCA to allow approval by other suitable governance arrangements.

Rights of set-off, etc. for third parties

CASS 6.3.6A R allows third parties to have a claim to assets under custody via security interest, lien or right of set-off. Any such right is subject to certain conditions e.g. that the debt relates to the provision of services by the sub-custodian to the firm's clients. Under CASS 17, cryptoasset sub-custodians do not have any claim to cryptoassets they hold to recover debts relating to the services they provide. This is not commercially practicable for cryptoasset sub-

custodians and may make it impossible for cryptoasset sub-custodians to obtain or support central clearing or settlement services for qualifying cryptoassets. We think that the regime for appointing third parties under the cryptoasset regime should align with CASS 6.

26: Do you agree with our assumptions and findings as set out in this CBA on the relative costs and benefits of the proposals contained in this consultation paper? Please give your reasons.

Please see our response to question 27.

27: Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?

The FCA's cost/benefit analysis (CBA) assessment appears to lack sufficient detail on two critical aspects of the adoption of stablecoins by the UK economy:

- The long-term systemic risks associated with an on-aggregate systemic amount of stablecoin issuance by non-systemic parties and sufficient details on how this risk will be managed by the Bank of England in collaboration with the FCA and the market.
- The impact of stablecoin adoption on commercial bank deposit balances and, therefore, the availability of credit for UK consumers and businesses. Following this, any consideration of the impact on the UK economy as a whole. In fact, following paragraph 2.49: 'did not identify evidence to suggest economic growth materialising from consumers purchasing cryptoassets', it is possible the assessment does not account for the risks to credit creation on the UK economy.

UK Finance would like these items to be considered in more detail in further CBA assessments[21].

[21] We would also like to reiterate the core points raised, particularly regulatory development in 'emerging markets' (page 5-6), in UK Finance's response to the Payment Systems Regulator's (PSR) '**Response to Payment Systems Regulator (PSR): Draft statement of policy on our cost benefit analysis framework (CP24/12)**'.