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*Ahead of the Curve:
Stablecoin Stocking
Fillers – a new licensing
regime and systemic
payment chain oversight*

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Introducing



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Ahead of the Curve: Proposals to bring fiat-backed stablecoin activities within the UK regulatory perimeter and for oversight of systemic DSA payment systems

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03 FCA Discussion Paper DP23/4

04 Oversight of systemic payment systems using stablecoins

05 PRA Dear CEO letter



The Financial Services Regulatory Initiative Forum Pipeline

Regulatory Initiatives Grid

- Seventh edition, planned regulatory initiatives for the next 24 months
- New Smarter Regulatory Framework section
- To remain biannual but Forum will provide updates between editions, where appropriate



New Statutory Instruments

| Tranche | SI | Policy intent | Accompanying regulator policy |
|---------|--|---|---|
| 1 | Draft Data Reporting Services Regulations 2023 | <ul style="list-style-type: none">– Replace REUL in relation to data reporting services providers (DRSPs) and establish a new legislative framework for the regulation of DRSPs– Seeks to encourage the emergence of a consolidated tape in the UK | FCA consultation on consolidated tape published July 2023. Policy statement anticipated in Q4 2023 |
| 1 | Draft The Public Offers and Admissions to Trading Regulations 2023 | <ul style="list-style-type: none">– Replace REUL relating to the prospectus regime and create a UK framework for public offers and admissions to trading | FCA feedback on engagement papers anticipated Q4 2023 FCA anticipates consulting on rules in summer 2024 |
| 1 | Draft The Securitisation Regulations 2023 | <ul style="list-style-type: none">– Replace REUL relating to securitisation framework | PRA consultation published July 2023 FCA consultation published August 2023 |

- The Financial Services and Markets Act 2023 (Resolution of Central Counterparties: Partial Property Transfers and Safeguarding of Protected Arrangements) Regulations 2023
- The Resolution of Central Counterparties (Modified Application of Corporate Law and Consequential Amendments) Regulations 2023

New Statutory Instruments (2)

| Tranche | SI | Policy intent | Accompanying regulator policy |
|---------|---|---|---|
| 2 | Draft Short Selling Regulations 2024 | <ul style="list-style-type: none">– Replace REUL related to short selling and create a new regulatory framework for short selling– Define and set out the Designated Activity of short selling of shares and related instruments– Provide FCA with related rule-making powers to specify firm facing requirements– Removes the requirements placed on investors when taking out short positions in sovereign debt or credit default swaps and the related reporting requirements, but the FCA's emergency intervention powers for short selling of these products will be retained | FCA to consult in Q1 2024 |
| 2 | Short Selling (Notification Threshold) Regulations 2023 | <ul style="list-style-type: none">– Increase the notification threshold for the reporting of net short positions to the FCA from 0.1% to 0.2% of total issued share capital | |
| 2 | Draft Consumer Composite Investments (Designated Activities) Regulations 2024 | <ul style="list-style-type: none">– New UK retail disclosure framework for consumer composite investments to replace PRIIPs | FCA consultation paper 'forthcoming' (2024) |
| 2 | Draft Money Market Funds Regulations 2024 | <ul style="list-style-type: none">– Restates provisions of the MMF Regulation, in some cases with modifications. The restated provisions were revoked by FSMA 2023. Most other provisions relating to MMFs are restated (where appropriate with modifications) in FCA rules | FCA consultation published December 2023 |

Future of Payments Review: July-November 2023

The review found that while the UK is in a good position today, the future is less certain.

National Payments Vision and Strategy

- The **primary recommendation**: a strategy to bring clarity to the Government’s future desired outcomes of UK payments, with a key objective to simplify the current landscape

Consumer Experience

- Move SCA requirements away from prescriptive technical standards and towards an outcomes-based approach overseen by the FCA



Open Banking

- Create a consumer dispute resolution process
- Prioritise agreement on a commercial model to address misalignment of costs and benefits
- Improve person-person bank transfer journey and develop Open Banking alternative payment journey

Improving regulatory oversight and alignment

- PSR to review new APP fraud rules 12 months after implementation
- Review whether current application of regulatory requirements to FinTechs is clear and appropriate

