

**To:**

F MID Payments Policy Team  
Bank of England  
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London  
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**Date:**

12 February 2024

**Bank of England - Regulatory regime for systemic payment systems using stablecoins and related service providers - Discussion Paper**

Coinbase Global, Inc. with its UK subsidiary CB Payments Ltd. (together, **Coinbase**) welcomes the opportunity to respond to the discussion paper on a regulatory regime for systemic payment systems using stablecoins and related service providers (**Discussion Paper**) published by the Bank of England (**Bank**).

Coinbase started in 2012 with the idea that anyone, anywhere, should be able to send and receive Bitcoin easily and securely. Today, we are publicly listed in the United States and provide a trusted and easy-to-use platform that millions of verified users in over 100 countries rely on to access the crypto economy. We are committed to the UK, where we have a significant presence reflecting its importance as one of our largest international markets outside of the US.

Digital money, in all its forms, has the potential to revolutionise payments, and Coinbase believes that stablecoins will be the next generation of payment instruments. A mixed payments ecosystem that includes a flourishing stablecoin market will deliver many benefits to UK consumers. Key to this is promoting a level playing field for stablecoins to compete with other forms of digital money.

We appreciate the thoughtful approach the Bank is taking to regulating systemic stablecoins, and we stand ready to support it in this important work.

Yours sincerely,



Tom Duff Gordon  
Vice President, International Policy  
Coinbase

## Introduction

We welcome the UK moving towards the implementation of a well-regulated market for fiat backed stablecoins and the Bank's consideration of a regime for systemic payment systems using stablecoins – one that aims to support innovation in money and payments, while maintaining financial stability. We agree that there is the potential for stablecoins to be used widely as a means of payment, and we support bringing them into the regulatory perimeter. We also welcome the UK vision for a “mixed payments ecosystem”, which will drive competition in the payments space and better outcomes for consumers. This is an important objective, and one to which the regulatory approach should align. We believe that, if appropriately and proportionately regulated, stablecoins can preserve financial stability and the singleness of money, promoting consumer confidence in these coins as a means of payment that can be used interchangeably without loss of value with all other forms of money.

According to a report by [Brevan Howard](#), stablecoins settled over \$11 trillion on-chain in 2022. While these numbers are crypto-centric and hard to verify from an economic relevance perspective, the reported magnitudes are remarkable, dwarfing the volumes processed by PayPal at \$1.4 trillion, and almost surpassing the payment volume of Visa (\$11.6tn). Adapting to this innovation, Visa, the largest payments provider, recently enabled settlement with Circle's USDC stablecoin allowing the network to send settlement payouts in USDC and routing these payments in USDC to merchant clients. Moreover, PayPal has launched its own US dollar denominated stablecoin (PYUSD). The movement of traditional payments operators into this market segment is strong evidence of their significant potential.

However, we are concerned that the Bank's approach for systemic stablecoins, when placed alongside the FCA's proposal for non-systemic stablecoins, will not facilitate the mixed payments ecosystem envisioned. A number of the proposed measures have the effect of putting stablecoin issuers and/or systemic payment system operators in a less competitive position with respect to each other and also issuers of other money or money-like assets (namely credit institutions and e-money issuers). Further, the proposed regime for systemic stablecoins would create a huge cliff edge effect, providing disincentives for stablecoins issuers to grow past the systemic threshold because doing so would require a different operational model. No stablecoin under FCA supervision will ever attain wide scale adoption without being required to switch regulatory regimes, and fundamentally overhaul their business and product offering in order to fulfill different regulatory requirements under the Bank's regime. This is, in effect, a cap on innovation and a cap on the growth of stablecoins as a payment mechanism.

In particular, the Discussion Paper proposes an issuance model that does not exist today and closes off critical revenue streams and incentive structures that would otherwise be available for credit institutions and e-money issuers. Other proposals also impose requirements or restrictions on systemic stablecoin issuers or operators of systemic payment systems that

are not applicable to persons responsible for similar functions under regimes which apply to other money or money-like assets. We urge the Bank to reconsider key proposed provisions to ensure that safe innovation supporting new and existing financial activities can occur via stablecoins, and UK consumers can benefit from technological developments that will transform how payments are made for the better.

We provide key observations and raise issues with the Bank's proposals below, and provide fuller responses to specific questions in the sections that follow.

## **Restricting reserve assets to central bank deposit accounts is not necessary**

We strongly urge the Bank to permit issuers to hold backing assets in high-quality liquid assets (**HQLAs**) and in commercial bank deposits. This is permitted with e-money issuers, and it should be permitted here to ensure a level playing field.

The Bank's rationale for requiring backing assets to be held 100% in central bank deposits is to ensure that systemic stablecoins always maintain their par value. We agree that there is no safer reserve asset. However, as evidenced by the e-money and banking regimes, holding assets in commercial bank deposits and HQLAs do not cause e-money or deposits to lose their par value. On the contrary, they remain redeemable at par on request, and interchangeable with cash and each other due to related safeguarding and capital requirements. There is no principled reason why stablecoins would behave differently, and we do not think it is prudent for the Bank to dictate a systemic issuer's revenue model in this way.

## **Issuers should be permitted to receive interest on backing assets**

The Bank should permit issuers to choose a revenue model that earns interest from backing assets. This is permitted with e-money issuers, and it should be permitted here to ensure a level playing field.

By prohibiting issuers to earn interest on backing assets, the Bank is betting on a stablecoin model that doesn't yet exist and stands in contrast to models that are already operational and well-functioning. This determination is being made on the basis that the regulatory regime should only support business models that generate revenue from payment services rather than liquidity and maturity transformation. However, it is possible to hold reserves in short duration, high quality liquid assets that present minimal financial risk without triggering the Bank's concerns, as is the current case with e-money issuers. Moreover, removing this line of revenue is tantamount to picking winners and losers, disadvantaging stablecoins relative to other forms of money by requiring their issuers to pass on higher costs to users.

## Stablecoin issuers should be permitted to pay interest to holders

Following the rationale for permitting issuers to earn interest on reserve assets, we see no inherent reason why holders of stablecoins should not be able to participate in those returns. This would be an unambiguously good outcome for consumers. We understand that prudential regulators have historically taken the view that payment of interest to e-money holders should be prohibited to help consumers distinguish between e-money and bank deposits, and furthermore that the Bank intends for the prohibition of paying interest payments to prevent stablecoins from being used as a means of investment. However, such a prohibition is unnecessary; to the extent that the Bank's concerns may relate to consumer confusion, this can be eliminated through clear disclosures. The only "risk" of stablecoins being held as investments would be the disruption of the current payment system that is deeply rooted in incumbency.

