coinbase

To:
Nikhil Rathi
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Financial Conduct Authority
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31 July 2025

Consultation Paper on *Stablecoin Issuance and Cryptoasset Custody*

Coinbase Global, Inc., together with its UK subsidiary CB Payments Ltd. and its other subsidiaries (**Coinbase**), appreciates the opportunity to respond to Consultation Paper CP25/14: *Stablecoin Issuance and Cryptoasset Custody* (**Consultation Paper**) published by the Financial Conduct Authority (**FCA**).

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.

Coinbase supports the FCA's policy objectives of promoting economic growth and helping consumers through cryptoasset regulation. We believe the FCA's goal of designing a regime appropriate for the UK will help to provide the certainty that will allow firms to continue creating and using cryptoasset products and markets domestically rather than being driven offshore. In this response, we have set out areas in the FCA's proposal (**Proposal**) that we believe merit further consideration and revision to deliver that result while still protecting consumers.

As a firm, we stand ready to assist the FCA as it designs the proposed new regulatory regime and look forward to engaging with the FCA on this important topic.

Yours sincerely,

Tom Duff Gordon, Vice President, International Policy, Coinbase

Keith Gross, UK CEO, Coinbase

Introduction

Blockchain technology is the backbone of a new financial architecture. While nascent, it is already bringing efficiency, transparency, and resiliency to the existing financial system. Blockchain applications facilitate rapid, cost-effective value transfers, particularly advantageous for cross-border transactions. Stablecoins that digitize fiat currencies will intensify competitive pressures within payment systems. Decentralized finance protocols, smart contract functionality, and related technological innovations will drive continued innovation while exponentially expanding financial system capabilities. Beyond financial applications, digital assets possess transformative potential across economic sectors.

1. The Stablecoin Opportunity

We appreciate the FCA's thoughtful and constructive approach to stablecoin regulation as outlined in the recent consultation. The FCA has explicitly recognized that stablecoins have the potential to drive efficiency in payments and settlement using blockchain technology, with particular benefits for cross-border transactions, which demonstrates a clear understanding of the transformative potential of this technology. We commend the FCA's commitment to supporting innovation that benefits consumers and markets, as expressed in the goal to "strike a balance in support of a sector that enables innovation and is underpinned by market integrity and trust." The FCA's extensive engagement process through roundtables and feedback on previous discussion papers shows genuine collaboration with industry stakeholders, and the plan to explore adding a specific focus on stablecoins to innovation services demonstrates forward-thinking regulatory support. The FCA's measured approach, working closely with the Bank of England and other regulators, reflects a sophisticated understanding of the need for coordinated oversight while fostering the opportunities that stablecoins present to financial services and the broader economy.

Stablecoins give users alternatives to incumbent payment systems that can be slow and more costly, particularly for cross border transfers. For example, current payment and remittance platforms require multiple intermediaries to execute a transaction, often resulting in longer transaction and settlement times and additional fees, such as foreign transaction fees. Stablecoin transfers settle as fast as the underlying blockchain, which is typically measured in minutes, whereas international transfers can take multiple business days. As the Bank of England itself notes, “in some instances, a cross-border payment can take several days and can cost up to ten times more than a domestic payment,”[1] a lag that can significantly stress cash flow and cause downstream effects.

Lack of interoperability among payment rails in traditional markets is an additional constraint to both individuals and commercial enterprises. Separate from high fees and lengthy delays, restricted and exclusive access to payment rails represent a significant

[1] https://www.bankofengland.co.uk/payment-and-settlement/cross-border-payments

disadvantage to consumers making payments and transfers. In contrast, stablecoins are not exclusive to a single blockchain, giving users competitive options on making and receiving payments and transfers. For example, credit card processing fees typically range from 1.5% to 3.5% of the value of each transaction, with the vast majority of transactions processed on one of only four large networks, each with a walled-garden of users. Of course, these networks offer tremendous value to consumers today, which is why high fees are possible, but increasing adoption and permissibility of stablecoins as an alternative will create competitive pressures that could lower the costs for merchants to receive payment for goods and services using incumbent services. The same is true for wire transfers and other traditional payment systems.

Stablecoin Adoption

According to Visa Onchain Analytics, stablecoins accounted for $36.8T in transactions in the last 12 months, with people-initiated activity (as opposed activity initiated by bots) reaching $7.6T.[2] While these numbers are crypto-centric and hard to verify from an economic relevance perspective, the reported total magnitudes are remarkable and dwarf the volumes processed by PayPal, Mastercard, and Visa combined. 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 that its potential is significant.

More generally, the current trajectory of stablecoins being broadly used for retail payments and transfers should be the guiding consideration of regulation. Stablecoins originated as a fiat onramp to the crypto-ecosystem, e.g. to purchase virtual currencies like Bitcoin, but this is best viewed as the proof of concept for wide scale adoption as a settlement instrument for any payment application. For example, Coinbase Commerce currently has 48,000+ merchants accepting digital assets including USDC and DAI from their customers globally. Moreover, the fees charged are 1%, well below the rate that merchants are typically charged by major card networks.