CBDC and BigTech

Central Bank Digital Currency

House of Commons Treasury Committee report on the digital pound

December 2023 Committee views on the need for a digital pound (that is, for a retail central bank digital currency in the UK)

- Benefits – could support innovation and international competitiveness
- Risks – could take time to fully understand the impact on financial stability and wider economy
- May accelerate the demise of physical cash
- Privacy safeguards vital

BigTech

FCA call for input and Online Fraud Charter

November 2023 FCA published a call for input on potential competition impacts from the data asymmetry between Big Tech and firms in financial services

Follows the FCA's discussion paper and feedback statement on the competition impacts of Big Tech in four retail sectors: payments, deposit taking, consumer credit and insurance

The FCA invites responses by 22 January 2024. It intends to report back in Q2 2024

November 2023 Voluntary Online Fraud Charter. Commitment from 11 largest tech companies

Pensions scheme, investment firm and commodity markets updates



Pensions

- FCA statement on next steps in value for money work (DC schemes)
- Government response to report on DB pension schemes with LDI



Investment Firm Regulation

- Alternative Investment Fund Designation Bill 2023-24
- IA interim report on UK fund tokenisation
- FCA consultation paper on implementing the overseas fund regime



Wholesale Markets Review

- FCA consultation on reforming the commodity derivatives regulatory framework





FCA expectations around ESG claims



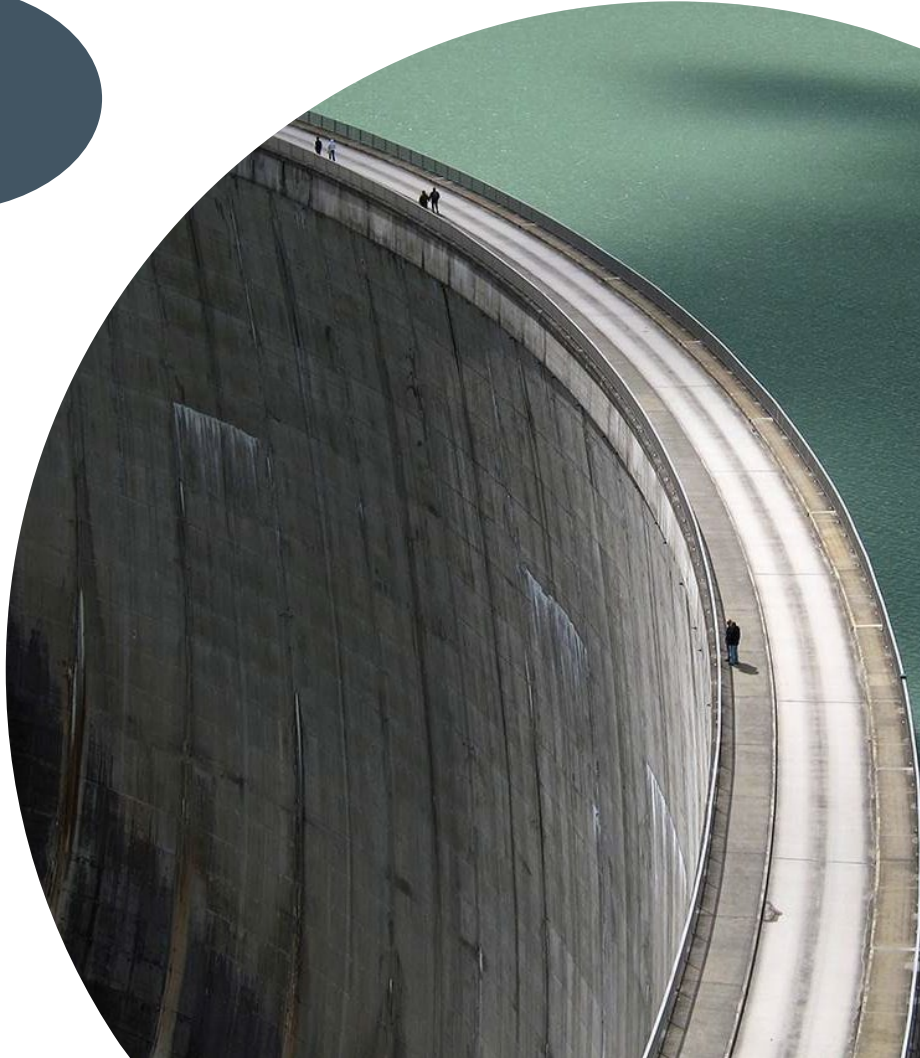
– FCA policy statement on sustainability disclosure requirements and investment labels



