

United Kingdom: The future of UK stablecoin regulation – Treasury and regulators provide more detail on approach

In brief

In a long-awaited update on its plans for the UK's crypto regulatory framework, on 30 October 2023 HM Treasury issued three interlinked policy documents on the future regulation of crypto, covering **fiat-backed stablecoins**, the **wider cryptoasset regulatory regime**, and the **failure of systemic digital settlement asset (DSA) firms**. The regulators followed shortly after, issuing a set of papers on 6 November 2023 on the forthcoming stablecoin regime: a **discussion paper from the FCA on stablecoin regulation**, a **discussion paper from the Bank of England (BoE) on the regulation of systemic payment systems using stablecoins**, a **PRA Dear CEO Letter to deposit-takers on issues relating to digital money**, and a cross-authority **roadmap paper on innovation in payments and money** (which explains how the regimes interact and the regulators' approach to dual regulation). Both discussion papers close to comments on 6 February 2024.

This briefing covers stablecoin regulation and the failure of systemic DSA firms – for more on the wider cryptoasset regulatory regime, see our **dedicated alert** issued alongside this one.

The Treasury's stablecoin policy update sets out more detail on the government's plan to regulate certain activities relating to fiat-backed stablecoins, almost 18 months after it first **confirmed** its plans to move forward with the regulation of stablecoins in the UK; for more on the Treasury's announcements at the time, see our related **client alert**. Whilst the update essentially confirms the approach previously set out by the Treasury, there are some evolving details and clarifications worth exploring. However, although the Treasury has already started to prepare for stablecoin regulation through the Financial Services and Markets Act 2023 (which contains measures allowing the Treasury to bring activities relating to fiat-backed stablecoins within the regulatory perimeter), it remains the case that most of the detailed requirements of the regime are left to the forthcoming secondary legislation and rules issued by the regulators. The FCA and BoE discussion papers give a helpful indication of how the finer details of the regime will shake out, but there is plenty of room for the regulators to manoeuvre, and further consultations to follow before the shape of regulation is fully set.

Phasing and timetable

The government still intends to take a phased approach to the regulation of cryptoassets and activities connected with cryptoassets. The regulation of fiat-backed stablecoin activities will take place in Phase 1. Activities relating to wider types of cryptoassets (including, for example, algorithmic stablecoins, and commodity-backed tokens not caught in Phase 1) will be in scope of Phase 2. We explore Phase 2 in more detail in our **dedicated alert**.

In the next stage of Phase 1 implementation, the Treasury intends to bring forward secondary legislation by early 2024, subject to available parliamentary time. These legislative provisions will bring activities relating to fiat-backed stablecoins into the regulatory perimeter, enabling the FCA to regulate them. Following the end of the feedback period to their discussion papers, the BoE and FCA expect to consult on more detailed policy proposals and enforceable rules in the second half of 2024. While the Treasury gives no

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indication as to when it intends for the regime to take effect, the regulators indicate in their roadmap that implementation of the regime is anticipated to take place in 2025.

Tokens in scope

The stablecoin regime will apply to fiat-backed stablecoins only. This category will be defined in legislation – the Treasury intends to capture those stablecoins which seek to maintain a stable value by reference to a fiat currency or basket of currencies, and hold (in whole or in part) that currency or basket as “backing”. This does not include algorithmic, crypto-backed or commodity-backed tokens – these tokens will be captured in Phase 2 (although the government does not at this stage intend to differentiate between those tokens and other unbacked cryptoassets in Phase 2). There will be no restrictions on particular currencies.

Other types of stablecoins (for instance, non-fiat backed stablecoins) or unbacked cryptoassets will still be allowed to be used in payment chains, but these transactions will remain unregulated. The Treasury and FCA are considering disclosure rules to ensure clear consumer messaging around the risks related to the use of unbacked cryptoassets in payment chains.

FCA regulatory regime

The Treasury intends to achieve the regulation of stablecoins through a mixture of amendments to the Payment Services Regulations 2017 (PSRs) and Regulated Activities Order (RAO) to bring activities within the regulatory perimeter. As we explain further, the activities of issuance and custody of UK issued fiat-backed stablecoin will be included in the RAO, enabling the FCA to make rules for firms conducting these activities. Firms wishing to apply for authorisation to conduct either of the issuance or custody activities will be subject to FCA rules and guidance as is usual for FCA regulated activities.