Views on the FCA's Regulatory Approach

Our perspective differs from the FCA's regulatory approach in several key areas and reflects our conviction that principles-based frameworks can deliver superior consumer protection while preserving the operational flexibility essential for UK market leadership in digital finance.

[2] Visa Onchain Analytics Dashboard, developed with Allium Labs, Visa, accessed July 29, 2025, https://visaonchainanalytics.com/.

- **As an overarching point, we reiterate that the FCA regime (for non systemic stablecoins) and the Bank of England regime (for systemic stablecoins) must “speak” to each other; if they do not, this will (i) bifurcate the stablecoin market, (ii) create a huge “cliff edge” effect and (iii) dis-incentivise stablecoin issuers from growing past the systemic threshold, because doing so would require a different operating model.** The current Bank of England proposals would prevent issuers from earning revenue on backing assets and place limits on holdings, undermining use cases and the viability of stablecoin business models. As a result no stablecoin issuer under FCA supervision will ever attain wide scale adoption without being required to switch regulatory regimes and to fundamentally overhaul their business and product offering in order to fulfill different regulatory requirements under the Bank of England’s regime. The practicality of applying substantially different regulatory regimes is such that a stablecoin issuer could never design a product that navigates both regimes. This is, in effect, a cap on innovation and a cap on the growth of stablecoins, limiting the ability of this payment innovation to flourish in the UK.

- **While not a subject of this consultation, we believe the UK has a unique opportunity to establish itself as the global leader in digital asset innovation by allowing stablecoin holders to earn interest on their holdings.** Current regulatory frameworks create artificial barriers that prevent stablecoin issuers from paying interest directly to users, limiting consumer choice and economic growth. Permitting on-chain interest would deliver multiple benefits: it would provide UK consumers with meaningful returns on their digital holdings compared to traditional low-yield savings accounts, strengthen the UK's position as a destination for stablecoin reserves that invest in government securities, and attract additional capital flows as global users seek interest-bearing digital assets. Furthermore, allowing interest payments promotes healthy competition between traditional banks and innovative crypto companies, ensuring consumers benefit from technological advancement rather than regulatory protection of incumbent institutions. As other jurisdictions grapple with restrictive approaches, the UK can differentiate itself by creating a balanced framework that treats stablecoins equivalently to traditional deposit products, positioning Britain as the premier destination for both crypto innovation and institutional capital in the digital economy.

- **We believe the FCA's restrictive approach to expanded backing asset composition creates unnecessary operational constraints without materially enhancing consumer protection.** The proposed limitations to short-term government treasury debt and cash deposits, while introducing complex "expanded backing assets" provisions, may disadvantage UK issuers in the global marketplace. We advocate for expanding default permitted asset categories to include high-grade money market instruments, similar to frameworks adopted in leading jurisdictions like the United States. This principles-based approach—emphasizing liquidity, credit quality, and transparency—can achieve equivalent consumer protection objectives while preserving the issuer flexibility necessary for innovation and competitive positioning.

- **We fundamentally disagree with the proposed requirement for unconnected third parties to safeguard backing asset pools.** Where group structures include appropriately regulated entities, we believe robust governance frameworks can effectively manage conflicts of interest while delivering significant operational advantages, including enhanced asset visibility and superior custodial control. The mandatory third-party requirement creates systemic concentration risks given the limited pool of qualified custodians, inevitably increasing consumer costs through reduced competition. We contend that targeted governance requirements—including board independence, comprehensive conflict management protocols, and structural separation measures—can provide equivalent assurance without the systemic risks and costs associated with mandatory external arrangements.

- **We differ with the FCA on the proposed T+1 redemption requirement, which we believe creates fundamental tensions with established AML/CFT compliance frameworks.** Rigid redemption timelines fail to accommodate legitimate due diligence procedures that can extend up to 60 days for complex customer verification processes, potentially compromising both consumer protection and regulatory compliance objectives. We recommend adopting a principles-based "prompt redemption" standard for pre-verified customers while allowing reasonable extensions for necessary compliance procedures. This approach would align the UK with international best practices rather than creating regulatory outlier status that could disadvantage domestic issuers.

2. Custody of Cryptoassets

We have read the FCA's proposals to regulate custody of cryptoassets with interest and note the very positive direction of travel. We believe the FCA custody team has undertaken significant work to understand how cryptoasset markets work in practice and, as a result, have set out proposals that are proportionate and that reflect the specificities of the market, while at the same time aligning where possible with the requirements applied in a traditional finance context, pursuant to the "same risk, same regulatory outcome" principle.