– FCA consultation on proposed guidance relating to its new anti-greenwashing rule



– FCA multi-firm review into authorised fund managers compliance with regulatory requirements and expectations on the design, delivery and disclosure of ESG and sustainable investment funds



Prudential updates and framework SIs

01

PRA-FCA joint consultation on prudential assessment of acquisitions and increases in control

03

FCA-PRA joint policy statement on remuneration and enhancing proportionality for small firms

05

Draft Financial Services and Markets Act 2000 (The Ombudsman Scheme) Regulations 2024

07

The Financial Services and Markets Act 2023 (Panel Remuneration and Reports) Regulations 2023

02

PRA policy statement on scope, criteria, liquidity and disclosure requirements under the strong and simple framework

04

PRA consultation paper on the identification and management of step-in risk, shadow banking entities and groups of connected clients

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Legislative approach – Regulation of fiat-backed stablecoins (1)

01

In January 2021, HM Treasury (**HMT**) published its consultation on the UK regulatory approach to cryptoassets and stablecoins, together with a call for evidence on distributed ledger technology in financial markets

02

HMT's consultation response was published in April 2022, confirming the government's plans to legislate to bring certain activities relating to stablecoins into the regulatory perimeter for financial services

03

HMT published its "Update on Plans for the Regulation of Fiat-backed Stablecoins" on 30 October 2023, setting out the government's plan to regulate certain activities relating to fiat-backed stablecoins (**phase 1** of the government's proposals for a wider Financial Services Regulatory Regime for Cryptoassets)

“The regulatory landscape will bring certain (fiat-backed) stablecoins within the remit of the Bank of England, Financial Conduct Authority (FCA) and Payment Systems Regulator (PSR), which altogether will aim to minimise potential for customer harm and mitigate the conduct, prudential, and financial stability risks arising from those stablecoins, particularly when used for payments.”

Legislative approach – Regulation of fiat-backed stablecoins

(2)

1

Use of fiat-backed stablecoins (**FBSCs**) in payment chains will be regulated through amendments to the Payment Services Regulations 2017 (**PSRs 2017**)

2

Activities of issuance and custody of FBSCs where the coin is issued in or from the UK will be brought within the regulatory perimeter of the Financial Services and Markets Act 2000 (**FSMA 2000**) through the Regulated Activities Order (**RAO**)

3

Government has already started to implement this regime through the Financial Services and Markets Act 2023 (**FSMA 2023**)

4

FSMA 2023 also provides the Bank of England (**BoE**) and Payment Systems Regulator (**PSR**) with powers over systemic and recognised digital settlement asset (**DSA**) payment systems and service providers, subject to HMT's recognition and designation

“Stablecoins can enhance digital retail payments in the UK. With this comes the need to make sure there is robust and clear regulation in place. Our proposals aim to support safe innovation so that firms can understand the risks they need to manage and ensure that the public can be confident in all forms of digital money and payments.”

Sarah Breeden, Deputy Governor for Financial Stability, Bank of England

What FBSC activities will fall within scope of “Phase 1”?