Pursuing a mixed payment ecosystem as the UK intends, if successful, will naturally result in the rebalancing of where assets (and associated liabilities) in the economy are held. We understand that the Bank is concerned about the potential for this leading to large-scale outflows from direct bank deposits. But this need not be a financial stability concern. Using the prohibition of interest payments on stablecoins (and e-money) is a rather draconian way to mitigate financial stability concerns. We believe such risk is better mitigated through capital requirements, which we describe below.

### 'Systemic' classification

The thresholds for systemic classification as contained in the Banking Act do not include quantitative thresholds. This, of course, is a critical determination. If set too low, it would place a drag on innovation. And if not set at all, and left subjective, industry participants will not have the guidance they need to predict when they will become systemic. Non-systemic issuers would be unable to prepare or restructure their businesses, operations, and revenue models in advance of needing to comply with the Bank's requirements instead of the FCA's. Assuming such a transition is even feasible, given the vast differences between the two regimes, to ensure legal certainty, clear, transparent, and predictable thresholds should be introduced for determining the point at which a stablecoin becomes systemic. Although the Bank may not have the power to set thresholds unilaterally, it can provide guidance on what the appropriate quantitative thresholds should be.

The Bank should also provide sufficient runway for issuers to make the transition from one regime to the other. This should be generous to ensure business continuity and considering that robust regulation (by the FCA) will already be in place. Reiterating that we have severe reservations about whether a transition would even be possible, and the regimes impose entirely different reserve requirements, we anticipate that it would take a minimum of 18 months and as long as 36 months to complete a full transition (consistent with our global experience with securing licenses and registrations generally).

A consultation process between HMT, the Bank, and the relevant entity will also be imperative due to the sea change that comes with being classified as systemic.

### **Definition of a systemic payment system that uses stablecoins**

The Bank should clarify that ledgers are not in themselves payment systems. The Discussion Paper states that the “transfer function” in a payment chain is performed by payment systems and suggests that ledgers are payment systems. This characterisation is at odds with the common understanding of a payment system as a set of common rules and procedures for the transfer of funds (or in this case stablecoins), between different parties, involving execution, clearing, and settlement (and record keeping). Ledgers are not in themselves payment systems as they perform a narrow record keeping function rather than the broader transfer function performed by payment systems which involve significantly more activities.

### **Issuing stablecoins on a public permissionless ledger**

We appreciate the Bank’s recognition that both permissioned and permissionless ledgers confer benefits in terms of efficiency and operational resilience, and that systemic stablecoins should be able to be issued using both ledgering methods. Coinbase strongly supports the principle that public, permissionless ledgers can support systemic stablecoins. To that end, we commend the Bank for its openness to the development of technological innovations and legal arrangements that address its concerns.

Like with email and internet protocols that exist today, which are foundational to global business operations, open blockchain record systems will be necessary and critical to global adoption of stablecoins. However, the Discussion Paper sets out the position that no currently existing stablecoin arrangements involving public, permissionless ledgers would meet the Bank’s standards for systemic stablecoins, noting in particular the need for governance arrangements to respond to unforeseen situations and the need for clarity as to the moment when settlement finality is achieved. Although, the Discussion Paper rightly acknowledges that the industry is already working actively on these issues.

We believe that these concerns in these areas are readily addressable with existing technologies and practices. In particular, levels of permission and governance can be built onto public, permissionless ledgers to achieve prudential goals. We note, however, that payment system regulation should be considered as separate and different from stablecoin issuer regulation. This would be consistent with how payment systems regulation and payment service provider regulation are treated separately today. Fit-for-purpose regulation of stablecoin payment chains operating on permissionless ledgers may differ from existing payment systems regulation, given the technological and operational differences, while still adhering to the principle of “same regulatory outcome.”

## **Redemption process**

We agree that there should be no undue restrictions or conditions that would prevent holders from redeeming their systemic stablecoins. However, there are both practical and regulatory reasons (e.g. hours of operation of the banking systems and financial crime controls) that should guide specific redemption conditions and procedures. As such, it will not always be appropriate for redemption to be immediate. However, we do not consider these potential redemption frictions to conflict with the ability of holders to redeem their stablecoins at par value, on demand.

## **Principles for Financial Market Infrastructure (PFMI)-level capital requirements should not apply**

The Bank proposes to apply capital at PFMI levels. The PFMI rules currently apply to financial market infrastructure with significantly greater operational risk, general business risk, and wind-down costs than stablecoin arrangements. We don't rule out that a stablecoin arrangement could in theory in the future be systemically important, but given that stablecoins are designed without leverage (i.e. no credit risk) and opacity (total amounts outstanding are fully observable on chain), the two biggest contributing factors to past financial crises, including the 2008 financial crisis, are absent. Hence, systemic risk would need to be defined in a way that diverges from conventional views and recent history.

For now, under the principle of "same risk, same regulation", we note that the risk profile of a stablecoin issuer more closely resembles that of an e-money issuer, which is not an FMI and therefore not subject to PFMI capital requirements. We believe that the Bank should more carefully consider any future systemic risk treatment for stablecoins as it may not be appropriate to adopt a one-size-fits all approach.

## **Shortfall reserves are not required**

The Bank proposes that systemic issuers hold a shortfall reserve to ensure backing assets are fully available to meet redemption requests. This overcollateralization requirement does not exist under any other UK financial services regulations and is not clear why it should be imposed here to achieve the Bank's objective.

The Bank's proposed restrictions on eligible backing assets (i.e. exclusively central bank reserves) do not entail credit or liquidity risk, making a shortfall reserve unnecessary. In addition, shortfalls should not in the ordinary course occur (interday) due to the requirement to hold backing assets 1:1 and related safeguarding obligations. If (intraday) shortfalls were to occur (e.g. due to a severe market event), it would be sensible to replicate the FCA CASS rules and require issuers to cover this with their proprietary capital, which is already envisioned under the proposed regime, by the end of the day. This should be sufficient to ensure that confidence in the peg is maintained until conditions are restored.

## **Holding limits are not required to mitigate financial stability concerns**

The Bank proposes a holding limit of between £5,000 to £20,000 for individual holders to mitigate risks to financial stability associated with large-scale outflows from bank deposits into stablecoins, as well as to mitigate risks posed by systemic payment systems using stablecoins while they are scaling up. We urge the Bank to remove these limits for the reasons below.

Financial stability concerns are better achieved by ensuring 1:1 reserve backing than through holding limits. As explained above, stablecoin arrangements do not involve leverage or opacity and therefore pose less risk to the financial system than other financial instruments. In particular, there is no run risk if stablecoins holders have confidence that the stablecoin is redeemable at par at all times. Restricting reserves to central bank money, as currently proposed, ensures that there is no safer market instrument. To this end, it may be that the Bank's real concern with financial stability risk relates not to any stablecoin arrangement, but the possibility that stablecoins could exacerbate the fragility of the banking system during a period of stress (e.g., if consumers prefer the safety of non-interest bearing stablecoins over bank deposits and other instruments).