Until the wider regime for regulation of cryptoassets comes into place in Phase 2, the scope of the regime will not cover the activity of facilitating the exchange of cryptoassets (including stablecoins) for other assets – this will fall within the Phase 2 activity of “operating a cryptoasset trading venue”. However, exchange providers will still need to register with the FCA under, and comply with, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) regime.

This stablecoin regime will be adapted, rather than replaced, when the wider regime for the regulation of cryptoassets comes into place in Phase 2. This has the potential to become a complex endeavour, particularly given the government's intention to shift payments regulation from the PSRs into the Financial Services and Markets Act 2000 (FSMA) model as part of the Smarter Regulatory Framework.

It is interesting to see that the Treasury's stablecoin update makes no reference to the Electronic Money Regulations 2011 (EMRs) regime. The Treasury had announced in its April 2022 consultation response that it intended to bring stablecoins within the regulatory perimeter primarily by amending and adapting the framework for payments and e-money established by the EMRs and PSRs. Further, the Treasury had signalled its intent to apply the overarching framework and key features of the EMRs regime to stablecoin issuance, to ensure consistency with e-money regulation – but as explained more below, issuance will instead become a regulated activity under the RAO. That being said, the Financial Policy Committee had previously expressed **concerns** that the e-money regulatory regime would not meet its expectations if e-money were to be used as a means of payments at systemic scale. More broadly, the pace of regulatory reform in the UK has quickened significantly since the Treasury's April 2022 announcements on stablecoins, with the government announcing its intention to move retained EU law (including payments and e-money regulation) into the FSMA model, along with its call for evidence from January 2023 considering, among other things, whether to merge the payments and e-money regimes (as is proposed in the European Commission's draft reforms to the revised Payment Services Directive). Perhaps this is a consideration in the Treasury's latest update – with further clarity to emerge when the draft secondary legislation is published.

The issuance activity

The Treasury intends to create a regulated activity under the RAO for the issuance of fiat-backed stablecoins in or from the UK. This will apply to all issuers of fiat-backed stablecoin located within the UK – including, as the FCA clarifies, issuing stablecoins that are not marketed to UK consumers. Fiat-backed stablecoins issued in or from the UK by persons authorised for the RAO issuance activity, termed “regulated stablecoins” by the FCA, will be permitted for use in UK payments.

The FCA's discussion paper specifies proposed requirements for redemption, capital requirements and backing assets issued under this activity.

Backing assets

Regulated stablecoin issuers will be expected to ensure that their regulated stablecoins maintain their peg, i.e. value relative to their reference currency or currencies, and can be promptly redeemed at par value by any holder of the stablecoin. To achieve this, the FCA proposes that, at all times, issuers would need to hold backing assets that are (i) equivalent in value to the circulating supply of the regulated stablecoin; (ii) stable in value; and (iii) sufficiently liquid to support consumers' right to redeem the regulated stablecoin promptly. Backing assets would also need to be properly identified, recorded, and segregated, as well as protected in the event of insolvency of the stablecoin issuer. The FCA is also considering requiring issuers to back regulated stablecoins they own themselves, to avoid unbacked regulated stablecoins entering circulation.

The FCA is considering a new framework where stablecoin issuers are required to secure their stablecoins with government treasury debt instruments that mature in one year or less, along with short-term cash deposits. The FCA would not allow the use of Money Market Funds when investing in treasury bills to back stablecoins.

The FCA proposes that regulated stablecoin issuers can continue to retain, for their own benefit, the revenue derived from interest and returns from the backing assets. The regulator is also considering that regulated stablecoin issuers should not be permitted to pay income or interest to consumers, but recognises that this may be perceived as unfair to consumers if interest rates remain high or rise higher.