| FBSCs to be narrowly defined in secondary legislation | Issuance and custody of FBSCs and “arranging” payments in Overseas FBSCs | Use of a UK or Overseas FBSC “within a payment chain” |
|---|--|--|
| <p>HMT expects to define FBSCs as a <i>“cryptoasset that seeks or purports to maintain a stable value by reference to a fiat currency and by holding fiat currency, in whole or in part, as backing”</i></p> <p>Includes those FBSCs:</p> <ul style="list-style-type: none"> – referencing any fiat currency – referencing a basket of currencies <p>Does not include:</p> <ul style="list-style-type: none"> – algorithmic / crypto-backed stablecoins – commodity-linked tokens <p>Tokenised deposits and electronic money to be defined more clearly in legislation to ensure “legal separation”</p> | <p>RAO to be extended to make regulated activities:</p> <ul style="list-style-type: none"> – issuance of FBSCs in or from the UK – custody of UK issued FBSCs, <i>i.e.</i> <ul style="list-style-type: none"> – safeguarding – safeguarding and administering – arranging of safeguarding and administering <p><u>Note:</u> Custody regime does not include custody of FBSCs issued outside the UK (“Overseas FBSCs”)</p> <p><u>Under discussion:</u> For Overseas FBSCs, any firm “initiating” or “arranging” payment(s) in Overseas FBSCs would need to be FCA authorised</p> | <p>PSRs 2017 to be amended to bring into regulation payment chains for:</p> <ul style="list-style-type: none"> – “mixed stablecoin payments” – “pure stablecoin payments” <p>Does not include:</p> <ul style="list-style-type: none"> – “[P2P] <i>stablecoin transfers where [the underlying payment service] is not offered on a commercial basis</i>” – the purchase of a stablecoin using fiat currency <p>“Arrangers” of Overseas FBSC payments:</p> <ul style="list-style-type: none"> – ensure an Overseas FBSC meets FCA standards – collect and report on the number of Overseas FBSC payment transactions |

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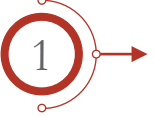


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FCA's regime

FCA Discussion Paper DP23/4 – Regulating cryptoassets Phase 1: Stablecoins (6 November 2023)

-  1 Sets out the FCA's proposed approach to regulating:
 - a. Issuance of a FBSC by a UK issuer
 - b. Custody of a UK issued FBSC by a UK custodian [Note: Overseas FBSCs “will not be captured under this regulated activity under the RAO”]
 - c. FBSC as a means of payment (whether issued by UK or overseas issuer)
 - by a UK firm or involving a UK consumer (including by non-UK firms)Does not cover exchanges of crypto for FBSCs (this comes in phase 2)
-  2 Discusses scope issues and operational requirements
-  3 Deadline for comments is 6 February 2024

Requirements for issuers

Safeguarding – Issuers will need to:

- Segregate backing assets from their own assets
- Hold backing assets on statutory trust
- Maintain accurate books and records
- Perform daily valuations of backing assets and at least daily reconciliations

Remuneration – Income and returns from backing assets:

- Can be retained by issuers
- Cannot be passed on to consumers

Backing assets – Issuers will need to:

- Hold backing assets that are:
 - Stable in value
 - Sufficiently liquid to support redemptions
 - Sufficient to back all issued stablecoins
- “Top-up” shortfalls in backing assets from own resources within one business day

Redemption – Issuers will need to:

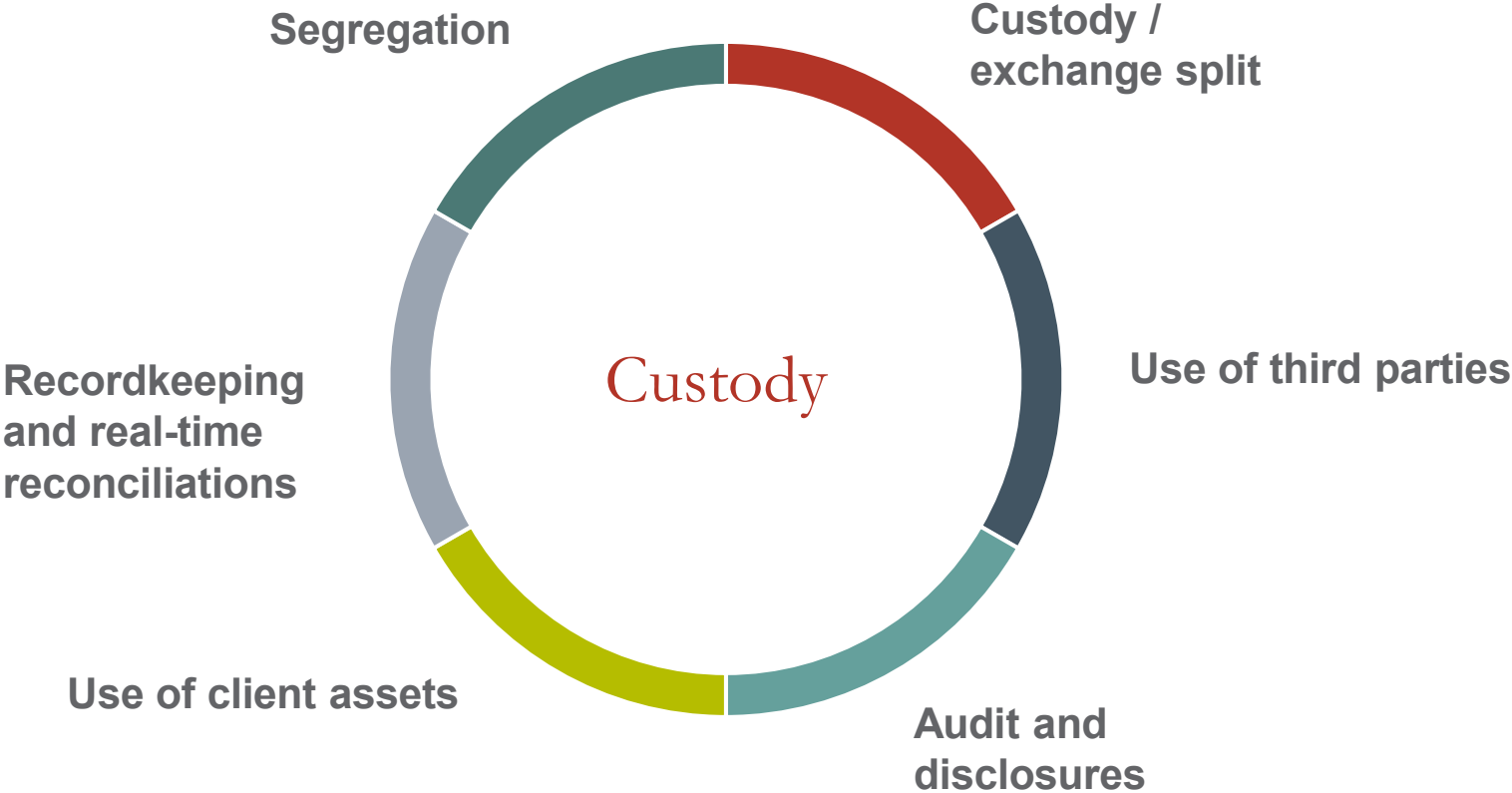
- Accept redemption requests from *any* holder (including consumers)
- Redeem at par by the end of the next UK business day following a redemption request
 - Clock starts once KYC information provided
 - FCA may have powers to temporarily suspend redemption rights

Independent custodian?

- FCA seeking views on whether issuers must appoint an independent custodian to safeguard backing assets

Custody requirements

Rules modelled on CASS and likely to apply to all cryptoassets in phase 2



Other requirements for issuers and custodians



Regulating payments using stablecoins

01 Scope of PSRs 2017 to be extended to capture two types of stablecoins used for payment

02 **The hybrid model** – envisages that a stablecoin would be used at the entrance or exit of an existing fiat payment chain, but the actual transfer of value would be in fiat by way of a traditional payment service

03 **The pure stablecoin model** – envisages that both the payer and payee transact in stablecoin, and the transfer of stablecoins between them occurs “on-chain”

04 Payment providers (in both models) would require authorisation and be subject to the conduct rules, capital requirements and safeguarding requirements under the PSRs 2017

Overseas stablecoins used for payment in UK

- FCA discusses HMT’s idea of allowing overseas stablecoins access to UK payment chains
- Looks at whether overseas stablecoins should be assessed and approved by a “payment arranger” against a set of FCA standards equivalent to those required for fiat-backed stablecoins issued in the UK
- “Payment arrangers” would need to be authorised under the PSRs 2017 and have FCA approval
- FCA proposes that “payment arrangers” will be required to:
 - Appoint an independent third party (such as an auditor) to verify certain elements of their assessment
 - These third-party assessments should be made on a regular basis