If holding limits are imposed, the Bank should acknowledge that this is not because stablecoins themselves engender a financial stability concern. Just the opposite; they would provide a financial stability backstop to restore consumer confidence during a period of financial uncertainty. If the Bank continues to believe that this may be a financial stability concern for the entire UK financial ecosystem, by encouraging outflows from bank deposits into stablecoins backed by central bank reserves, then the Bank should also recognize that this concern is of its own creation, by proposing a financial instrument that is safer by design than what can be offered by private banks.

With this in mind, we believe that any proposal to impose holding limits is effectively a measure to protect the incumbency of the existing financial system. We further believe that such an imposition would be inconsistent with pursuing a mixed payment ecosystem that, if successful, will (and should) naturally result in a rebalancing of consumer assets, including away from traditional bank deposits. And while this could have knock-on effects, for example, on the availability of private credit due to deposit outflows, these consequences do not justify targeting stablecoins to address the fragilities of traditional banks.

As such, the Bank should eliminate the proposed holding limit for individual holders altogether. If a stablecoin itself is not systemically important, any such limit would only serve to lower its utility as a payment instrument. In particular, the holding limits would introduce frictions that could render the stablecoin a less effective tool for commerce, as tracking and enforcing holding limits is both impractical and unnecessary. Notably, holding limits at the proposed level would constrain the use of stablecoins by SMEs and therefore exclude a key population of users.

## **Unhosted wallets should remain outside of the Bank's regime**

We understand that the Bank is still exploring the risks associated with unhosted wallets and whether they are suitable for use at systemic scale for payments in the UK.

We do not consider the use of unhosted wallets (a.k.a. self-hosted wallets) to be incompatible with transactions in, or holdings of, systemic stablecoins. They are a critical element of the future payments ecosystem. Their availability ensures peer-to-peer value transfer without the need of an intermediary, just like with the use of cash in the existing payments ecosystem. But unlike cash, transfers between unhosted wallets are pseudonymous and not anonymous, meaning that they can be traced back to individuals and entities at regulated on- and off-ramps in the financial system (e.g. at firms like Coinbase that are subject to high levels of regulatory requirements including AML and KYC standards). To this end, they have the ability to increase the safety and soundness of the payments ecosystem.

In addition, permitting peer-to-peer transfers through unhosted wallets will unambiguously benefit consumers by increasing financial inclusion and lower fees. Citizens that are unbanked or underbanked frequently rely on coins and banknotes in the current payments system. Were the Bank to restrict the use of systemic stablecoins to hosted wallets, the resulting frictions would: (a) perpetuate the financial exclusion of certain populations who live and operate on the fringe or outside of the current financial system – those who do not have accounts with existing or future cryptoasset providers or custodian wallet providers; and (b) force UK persons to open hosted wallets and as a result pay service fees which they would not pay were they to use unhosted wallets instead.

Ultimately, the imposition of any hosted wallet restrictions would reduce scope for competition and therefore innovation in meeting different customer preferences.



## Section 2: The Bank's proposed regulatory framework

### **Q4: Do you agree with the Bank's proposed approach to assessing the systemic importance of stablecoins used for payments?**

Part 5 of the Banking Act 2009 (**Banking Act**) sets out the criteria that must be satisfied for HMT to recognise a stablecoin payment system or service provider as "systemic" and therefore within the Bank's regulatory remit.

In summary, for a payment system or service provider to be categorised as "systemic" HMT must be satisfied that deficiencies in the design of a stablecoin payment system, or any disruption of its operation, would be likely to: (a) threaten the stability of, or confidence in, the UK financial system; or (b) have serious consequences for business or other interests throughout the UK, having regard to the likely number, value and nature of transactions carried out on a system and the value of services provided by a service provider.

Without quantitative thresholds the criteria are inappropriately subjective. This means that entities cannot meaningfully predict when they will become systemic and therefore cannot appropriately plan for a transition into a dual-regulatory regime and/or restructure the business, operational, and revenue models. To ensure legal certainty, clear and transparent thresholds must be introduced to help issuers, payment systems, and service providers predict when they approach systemic classification. Although the Bank may not have the power to set systemic thresholds, it can and should provide guidance to suggest what the appropriate quantitative thresholds should be.

It is also unclear whether HMT, when making a systemic assessment of a particular stablecoin, will consider cross-border or overseas transactions, or whether it will consider domestic transactions only, in reaching its determination. Given that the Bank's regime aims to support innovation in UK money and payments, as well as safeguard UK financial stability, only UK transactions should be in scope.

Finally, to the extent that a stablecoin is deemed systemic and required to change its design and supervisory regime, we anticipate that such a transition could take significant time and resources. We envision, based on our own experience working with regulators (albeit in different contexts), that such an endeavour could take 12 to 36 months.

To avoid a cliff-edge scenario, the Bank should introduce a generous transitional period, for example of three years. This is critical as the Bank's proposed requirements would be prohibitively costly, or potentially impossible, for certain issuers to comply with in short order. Given the sea change that comes with being classified systemic, a consultation process between HMT, the Bank, and the relevant entity is also imperative.

**Q5: Do you agree with the Bank’s proposed approach to the regulatory framework for systemic payment stablecoins, as set out in Section 2?**

The Banking Act at section 182(1) defines a “payment system” as “*an arrangement, or proposed arrangement, designed to facilitate or control **the transfer** of money or digital settlement assets*” (our emphasis). The Bank further explains that in a generic stablecoin payment chain, the ‘transfer’ function is one which “**records transactions and transfers the stablecoins, and the ownership rights and values associated with them, between customers.** In existing stablecoins, a significant part of this transfer function is performed by public permissionless ledgers”. The Bank suggests that payment operators could be the entity operating a permissioned ledger, as well as issuers that use a permissioned ledger and sets the rules for transferring stablecoins on top of the consensus mechanism, depending on the structure of the payment system.

We believe it is important that the narrow record keeping functions of ledgers not be conflated with the broader transfer functions envisioned to be regulated by the Bank. The Bank should therefore clarify that ledgers are not in themselves payment systems. Many issuers of stablecoins today do not provide services to stablecoin holders, for example transfer, trading, or custody / wallet services. We anticipate that this delineation between issuers and service providers, including providers (or operators) of payment systems will continue in at least the short to medium term, and that stablecoin issuers are therefore unlikely to operate payment systems themselves.

We do not agree with the suggestion that operators of permissioned ledgers should also be deemed payment system operators. Such a determination is at odds with the Banking Act definition and common understanding of a ‘payment system’ today. The ‘arrangements’ in the Banking Act’s definition refer to the set of common rules and procedures for the transfer of funds, or in this case digital settlement assets, between different parties, involving execution, clearing, and settlement. We agree with the premise that a ledger – regardless of whether it is permissioned or permissionless – can facilitate more efficient settlement, but it has the very narrow function of being a record of the stablecoin transactions. It is effectively a database. Records do not facilitate or control a transfer; they simply reflect the transfer.

