

SUBMITTED VIA WEB FORM TO:

[https://www.onlinesurveys.fca.org.uk/jfe/form/SV\\_8BSH9ESd6HbEy34](https://www.onlinesurveys.fca.org.uk/jfe/form/SV_8BSH9ESd6HbEy34)

To whom it may concern,

**Re: Financial Conduct Authority (FCA) Discussion Paper 23/4 on Regulating  
cryptoassets Phase 1: Stablecoins**

**About Global Digital Finance (GDF)**

GDF is the leading global members association advocating and accelerating the adoption of best practices for crypto and digital assets. GDF's mission is to promote and facilitate greater adoption of market standards for digital assets through the development of best practices and governance standards by convening industry, policymakers, and regulators.

The input to this response has been curated through a series of member discussions and roundtables, and GDF is grateful to 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 further discuss these matters in more detail with our members.

Yours faithfully,

Elise Soucie - Director of Global Policy & Regulatory Affairs - GDF



## Response to the Consultation Report: Executive Summary

The GDF convened its members to analyse the Financial Conduct Authority (FCA) Discussion Paper 23/4 on Regulating cryptoassets Phase 1: Stablecoins.

Overall GDF is supportive of the aim of the discussion paper and the broader aims of the recommendations made in the FCA Discussion Paper (referred to henceforth as the DP). GDF believes firmly in their intent to support innovation and provide end to end regulation while following the principles of same risk, same regulatory outcome and simultaneously developing new regulatory requirements for new risks. We also appreciate the agility and speed with which the FCA has set out their DP alongside the Bank of England (BoE) DP, and the Prudential Regulatory Authority (PRA) Dear CEO letter. The UK working towards its stated timelines for digital asset regulation. This is crucial for providing clarity to the financial services sector, and we believe the DP is an important step towards that end. As such, 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 has worked with our members to provide constructive feedback on the regulatory regime, and also aims to identify options to overcome challenges identified in the DP. Through this process GDF members identified key areas that may require further drafting consideration or additional guidance for purposes of clarity, proportionality, and effective implementation. The five core areas identified are:

- 1. Proposed reconsideration of the treatment of overseas stablecoins;**
- 2. Further consideration of the practical implementation of the ‘payments arranger’;**
- 3. Additional guidance on custody requirements;**
- 4. Further consideration of the reconciliation requirements; and**
- 5. Further consideration of the recommendations for backing assets.**

### Proposed reconsideration of the treatment of overseas stablecoins

Overall, GDF remains supportive of the FCA and their considerations of how to position the UK globally with regards to overseas stablecoins. We are supportive of the FCA granting the ability for overseas stablecoins being used in the UK where the appropriate safeguards are in place. However, we would raise for consideration a few areas where it may be beneficial to provide further clarity on the rules for overseas issuers and how these requirements may be implemented. We would also urge consideration of the different types of stablecoins that may exist. There may be some overseas stablecoins that are sterling backed, but there are also likely to be many that are not sterling backed. We would encourage the FCA to consider what requirements may or may not be appropriate for different types of stablecoins. Further to this, different types of stablecoins may not be appropriate for UK retail consumers but may serve a different purpose in wholesale markets. This is further discussed in our response to Q39.



### **Further consideration of the practical implementation of the ‘payments arranger’**

As noted above, GDF is supportive of the FCA granting the ability for overseas stablecoins in the UK, yet there are some potential risks of the payments arranger as this is a challenging construct. Further clarity is required on what kind of exclusivity may or may not apply to the arranger. We are concerned that if this not a contractual relationship it could result in an increase in risk for both sides. GDF would also encourage consideration of the risk of trust and reliability of the arranger. For the arranger, they are taking on a reputational risk. For the overseas issuer there would also be the potential risk of a captive audience. This is further discussed in our response to Q39.

### **Additional guidance on custody requirements**

GDF is broadly supportive of the DP’s proposal to apply existing custodian regime to address concerns with digital custody. For a few core components of the regime, we have added some additional comments for consideration. We believe these additional aspects may be appropriate to include in the final framework. We have expanded on additional considerations for the following areas under our responses to the questions within Chapter 5 (among other comments). We have provided additional considerations for: adequate arrangements to protect clients’ rights to their cryptoassets, adequate organisational arrangements to minimise risk of loss or diminution of clients’ custody assets, recording clients’ custody assets holdings and, adequate controls and governance to protect clients’ custody asset holdings.