In particular, we are strongly supportive of the most recent proposals set out by the FCA, whereby customers' cryptoassets should be held in trust to deliver ownership rights, asset segregation, and bankruptcy remoteness. Mandating legal separation - as proposed in DP 23/4 on *Regulating Cryptoassets Phase 1: Stablecoins* - would increase costs to clients, introduce potential frictions and vulnerabilities during trading activity, and result in operational inefficiencies, all while in our view not delivering additional benefits in terms of addressing conflicts of interest or bankruptcy remoteness. Whilst it should be an option to operate a separate exchange and custody arrangement, it should not be mandatory; clients benefit most from flexibility and choice in custody models. We are grateful for the FCA's full consideration of the issues here.

A key outstanding question for the industry is on the interaction between the licensing arrangements set out in DP 25/1 on *Regulating Cryptoasset Activities* and the custody requirements set out in CP 25/14 on *Regulating Stablecoin Issuance and Cryptoasset Custody*. In particular, it is our assumption that the FCA intends for the CATP's UK regulated subsidiary (which sits alongside the proposed regulated branch) to be appointed as the UK-licensed custodian. This means that the UK-licensed cryptoasset custodian may also, for example, be an e-money institution. It is important that the FCA makes clear that it is possible for the UK based subsidiary to attain multiple licenses across different activities and offer multiple services so as to prevent the proliferation of entities under the UK-based regime, which is both unnecessary and costly for firms wanting to undertake business in the UK.

Finally, we note the following areas where we believe further consideration is needed:

- **We are strongly supportive of the FCA's proposals to require a UK-based authorised custodian, but which allows for the appointment of a sub-custodian within the group;** this affords the benefits of firms seeking best in class, mature, global custody infrastructure arrangements, whilst aligning with the provisions set out in CASS, in a traditional finance context. However, **we believe the FCA should go further than its proposals and require that any appointed third party for cryptoasset custody should be a regulated entity within the non-UK jurisdiction.** It should be the responsibility of the UK-licensed custody entity to ensure that the sub-custodian meets the necessary high standards for key management and security – it is important that the FCA does not impose specific operational requirements which may conflict with the sub-custodian's own regulatory obligations.

- **We are strongly supportive of the FCA's technology-agnostic and outcomes-based approach to key management, requiring firms to have adequate organisational controls and arrangement, including to make sure that private keys and the means of access to cryptoassets are generated, stored and**

controlled securely throughout their lifecycle. As the FCA develops its thinking, we note that current security best practices involve separating, storing, and operating wallet key materials across different locations and time zones. Any requirement for specific human or technical resources to be exclusively located in the UK could materially undermine the availability and resiliency of secure wallet operations.

- **We disagree with the requirement to notify the FCA if a shortfall is unlikely to be resolved by the next reconciliation (i.e. the next business day), particularly given that this notification requirement includes setting out details of why the shortfall has arisen, the extent of the shortfall, number of clients affected, and the firm's expected timeframe for resolving the shortfall.** There are often shortfalls for non-critical reasons, largely due to timing differences between transactions being processed on-chain versus on the internal ledger. The FCA should allow firms to assess the materiality of the shortfall (i.e. within an agreed risk policy tolerance) in order to decide whether to notify the supervisor. We also disagree with the proposal that the cryptoasset firm should inform customers of any reconciliation difference. Customer notification of a material shortfall in assets is considered to be an existential event for crypto firms and ambiguity in this disclosure could significantly increase risk of a mass exodus of customer deposits, compounding problems and significantly impacting the firm and markets.
- **On asset segregation, firms should have the ability to hold a de minimis amount of house originated assets within client omnibus wallets for operational purposes,** including to (1) support customer business, (2) cover costs incurred from the omnibus wallets, and (3) receive fees denominated in the form of the crypto for which it was earned before sweeping these house assets out of the client omnibus wallet. In our view, this de minimis amount should be no more than 3% of the total omnibus wallet balances.

These perspectives reflect our belief that principles-based regulation, emphasizing robust risk management within flexible operational frameworks, delivers superior outcomes for both consumer protection and market competitiveness in the evolving digital finance ecosystem.

Chapter 3 – *Requirements for issuing qualifying stablecoin*

Question 1: Do you agree that the Consumer Duty alone is not sufficient to achieve our objectives and additional requirements for qualifying stablecoin issuers are necessary?

We support the FCA's assessment that while the Consumer Duty establishes an essential regulatory foundation, it proves insufficient as a standalone framework for achieving the comprehensive objectives necessary for qualifying stablecoins. The Consumer Duty provides valuable baseline conduct expectations, but it must operate alongside targeted, enforceable requirements that directly address the distinctive risk profile inherent in stablecoin operations. Qualifying stablecoins function as money-like instruments within the digital economy, necessitating robust protective frameworks that extend beyond general conduct standards to encompass specific operational safeguards. These include guaranteed 1:1 redemption at par value, maintenance of secure and highly liquid backing assets, and consistent redemption rights that preserve user confidence and payment utility across varying market conditions.