In support of this view, we note that the BIS also excludes record keeping from its description of a transfer function. BIS states that the transfer function entails the “*operation of a system, a set of rules for the transfer of coins ... and a mechanism for validating transactions*”.<sup>1</sup> This is inconsistent with the Bank’s description above, which involves not only the recording of transactions, but also the transfer of the stablecoin and the ownership rights and values associated with them. The latter activities which are key to transfers are generally

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<sup>1</sup> BIS, “*Application of the PFMI to stablecoin arrangements*” (July 2022), page 4.

performed by an entity that is separate and distinct from the ledger 'operator' (should there be one).

**Q7: Do you agree with our approach regarding subsidiarisation of non-UK issuers? Do you agree with our approach to other non-UK elements of the payment chain? What alternative policy arrangements could be used to effectively supervise, oversee, and regulate non-UK systemic stablecoin issuers and other non-UK elements of the payment chain?**

The Bank proposes to limit the issuance of systemic stablecoins to UK entities or subsidiaries. This is to ensure that capital and backing assets are held locally in the UK. The Bank believes it is impractical to impose the necessary prudential controls on overseas firms or UK branches of overseas firms. Moreover, the Bank does not currently believe that equivalence through a substituted compliance regime would be enough.

#### *Global Coordination and Equivalence Frameworks*

A significant challenge for global stablecoin issuers is regulatory fragmentation: how to comply with different regulatory regimes across multiple jurisdictions. Stablecoin arrangements are global by nature, and the application of different and conflicting regulatory regimes will fragment liquidity pools. Global collaboration and coordination is necessary for global stablecoins.

As envisaged by the FCA's Discussion Paper on stablecoins, we believe that overseas stablecoins should be permitted to operate in the UK, provided they meet equivalent standards to the UK regime. This is already a common practice in many areas of financial regulation. Where equivalence can be established, consumers would continue to have an appropriate degree of protection. In allowing an equivalence regime, overseas stablecoins that meet this standard would not need line by line compliance for practices that are otherwise established as substantially the same from an outcomes-based approach. We believe that there is a role for the Bank in determining whether other jurisdictions' rule sets are deemed UK equivalent. It may be that some stablecoins, regulated in other jurisdictions deemed equivalent, could be used in the UK (without a payment arranger as envisaged under the FCA Discussion Paper) while maintaining high standards of consumer protection and financial stability.

With equivalence in mind, it is also important the UK does not introduce a significantly more stringent regime than other regimes around the world, otherwise equivalence will not be possible and no overseas stablecoin will be able to operate in the UK; for example, we note that the proposed UK stablecoin regimes goes further than the EU with regards to certain requirements, such as with respect to a separate entity for custody, ban on interest on reserves, cap on individuals holdings, and other areas.

### Section 3: Requirements for the transfer function

**Q9: Do you consider that stablecoin issuers can exercise sufficient control over, and mitigate the risks of, public permissionless ledgers (be it via rule setting and/or the use of innovative solutions)?**

**Q10: How do you consider that existing and emerging stablecoin payment chains operating with a public permissionless ledger may be adapted in order to meet the Bank's expectations and international standards?**

We appreciate the Bank's recognition that both permissioned and permissionless ledgers present benefits in terms of efficiency and operational resilience, and that systemic stablecoins should be able to be issued using either method. Coinbase strongly supports the principle that public, permissionless ledgers can support systemic stablecoins. To that end, we commend the Bank for its openness to the development of technological innovations and legal arrangements to address its concerns.

The Bank specifically identifies two key concerns with public permissionless ledgers, and why they may not meet regulatory requirements or international standards:

- **Governance:** there is no entity in charge of comprehensively assessing the risks of the entire payment chain and building the right controls to mitigate them; and
- **Settlement finality:** settlement of transactions may not always be final, e.g. because complex and elaborated 'attacks' on the ledger by fraudulent actors may cause disruptions to settlement, if those attacks result in a new 'chain' of transactions being created, rendering the previous ones obsolete and, in effect, annulled.

#### *Governance*

It is a strength of many stablecoin payment chains that there is no single entity responsible for ensuring the robust operation and risk management of the 'transfer function.' This is a feature of an open, permissionless network, not a bug. Many blockchains like Bitcoin and Ethereum among others have a robust history of demonstrating this. Instead of a single entity responsible for addressing risks across the entire payment chain, there are many independent entities, each effectively addressing risks within its area of responsibility, and collectively they ensure the integrity of a payment system that is far more resilient than could ever be implemented by any single entity acting alone.

One advantage of permissionless ledgers is that **every** entity that powers that ledger is responsible for its functioning. When issuing any kind of token on a permissionless ledger, such as Ethereum, each token is issued via a smart contract (program). These smart contracts define how tokens are transferred, and any user can use this feature to transfer the tokens held in their wallet to another wallet. The work of processing this transaction is

performed by the entire network. In the case of Ethereum, there are more than 900,000 validators with 29m ETH – representing approximately \$69 billion in staked assets – securing this network.

The Bank should have no greater concern than with a traditional payment system that relies on the internet for the transmission of payment instructions among participants. We would not expect that a payment system operator, to perform their role well, would need to become an internet service provider. Rather, we expect payment system operators and payment service providers to take precautions to reduce their vulnerability to internet service disruption, and minimize the impact to customers if one does occur..

In approving a permissionless ledger for stablecoin transfers, the Bank should implement a fit-for-purpose regime that refrains from designating permissionless ledgers as payment system operators. Notably, while stablecoin payment chains may have operational differences from existing payment systems regulation due to technological differences, we believe the Bank can today rely on this technology to approve a permissionless ledger according to the principle of “same regulatory outcome.”

### *Settlement finality*

As the Bank points out, there is a novel risk with permissionless ledgers relative to other recordkeeping technologies. Consensus mechanisms like Proof of Work and Proof of Stake depend on a community of validators that could, in theory, compromise the integrity of the chain. However, this would require tremendous resources, making it extremely difficult to attack the ledger. As a case in point, neither Bitcoin or Ethereum have ever been maliciously attacked and had their chain overwritten (also known as a “reorg”), in their 15 and 9 years of operations, respectively.

The concept of settlement finality is also novel. It is a technical concept referring to the likelihood that a transaction recorded onchain could be subsequently be changed. Once a block is finalised on a network like Ethereum, the only way it can be altered is through a hard fork that creates a new version of the blockchain. In the case that a fork does occur, whether accidental or intentional, users are not at risk of losing their transaction history or their token balances. At the block height (location in the chain) at which the chain splits in two, the user will have the same exact balances and transaction histories on both blockchains. At that time, the centralised entity managing the smart contract that powers the stablecoin – i.e. the stablecoin issuer – will need to select which chain is ‘canonical’ meaning that the stablecoin tokens on that chain can be redeemed for fiat. The stablecoins on the non-canonical chain will become worthless, as they will not be able to be redeemed for fiat and will therefore be unbacked. Users will always be made whole.