### **Further consideration of the reconciliation requirements**

GDF would note that with certain public chains, on-chain records could serve as external records, and this would allow efficient reconciliation. If a mix of on-chain and off-chain is used, we believe that reconciliations should also be required, regardless of the additional costs. Furthermore, we would encourage further clarity and guidance on the proposals around daily reconciliation. While we are broadly supportive of the reconciliation proposals, if the intent of the DP is to mandate daily reconciliations that are shared with supervisors, we would caution that daily reconciliation may capture unnecessary market noise and not provide supervisors and risk managers with useful data points. We would encourage a less restrictive reconciliation requirement and for the public and private sector to work together to determine what data would be most useful to share in real time. GDF is supportive of an approach similar to CASS 6.6.44 R which provides for a more flexible and proportionate approach to frequency of reconciliations. This is further expanded upon in our responses to Q16 and Q17.

### **Further consideration of the recommendations for backing assets**

GDF is supportive of the FCA proposal that a future regime for backing assets should ensuring that the stablecoin maintains its value relative to its reference currency or currencies, and that the stablecoin can be promptly redeemed at par value by any holder of the stablecoin. Yet, while we agree with the importance of high-quality liquid reserves as backing assets, we believe that some aspects of the current proposals are slightly restrictive and may not account for all of the options available to safely manage reserves and the many different ways that stablecoins may be used. For example, other stablecoin proposals in other jurisdictions have presented alternative approaches that set a more flexible standard for backing assets.

We would note of course and accept that prudential requirements might need to be different or more stringent as appropriate. Yet there are also cases where more flexibility may also be warranted. For example, short-dated reverse repurchase agreements overcollateralized by



government debt instruments present an important alternative that can help provide liquidity and manage credit and duration risk. For these, as well as other unique arrangements it may be appropriate for the framework to support alternative arrangements for backing assets. This is further expanded upon in our response to Q4, Q6, Q8 and Q9.



## Response to the Discussion Paper: Questions for Public Consultation

Please note that given our focus areas set out in the executive summary that we have not responded to each question in the DP. Instead, we have provided feedback and input on the specific questions and chapters that are relevant to the key areas.

### *Chapter 1: Overview* *[comment]*

### *Chapter 2: A new stablecoin regime*

#### *Q1: Should the proposed regime differentiate between issuers of regulated stablecoins used for wholesale purposes and those used for retail purposes? If so, please explain how.*

In general, GDF is supportive of the FCA distinguishing between retail and wholesale activities in order to ensure a proportionate approach - that reflects the approach taken across financial services legislation where wholesale businesses are often subject to less onerous requirements than retail businesses given the different risks. However, we would caution against the activity itself being defined by reference to whether business is wholesale or retail. We would support the development of a regulatory framework where there is a single regulated activity, with additional detailed FCA rules and guidance as appropriate that can then apply differently depending on whether retail clients are involved. Additionally, within traditional financial services, the requirements would be on the enterprise conducting an activity, rather than on the money itself so we would encourage a similar approach to stablecoin regulation.

Furthermore, it is both likely, and feasible stablecoin could be used for both retail and wholesale purposes, as well as stablecoins being used for non-payments purposes; and indeed, the vast majority of stablecoins in circulation today are used interchangeably by service providers for business and treasury management and retail users for payments. Stablecoins also have multiple use cases beyond payments, including but not limited to trading, investment, as a store of value, and as collateral to transactions. As such, we would encourage the FCA, as also noted in our response to the BoE DP, to develop a framework that recognises that stable Coins will usually be used for multiple purposes and the issuer usually would not have control over what they're used for following issuance.

We are supportive of a universal regulatory framework that is applicable to all stablecoin issuers, with some proportionate distinction between those used at a systemic level, and therefore capable of giving rise to financial stability risks, and those used at a non-systemic level. Such a regulatory framework should ensure outcomes of consumer protection and preservation of the singleness and uniformity of money.

#### *Q2: Do you agree with our assessment of the type of costs (both direct and indirect) which may materialise as a result of our proposed regime? Are there other types of costs we should consider?*

#### *Q3: Do you agree with our assessment above, and throughout this DP, that benefits, including cheaper settlement of payment transactions, reduced consumer harm, reduced uncertainty, increased competition, could materialise from regulating fiat-backed stablecoins as a means of payment? Are there other benefits which we have not identified?*



Yes, GDF agrees and is supportive of these benefits.