Interestingly, the Treasury confirms that the FCA (and BoE if appropriate) will have the power to require that these backing assets are held in a statutory trust – the FCA's discussion paper confirms that the regulator will take this approach, with the terms to be set out in the FCA's rules. This approach aligns with the position taken by the FCA before the Court of Appeal in *Re Ipagoo (in Administration)* [2022] EWCA Civ 302, where the regulator argued that the construction of a statutory trust for safeguarded assets in the EMRs was necessary for the protection of e-money holders. The Court of Appeal ultimately disagreed, with the result that e-money holders have no proprietary interest in funds received in exchange for e-money. This also aligns with the Treasury's confirmation in April 2022 that it intended to apply the EMRs safeguarding requirements to stablecoins (although it is unclear if the Treasury considered here how the *Ipagoo* outcome changed the understanding of those requirements) - though note, again, the uncertainty around the EMRs regime and stablecoins as detailed above. If the FCA moves forward with its proposed approach, it may be the case that safeguarding under the stablecoin regime diverges from that applying to "traditional" e-money or fiat payments safeguarded funds.

Where a firm plans to issue more than one regulated stablecoin, the FCA is exploring a requirement to ensure each coin's backing assets are segregated from each other. Recordkeeping requirements, including internal and external reconciliations, would apply. The FCA is also considering requiring regulated stablecoin issuers to appoint a CASS oversight officer, to provide the FCA with an annual audit, and to report monthly.

While the FCA's proposals assume that most regulated stablecoin issuers who hold the regulated stablecoin's backing assets will appoint a third party (e.g. a credit institution or a custodian) to hold those assets (with the issuer remaining legally responsible for safeguarding), the FCA is also inviting views on the independent custodian model, where a regulated stablecoin issuer partners with an independent institution and appoints that institution to take on the safeguarding responsibility and day-to-day administration of the regulated stablecoin backing assets (with the independent custodian being legally responsible for ensuring those assets are safeguarded appropriately, similar to the independent depositary model for regulated funds).

Redemption

On redemption, the FCA proposes that all holders of regulated stablecoins should be able to convert their stablecoin into fiat at par value at all times while the issuer is a going concern, by the end of the next UK business day after the redemption request. Although they can sell their stablecoins on an exchange at any time, this will allow them to redeem with the issuer at par when the coin has de-pegged on the secondary market. This will be a significant change for stablecoin issuers who currently only seek to interact with wholesale or institutional clients. While the FCA is open to outsourcing the redemption activity, the legal redemption claim, and any corresponding liability, would remain on the regulated stablecoin issuer at all times.

Additional requirements include:

- The full redemption policy must be clearly disclosed and accessible on the regulated stablecoin issuer's website at all times.
- Any redemption fees must be cost-reflective. No further restrictions are currently proposed.
- Regulated stablecoin issuers will be required to carry out customer AML checks when dealing with customers directly at redemption if this is the issuer's first point of interaction with those customers. Redemption requests received from unhosted wallet owners would also require AML checks at the point of redemption. The redemption period would start once the consumer has submitted all of the necessary information for AML checks.

- Redemption should take place in the same currency in which the regulated stablecoin is denominated.

Temporary suspensions of the redemption period would be permitted in exceptional cases.

Other regulatory expectations

Regulated stablecoin issuers, whose stablecoins could be accessed by retail consumers (including through secondary markets), will need to consider the Consumer Duty in the design and build of their stablecoins, as well their ongoing operation. Crypto businesses are reminded that the Consumer Rights Act 2015 will also apply to terms in consumer contracts.

Regulated stablecoin issuers will be expected to publish key information on their regulated stablecoins on their website and main communication channels so that consumers can access and understand this information. This information would need to be communicated in a way that meets the requirements of the Consumer Duty and the financial promotions rules – all information should be communicated in a way that is fair, clear and not misleading, updated frequently (e.g. on a daily basis if necessary), and, as a minimum, include:

- A description of the regulated stablecoin, details of how the form of stability or links to a fiat currency is maintained and total number of tokens in circulation.
- The composition and value of the backing assets, and any relevant evidence to support these claims.
- Rights and obligations of the regulated stablecoin issuer and stablecoin holders (e.g. the terms and conditions) – including clear terms of redemption, proof of ownership requirements, and the type of asset/currency returned to the consumer after redemption.
- Risks that could affect the stability of the reference value and the backing assets.

The FCA is also considering whether regulated stablecoins should remain categorised as “restricted mass-marketed investments” for the purposes of communicating financial promotions to consumers, or whether recategorisation or the creation of a new tailored category is more appropriate to reflect their regulated status. For more on the cryptoasset financial promotions regime, see our related [briefing](#) and [top tips for compliance](#).