The regulatory framework requires prescriptive clarity to ensure market-wide consistency and prevent fragmented implementation approaches that could undermine consumer protection. While the Consumer Duty establishes broad interpretive expectations, it leaves substantial discretionary space for firms to develop varying operational standards. Without explicit, measurable requirements governing critical features such as redemption timeliness, asset segregation protocols, and backing asset transparency, market participants could adopt inconsistent practices that generate consumer confusion and enable regulatory arbitrage. This variability poses systemic risks to market integrity and consumer confidence in digital payment instruments.

Targeted regulatory requirements directly address the novel risk vectors presented by innovative stablecoin business models that fall outside traditional financial service frameworks. Stablecoin issuers frequently employ complex operational structures that present unique vulnerabilities, including potentially inadequate or opaque redemption policies, insufficient segregation of customer assets from issuer capital, and limited disclosure regarding backing asset composition and liquidity characteristics. Prescriptive regulatory standards provide direct mitigation mechanisms for these specific risks, ensuring that innovation proceeds within protective boundaries that safeguard both individual consumers and broader financial system stability while enabling continued technological advancement in digital payment infrastructure.

Question 2: Do you agree that issuers of multi-currency qualifying stablecoins should be held to similar standards as issuers of single-currency qualifying stablecoins unless there is a specific reason to deviate from this? Please explain why? In your answer please include: i. Whether you agree with our assessment of how multi-currency stablecoins may be structured, and whether there are other models. ii. Whether there are specific rules proposed which do not work for multicurrency qualifying stablecoins, and explain why. iii. Whether there are any additional considerations, including risks and benefits, we should take into account when applying our regulation to multi-currency qualifying stablecoins.

Yes, we agree that multi-currency qualifying stablecoins (MCQS) should generally be held to similar standards as single-currency stablecoins, with targeted adaptations to address their unique structural characteristics. This approach would provide regulatory consistency while recognizing the inherent differences in how MCQS operate.

We broadly agree with the FCA's assessment that MCQS may reference currency pairs or baskets of multiple fiat currencies, including fixed-weight baskets or multilateral exchange rate models. However, the market for MCQS is at an early stage and likely to evolve significantly, with issuers potentially developing innovative structures beyond simple baskets, such as dynamic weighting or hedged synthetic baskets. We encourage the FCA to maintain a technology- and model-neutral stance, focusing on regulatory outcomes like robust backing, transparent redemption rights, and effective risk management rather than overly prescriptive definitions that might stifle innovation.

Several provisions in the single-currency regime require adaptation for MCQS. The definition of "par value" becomes inherently dynamic for basket-referenced MCQS, reflecting FX market movements, requiring flexibility in redemption value calculations. The requirement that backing assets match the reference currency denomination may be impractical, as MCQS by design must hold assets across multiple currencies with appropriate liquidity management and FX risk controls. Redemption mechanics may involve FX conversions, requiring clarification that redemption at "par" means fair value of the basket in the target currency, net of transparent conversion costs. Additionally, MCQS issuers will need enhanced disclosure obligations covering basket composition, FX risk management policies, and redemption conversion methodology.

The benefits of MCQS include reducing cross-border payment frictions and promoting financial inclusion by providing stable value references in volatile currency jurisdictions. However, FX and liquidity risk management is inherently more complex, particularly during market stress, and redemption values may fluctuate in users' local currency terms, potentially creating confusion. We recommend the FCA require robust, documented FX risk management policies, clear expectations for comprehensive disclosures, and maintain flexibility to adapt rules as the MCQS market evolves.

Question 3: Do you agree with our proposals for requirements around the composition of backing assets? If not, why not?

While we appreciate the FCA's intent to ensure stablecoin stability through conservative backing asset requirements, we believe that the proposed restrictions on backing asset composition may unnecessarily limit operational flexibility and innovation without materially enhancing consumer protection. The FCA's conservative approach to limiting default composition to short-term government treasury debt and cash deposits, while introducing some flexibility through "expanded backing assets" with strict limitations, creates operational complexity that could hinder the development of a competitive UK stablecoin market.

As demonstrated by the GENIUS Act's approach, which permits U.S. dollars, short-term treasuries and similarly liquid, high-quality assets while maintaining full 1:1 backing, a more principles-based framework focused on liquidity, credit quality, and transparency can achieve the same consumer protection objectives while preserving issuer flexibility. We recommend the FCA consider expanding the default permitted asset categories to include high-grade money market instruments and allowing market-driven innovation within clear prudential boundaries, similar to successful regulatory frameworks in other jurisdictions. The current proposal's prohibition on passing interest to holders, while aligning with EU rules, may disadvantage UK issuers in the global marketplace and limit the economic incentives for widespread adoption that could strengthen the UK's position as a leading digital finance hub.