### **Chapter 3: Backing assets and redemption**

**Q4: Do you agree with our proposed approach to regulating stablecoin backing assets? In particular do you agree with limiting acceptable backing assets to government treasury debt instruments (with maturities of one year or less) and short-term cash deposits? If not, why not? Do you envision significant costs from the proposal? If so, please explain?**

First, GDF is supportive of the FCA proposal that a future regime for backing assets should ensuring that the stablecoin maintains its value relative to its reference currency or currencies, and that the stablecoin can be promptly redeemed at par value by any holder of the stablecoin. These objectives are crucial to ensuring that the singleness and uniformity of the Pound sterling is preserved across all regulated GBP-referenced stablecoins.

While we agree with the importance of high-quality liquid reserves as backing assets, we believe that some aspects of the current proposals are quite restrictive and may not account for all of the options available to safely manage reserves and the many different ways that stablecoins may be used.

For example, other stablecoin proposals in other jurisdictions have presented alternative approaches that set a more flexible standard for backing assets. The HKMA Proposals for example set out that:

*“6.2.2. Investment limitations: The reserve assets must be of high quality and high liquidity with minimal market, credit and concentration risk. Reserve assets should be held in the referenced currency, with flexibility allowed on a case-by-case basis, subject to approval by the MA. In determining the composition of reserve assets, the FRS issuer should take into account the liquidity requirements of the FRS concerned and how the reserve assets will be managed and invested to meet such requirements. The MA will need to be satisfied that the types of investment the FRS issuer proposes to hold are appropriate. In this regard, the FRS issuer should put in place an investment policy for reserve assets that is reviewed for suitability on a sufficiently frequent basis as the FRS business develops.<sup>1</sup>”*

Compared to HKMA’s proposals, those under the EU’s Markets in Cryptoassets (MiCA) regulation, and the proposals from standard setting bodies such as the BIS we are concerned that the UK’s proposal is overly restrictive. GDF members have serious concerns as to whether it would be commercially viable to be a stablecoin issuer in this system given the limits placed on revenue streams. This could have the unintended consequence of disincentivising issuers in the UK compared to those based in the EU or elsewhere.

We would note of course and accept that prudential requirements might need to be different or more stringent as appropriate. Yet there are also cases where more flexibility may also be warranted. For example, short-dated reverse repurchase agreements overcollateralized by government debt instruments present an important alternative that can help provide liquidity and manage credit and duration risk. For these, as well as other unique arrangements it may be appropriate for the framework to support alternative arrangements for backing assets.

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<sup>1</sup> <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf>



***Q5: Do you consider that a regulated issuer's backing assets should only be held in the same currency as the denomination of the underlying regulated stablecoin, or are there benefits to allowing partial backing in another currency? What risks may be presented in both business-as-usual or firm failure scenarios if multiple currencies are used?***

***Q6: Do you agree that regulated stablecoin issuers should be able to retain, for their own benefit, the revenue derived from interest and returns from the backing assets. If not, why not?***

GDF strongly agrees that issuers should be able to retain the revenue from interest and returns from backing assets. An important objective of stablecoins as a payment utility is to provide near-instant, near-free payments. As such, to ensure a competitive market and incentives to meet those objectives, issuers should be able to retain revenue provided by safeguarding the backing assets. We would also encourage the FCA approach to be part of the BoE framework for systemic stablecoins as well. If this was not consistently supported about both regimes it could result in cliff edge risks for businesses when they transition.

***Q7: Do you agree with how the CASS regime could be applied and adapted for safeguarding regulated stablecoin backing assets? If not, why not? In particular:***

- i. Are there any practical, technological or obstacles to this approach?***
- ii. Are there any additional controls that need to be considered?***
- iii. Do you agree that once a regulated stablecoin issuer is authorised under our regime, they should back any regulated stablecoins that they mint and own? If not, why not? Are there operational or legal challenges with this approach?***

GDF strongly supports the approach of regulating crypto custodians using a CASS style approach, with appropriate adaptations to reflect the differences between digital asset and traditional custodial models.

***Q8: We have outlined two models that we are aware of for how the backing assets of a regulated stablecoin are safeguarded. Please could you explain your thoughts on the following:***

- i. Should regulated stablecoin issuers be required to appoint an independent custodian to safeguard backing assets?***

The objective and requirements for regulated issuers should focus on ensuring adequate protections of holder backing assets, including protection in the event of insolvency and priority over other creditors. While this can be achieved through appointment of an independent auditor, this may not adequately protect ultimate holders and may prevent alternatives models in which an issuer is able to safeguard the assets.