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Re-cap on existing regime for systemic payment systems oversight






| Regulator | Legal Source | Application | Purpose |
|---------------------------|--|--|--|
| Bank of England | Banking Act 2009, Part 5 | Payment Systems and Service Providers to payment systems recognised by HMT | <ul style="list-style-type: none"> – Oversight of recognised systems and service providers to such systems against the CPMI-IOSCO Principles for Financial Market Infrastructure (PFMI) in furtherance of the BoE’s objective to protect and enhance financial stability – Power to give directions |
| Payment Systems Regulator | Financial Services and Banking Reform Act 2013 | Payment systems designated by HMT | <ul style="list-style-type: none"> – Oversight of designated payment systems for competitor and innovation purposes – Power to give general directions, including to participants in designated payment systems, and specific directions |

In addition, the PRA and the FCA have roles in connection with regulation of Participants in Payment Systems

BoE's proposed regime - Scope

 BoE Discussion Paper on the Regulatory regime for systemic payment systems using stablecoins and related service providers (6 November 2023)

See also the Cross-Authority Roadmap on Innovation in Payments

-  FSMA 2023 expands the BoE's powers over payment systems in Part 5 of the Banking Act 2009 to include (i) payment systems using new forms of digital money, referred to as digital settlement assets (**DSAs**), and (ii) service providers to such payment systems (**DSA Service Providers**)
-  Regime applies to payment systems that use stablecoins as the DSA and which are recognised by HMT as systemic. BoE focus is on such systems as are “widely used and that may pose risk to financial stability”
-  Regime focuses on systems for sterling-denominated stablecoins and retail uses of such systems. The BoE expects that stablecoins used in systemic payment systems will be backed by sterling denominated assets, with coins redeemable at par in that currency
-  PSR will play its competition and innovation focused role
-  Activities other than payments, such as lending or investment services, are not captured by these proposals, as they pose risks that are better captured within other regulatory regimes

BoE's proposed regulatory framework

01

Requirements will be consistent with recommendations, standards and guidance by international standard-setting bodies and the Financial Stability Board. In particular, the BoE will apply the PFMI, although further guidance may be needed around application of the PFMI in the stablecoins context

02

BoE will regulate the entity identified (and recognised by HMT) as the **payment system operator** *i.e.* the entity responsible for the robust operation of the transfer function

03

In view of its powers regarding DSA Service Providers, BoE will be able to regulate “any critical entity” in a systemic stablecoin payment chain, if recognised by HMT, in the light of the activity performed and the risks posed. The BoE considers that this could extend to certain payment service providers, such as wallet providers

04

BoE is examining potential risks around the resilience of systemic payment systems using stablecoins involving entities that undertake multiple functions and is considering how to mitigate these risks, including via legal separation of activities, if appropriate