Question 6: Do you think that a qualifying stablecoin issuer should be able to hold backing assets in currencies other than the one the qualifying stablecoin is referenced to? What are the benefits of multi-currency backing, and what risks are there in both business-as-usual and firm failure scenarios? How might those risks be effectively managed?

Yes, UK qualifying stablecoin issuers should be permitted to hold backing assets in currencies other than the reference currency, subject to appropriate risk management requirements. While same-currency backing is generally preferable, multi-currency backing would be particularly valuable for sterling-referenced stablecoins seeking to diversify into highly liquid USD assets, or for issuers launching stablecoins referenced to currencies where sufficient UK government securities may not be readily available. This flexibility could enhance the UK's competitiveness as a stablecoin issuance hub by enabling innovative products that serve global markets while maintaining robust backing. The primary benefits include access to deeper, more liquid backing asset markets and the ability to serve diverse international customer bases. However, multi-currency backing introduces foreign exchange management challenges, potential volatility exposure, and liquidation complexities during firm failure scenarios that could impact redemption reliability. These risks can be effectively managed through requirements for mature and liquid FX hedging markets, comprehensive risk management frameworks addressing residual basis risk, and enhanced governance including regular stress testing, daily reconciliation requirements, and prudent asset-liability management. The FCA should consider permitting this approach with appropriate guardrails rather than an outright prohibition, ensuring the UK remains an attractive jurisdiction for international stablecoin innovation.

Question 7: Do you agree that qualifying stablecoin issuers should hold backing assets for the benefit of qualifying stablecoin holders in a statutory trust? If not, please give details of why not.

We agree that qualifying stablecoin issuers should hold backing assets for the benefit of qualifying stablecoin holders in a statutory trust, with one distinct trust established for each qualifying stablecoin issued by an issuer. While the rationale for specifying a statutory trust structure is not explicitly articulated in the consultation, we presume this approach aims to establish a framework analogous to client money protections, potentially incorporating waterfall procedures similar to those outlined in CASS 7.17. This alignment would provide valuable precedent and clarity for market participants.

We do not object to the statutory trust designation, provided it does not impose additional obligations beyond the fundamental requirements to hold title and maintain secure custody of backing assets. The terms of any statutory trust must accommodate scenarios where the trustee may hold portions of the trust property for its own benefit, particularly when the issuer holds its own stablecoins. Consequently, segregation obligations must be carefully structured to permit trust property being partially held for the issuer's benefit without compromising the overall trust framework. Additionally, careful consideration must be given to the relationship between the statutory trust and third-party custody arrangements for backing assets. The custody structure must not undermine the issuer's obligation to hold assets on trust for beneficiaries, necessitating that the issuer retains legal title to the assets in its own name, as appropriately recognized in paragraph 3.95 of the consultation paper.

Question 8: Do you agree with our proposal that qualifying stablecoin issuers are required to back any stablecoins they own themselves? If not, please provide details of why not.

We agree that under this regime issuers should not be allowed to distribute qualifying stablecoins that are not 1:1 backed; however we believe it should be possible for issuers to hold qualifying stablecoins that are not backed as part of the initial minting process prior to distribution. Having an inventory of preminted coins is operationally efficient and leads to better service level agreements with respect to software integrations and ultimately to a better customer response times and experience. We believe the risk of unbacked assets being issued is low and can be managed via internal processes including the FCA's proposed reconciliation processes against blockchain records (for example mandating that unbacked stablecoins must be held in a firm segregated wallet designated for that purpose, which can be disregarded for the purposes of reconciling issued stablecoins vs backing assets), as this will allow more flexibility from a technical perspective and allow an issuer to issue coins more quickly on customer request.

Ultimately, this enables a higher velocity of 'money' onchain without compromising the integrity of the backing assets.

Question 9: Do you agree with our proposal to require third parties appointed to safeguard the backing asset pool to be unconnected to the issuer's group?

We disagree with the proposal to require third parties appointed to safeguard backing asset pools to be unconnected to the issuer's group. Where a group structure includes appropriately regulated entities—such as a credit institution for cash holdings or an investment firm for investment assets—it should be possible to effectively manage conflicts of interest and ensure operational independence through robust governance frameworks. The categorical exclusion of connected parties overlooks the potential benefits of integrated group structures while creating unnecessary market constraints.

Mandating third-party arrangements will generate significant concentration risks given the limited pool of banks capable of providing custody services for fiat assets. The current market already presents challenges in securing basic corporate treasury accounts, and requiring unconcentrated third parties for qualifying stablecoin backing assets will further constrain available options and create systemic dependencies. This requirement will inevitably increase costs for consumers due to the market dynamics that emerge when third-party firms are granted protected market positions that cannot be contested by crypto-native entities. Conversely, permitting the use of connected parties can provide meaningful operational advantages, including enhanced visibility over backing assets and greater influence over safekeeping arrangements. Where group entities are utilized, appropriate safeguards can be implemented through targeted requirements around board independence, comprehensive conflict management protocols, mandatory disclosure requirements, strategic deployment of non-executive directors, and other structural separation measures that provide equivalent assurance of independence without the systemic risks and costs associated with mandatory third-party arrangements.