- ii. What are the benefits and risks of this model?***
- iii. Are there alternative ways outside of the two models that could create the same, or increased, levels of consumer protection?***

***Q9: Do you agree with our proposed approach towards the redemption of regulated stablecoins? In particular:***

- i. Do you foresee any operational challenges to providing redemption to any and all holders of regulated stablecoins by the end of the next UK business day? Can you give any examples of situations whether this might be difficult to deliver?***





While we agree in principle with the need for all issuers to provide timely redemption of holder assets, the standard of one business day may be impractical and create AML/CFT risks. As written, the standard requires the redemption period to begin at the time a holder *submits* documentation for AML/CFT checks. As a result, a T+1 timeline is tantamount to completing all AML/CFT processes within one business day which may be operationally infeasible particularly with higher risk holders. This may be unfeasible for many businesses, especially when meeting KYC requirements. Other jurisdictions, have taken more relaxed standards, including the Monetary Authority of Singapore which requires processing within T+5 business days beginning on the date of request of a compliant holder (i.e. that has been successfully onboarded), under EU's MiCA there is no prescriptive redemption timeframe, and the New York Department of Financial Services requires processing of redemption requests not more than two full business days (T+2) beginning the day after a request and only upon successful onboarding of the holder.

Given the above, GDF members would propose a timeline between T+3 and T+5 business days.

- ii. Should a regulated issuer be able to outsource, or involve a third party in delivering, any aspect of redemption? If so, please elaborate.*

Yes, GDF is supportive of this given that some issuers may be wholesale issuers.

- iii. Are there any restrictions to redemption, beyond cost-reflective fees, that we should consider allowing? If so, please explain.*
- iv. What costs associated with our proposed redemption policy do you anticipate?*

*Q10: What proof of identity, and ownership, requirements should a regulated stablecoin issuer be gathering before executing a redemption request?*

#### **Chapter 4: Other key expectations of stablecoin issuers**

*Q11: Do you agree with our approach to the Consumer Duty applying to regulated stablecoin issuers and custodians. Please explain why.*

*Q12: Do you consider that regulated stablecoins should remain as part of the category of 'restricted mass marketed investments' or should they be captured in a tailored category specifically for the purpose of cryptoasset financial promotions? Please explain why.*

#### **Chapter 5: Custody requirements**

*Q13: Should individual client wallet structures be mandated for certain situations or activities (compared to omnibus wallet structures)? Please explain why.*

We believe further clarification is required for the wallet structure and if the CASS requirements discussed in the DP would still apply in their normal way.

*Q14: Are there additional protections, such as client disclosures, which should be put in place for firms that use omnibus wallet structures? Are different models of wallet structure more or less cost efficient in business as usual and, (ii) firm failure scenarios? Please give details about the cost efficiency in each scenario.*

First, we would note that the DP implies that custody of a cryptoasset is holding the private key that allows access and use of the cryptoasset. It does not cover situations where custodian





would hold the seed phrase or have control over the asset in any other way than by holding the private key. This is a limitation that may result in players providing custody solutions looking for a workaround to avoid being considered as a custodian, so we believe it would be appropriate to address the notion of control over the asset. This is an equally important protection to be managed and we would encourage the FCA to include guidance on this in their final framework.

*Q15: Do you foresee clients' cryptoassets held under custody being used for other purposes? Do you consider that we should permit such uses? If so, please give examples of under what circumstances, and on what terms they should be permitted. For example, should we distinguish between entities, activities, or client types in permitting the use of clients' cryptoassets?*

*Q16: Do you agree with our proposals on minimising the risk of loss or diminution of clients' cryptoassets? If not, please explain why not? What additional controls would you propose? Do you agree with our proposals on accurate books and records? If not, please explain why not.*

The DP mentions that harm associated with cryptoasset custody primarily arises due to poor safeguarding arrangements by the custodian, and that without robust custody protections in place, there is a risk that consumers' rights to their stablecoins are not protected, increasing the chance of their cryptoasset being lost.

Additionally, the DP addresses the concern that, if a cryptoasset custodian were to fail today, the lack of a clear regulatory framework could result in uncertainty that would likely cause harm to clients through delays in the return of assets, extra costs or, worst of all, loss of their assets.