Permissionless ledgers like Bitcoin and Ethereum have an unblemished record of security, reliability, and resilience, making them a strong choice for stablecoins to be used in retail payments at scale.

## Section 4: Requirements on backing assets and restrictions on remuneration for the issuance of stablecoins used in systemic payment systems

### **Q11: Do you agree with the Bank’s assessment of the important role of backing assets in ensuring the stability of value of the stablecoin?**

Yes we agree that backing assets play an important role in ensuring the stability of the stablecoin. The Bank’s rationale for this requirement is that doing so will ensure that systemic stablecoins maintain their par value at all times, which allows them to be used with full confidence as a means of payment in sterling and can be exchanged on demand and at par for other forms of money circulating in the economy, thereby maintaining the singleness of money. However, we think the Bank’s proposed requirement to back 100% of reserves with central bank deposits marks a significant departure from existing stablecoin revenue models, is at odds with the direction being taken by the international regulatory community (e.g. MiCA in the EU), and is unnecessary given the risks posed by conventional stablecoin arrangements. Ultimately, this requirement will be viewed as anti-competitive if it prevents other viable stablecoin designs from emerging in the mixed payments ecosystem that the UK envisions.

#### *Not central to maintaining par value and the singleness of money*

Central bank reserve backing is not necessary to ensure a stable value. Allowing issuers to hold backing assets in different types of assets – i.e. other than central bank reserves – would *not* result in stablecoins moving from the par value so long as the assets are high quality, short duration, and highly liquid, as is evident in other money-related regulatory regimes. That is because a portfolio composition of this nature would not create risks of liquidity and maturity mismatch between the issuer’s assets and liabilities and therefore would not create issues with the issuer meeting its redemption requirements.

For example, under the Electronic Money Regulations 2011 (**EMRs**), issuers can place relevant funds in accounts with central or commercial banks, and they are also permitted to invest the funds in secure, liquid, low-risk assets and placed in a separate account with an authorised custodian (or alternatively ensure that relevant funds are covered by an insurance policy). Deposit takers can on-lend funds received by way of deposits as well as invest them in a variety of assets. Notwithstanding this, e-money and deposits maintain their par value, redeemable at par on request, and remain interchangeable with cash. There is no reason why stablecoins with similar or safer backing should be treated differently with respect to their ability to be redeemed at par.

For completeness, whilst there have been some high profile cases of e-money businesses not meeting their redemption obligations and therefore breaching the singleness of money

principle, this was not caused by issuers holding relevant funds in different assets, but rather was caused by fraudulent financial reporting, bad management etc.

The Discussion Paper states that the FPC considers that a model in which the liabilities of a systemic stablecoin issuer are backed by commercial bank deposits would pose significant risks to financial stability and is not appropriate for stablecoins used at systemic scale. The Bank gives the example of the collapse of Silicon Valley Bank (**SVB**), which caused a temporary loss of confidence in USDC due to its issuer Circle holding a high proportion of its backing assets with SVB. Significant redemption requests, secondary sale pressure, and uncertainty of recovering the reserves resulted in the loss of USDC's \$1 peg. Commercial bank deposits carry credit risk due to the fractional reserve nature of banking, and we agree that this risk can be transmitted to stablecoin issuers, as this example illustrates. However, it is also important to note that the USDC's peg was restored once US regulators took decisive action to assure markets that uninsured depositors of SVB would be made whole. Hence, USDC was (and currently is) no less stable than the US banking system.

While we agree that limiting backing assets to central bank deposits would significantly reduce credit, liquidity, and market risks, there is no principled reason why stablecoin issuers should be subject to regulatory restrictions that are not applicable to other types of money, such as commercial bank deposits and e-money. These categories of financial risks can be effectively managed using risk management methods and principles that have been developed and tested over decades in traditional finance. To mitigate such risk by entirely prohibiting stablecoin issuers from holding reserves in safe, highly liquid assets – such as commercial bank deposits, or short-term gilts – is extreme and unnecessary. It is at odds with the principle of “same risk, same regulatory outcome.”

#### *Creating barriers to entry and unlevel playing field*

For the reasons set out above, it is unnecessary for the Bank to dictate a systemic issuer's revenue model by limiting backing assets to only central bank deposits, which are non-interest paying (see our response at Q12 with respect to interest). The result of this prescription is an unlevel playing field with other traditional financial services providers; it would make systemic stablecoin issuers subject to a more restrictive regime than (a) e-money issuers, even though systemic stablecoin issuers will be subject to higher capital and liquidity requirements, and therefore more protected against credit, liquidity, and business risks; and (b) deposit takers, even though the stablecoin business model is less risky, as it does not involve liquidity and maturity transformation. The result puts stablecoin issuers at a competitive disadvantage.

#### *Significant departure from existing revenue models*

In addition, the proposal is a marked departure from existing revenue models. Today, stablecoin issuers generally hold highly liquid cash and cash-equivalent assets. Under the proposed regime, issuers deemed to be significant would need to make a potentially

existential change to their business models by liquidating and moving existing backing assets into a central bank deposit account. There is no guarantee that issuers can open an account with the Bank given the applicable operational and regulatory conditions, and issuers would no longer be able to earn interest on reserves. Requiring such changes, particularly for issuers that design a product structure to operate on a revenue model that is different from what the Bank would require (e.g. under the FCA proposal), is an unreasonable business and product market expectation (to the detriment of the end consumer).

The proposal therefore conflicts with the Bank’s new competition objective as well as the principle of technology neutrality, as the proposal has the effect of penalising issuers of systemic stablecoins (as they utilise DLT systems as the underlying technology) in comparison to e-money issuers.

*Diverging from international approaches to stablecoin regulation*

For completeness, the proposal is also a marked departure from stablecoin regimes in other jurisdictions, notably in Europe, Singapore, and Japan (see below).