Question 10: Do you consider signed acknowledgement letters received by the issuer with reference to the trust arrangement to be appropriate? If not, why not? Would you consider it necessary to have signed acknowledgement letters per asset type held with each unconnected custodian?

We consider signed acknowledgement letters to be a pragmatic safeguarding mechanism, though not strictly necessary where the underlying custody arrangement properly aligns with the issuer's trust obligations. Provided that the structural arrangement for asset title and custody directly supports the issuer's requirement to hold assets on trust for qualifying stablecoin holders, acknowledgement letters represent an additional procedural layer rather than a fundamental legal necessity. However, we recognize the incremental protective value that formal acknowledgement provides in clarifying custodial relationships and establishing clear documentary evidence of the trust arrangement. Given the relatively limited administrative burden associated with implementing such letters, we view this as a sensible precautionary approach that enhances transparency and reduces potential ambiguity in custodial relationships. We would recommend that acknowledgement letters be structured at the custodian level rather than segmented by asset type, with a single comprehensive letter per custodian covering all assets held by that entity. This approach provides equivalent protective coverage while minimizing administrative complexity and avoiding unnecessary duplication of documentation across asset categories held with the same custodial provider.

Question 13: Do you agree with our proposed rules and guidance on redemption, such as the requirement for a payment order of redeemed funds to be placed by the end of the business day following a valid redemption request? If not, why not?

While we support the principle of timely redemption to maintain stablecoin credibility and consumer protection, we believe the proposed T+1 requirement may be overly prescriptive and could create operational challenges that undermine both AML/CFT compliance and the UK's competitiveness. Other major jurisdictions including the US and Hong Kong have adopted more flexible redemption standards, and the UK should avoid being an outlier that could disadvantage domestic issuers. The T+1 requirement fails to adequately account for legitimate delays in customer onboarding processes, where AML/CFT checks can require up to 60 days depending on customer complexity and risk profile. We recommend the FCA adopt a more principles-based approach that requires "prompt" redemption for pre-verified customers while allowing reasonable extensions for necessary compliance procedures. This would align with international best practices, preserve the integrity of financial crime prevention measures, and ensure the UK remains an attractive jurisdiction for stablecoin innovation while maintaining appropriate consumer protections.

Question 14: Do you believe qualifying stablecoin issuers would be able to meet requirements to ensure that a contract is in place between the issuer and holders, and that contractual obligations between the issuer and the holder are transferred with the qualifying stablecoin? Why/why not?

Yes, qualifying stablecoin issuers should be able to meet requirements for contractual structures that transfer obligations with token movement, as tokenization technology inherently enables sophisticated UK law contractual frameworks that facilitate the transfer of contractual rights through token transfers. Contracts can be structured to grant all tokenholders specific rights, with counterparties defined by reference to current token ownership, creating a dynamic contractual relationship that evolves with token transfers. Holders would demonstrate current token ownership to exercise rights under the issuer agreement, or prove historical ownership for specific time periods when seeking to enforce past obligations that should have been discharged by the issuer.

This structural approach already exists within established UK financial markets through securitization and loan note arrangements, where in some transactions deed poll mechanisms are used to enable issuers to unilaterally execute instruments while allowing a fluid pool of beneficiaries to enforce terms without requiring individual consent to contractual conditions. The technological infrastructure of blockchain-based tokens provides enhanced transparency and verifiability compared to traditional bearer instruments, as token ownership can be cryptographically verified and historically tracked, creating a more robust foundation for contractual enforcement while maintaining the operational flexibility required for liquid digital asset markets.

Chapter 4 – *Regulating custody of cryptoassets*

Proposed regulatory approach

Question 18: Do you agree with our view that the Consumer Duty alone is not sufficient to achieve our objectives and additional requirements for qualifying cryptoasset custodians are necessary?

We agree that the Consumer Duty alone is not sufficient to achieve the FCA's objectives and additional requirements are necessary for the safeguarding of UK customers' cryptoassets. We have read the FCA's proposals to regulate custody of cryptoassets with interest and note the very positive direction of travel. We believe the FCA custody team has undertaken significant work to understand how cryptoasset markets work in practice and, as a result, have set out proposals that are proportionate and that reflect the specificities of the market, while at the same time aligning where possible with the requirements applied in a traditional finance context, pursuant to the "same risk, same regulatory outcome" principle.