The DP then proposes to apply the core components of the existing custodian regime to address these concerns. We are broadly supportive of these proposals from the FCA but for a few of the components of the regime we have added some additional comments for consideration. We believe these additional aspects may be appropriate to include in the final framework:

## **1. Adequate arrangements to protect clients' rights to their cryptoassets**

- a. Segregation of client assets
  - i. We would encourage the FCA to consider what additional requirements may be needed to effectively preserve ownership rights with omnibus wallets.
- b. Recording ownership
  - i. Provided that all transactions are carried out on-chain, we believe that DLT records should be sufficient to ensure that ownership rights are recorded. When transactions are carried out off-chain, we would encourage the FCA to clarify in the final framework whether a register kept by the custodian would be sufficient as a safeguard.
- c. Use of clients' cryptoassets
  - i. In the case that the assets are given as collateral, we believe that the custodian should ensure that the collateral provider no longer has access to the custodied wallet where the assets are located. This could operate in a similar way to a blocked bank account, where the custodian does not grant access to the assets to the collateral provider



without the consent of the collateral receiver. We foresee these collateral transactions to become very relevant in the near future and believe that custodians of cryptoassets should be able to operate these solutions as a they could become an essential component in this type of transactions.

**2. Adequate organisational arrangements to minimise risk of loss or diminution of clients' custody assets**

- a. Adequate organisational arrangements
- b. Liability for loss of cryptoassets

We have no additional comments on this section and are supportive of the FCA proposals.

**3. Recording clients' custody assets holdings:**

- a. Accurate books and records
  - i. We believe that full on-chain records should be permitted, as long as accuracy and integrity can be preserved, to foster transparency.
  - ii. Off chain records could also be used in order to reconcile the assets held on chain (which would presumably be in the name of the firm) to the firm's books and records (which would reflect the client's ownership of the asset).
- b. Reconciliations
  - i. With certain public chains, on-chain records could serve as external records, and this would allow efficient reconciliation. If a mix of on-chain and off-chain is used, we believe that reconciliations should also be required, regardless of the additional costs.

**4. Adequate controls and governance to protect clients' custody asset holdings**

- a. Use of third parties
  - i. The DP states that "whether technology providers will also be caught by our custody requirements will depend on whether they undertake custody activities that would be captured by the new custody regulated activity created by the Treasury." However, we would encourage the FCA to provide further clarity and additional guidance to technology providers, particularly those situated in other jurisdictions than the UK, on how they would be able to assess whether they are undertaking custody services or not in the UK, and what would be the consequence of undertaking such services (in particular, whether a technology provider would need to obtain a license in the UK even if its providing its services from/in other jurisdictions).
- b. client disclosures and statements
- c. CAAS oversight officer
- d. client assets audit
- e. regulatory reporting

We have no further comments on the additional controls under this section.

***Q17: Do you agree with our proposals on reconciliation? If not, please explain why not? What technology, systems and controls are needed to ensure compliance with our proposed requirements?***



GDF is broadly supportive of the proposals, yet we believe further clarity and guidance would be beneficial on the daily reconciliations which are mentioned throughout the DP. While we are supportive of the FCA's aims, we would encourage a less restrictive reconciliation requirement and for the public and private sector to work together to determine what data would be most useful to share in real time. For example, where off-chain records are used, and these off-chain records are held on traditional systems. Firms would need to ensure that their existing systems are capable of interacting with the blockchain on a real-time basis. If this is not feasible, then some flexibility may be beneficial as record keeping systems continue to evolve with new technology. GDF is supportive of an approach similar to CASS 6.6.44 R which provides for a more flexible and proportionate approach to frequency of reconciliations.

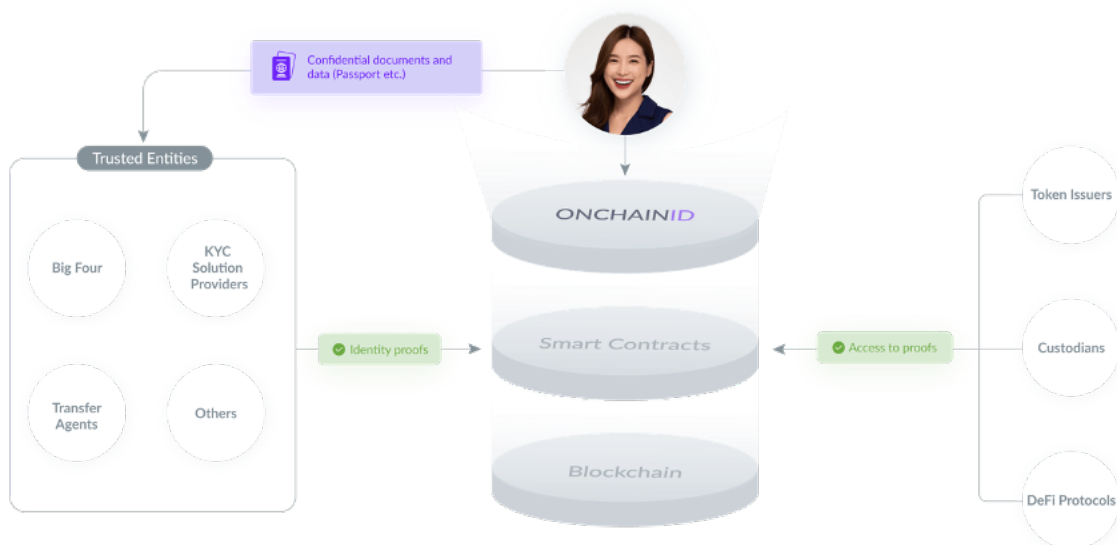
***Q18: Do you consider that firms providing crypto custody should be permitted to use third parties? If so, please explain what types of third parties should be permitted and any additional risks or opportunities that we should consider when third parties are used.***