The custody activity

A new regulated activity will be created under the RAO for custody, comprising the safeguarding, safeguarding and administering, or the arranging of safeguarding or safeguarding and administering of UK issued fiat-backed stablecoins (i.e., those issued under the new regulated issuance activity above). Custody of security tokens and commodity-linked tokens will also shift from existing regulation into the scope of this new regulated activity for custody. It is interesting to note here that the cryptoasset custody activity will be broader than the activity for other financial instruments under the MLRs and the FSMA regime for traditional assets, insofar as it will capture safeguarding when carried on without administration.

Custody of fiat-backed stablecoins issued outside of the UK will remain outside scope. However, as is the case for exchange providers, custodian wallet providers – including in relation to overseas stablecoins – will still need to register with the FCA for AML purposes and comply with the MLRs regime.

The FCA is considering using existing custody provisions in CASS as a basis to design bespoke custody requirements for cryptoassets, applying the following core components of the existing regime:

- Adequate arrangements to protect clients’ rights to their cryptoassets. The FCA proposes to permit firms to continue the use of omnibus wallets, provided that ownership rights are preserved at all times. Ownership recording requirements would apply – the FCA would allow an on-chain record of ownership rights where all transactions are undertaken on-chain. The FCA is also considering whether to permit the use of clients’ cryptoassets held under custody, for example to provide staking services, hold cryptoassets as collateral, or in some instances lend them to other clients.
- Adequate organisational arrangements to minimise risk of loss or diminution of clients’ custody assets. Following on from the Treasury’s proposal to take a proportionate approach to cryptoasset custody which may not impose full, uncapped liability on the custodian in the event of a loss that was not within the custodian’s control, the FCA is considering requiring custodians (and sub-custodians, if applicable) to disclose their safeguarding controls and liability if at fault for loss of clients’ cryptoassets explicitly in client agreements.
- Accurate books and records of clients’ custody assets holdings. This may include permitting firms to use on-chain records subject to preserving the accuracy and integrity of the record. The FCA is considering requiring custodians to conduct

reconciliations of each client's cryptoassets on a real-time basis to identify and resolve discrepancies promptly, and to cover shortfalls that arise if discrepancies are not resolved following reconciliations.

- Adequate controls and governance to protect clients' custody asset holdings. Arrangements involving technology providers providing technology infrastructure, specialist expertise or storage facilities to safeguard clients' cryptoassets are likely to be subject to the FCA's proposals on operational resilience requirements. Custodians using sub-custodians will need to comply with requirements relating to the sub-custody arrangement, including among others adequate due diligence. Client disclosures will be required, including possibly Proof of Reserves. The FCA is also considering requiring the appointment of a CASS oversight officer, and the application of audit and monthly reporting requirements.

Significantly, the FCA proposes to require cryptoasset exchanges to operate a separate legal entity for custody-like activities. This would include a separate governance structure for the cryptoasset custodian and the development of a mechanism by which cryptoasset exchanges did not take possession of clients' cryptoassets to prefund trading activities.

While the above deals with custody asset holdings, the FCA is also considering whether to apply the client money rules where a firm holds client money (in fiat currency) that arises in connection with regulated cryptoassets held in custody (for example, where fiat currency is held for the purpose of purchasing regulated cryptoassets on behalf of clients). The FCA also invites views on what role custodians should have in the redemption process.

In Phase 2, the Treasury will expand the custody activity in the RAO to cover the custody of a wider category of cryptoassets coming into the regulatory perimeter. The FCA notes that, although its proposals are focused on Phase 1 regulation, its expectations of firms that provide custody of regulated stablecoins (or the private keys to access them) would likely be the same when they provide custody of other types of cryptoassets that come into regulation in Phase 2.

