GLOBAL DIGITAL FINANCE

Bank of England (BoE) Discussion Paper on the regulatory regime for systemic payment systems using stablecoins and related service providers

- Key Takeaways –

GDF convened its members to respond to the Bank of England (BoE) Discussion Paper (DP) on the regulatory regime for systemic payment systems using stablecoins and related service providers. GDF's response the response to this DP looks to provide suggestions of areas where further consideration and clarity may be needed for the creation of an appropriate and effective stablecoin framework in the UK. GDF worked with its members to provide constructive feedback on the regulatory regime, and to identify options to overcome challenges identified in the DP across six themes:

1. **Greater clarity needed on what is 'systemic' and what the regime aims to capture;**
2. **Clear delineation of the scope of the regime for business models (e.g., capturing the action of systemic payments or the systemic coins themselves);**
3. **Additional guidance on cliff edge risks when transitioning from non-systemic to systemic stablecoins;**
4. **Further consideration of the recommendations for backing assets;**
5. **Further consideration of the recommendations for capital buffers; and**
6. **Greater clarity on limits and how such limits would impact retail businesses as well as consumers.**

This document outlines the key takeaways across the six themes, condensing the crucial considerations detailed in each of these principles for readers' ease of reference.

1. Greater clarity needed on what is 'systemic' and what the regime aims to capture
Key Takeaways

- **Support for Systemic Delegation**: GDF is supportive of the proposed aims of designating certain stablecoins which may have a large impact on financial stability, markets, and retail and wholesale consumers as systemic.

- **Further Clarity is Crucial for the Assessment of Systemic Status**: We would encourage additional detail be provided in future phases of the regulatory framework on the scope of the regime, on how systemic importance will be assessed, who would be captured by the regime, how it would be applied, and at what stage of a company's growth compliance with different aspects of the BoE regime would be required. GDF would welcome the introduction of a clear and transparent process under which firms could seek indicative assessments from the BoE as to whether they are likely be considered systemic.

- **Cliff Edge Risks Should be Considered**: Cliff edge risks may occur for the transition from systemic to non-systemic if the process is not transparent or if firms lack appropriate time to prepare. For example, significant changes would be needed to the issuer's business model under the current proposals, but this risk could be mitigated through transparent and clear transition guidance and metrics.

2. Clear delineation of the scope of the regime for business models (e.g., capturing the action of systemic payments or the systemic coins themselves)
Key Takeaways

- **Stablecoins Have Multiple Use Cases Beyond Payments:** As they exist today, stablecoins have multiple use cases beyond payments, including but not limited to trading, investment, as a store of value, and as collateral to transactions. If a stablecoin is issued, it could feasibly be used for payment purposes whether or not they are intended for that purpose by their issuers. There may also be stablecoins that emerge as systemic, in some form, but are not used widely for payments.

- **Regulatory Frameworks Should Set a Clear Scope**: Given the multiple possible use cases for stablecoins we would encourage the BoE to make clear delineations on what the framework will capture. GDF would also welcome clarification that should such a stablecoin emerge that is widely used for purposes other than payments, the BoE would not seek to regulate it (or, for example, its issuer), given the framework under the Banking Act 2009 is intended for payments firms.

3. Additional guidance on cliff edge risks when transitioning from non-systemic to systemic stablecoins

Key Takeaways

- **Technology-Neutral Approach and 'Same Activity, Same Risk, Same Regulatory Outcome'**: These concepts are typically associated with centralized control and operations in traditional finance (TradFi) and can and should be appropriately applied to all regulated financial products and services, regardless of whether they are created on DeFi Arrangements.

- **Challenges of Equivalence in Risk**: The principle of "same activity, same risk, same regulatory outcome" assumes an equivalence of risk across activities considered the same. However, in the case of decentralised finance (DeFi) and digital assets, this may not account for the differences in how DeFi products and services are delivered compared to centralized TradFi entities. These differences encompass governance, novel technologies (smart contracts, decentralized Protocols, etc.), and new products and services (aggregators, liquid staking). Therefore, there should be an appropriate risk weighting and assessing where the true risk lies, including novel risks not present in TradFi.

- **Emphasis on Defining Regulation Targets**: Clarity on who or what IOSCO intends to regulate when addressing specific risks arising from the use of DeFi Protocols would help regulators in understanding the regulatory scope and targets within the DeFi space.

4. Further consideration of the recommendations for backing assets

Key Takeaways

- **Flexibility is Key to Future Proof a Regulatory Regime**: GDF believes that it would be beneficial for the proposed regime to accommodate different business models and structures. Mandating 100% backing by reserves held at the central bank would severely limit the business models that currently exist in today's market. This may also have the unintended consequence of increasing some of the cliff edge risks that may occur if issuers transitioned from systemic to non-systemic. Furthermore, while it is important for backing assets to be part of the framework, perhaps not limiting this to sterling would be more future proof.

5. Further consideration of the recommendations for capital buffers

Key Takeaways

- **Capital Buffers Should be Adjusted According to the Credit Risk Profile**: In theory, if the stablecoin is backed 100% by reserve assets held in the central bank, there should be zero credit risk and the capital buffer should only cover wind down expenses. Unlike for banks, who hedge their credit risk, you should not fail if the central bank, in this case the bank of England, holds all of your reserve assets. Capital buffer requirements should then be adjusted accordingly.

6. Greater clarity on limits and how such limits would impact retail businesses as well as consumers

Key Takeaways

- **Limits for Businesses Must be Considered**: GDF would encourage further clarity in the distinction between limits for consumers and limits for businesses. It is crucial that the final framework does not exclude businesses and that it is workable, appropriate, and able to be effectively supervised by the BoE.