In particular, we note that the FCA had at one stage been considering a requirement for custody activities to take place in a separate legal entity from other activities. As set out in Coinbase's response to DP 23/4 on *Regulating Cryptoassets Phase 1: Stablecoins,* mandating legal separation would increase costs to clients, introduce potential frictions and vulnerabilities during trading activity, and result in operational inefficiencies, all while in our view not delivering additional benefits in terms of addressing conflicts of interest or bankruptcy remoteness. Whilst it should be an option to operate a separate exchange and custody arrangement, it should not be mandatory; clients benefit most from flexibility and choice in custody models. We are, therefore, strongly supportive of the most recent proposals set out by the FCA, whereby customers' cryptoassets should be held in trust to deliver ownership rights, asset segregation, and bankruptcy remoteness.

Furthermore, the UK is proposing a framework that requires a UK-based authorised custodian, but which allows for the appointment of a sub-custodian within the group; this affords the benefits of firms seeking best in class, mature, global custody infrastructure arrangements, whilst aligning with the provisions set out in CASS, in a traditional finance context. We are strongly supportive of the FCA's proposals in this regard, and believe that the trust proposals should deliver a high level of confidence in the UK regime for users, without compromising on firms' operational efficiencies.

This arrangement would be supplemented by a provision in the draft Statutory Instrument (SI), which states that cryptoassets held "temporarily and specifically for the purpose of settling trades" are excluded from "safeguarding" requirements. This is important where there *is* a separate custodian (with cold/vault storage) from the exchange (where the "hot" wallet is housed), regardless of whether the custodian/exchange is based in the UK or internationally. It is not possible to send assets directly from vault storage, as this is much slower: the ability to hold assets temporarily on the exchange therefore preserves access to deep liquidity pools and near instant transfers.

It is important that this exemption covers two trade flows relating to both "settlement" and "execution"; in the context of MiCA, the ESMA opinion on this topic refers only to "settlement", which has raised complex implementation challenges for firms. This is an example of where the UK's second mover advantage can deliver tangible improvements on how regulatory regimes are designed and implemented compared to other jurisdictions. By way of further information on the two trade flows in question for this exception, we believe this should apply in the following instances:

- Firstly, when UK customers are buying cryptoassets in exchange for fiat or another cryptoasset, or there are incoming deposits. As part of the **settlement process** these cryptoassets land in the hot wallet in the first instance and time is needed for these assets to be flushed into vault storage (i.e. custody); and

- Secondly, when a UK customer wants to withdraw assets or send assets off platform, **execution** must happen on the exchange. To **facilitate this execution**, there needs to be a cycling buffer of cryptoassets that flows through the exchange on a regular basis (otherwise known as "pre-funding"). As mentioned above, assets cannot be sent directly from vault storage as this is much slower and does not allow for instant transfers.

As part of this, CATPs must estimate what funds need to be held on the exchange to facilitate settlement and execution, and define the rebalancing thresholds subject to regulatory requirements. For example, when there are excess funds on the exchange, these assets are flushed back into custody, and when they are depleted, assets will be cycled back to the exchange for pre-positioning, to facilitate execution. By way of jurisdictional comparisons, Canada requires 80:20 and Singapore 90:10 of assets held in vault storage versus hot wallets (whereas in the EU this ratio is determined by supervisors on a firm by firm basis). In terms of the rebalancing window, Coinbase follows a 12 hour cycle in all jurisdictions.

A key outstanding question for the industry is on the interaction between the licensing arrangements set out in DP 25/1 on *Regulating Cryptoasset Activities* and the custody requirements set out in CP 25/14 on *Regulating Stablecoin Issuance and Cryptoasset Custody*. In particular, it is our assumption that the FCA intends for the CATP's UK regulated subsidiary (which sits alongside the proposed regulated branch) to be appointed as the UK-licensed custodian. This means that the UK-licensed cryptoasset custodian may also, for example, be an e-money institution. It is important that the FCA makes clear that it is possible for the UK based subsidiary to attain multiple licenses across different activities and offer multiple services so as to prevent the proliferation of entities under the UK-based regime, which is both unnecessary and costly for firms wanting to undertake business in the UK. Furthermore, where the UK-based subsidiary performs custody activities, this may inevitably lead to separation of exchange versus custody activities, where there is also a branch of a global exchange in the UK. In this instance, there may therefore be separation of the custody from exchange activities. The implications of this should be carefully considered; for example on the need for a portion of assets to be held on the global exchange for settlement and execution, as noted above.

Further, it should be the responsibility of the UK-licensed custody entity to ensure that the sub-custodian meets the necessary high standards for key management and security; we believe the FCA should go further than its proposals and require that any appointed third party for cryptoasset custody should be a regulated entity within its jurisdiction. However, it is also important that the FCA should not impose specific operational requirements which may conflict with the sub-custodian's own regulatory obligations. We further note that current security best practices involve separating, storing, and operating wallet key materials across different locations and time zones. Any requirement for specific human or technical resources to be exclusively located in the UK could materially undermine the availability and resiliency of secure wallet operations. This is an issue we return to in our answer to Question 23.