Organisational requirements, conduct of business and redress

High-level systems and controls requirements (for example, managing conflicts of interest etc.) are expected to apply. Other notable proposed requirements include:

- **Operational resilience:** The FCA is considering applying its existing framework for operational resilience to regulated stablecoin issuers and custodians. This will include strong cyber resilience measures. As noted above, arrangements involving technology providers providing technology infrastructure, specialist expertise or storage facilities to safeguard clients' cryptoassets are likely to be subject to the FCA's proposals on operational resilience requirements.
- **Financial crime:** MLR-registered firms that fall within the scope of the new regime will require full authorisation and will therefore be required to comply with the financial crime requirements under FSMA and the MLRs. In addition to the MLRs, regulated stablecoin issuers and custodians would be expected to establish and maintain effective systems and controls to counter the risks of financial crime. The FCA is also proposing to apply its **financial crime guidance** to regulated stablecoin issuers and custodians. Regulated stablecoin issuers and custodians would be required to appoint a Money Laundering Reporting Officer and to provide annual financial crime reports.
- **Senior Managers and Certification Regime (SMCR):** In the absence of changes to the rules arising from the SMCR Review, the current SMCR rules will apply to regulated stablecoin issuers and custodians. The FCA is considering including further activities under the Certification Functions that are more tailored to regulated stablecoin issuers and custodians – for example, the liquidity management of backing assets held for regulated stablecoins. No modifications are proposed to the application of the Senior Managers Regime and Conduct Rules.
- **Consumer Duty:** Again, the Consumer Duty will apply to issuers and custodians – for example, issuers will need to consider the Consumer Duty in the design and build of their stablecoins. The Consumer Duty will also apply to an issuer or custodian's unregulated ancillary activities. The FCA provides some indications of where this might bite: for example, obligations on firms to disclose details around backing assets would likely require firms to consider the Consumer Duty to ensure there is consumer trust through accurate reporting and the communication of reserves (such as the composition of reserves and redemption of reserves).
- **Conduct of business:** Issuers of regulated stablecoins and custodians are expected to be subject to the rules set out in COBS (rather than the narrower application of BCOBS). In particular, the FCA invites views on the application of the inducements rules and whether the client categorisation rules are suitable for the stablecoin regime. The FCA is also open to feedback on whether it would be more appropriate to create a bespoke conduct of business sourcebook for cryptoassets.

- **Complaints and redress:** Complaints-handling rules will apply. Access to the Financial Ombudsman Service (FOS) will be available in relation to the business of regulated stablecoin issuers and custodians, although the FCA recognises that based on current market practices, consumers are unlikely to have a direct relationship with a regulated stablecoin issuer.
- **Compensation:** The FCA does not propose to extend Financial Services Compensation Scheme (FSCS) cover to regulated stablecoin issuers or custodians. However, that will not affect the existing position that FSCS protection already applies in the indirect circumstance of a secondary pooling event where a UK bank or an authorised custodian holding the backing assets of a regulated stablecoin issuer fails. In these circumstances, the bank or authorised custodian will be undertaking traditional financial services, where FSCS cover already applies, and will fall outside the scope of the proposed stablecoin regime.

Prudential requirements

The FCA intends to create a new prudential sourcebook (with the working title CRYPTOPRU), inspired by the Investment Firms Prudential Regime (IFPR), for a new prudential regime for regulated stablecoin issuers and custodians. This is likely to consist of a permanent minimum requirement (PMR), a fixed overhead requirement (FOR), and an activity-based 'K-factor' requirement (KFR). For group risk, the FCA proposes to apply the IFPR's Group Capital Test rather than prudential consolidation. The IFPR's concentration risk requirements are also expected to map over to the CRYPTOPRU regime. Minimum liquidity requirements will apply. The FCA is considering whether to oblige firms to conduct an individual capital adequacy and risk assessment (ICARA) process on an ongoing basis.

The FCA expects that regulated stablecoin issuers and custodians will need to publish their prudential disclosures on a dedicated part of their website which is easily accessible (or made freely available if there is no website).

Payments

The use of fiat-backed stablecoins in payment chains will be regulated through amendments to the payment services regime in the PSRs. Amendments will bring into regulation payment chains for:

- Mixed stablecoin payments – where the on-ramp to the payment chain is from a stablecoin, but it is converted to fiat by the payment service provider (PSP) within the payment chain, and the off-ramp is in fiat (or vice versa). The FCA calls this the "hybrid model". The payment processing itself is regulated as a payment service under the PSRs, but the 'add-on' functionality of linking this to a purchase or sale of cryptoassets including stablecoins is not.
- Pure stablecoin payments – where both the on-ramp and off-ramp in the payment chain are in stablecoin and the transfer of value occurs in stablecoin. The FCA calls this the "pure stablecoin model".