<p>European Markets in Cryptoassets Regime (<b>MiCA</b>)</p>	<p>There is no requirement under MiCA for issuers of stablecoins (which MiCA refers to as asset-back tokens and e-money tokens) to hold backing assets (which MiCA refers to as reserve assets) only in central bank deposit accounts.</p> <p>For significant e-money tokens (which is the closest to the UK concept of systemic stablecoins), there are constraints on the concentration of custodians. The backing assets should also be at least 60% deposited in separate accounts in credit institutions with the remaining funds invested in secure, low risk assets that qualify as highly liquid financial instruments with minimal market risk, credit risk and concentration risk, and can be liquidated rapidly with minimal adverse price effect, and are denominated in the same official currency as the one referenced by the e-money token.<sup>2</sup></p>
<p>Monetary Authority of Singapore (<b>MAS</b>), and the Payment Services Act 2019</p>	<p>Stablecoins which are pegged to a single currency (<b>SCS</b>) where the value of SCS in circulation exceeds S\$5 million will be subject to the Payment Services Act 2019 (the Singapore stablecoin regulatory regime). However, there is no</p>

<sup>2</sup> Regulation (EU) 2023/1114 on markets in crypto-assets, Articles 45(7) and 58(1).



	requirement for SCS issuers to hold reserve assets (i.e. backing assets) solely in central bank deposit accounts. <sup>3</sup>
Japanese Financial Services Agency (JFSA) and the Payment Services Act	E-money stablecoin reserves (which is the closest to the UK concept of systemic stablecoins) are not limited to central bank deposit accounts, but are subject to certain composition requirements.

**Q12: Do you agree that the proposed remuneration policy is consistent with systemic stablecoins being used primarily for payments?**

*Receiving interest on backing assets does not equate to liquidity and maturity transformation*

Holding backing assets in revenue generating assets, whether that be interest payments on central bank deposits, commercial bank deposits, or HQLAs would not involve liquidity and maturity transformation (i.e. commensurate with operating a deposit taking / banking business model). This assumption is misplaced and premised on an artificial distinction between bank and payments business models.

By way of comparison, e-money issuers are permitted to hold relevant assets in interest bearing accounts. In doing so, their business models are not characterised as involving liquidity and maturity transformation and we don't see why this would be different for systemic stablecoins so long as:

- the value of the backing assets equal the par value of all systemic stablecoins issued (i.e. backed 1:1, and any excess to be 'swept' into the issuer's proprietary account for example or 'topped up' by the issuer's proprietary capital);
- backing assets are appropriately safeguarded and held on trust so that holders have proprietary rights in them; and
- the backing assets cannot be on-lent to other persons (credit creation), cannot be utilised to materially fund other parts of the issuer's business, and cannot be invested in long term illiquid assets.

We also note that the Banking Act permits the Bank to establish rules for the operation of systems and services that form part of the arrangements constituting or connected with the payment service. An issuer's ability to receive interests on backing assets does not relate to

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<sup>3</sup> MAS, "Consultation Paper on Proposed Regulatory Approach for Stablecoin-Related Activities" (October 2022), paragraph 4.13.

its stablecoin issuing services. The proposal therefore potentially goes further than the Bank's powers with respect to digital settlement assets, in addition to being an unnecessary restriction.

### *Creating barriers to entry and making issuers uncompetitive*

Prohibiting interest payments on backing assets also puts systemic issuers at a material disadvantage to other providers of money (commercial banks) and money-like assets (e-money issuers) as this type of income is open to them.

Further, the most widely used revenue model of fiat-backed stablecoins today is for issuers to earn revenue derived from the interest and returns from backing assets. This revenue is crucial for issuers as they are generally not involved in, or do not have control over, the transfer of stablecoins (which would allow it to be used as a means of payment). Therefore their revenue models generally are not transaction based, nor do they receive revenue from liquidity and maturity transformation.

The Bank's proposed model poses an existential threat to existing stablecoin arrangements that have already demonstrated their commercial viability. Eliminating the returns on reserve assets as a potential revenue stream is likely to make the UK an unattractive place for systemic stablecoin issuers as well as discourage non-systemic issuers from investing in growing their UK business to avoid being classified as 'systemic'. The proposal therefore conflicts with the Bank's new competition objective and would pose substantial challenges for the medium to long-term growth of the UK stablecoin market.

Prohibiting these revenue streams may also not be in holders' best interest, as it may have the unintended consequence of pushing up prices and fees associated with stablecoin usage. In general, systemic issuers will likely seek to pass on their increased costs or decreased revenue to customers (here stablecoin holders) in the form of higher fees. A ban on revenue from reserve assets would also favour a systemic issuer that is able to subsidise the costs by other product offerings, e.g., a technology or commercial platform that generates fees from advertising or other sources. In both situations, consumers could be made worse off.

Alternatively, if revenue generated from the backing assets were permitted to absorb the costs associated with being an appropriately regulated systemic issuer, this could enable issuers to be more competitive on price. This would also be consistent with the Bank's new competition mandate and support medium to long-term growth of the stablecoin market.

Permitting this alternative revenue model for systemic stablecoin issuers would benefit consumers who, in traditional payment systems, often experience fees that approach 1.5-3% of the value of a transaction (including e.g. merchant acquirers, card schemes, etc). Forcing stablecoin issuers to adopt a similar fee-based model would benefit existing payment practices rather than supporting a mixed payments ecosystem. Pushing systemic issuers

into a fee based revenue model may also create a ‘winner-takes-all’ outcome, because fee income will be driven primarily by the velocity of the stablecoin. Larger issuers with a higher velocity will have the ability to charge lower fees to further drive adoption. This in turn could create a material barrier to entry, and ultimately an uncompetitive market dominated by a small number of issuers.

By not permitting this alternative revenue model, and as indicated above, this may create an advantage for subsidised models, where issuers compete not based on the quality of the stablecoins themselves, but by monetising other aspects of the service (e.g., by displaying advertisements or selling consumers’ financial data).

We strongly urge the Bank to refrain from picking winners and losers and instead focus on appropriately mitigating the potential risks posed by the various potential models, and allow markets to decide through consumer use and preferences which revenue models work best.

*Diverging from international approaches to stablecoin regulation*

For completeness, the proposal is also a marked departure from stablecoin regimes in other jurisdictions, notably in Europe, Singapore, and Japan (see below).

European Markets in Cryptoassets ( <b>MiCA</b> ) regime	MiCA does not prohibit issuers of stablecoins, including significant e-money tokens (which is the closest to the UK concept of a systemic stablecoin) from receiving interest on their reserve assets / funds (effectively backing assets).
Monetary Authority of Singapore ( <b>MAS</b> ), and the Payment Services Act 2019	There is no prohibition on single currency stablecoin issuers from receiving interest on their reserve assets (effectively backing assets).
Japanese Financial Services Agency ( <b>JFSA</b> ) and the Payment Services Act	There is no prohibition on e-money stablecoin issuers from receiving interest on their reserve assets (effectively backing assets).

*Prohibition on issuers paying interest to systemic stablecoin holders*

The Bank’s view is that issuers should not pay interest to holders on the basis that stablecoins used in systemic payment systems should not be used as a means of investment. The Bank states that this would align the treatment of systemic stablecoins with cash, e-money, and a potential digital pound. However, we doubt whether this prohibition achieves the Bank’s objective.