Yes, third party custodians should be able to be used (they may provide safer/better custody than the firm itself in some cases), but they should be subject to appropriate due diligence, monitoring, and the third party should meet the same standards the FCA is putting in place for custodians. For legal consistency, we would encourage third parties to crypto firms, to meet the same standards expected for third party outsourcing across financial services.

For example, we believe that one area where third parties would be beneficial is in the case of digital identities (or digitalID). Several open-source digital identity solutions exist and offer a self-sovereign identity system on the blockchain, bringing trust and compliance to the cryptoasset industry. These systems offer several benefits:

- Private data is kept off-chain with trusted parties, and encrypted identity proofs of data validation are published on the blockchain.
- It enables compliant permissioned cryptoassets and guarantees their ownership.
- Permissioned cryptoassets embed token transfer rules and link ownership to onchain identities, not wallets.
- The transfer of permissioned cryptoassets can only occur between eligible onchain identities.
- It is possible to recover permissioned cryptoassets in case of loss of the wallet's private key, as the owner can identify itself towards the issuer via its onchain identity and the cryptoassets can be reallocated to a new wallet of the same owner.

Please find the below example of how this might work in practice:



These solutions bring several opportunities to the cryptoasset custody industry, and we believe they should be further considered in the FCA's eventual framework.<sup>2</sup>

GDF members would also highlight some additional considerations to address DLT specific risks that firms may need to make when using third parties:

- The results of any third-party assurance reports over the third-party custodian over their controls, such as an ISAE3402 report, or a SOC1/SOC2 report.
- The results of any third-party assurance reports over any service providers over their controls, such as an ISAE3402 report, or a SOC1/SOC2 report.
- Which security protocols any third parties are using – e.g., multi-signature or multi-party computation.
- The wallet storage method used at third parties.
- Compatibility of different blockchains at each third party.
- The policies and procedures in place at any third parties – specifically around what will be paid back to clients in the event of a failure. i.e. (Crypto/fiat).

***Q19: Do you agree with our proposals on adequate governance and control? If not, please explain why not? What (if any) additional controls are needed to achieve our desired outcomes? What challenges arise and what mitigants would you propose?***

We would reiterate our suggestions under Q16. We are broadly supportive of these proposals from the FCA but for a few of the components of the regime we have added some additional comments for consideration.

GDF would suggest that some additional disclosures specific to the underlying DLT or blockchain may be required, such as:

- The consensus protocol used at the custodian.
- Blockchain security protocols in place (e.g., Multi-party computation or Multi-party signature)
- The Omnibus structure in place

<sup>2</sup> The above chart illustrating this example was provided by GDF member Tokeny. Please note it was not included in the FCA WebForm submission for Q18 as it did not allow for attachments or graphics. It was included in our attached PDF full response.



- With regard to proof of reserves, there would need to be clarity around how frequently proof of reserves assurance would be required and the audit methodology required to verify the reserves

While a CASS audit may be beneficial as a starting point, the financial reporting council (FRC) standard would likely need to be updated for the final framework in order to include DLT/blockchain specific considerations. Auditors will also need to be trained in order to have the appropriate skill set and tools to appropriately audit a DLT and meet FCA Standards.

*Q20: Should cryptoasset custodians undertaking multiple services (e.g., brokers, intermediaries) be required to separate custody and other functions into separate legal entities?*

*Q21: Are there any practical issues posed by requiring cryptoasset exchanges to operate a separate legal entity for custody-like activities? Specifically, please could you explain your thoughts on the following:*

- Would these issues differ between institutional and retail clients?*
- What would be the operational and cost impact?*
- What are the benefits to clients of cryptoasset exchanges prefunding trades? Can these be achieved if there is legal separation of entities?*

Overall, while we appreciate that legal separation may in some cases be justified, we would encourage the FCA to maintain a flexible and future-proof approach. It may be possible, as business models continue to evolve and develop for organisations to build in new types of risk mitigation that meet FCA principles and requirements.