These activities will cover payments including those relating to purchasing a service or good in a retail payment in shops or online. The regime will not cover:

- Peer-to-peer stablecoin transfers where the payment service underpinning or facilitating the transfer is not offered on a commercial basis.
- The purchase of stablecoin using fiat currency (which is already regulated under the PSRs).

The Treasury is exploring whether firms offering these payment services will need new permissions under the PSRs for one or more of the new payment models noted above. The FCA refers to firms providing these services as payment arrangers. The Treasury also proposes to bring ancillary crypto-related activities (such as the exchange of stablecoin to fiat in the hybrid model) into scope of the PSRs as payment services. The FCA refers to these new payment services as "ancillary stablecoin payment services".

Geographically, the payment chain activities will include:

- Payment transactions involving UK consumers, where at least one end of the transaction is in the UK; or
- UK firms facilitating payment transactions, regardless of whether the transaction takes place in the UK.

The intention is that the payments regulatory regime would cover the use of fiat-backed stablecoin issued in or from the UK under the new RAO issuance activity.

The FCA's proposed regulatory requirements include:

- In general, the existing conduct rules for PSPs in the PSRs should apply for both the new pure stablecoin payments activities, and to the ancillary stablecoin payment service activities being brought into the scope of the PSRs for hybrid payment models.

As with existing PSPs, payment arrangers are expected to be subject to the FCA Principles, including the Consumer Duty. Note that many of the firm facing requirements in the PSRs are expected to move into the FCA rulebook as a result of the Smarter Regulatory Framework and the restatement and repeal of the PSRs. In the meantime, the FCA may issue guidance on how the provisions in the PSRs will apply to payment arrangers.

- Custody arrangements are likely to arise in hybrid payment services, and may also arise in pure stablecoin payment services where payment firms intermediate payments in stablecoins. Where this occurs, the FCA expects that the same requirements set out above relating to custody will apply to them.
- The MLRs apply to payment services regulated under the PSRs and are likely to apply to pure and hybrid stablecoin payment services.
- Operational and prudential resilience requirements similar to those set out above are likely to apply to payment arrangers.
- PSPs coming into scope of the new ancillary and pure stablecoin payment service activities would need to comply with complaints handling requirements, and consumers of payment arrangers would have access to the FOS.
- FSCS cover will not be applied to payments using stablecoins. The FCA cannot extend FSCS protection to activities that are not in the RAO – for example, electronic money or payment services which are activities in the PSRs. This means that FSCS cover could not be applied to firms facilitating payments using fiat-backed stablecoins, as these activities will be regulated through amendments to the PSRs and not the RAO.

Overseas stablecoins used for payment in the UK

There is also work ongoing to open UK payment chains to overseas fiat-backed stablecoins through regulation of different entities within the payment chain, in order to ensure adherence to regulatory standards. In order to do this, the Treasury intends to explore the workability of an approach whereby the payment arranger is authorised by the FCA and is responsible for ensuring the overseas stablecoin used by it in a payment chain meets FCA standards for use in UK payments. Under this potential approach, the FCA will be empowered to take action against payment arrangers where the regulator believes they have not undertaken adequate checks against its standards for stablecoins.

The FCA's discussion paper explores this proposed approach further. In this scenario, the payment arranger would have to assess and approve any overseas stablecoin to be used as a means of payment in the UK before the overseas stablecoin can be used in UK payment chains. To undertake this assessment, firms would need a further permission under the PSRs (in effect, an additional gateway). This would be in addition to any authorisation they require to carry on any other regulated activities, including other stablecoin-related payment services in the UK. All payment arrangers would need to meet all standards set out in the PSRs as well as, where relevant, have the skills, expertise, knowledge and relevant experience to assess and approve overseas stablecoins before the FCA would authorise them to act in this capacity.