With respect to stablecoin issuers and e-money, we understand the historical rationale for prohibiting interest payments to e-money account holders – now being applied to stablecoin holders – was to avoid confusing an e-money account with a commercial bank deposit account, i.e. to clearly delineate the payment versus store of value functions. However, the risk of confusion can be significantly mitigated with clear disclosures as well as educational tools to explain the difference between stablecoins and other types of money and money-like assets. We trust that consumers will have the capacity to understand the tradeoffs, risks, and benefits of each product.

Another rationale for prohibiting interest payments is to mitigate risks to financial stability associated with the potential large-scale outflows from bank deposits into e-money accounts and, prospectively, into systemic stablecoins. As discussed above, if the Bank has similar concerns for stablecoins, a mitigating measure would be for reserve assets to *not* be held in central bank deposits, because a key appeal of systemic stablecoins under the proposed regime is that they are the closest asset to a central bank deposit that can be accessed by retail users. The Bank could also apply limits on the interest levels or interest payments that an issuer can make, rather than prohibiting them altogether.

We understand that the Bank is considering whether to allow issuers to offer transaction-based incentives in lieu of interest payments to stablecoin holders. The Bank explains that payment firms often provide users with incentives, not limited to points or rewards linked to transaction volumes. For context, these incentives are provided because payment firms receive fees when a user makes a payment transaction and can therefore share these fees in the form of transaction based incentives. On the other hand, stablecoin issuers generally do not receive fees in this manner, as they generally are not involved in the transfer of stablecoins, and therefore their revenue model is not transaction-based. Although issuers can hypothetically provide holder with transaction based incentives, such as rebates or percentage based 'cash-back', it would be more practicable for them to provide interest payments, particularly if the issuers could themselves receive interest on backing assets and have the optionality to 'share' such interest. Interest payments also allow holders to continue to receive economic benefits without the need to redeem stablecoins for alternative stores of value during idle periods.

Given the above, proceeding with this proposal would penalise stablecoin issuers (simply because they utilise a DLT system) and hinder the further growth and development of stablecoin markets which directly contradicts the Bank's new competition mandate as well as the principle of technology neutrality.

## Section 5: Other requirements for the issuance of money used in systemic payment systems

### **Question 13: Do you agree with the Bank's proposed requirements on the redemption process, including the role of all firms in the payment chain?**

To maintain confidence in systemic payment stablecoins as a form of private money, the Bank proposes to require systemic issuers to ensure that there are no undue restrictions or conditions that would prevent holders from redeeming their stablecoins. They would be required to meet redemption requests of any size and at par at any time and by the end of the day on which a valid redemption request is made. The Bank states that this is essential to meet the FPC's expectation that stablecoins used in systemic payment systems should meet standards equivalent to those expected of commercial banks.

However we query the requirement to have a completely unrestricted redemption process, particularly as this requirement is not applicable to all types of money, such as commercial bank deposits. There are both practical and regulatory reasons (e.g. hours of operation of the banking system and financial crime controls) that should guide specific redemption conditions and procedures. As such, it will not always be appropriate for redemption to be immediate. However, we do not consider these potential redemption frictions to conflict with the ability of holders to redeem their stablecoins at par value, on demand.

Further, it is common practice for banks to set daily limits on the amount of cash that can be withdrawn from deposit accounts (i.e. changing deposits for fiat) whether from an ATM or at a branch. In addition, where a deposit account holder intends to withdraw a large amount of cash, this generally requires prior notice with most banks, and even low value transactions may be delayed so that the bank can apply appropriate financial crime checks. Accordingly it is not appropriate for every withdrawal (or in this case redemption) request to be processed immediately and we do not consider such delays to conflict with the obligation for redemption to be on demand.

On this basis, we propose that holders have the right to redeem at par at any time but that the conditions for redemption, including timelines, thresholds and periods are at the issuer's discretion and clearly disclosed to holders.

### **Question 20: Do you consider that the capital requirements would effectively mitigate risks that may result in a shortfall in the backing assets or that can threaten the ability of issuers to operate as a going concern?**

### **Question 21: Do you have views on the approach (including any existing or bespoke methodologies) that should be considered for calibrating capital requirements?**

We are concerned that capital requirements are disproportionate to the risks posed and make non-bank issued stablecoins unviable (particularly given limits on the revenue model as referenced above).

The Bank proposes that issuers of systemic stablecoins hold capital against other risks (e.g. operational risks such as cyber-attacks, general business risks, market distress) that may result in a shortfall in the backing assets or that can threaten the issuer's ability to operate as a going concern. The proposal involves the issuer holding capital at an amount which reflects standards under the PFMI as well as a 'shortfall reserve'. Particularly when coupled with the proposed requirements for backing and reserve assets, we do not see the need for the proposed level of additional capital buffers.

#### *PFMI capital requirements to account for business risk*

Using the PFMI as a baseline with some modifications, the Bank proposes for issuers to hold capital in an amount at least equal to the highest of any of the following:

- six months of operating expenses;
- potential business losses; or
- wind-down costs.

The proposal conflicts with the principle of "same risk, same regulation", as PFMI-level capital requirements currently only apply to financial market infrastructures, which have more complex business models and are subject to substantially greater levels of operational risk, general business risk, and wind-down costs compared to a systemic stablecoin issuer. Systemic stablecoin issuers are much closer to e-money issuers than to financial market infrastructures in terms of business and risk profile, and the applicable prudential requirements should therefore be aligned more closely with e-money issuers.

As we also discuss in our response to the FCA's Discussion Paper on stablecoins, although Coinbase is not a stablecoin issuer, stablecoins are a critical component to the digital economy, and as such, we have undertaken a rigorous quantitative analysis to assess what levels of financial resources, including a capital buffer, the issuer of a fiat-backed stablecoin should maintain. The purpose of the exercise was to better understand and quantify the risks associated with stablecoins as it relates to our activities.

The initial results of this analysis indicated that, if the stablecoin's reserves are composed entirely of highly safe, liquid assets – such as highly rated sovereign debt securities maturing in less than 90 days, and deposits at regulated financial institutions – then the stablecoin's exposure to financial risks can be minimal. Our initial estimates depended significantly on assumptions regarding the accounting treatment of reserve assets – i.e., approximately 20 basis points under held to maturity (**HTM**) assumptions, and 36 basis points under available for sale (**AFS**) assumptions. Given this composition of assets, a

minimal capital buffer would be sufficient to fully protect stablecoin holders against all categories of financial risk, including credit risk and market risk.

The stablecoin's remaining risk exposures are operational in nature. In our exercise of estimating operational risks we considered a bottom-up, scenario-based methodology that proceeded as follows. First, we identified all of the potential categories of operational risk events. This included, for example, activities related to minting, reserve reconciliation, illicit financial transactions, theft, loss, misuse of assets, cyber incursions, and data breaches.

