02 August 2022

To whom it may concern,

Re: Managing the failure of systemic Digital Settlement Asset (including stablecoin) firms

GBBC Digital Finance (**"GDF"**) supports efforts by global standard setters, national authorities and regulators to consult and work with the nascent global digital / virtual asset industry.

To that end, we are hereby providing input to the HM Treasury consultation paper on Managing the failure of systemic Digital Settlement Asset (including stablecoin) firms.

About GDF

GDF is a not-for-profit industry body that promotes the adoption of best practices for crypto and digital assets, and digital finance technologies through the development of conduct standards, in a shared engagement forum with market participants, policymakers and regulators.

Established in 2018, GDF has convened a broad range of industry participants, with 300+ global community members - including some of the most influential digital asset and token companies, academics and professional services firms supporting the industry.

The GDF Code of Conduct (the 'Code') is an industry-led initiative driving the creation of global best practices and sound governance policies. GDF is informed by close conversations with regulators and developed through open, inclusive working groups of industry participants, legal, regulatory and compliance experts, financial services incumbents and academia. The principles set out in the Code undergo multiple stages of community peer review and open public consultation prior to ratification.

The input to this response has been curated through a series of discussion and roundtables and GDF is grateful for all of its members who have taken part.

As always, GDF remains at your disposal for any further questions or clarifications you may have and we would welcome a meeting with you to discuss these matters in more detail with our members.

Yours faithfully,

Lavan Thasarathakumar
Director of Government and Regulatory Affairs, Global Digital Finance

Overall, GDF supports the government's aim to manage the failure of a systemic digital settlement asset (including stablecoin) firms.

However, GDF is conscious of the fact that the consultation paper is quite high level and in places vague, leaving a number of unanswered questions. Whilst GDF understands that the proposal needs to be general enough and principles-based in order to allow for flexibility, however members have called for more specific details or illustrative examples which could illuminate how the regulations would impact stablecoin arrangements in practice.

Do you have any comments on the intention to appoint the FMI SAR as the primary regime for systemic DSA firms (as defined at para 1.8) which aren't banks? Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the PESAR, to apply solely to systemic DSA firms?

GDF understands the rationale behind appointing the Financial Market Infrastructure Special Administration Regime (FMI SAR) as the primary regime for systemic digital settlement asset (DSA) firms which are not banks. However, GDF members are concerned that the current structure is based around a traditional financial market structure. As such, it operates on the basis that there is a central entity that sits between the users and the FMI SAR will ensure the continuity of this entity. With stablecoins, it is slightly different as the DSA firm could be doing any number of activities and it is unclear what falls within scope under this consultation. At present the consultation states that in scope activity includes:

'issuing, creating or destroying asset-linked tokens; creating or destroying fiat-linked tokens; value stabilisation and reserve management; validation of transactions; access; transmission of funds; safeguarding and administering assets belonging to a third party/or another; executing transactions in stable tokens; exchanging tokens for fiat money and vice versa.'

As such there could be a number of partners involved in a stablecoin arrangement and it is not clear whether the FMI SAR would apply to all of the activities or just failed aspects. There is wider cause for concern first of all due to the disruption it can cause and secondly for the lack of tech neutrality. In traditional finance, if an issuer of something that is settled on an FMI goes insolvent, the FMI SAR does not apply to the third party, it can only apply to the FMI itself. Greater clarity is needed here. The consultation implies that there needs to be an operator that this regime is applied to but there can be any number of entities that this can be applied to and there is a lack of certainty as to who this is.

Whilst the need to be broad with the approach is understood, GDF members want to understand better the extent of the powers being conferred to intervene and the reach that this has to indirectly linked institutions.

The Consultation acknowledges that neither of the existing regimes are suitable, however, it is not clear as to what the solution to this is and it needs to be clear what is protected when a stablecoin goes into administration. Whilst GDF acknowledges that in principle the FMI SAR is a step in the right direction, it suggests a bespoke regime should be developed in due course taking into consideration the different arrangements that stablecoins have.

Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the PESAR, to apply solely to systemic DSA firms?

GDF acknowledges the intentions of the proposed approach, however again highlights that differing stablecoin arrangements could make this quite difficult to apply.

The first point to highlight is that in traditional finance, customer funds would ordinarily be segregated from company assets and held on trust, therefore being unavailable to creditors. In this case, GDF would not have any concern in this regard to the return of customer funds. However, the difficulty is lieu of conduct regulation, there is no strict provision separating firm and client assets, which could make the return or transfer of customer funds complicated.

Furthermore, this approach is only effective depending on to what / which entities this regime applied to. Depending on the scope, the FMI SAR might not be applicable to the entity that has control of the customer funds, this may be with a service provider or issuer who continues to be solvent and operational. The part of the ecosystem that has gone bust could be the technology service, in which case it would be impossible to make them return customer funds. Therefore, it is important to get more detail around how this will be applied to meet the regulatory aims.

On a separate note, the objective of continuing the payments system and the objective of returning customer funds are not complimentary. GDF members called for greater clarity as to which priority takes precedent.

Do you have any comments on the intention to provide the Bank of England with the power to direct administrators, and to introduce further regulations in support of the FMI SAR to ensure the additional objective can be effectively managed, or what further regulation may be required?

GDF welcomes the decision to provide the Bank of England with the power to direct administrators and to introduce further regulations in support of the FMI SAR. GDF notes the need for a special administrator to fully understand the business model before being able to make any decisions and given the lengthy fact finding and familiarisation process required for special administrators when it comes to traditional finance, it is reasonable to expect that this will only be compounded with the complexity of stablecoins arrangements. Therefore guidance from the bank of England will be welcome to help the special administrator get up to speed and acquainted with how operations and business models work.

This being said, GDF submits that there is a need for a more specific outline of the Bank of England's regulatory powers, to ensure clarity and consistency. For example, whilst there is a focus on the return of client funds it is unclear how the Bank will rank other objectives in an administration and whether there will be different priorities for stablecoins in comparison to other assets.

Do you have any comments on the intention to require the Bank of England to consult with the Financial Conduct Authority prior to seeking an administration order or directing administrators where regulatory overlaps may occur?

GDF considers that the requirement for the Bank of England to consult the Financial Conduct Authority prior to seeking an administration order as sensible. There can be a situation where a stablecoin could be used to support trading systems which are regulated by the FCA, therefore consulting the FCA, perhaps even working with the FCA, before seeking administration is sensible so that the Bank of England is aware of the wider impacts when exercising its powers beyond its primary objectives. However, it is imperative that this done quickly to avoid a lengthy process.