In order for overseas stablecoins to be assessed, overseas issuers will need to provide all relevant information to payment arrangers, on an ongoing basis, for their stablecoins to be used for payments in the UK (without themselves being established and authorised in the UK as an issuer). Similar to the requirements for regulated stablecoin issuers, the FCA would also expect these issuers to publish, and regularly update, key information about their stablecoin - the payment arranger would need to take account of this during their assessment. Payment arrangers will be required to appoint an independent third party (such as an auditor) to verify certain elements of their assessment. The FOS would also be available in circumstances where a payment arranger did not conduct adequate due diligence in relation to an overseas stablecoin.

Overseas stablecoins introduced to the UK payment chain would need to be monitored by the payment arranger on a weekly basis to ensure they remain compliant with the required standards. The FCA is considering whether any further requirements, e.g. reporting and disclosures, should be made, as well as what requirements should apply to manage risks when an approved stablecoin ceases to be compliant.

The FCA anticipates that the liability requirements in the PSRs for misdirected or failed payment transactions would apply where the reason for failure is outside the control of the payment arranger and rests with the issuer of an overseas stablecoin (for example, failure to redeem at par). However, payment service users would not have a claim against the payment arranger for loss of value of the relevant stablecoin during the payment transaction (or while it was held in custody with the PSP for the purposes of executing payment transactions).

Firms seeking permission as payment arrangers to assess and approve overseas stablecoins will need to be aware of the potential liability risks noted above, including that there could be recourse to the FOS.

Regulation of systemic DSA payment systems and service providers

In addition to the FCA's regulatory regime, the BoE is empowered under Part 5 of the Banking Act 2009 to regulate recognised systemic DSA payment systems and service providers. The Payment Systems Regulator has similar powers in relation to the regulation of designated DSA payment systems for competition purposes.

The BoE's remit is drawn more widely in some respects than the FCA's regulatory regime: it will include payment systems and service providers using stablecoins issued both in or from the UK or issued overseas, and will cover a wider category of payments (including those on exchanges) to that proposed for the FCA under the PSRs above. The BoE will act as the lead prudential regulator for dual-regulated recognised firms. Dual regulation may also apply to service providers such as custodians and exchanges (and issuers if separate from the firm recognised as the payment system operator), which may be systemic in their own right or provide essential services to systemic payment systems using stablecoins or recognised stablecoin service providers. Service providers may also be captured by the proposed regulatory regime for **critical third-parties**.

The BoE's discussion paper includes proposals on the choice and management of backing assets, capital and shortfall reserves requirements, UK presence requirements, and limit requirements. It also includes requirements around the use of ledgers and the standards that intermediaries (including custodial wallets) in systemic stablecoin payment chains should meet. Key points include:

- The BoE's current assessment is that sterling-denominated stablecoins that are intended to be used widely for retail payments in the UK would likely be recognised as systemically important, and that non-sterling stablecoins are unlikely to become widely used for retail payments.
- Systemic payment systems using stablecoins would need to focus particular attention on certain aspects of their governance and risk-management arrangements to address the risks posed by vertical integration. This may include legally separating the non-stablecoin services that a multi-function entity provides. In particular, the BoE may require the issuer to form a legal entity that is sufficiently financially, operationally, and organisationally separate from other entities in the wider group, so that it is bankruptcy-remote.
- Issuers of systemic payment stablecoins will be required to establish UK subsidiaries in order to carry out business and issuance activities into the UK and with UK-based consumers, both directly and through intermediaries. The backing assets and the issuer's capital will also need to be held in the UK.
- Systemic stablecoin issuers must ensure that they can be exchanged at par for other forms of money, including a digital pound (if introduced), on demand. Issuers will need to process redemption requests by the end of the day on which a valid redemption request is made, and in real time wherever possible.
- Systemic stablecoins will be required to be backed by central bank deposits, whereas a deposit account with the BoE will not be available to non-systemic stablecoin issuers. Issuers will not be permitted to receive interest on their central bank deposits or pay interest to coinholders.
- The safeguarding regime would be centred on two key features: (a) statutory trust, where the backing assets are held for the benefit of coinholders (aligned with the FCA's proposals); and (b) safeguarding rules. The rules will govern the segregation of backing assets, reconciliations, organisational controls, and reporting. While the BoE is considering its position on treasury wallets, its current view is that issuers should be required to comply with safeguarding rules so as to fully back all stablecoins held in treasury wallets (also aligned with the FCA's proposals).
- Additional capital requirements will apply.
- Holding limits are likely to apply, at least during a transition. The BoE expects that any limits would be set at a relatively low level initially. Any stablecoin limits would be set at a level that is consistent with, and no higher than, those set for the digital pound, if introduced – the Treasury and the BoE recently **consulted** on an individual holding limit of digital pounds between GBP 10,000 and GBP 20,000, and sought views on a lower limit, such as GBP 5,000.
- The BoE does not expect to regulate custodial wallets directly – instead, it intends to rely on the FCA's regulatory regime for stablecoin custodians to mitigate their risks, but could also apply its own requirements directly to a custodian, if recognised as a service provider. The BoE is concerned about the money laundering risks presented by unhosted wallets operating at scale, and is still exploring their suitability to be used at systemic scale for payments in the UK in the way that they currently operate.
- The BoE will regulate exchanges providing custody services against its proposed requirements for custodians, if recognised by the Treasury. Exchanges that perform trading activities for speculative purposes are expected to be beyond the BoE's remit for systemic payments systems.