Then, for each category, we estimated the probability of an operational risk event occurring and the magnitude of financial losses that would be realised if it does. In the final phase of the analysis we calibrated and extrapolated the probability/loss distribution curves to ascertain the amount of capital necessary for sufficient certainty that all reasonably foreseeable losses are adequately addressed, with an additional margin for error.

As with any analysis of this nature, the results are sensitive to a wide range of factors, including expert judgments and assumptions regarding such matters as the likelihood of events that may range from 'vanishingly improbable' to 'not in a million years.' While the crypto asset industry does not have a long history with which to calibrate results, many aspects of operational risk can be extrapolated from the traditional financial system. Based on these assumptions, our estimates supported an operational risk capital buffer of between 39 and 76 basis points.

Hence our initial findings indicate that a capital buffer of a well-structured and properly regulated stablecoin on the order of one percent of the total amount of stablecoins outstanding should be sufficient to protect against financial and operational risks for an issuer that maintains a reasonably effective risk management program. We would welcome the opportunity to discuss these analyses with the Bank.

Finally, we also note that it is unclear whether the requirements considered in the Discussion Paper would apply in addition to, or instead of, the FCA's proposed capital requirements for non-systemic stablecoins. More broadly, PFMI-level capital requirements will likely be prohibitively costly, or potentially impossible, for issuers to meet. Excessively high capital requirements will likely deter stablecoin issuers from growing their UK offerings, thereby impeding competition and innovation in the UK stablecoin markets.

#### *Maintaining a shortfall reserve*

The Bank proposes that issuers hold a shortfall reserve to ensure that sufficient reserve assets are always available to meet redemption requests. We consider that the Bank's objective can be achieved without this requirement, as evidenced by the fact that the concept of a shortfall reserve does not exist for issuers or providers of any other money or

money-like assets, or under any other UK financial services regulation. In addition, should the Bank's proposed restrictions with respect to backing assets apply, issuers would have little to no credit and liquidity risk which also makes a shortfall reserve unnecessary.

As a starting position, shortfalls should not occur (interday), as issuers must ensure that the value of the backing assets equal the par value of all systemic stablecoins issued at all times (i.e. backed 1:1). This would be achieved through the safeguarding rules detailed by the Bank at Section 5.2 of the Discussion Paper including:

- holding backing assets on a segregated basis from proprietary assets;
- holding backing assets on trust for the benefit of stablecoin holders;
- having accurate and consistent reconciliation processes;
- having in place governance and controls to mitigate the risk of misapplying or mismanaging the backing assets, fraud, inadequate record keeping, or negligence; and
- regulatory reporting and external audits.

If (intraday) shortfalls occur (e.g. due to a severe market event), it would be sensible to replicate the FCA CASS rules and require issuers to cover this with their proprietary capital by the end of the day. We further discuss the application of CASS rules to stablecoin arrangements in our response to the FCA's Discussion Paper, and the same comments apply equally here as well in relation to systemic stablecoins.

**Question 24: Do you agree that, at least during a transition, limits would likely be needed for stablecoins used in systemic payment systems, to mitigate financial stability risks stemming from large and rapid outflows of deposits from the banking sector, and risks posed by newly recognised systemic payment systems as they are scaling up?**

**Question 25: Do you have views on the use, calibration and practicalities of limits?**

The Bank proposes a holding limit of between £5,000 to £20,000 for individual holders of systemic stablecoins (which is similar to the proposal for the digital pound). The limit is intended to mitigate risks to financial stability associated with large-scale outflows from bank deposits into stablecoins, as well as mitigate risks posed by systemic payment systems using stablecoins while they are scaling up. Rather than applying a holding limit, we consider that the Bank's objective can be achieved through other means, such as for reserve assets to *not* be held in central bank accounts as a key appeal of stablecoins under the proposed regime is that they are the closest asset to a central bank deposit account (and therefore fully insolvency remote) that can be accessed by retail users and / or by limiting the interest that can be paid to holders.



Separately, any holding limit would constrain wide-spread adoption of stablecoins in the UK and may see stablecoin issuance in other currencies become more popular which could weaken the value of the pound. Therefore we strongly advocate for the Bank to remove such holding limits. However, were the Bank to proceed with this proposal, a higher limit would be more appropriate, as the current value would constrain the use of stablecoins by SMEs (which are often still treated as retail clients) who generally have larger accounts as they transact in higher volumes and values. The proposed limit would therefore unfairly exclude a key population of users.

Further, as holding limits would not apply to non-systemic stablecoins, issuers transitioning to the Bank's regime would need to require holders with account balances above the limit to liquidate their systemic stablecoins. Not only is this legally and operationally challenging to enforce, but it could also create a 'forced' run on the stablecoin (particularly if the limit is set at the lower end as it would capture more holders) which will be significantly disruptive, materially reduce confidence in the stablecoin as well as Sterling denominated stablecoins more widely.

## Section 6: Requirements for wallet providers

**Question 29: Do you consider that unhosted wallets could operate in a way that the systemic stablecoin payment chains can meet the Bank's expectations (including for the issuer to deliver against the Bank's requirements set out in this Discussion Paper)?**

As stated in the introduction above, we understand that the Bank is still exploring the risks associated with unhosted wallets and their suitability to be used at systemic scale for payments in the UK.

We do not consider unhosted wallets to be incompatible with transactions in or holdings of systemic stablecoins. On the contrary, they are a critical element of the future payments ecosystem. By analogy, coins and banknotes offer the same peer-to-peer transferability – i.e. without need for an intermediary – as the use of unhosted wallets for digital assets. Rather than being prohibited, they are widely used, and are not seen as incompatible with bank deposits, e-money, or the wider economy.

Unlike cash, transfers between unhosted wallets are pseudonymous and not anonymous, meaning that they can be traced back to individuals and entities at regulated on- and off-ramps in the financial system (e.g. at firms like Coinbase that are subject to high levels of regulatory requirements including AML and KYC standards). To this end, they have the ability to increase the safety and soundness of the payments ecosystem.

In addition, permitting peer-to-peer transfers through unhosted wallets will unambiguously benefit consumers by increasing financial inclusion and lower fees. Citizens that are unbanked or underbanked frequently rely on coins and banknotes in the current payments system. Were the Bank to restrict the use of systemic stablecoins to hosted wallets, the resulting frictions would: (a) perpetuate the financial exclusion of certain populations who live and operate on the fringe or outside of the current financial system – those who do not have accounts with existing or future cryptoasset providers or custodian wallet providers; and (b) force UK persons to open hosted wallets and as a result pay service fees which they would not pay were they to use unhosted wallets instead.

Further, unhosted wallets enable owners to hold assets without counterparty risk and engage in new modular business models with great innovative potential and lower risk profiles. Preventing users from being able to use unhosted wallets to hold stablecoins will also reduce scope for competition and therefore innovation in meeting different customer preferences.