Requirements of BoE's proposed regime

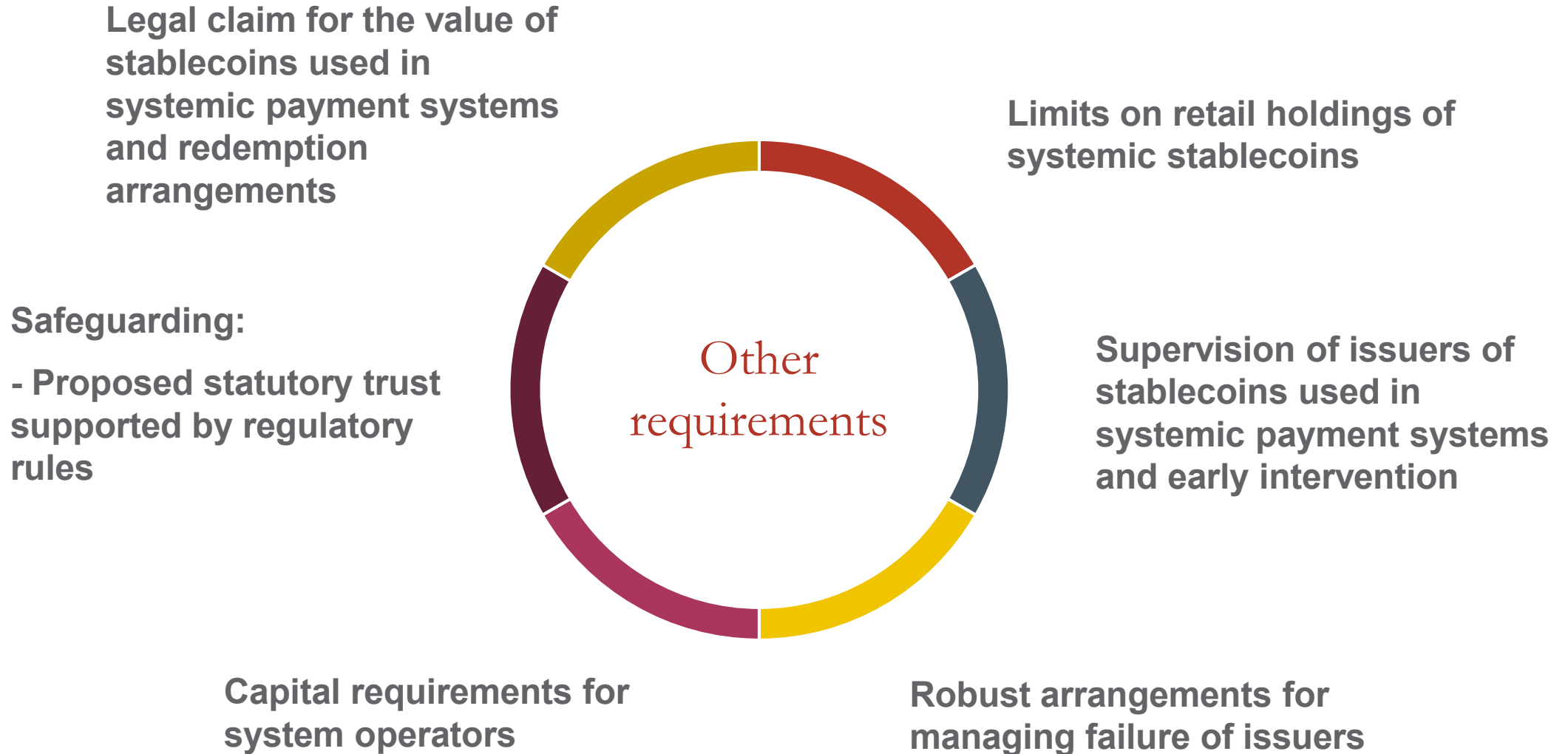
Transfer function

- Systemic payment systems using stablecoins will need to determine **an entity** that should be held **responsible** for the **safe and proper operation of the transfer function**
- BoE's approach to regulating systemic payment systems using stablecoins will aim to ensure that they deliver **end-to-end financial and operational resilience**
- Requirements for systemic payment systems using stablecoins should reflect their similarities with other payment systems, while accounting for their innovative nature
- **Ledgers** are critical to performing the transfer function in stablecoin payment chains
- Particular issues arise in the context of leveraging the benefits from, and addressing the risks of, innovative forms of ledgers, including public permissionless ledgers

Backing assets and restrictions on remuneration for the issuance of stablecoins used in systemic payment systems

- Requirements on backing assets and restrictions on remuneration need to ensure that stablecoins used in systemic payment systems are **always stable in value**
- **Backing assets:** BoE's preferred option is for systemic stablecoin issuers to back the stablecoins in issue fully with central bank deposits
- **Remuneration:** In line with the principle that stablecoins used in systemic payment systems should be primarily used for payments, the BoE proposes that **issuers should not receive interest on their central bank deposits or pay interest to coinholders**

Other requirements for the issuance of money used in systemic payment systems



Requirements for wallet providers



Wallet providers

- Possible BoE oversight as DSA Service Providers
- Wallet providers will need to ensure that coinholders' legal rights and ability to redeem the stablecoins at par in fiat are always protected



Custodial wallets

- FCA is developing a regime for the custody of stablecoins
- BoE does not expect to regulate stablecoin custodians directly
- BoE will seek assurances from the firms within its supervision
- BoE may, however, consider that a custodial wallet provider warrants recognition by HMT as a service provider



Unhosted wallets

- FCA's proposed regulatory regime for stablecoin issuers will require issuers to carry out customer anti-money laundering checks, including when redemption requests are received from unhosted wallet owners
- Additional checks may not be sufficient to ensure the integrity of day-to-day payments and transfers
- BoE is still exploring the risks associated with unhosted wallets

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PRA Dear CEO letter

 Dear CEO letter: Innovations in the use by deposit-takers of deposits, e-money and regulated stablecoins(6 November 2023)