Managing failure

For non-systemic stablecoin issuer, custodian or payment arranger failure, the Treasury confirms that the standard corporate insolvency procedures under the Insolvency Act 1986 will continue to be available. The FCA is considering applying (and adapting as necessary) the primary and secondary pooling events (PPE and SPE) to stablecoin backing assets. The FCA is also considering including rules on triggering a PPE when there is a critical failure of the technology underpinning the regulated stablecoin (for example, a blockchain or another distributed ledger).

The FCA proposes to apply distribution (and transfer) provisions to regulated stablecoin backing assets in the event of firm failure which are similar to those applying to traditional finance, with modifications to take into account that a regulated stablecoin issuer will likely not know, or have access to records that identify, all the current holders of the coin, but rather only the wallet address that the coin is stored in. The FCA does not propose to prevent post-failure secondary trading, but may consider this further as part of issuance and disclosure requirements in the future regulated cryptoasset regime.

For the failure of a custodian, the FCA anticipates that its existing approach in CASS to the treatment of custody assets post-failure should be applicable.

For systemic DSA firms, the Treasury has confirmed (in its [policy statement](#) of the failure of systemic DSA firms) that it will appoint the Financial Market Infrastructure Special Administration Regime (FMI SAR), with necessary modifications, as the primary failure regime. The Treasury intends to establish an additional objective for the FMI SAR as it applies to DSA firms, focused on the return or transfer of client assets. Further secondary legislation will outline the procedural insolvency rules and processes by which return of customer funds and custody assets will be handled.

PRA Dear CEO Letter to banks

Alongside the Treasury policy statements and discussion papers issued by the regulators, the PRA has also published a [Dear CEO Letter](#) to UK banks on innovative uses of deposits, e-money and stablecoins. The letter provides that, to avoid contagion and confusion, banks should ensure that they only provide innovations in digital money to retail customers in the form of deposits (which are protected by deposit insurance). The letter also sets out that if a bank wishes to issue e-money or stablecoins to retail customers, this should be done from a separate non-bank insolvency-remote entity, with distinct branding to the bank and adequate legal structure to ensure its failure would not adversely affect the rest of the banking group. That entity would then be regulated under the regimes for stablecoins or e-money but would also be subject to the PRA's existing banking regulation as applied at consolidated-group level.

Next steps

Again, the Treasury intends to bring forward secondary legislation on Phase 1 regulation by early 2024, subject to available parliamentary time. No specific timing is provided for the secondary legislation relating to the failure of systemic DSA firms. Whilst the regulators indicate in their roadmap that implementation of the regime is anticipated to take place in 2025, no details have been provided on any implementation periods which may apply. However, with the release of the regulators' discussion papers and the opportunity to shape future regulation, industry participants should ensure that they engage with the consultations.

More broadly, whilst the Treasury's update provides clarifying details on its evolving approach to the mechanics of stablecoin regulation, much of the detailed requirements on scope and operationalisation have been left to secondary legislation and rules issued by the regulators, which have just begun their consultative processes. Although the release of these papers is an important milestone, there is still a considerable period of consultation to be completed before the regime's requirements are finalised – this still has some distance to run before the final details are set.

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