Furthermore, while it is important to mitigate conflict of interest, it may be possible to do so without legal separation. Having one legal entity may also provide benefits of quicker settlement, greater efficiency in transactions, and mitigation of third-party risk. Given this, we would encourage the FCA to remain open to diverse and new business models that can still meet the appropriate regulatory requirements.

- Would separating custody and exchange functions impact the way clients' accounts are managed and structured (in omnibus and individual client wallets)?*
- Do you agree that the conflicts of interest we have identified exist? Are there other conflicts of interest we should consider?*
- Are there alternative ways to ensure the same level of consumer protection?*

*Q22: What role do you consider that custodians should have in safeguarding client money and redemption? What specific safeguards should be considered?*

## **Chapter 6: Organisational requirements**

*Q23: Do you agree that our existing high-level systems and controls requirements (in SYSC) should apply to the stablecoin sector? Are there any areas where more specific rules or guidance would be appropriate?*

*Q24: Do you agree with our proposal to apply our operational resilience requirements (SYSC 15A) to regulated stablecoin issuers and custodians? In particular:*



- i. *Can you see how you might apply the operational resilience framework described to your existing business (e.g., considering your important business services and managing continuity)? Please set out any difficulties with doing this?*
- ii. *What approach do you take when assessing third party-providers for your own internal risk management (such as responding to, testing and managing potential disruption)?*
- iii. *Are there any minimum standards for cyber security that firms should be encouraged to adopt? Please explain why.*

*Q25: Do you agree with our proposal to use our existing financial crime framework for regulated stablecoin issuers and custodians? Do you think we should consider any additional requirements? If so, please explain why.*

*Q26: Do you agree with our proposal to apply our existing Senior Managers and Certification Regime to regulated stablecoin issuers and custodians? In particular:*

- i. *Should we apply the current SMR and requirements to issuers and custodians of regulated stablecoins? Are there additional SMFs or requirements needed to capture the nature of regulated stablecoin business services?*  
GDF would encourage the FCA to provide further guidance on the expectations for local presence requirements. For example, some issuers who will be regulated by this framework will likely be based overseas. It will be important to determine how the territorial scope of SM&CR will apply to those issuers and if this will be consistent with broader FCA policy for third country firms and branches. Depending on the application of the regimes, this may either encourage or disincentivise issuers from operating in the UK.
- ii. *Should we create additional criteria to determine when the ‘enhanced category’ of the regime should apply to regulated stablecoin issuers and custodians?*
- iii. *Should we apply the current certification functions and requirements to regulated stablecoin issuers and custodians? Are there any additional functions needed to capture the nature of regulated stablecoin issuers and custodians business services?*
- iv. *Do you agree that we should apply the existing Conduct Rules to regulated stablecoin issuers and custodians?*

## **Chapter 7: Conduct of business and consumer redress**

*Q27: Do you agree with our consideration to apply our Principles for Businesses and other high-level standards to regulated stablecoin issuers and custodians? Are there any particular areas you think we should apply detailed rules regarding information to (other than those for backing assets set out in Chapter 3)?*

*Q28: Do you consider that we should design more specific conduct of business rules to regulated stablecoins issuers and custodians? In particular what approach should we take to applying rules on inducements and conflicts of interest management to regulated stablecoin issuers and custodians?*

*Q29: Do you agree that the dispute resolution mechanisms provided in traditional financial services (i.e., the application of the DISP sourcebook and access to the Ombudsman Service) should be applied to the business of regulated stablecoin issuers and custodians? Have you identified any gaps or issues in relation to dispute resolution? Please explain.*





*Q30: Do you agree that the FCA should not be proposing to extend FSCS cover to the regulated activities of issuing and custody of fiat-backed stablecoins? If you do not agree, please explain the circumstances in which you believe FSCS protection should be available.*

#### **Chapter 8: Prudential requirements**

*Q31: Do you agree with our proposed prudential requirements for regulated stablecoin issuers and custodians? In particular, do you agree with our proposals on any of the following areas:*

*i. Capital requirements and quality of capital*

We believe that further clarity is required on the prudential capital requirements.