-  PRA sets out how it expects deposit-taking institutions to address risks to their customers' safety, and to the soundness of the financial system, while supporting innovation and competition
-  Focus is on the risks that may arise considering the parallel availability of deposits, e-money and (in due course) regulated stablecoins to retail customers
-  PRA notes that these can appear similar to customers, but each come with differing forms of legal protection
-  PRA is concerned that there is a risk of customer confusion, especially retail customers, if deposit-taking entities offer e-money or regulated stablecoins under the same branding as their deposits

Mitigating risks

01

- Deposit-taking entities should only provide innovations in digital money to retail customers in form of deposits (e.g. tokenised deposits)
- If they wish to issue e-money or regulated stablecoins to retail customers, this should be done using separate entities
 - Those separate entities should be distinctly branded, and their failure should not adversely impact on the rest of the group
 - Where deposit-takers have already issued e-money to retail customers, need to engage ASAP with PRA on how will restructure and mitigate contagion risk

02

Where issuer of e-money or regulated stablecoins to retail customers seeks deposit-taking permission, must ASAP transition UK customers to deposits and engage with PRA on their plans to do so

Mitigating risks

03

Where deposit-taker intends to innovate how it takes deposits from retail customers (e.g. tokenised deposits), must:

- Do so in a way that meets PRA rules for eligibility for depositor protection under the Financial Services Compensation Scheme
- Meet single customer view and exclusions view requirements for protected deposits
- Implement strong risk controls, including with regards to management of AML risks, liquidity risks and operational risk and resilience (including third party risk management)
- Have appropriate Board/Senior Manager review and sign off

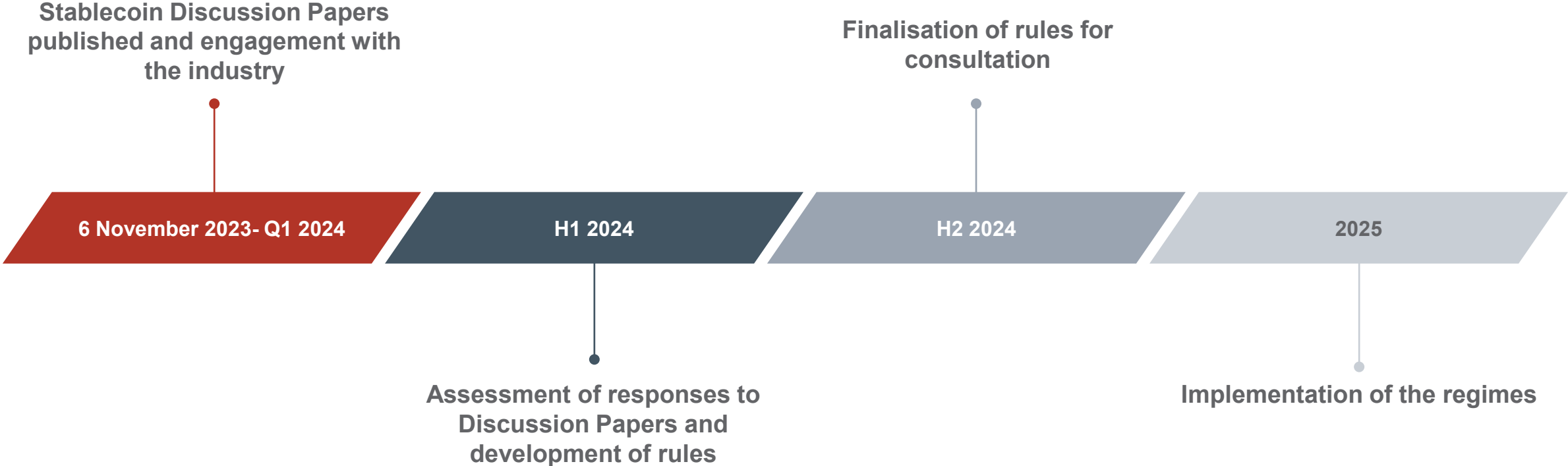
04

PRA reminds firms to keep their supervisor updated about any material developments in their planned innovations in the use of digital money or money-like instruments and how their plans meet the expectations set out in the letter

Next steps



Estimated timeline for regulators' next steps on stablecoins



Questions?

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