*ii. Liquidity requirements and eligible liquid assets*

*iii. Group risk*

*iv. Concentration risk*

*v. Internal risk management*

#### **Chapter 9: Managing stablecoin firm failure**

*Q32: Do you agree with applying the existing CASS rules on post-failure treatment of custody assets to regulated stablecoin issuers and other firms holding backing assets for regulated stablecoins, as well as CASS pooling events? If not, why not? Are there any alternative approaches that should be considered? If so, please explain.*

*Q33: Do you agree with our thinking on how the CASS rules can be adapted for returning regulated stablecoin backing assets in the event of a firm failure or solvent wind-down? If not, why not? Do you foresee the need for additional protections to ensure prompt return of backing assets to consumers or otherwise reduce harm in firm failure (e.g., strengthening wind-down arrangements, a bespoke resolution regime)? If so, please explain.*

*Q34: Do you agree with the proposed overall approach for post-failure trading? If not, is there anything else that should be considered to make the approach more effective? If so, please explain. Are there any arrangements that could avoid distribution of backing assets in the event an issuer fails and enters insolvency proceedings?*

*Q35: What challenges arise when stablecoins are returned to consumers, particularly with respect to their entitlements? Do you foresee the need for additional protections to facilitate the prompt return of regulated stablecoins to consumers or otherwise reduce harm in firm failure (e.g., introducing distribution rules within CASS for cryptoassets, strengthening wind-down arrangements, or a bespoke resolution regime)? If so, please explain.*

#### **Chapter 10: Regulating payments using stablecoins**

*Q36: Do you agree that this approach to integrating PSR safeguarding requirements and custody requirements will secure an adequate degree of protection for users of stablecoin payment services?*

*Q37: Do you agree that the custody requirements set out in chapter 5 should apply to custody services which may be provided by payment arrangers as part of pure stablecoin payment services?*





*Q38: Are there additional risks or opportunities, not considered above, of different stablecoin payment models that our regulation of payment arrangers should seek to tackle or harness?*

**Chapter 11: Overseas stablecoins used for payment in the UK**

*Q39: What are the potential risks and benefits of the Treasury's proposal to allow overseas stablecoins to be used for payments in the UK? What are the costs for payment arrangers and is the business model viable?*

Overall, GDF remains supportive of the FCA and their considerations of how to position the UK globally with regards to overseas stablecoins. We are supportive of the FCA granting the ability for overseas stablecoins being used in the UK where the appropriate safeguards are in place. This is important for the competitiveness of the UK and in line with the UK's stated intention of being a global hub for digital finance. Further to this, we would raise for consideration a few areas where it may be beneficial to provide further clarity on the rules for overseas issuers and how these requirements may be implemented.

First, we have some concerns about the potential risks of the payments arranger as this is a challenging construct. In effect, the arranger would be responsible for a stablecoin entering the market which may have the unintended consequence of increasing counterparty risk.

Additionally, further clarity is required on what kind of exclusivity may or may not apply to the arranger. For example, could an issuer have multiple arrangers? Will arrangers validate for multiple parties? We are concerned that if this not a contractual relationship it could result in an increase in risk for both sides.

From the perspective of an overseas firm, we would also encourage consideration of the risk of trust and reliability of the arranger. For the arranger, they are taking on a reputational risk. In addition to this, under this proposal a payment arranger could potentially have liability for an overseas stablecoin for which it has no responsibility over or ability to influence outcomes. For the overseas issuer there would also be the potential risk of a captive audience, (e.g. they could become a customer of the arranger who are then reluctant to substitute one arranger with another, because of the high cost (in terms of discomfort, effort, and/or money) involved in switching.)

Furthermore, the arranger would be similar to an S21 approver for financial promotions yes this is a role that is now under review and being amended. We would encourage aligning this role, in the form it takes in the overall framework to the practices and roles that exist within other aspects of the UK's financial services regulatory regime. It will also be crucial to ensure that any overseas requirements take into consideration the other overseas regimes that exist and how these regimes may already mitigate some risks. For example, the FCA's financial promotions regime may already apply to overseas issuers.

Finally, we would also urge consideration of the different types of stablecoins that may exist. There may be some overseas stablecoins that are sterling backed, but there are also likely to be many that are not sterling backed. We would encourage the FCA to consider what requirements may or may not be appropriate for different types of stablecoins. Further to this, different types of stablecoins may not be appropriate for UK retail consumers but may serve a different purpose in wholesale markets.



*Q40: What are the barriers to assessing overseas stablecoins to equivalent standards as regulated stablecoins? Under what circumstances should payment arrangers be liable for overseas stablecoins that fail to meet the FCA standards after approval, or in the case where the approval was based on false or incomplete information provided by the issuer or a third party?*

Please see our above comments under Q39.

**Chapter 12: conclusion**  
*[comment]*