Segregation of client assets

Question 19: Do you agree with our proposed approach towards the segregation of client assets?

We agree that segregation of client versus firm assets should form a core element of any custody regime for cryptoassets, to ensure only appropriate use (and avoidance of misuse) of client assets, and to ensure bankruptcy remoteness. We further agree with the FCA's proposals on the requirement to establish a non-statutory trust over client assets, in order to strengthen the position on ownership and asset segregation in the event of insolvency of the custodian. We agree that the custodian should be able to operate as a bare trustee and rules should be drafted such that they do not prevent custodians from being able to actively disapply elements of the Trustee Act 2000 (including the duty of care within article 1(1) of the Trustee Act 2000) in order to ensure that the custodian can act as a true bare trustee regardless of whether the client is retail or professional, with an obligation simply to hold title and keep the assets safe on trust for the beneficiary.

On asset segregation specifically, as noted in paragraph 4.24, firms should have the ability to hold a de minimis amount (in our view, no more than 3%) of the total omnibus wallet balances) of house originated assets within client omnibus wallets for operational purposes to (1) support customer business, (2) cover costs incurred from the omnibus wallets, and (3) receive fees denominated in the form of the crypto for which it was earned before sweeping these house assets out of the client omnibus wallet. This number can vary significantly based on the type of services provided. The amounts needed for typical retail activity are quite low, and significantly higher for activity that entails services provided to institutional clients such asset managers and market makers, whose trade flows are more complicated.

CASS 6.2.6 contemplates the use of firm funds in customer accounts in limited circumstances, for example where this is necessary for operational or compliance purposes and arises incidentally to investment business carried out for a client. We believe that an analogous provision should similarly be included for cryptoassets, given how the cryptoasset market operates and how cryptoassets are transacted.

The need for house originated assets to be held in the omnibus wallet primarily arises from two situations:

1) **To pay onchain gas fees for both firm & customer-initiated onchain movements (payables).**

   Platforms incur gas fees when moving assets between wallets, including between hot and cold wallets. Some of the movements are not customer initiated; they are firm generated movements (e.g. for security reasons moving assets from hot to cold wallets), so it is incumbent on the firm to pay these fees. For this to happen, firm funds must be in the same wallet as the asset that the firm is moving.

   Firm funds are also required to cover gas fees incurred as a result of customer-initiated transactions. Charging fees in advance of transfer is often impractical because the expected gas fee is typically different from the incurred fee. These deviations occur because it is impossible to know exactly what the fee will be in advance of a block being recorded. To provide certainty to customers, and to ensure the transaction is completed as intended, current market practice is for platforms to pay gas fees on behalf of customers, and then be compensated in the form of a fee, although many platforms also offer to subsidize these fees in whole or part.

   If firms do not have the option to keep house originated assets in omnibus wallets, it is not clear how platforms would balance between cold and hot wallets, potentially delaying settlement or action upon customer instructions. Moreover, because customers would be required to pay upfront the full gas fees, and because gas fees cannot be predicted in advance, it would be challenging for a customer to attain a zero balance without risking a transaction failure. These options would, at a minimum, increase costs for customers and provide an inferior customer experience (such as by delaying settlement or access to customer assets).

2) **When firms earn Commission paid in crypto e.g. for staking services / crypto to crypto trades (receivables).**

   For crypto-to-crypto trades, platforms earn fees on transactions, which accrue in the omnibus wallet. Similarly, when providing staking services, the rewards accrue in the omnibus wallet from which the assets are staked, and fees owed to the custodian providing those services are earned as a percentage of those rewards. There is no technical solution to prevent these new house assets from originating in an omnibus wallet. The most that could be done is to immediately sweep any firm receivables into a separate onchain wallet the moment they are earned. However, realtime asset sweeps would involve an enormous number of onchain movements, substantially increasing operational costs, which would ultimately be borne by customers.

   These house originated assets are "in flight" and should be allowed to sit within firm omnibus wallets until they are swept out, in a batch process, and at a rate determined by permissible thresholds of omnibus house assets.

Having considered all options, we strongly believe that the best way for firms to manage their business is by permitting a de minimis amount of firm originated assets in the customer omnibus wallets, as the "cleaner" and safer approach. We believe that: (1) with appropriate safeguards around these de minimis balances (e.g. clear segregation of client and firm assets preserved at all times through the internal ledger system), and (2) using a "waterfall" arrangement for the statutory trust, similar to that adopted by exchange-traded product issuers for distribution of assets (i.e. where client monies are paid out in full prior to any assets being remitted back to the firm) - would additionally reduce client risk by ensuring that firm assets would be used to make clients whole.

i. Do you agree that client qualifying cryptoassets should be held in non-statutory trust(s) created by the custodian? Do you foresee any practical challenges with this approach?

Yes, we agree. A non-statutory English law trust structure is a well-established concept globally that provides a robust way of holding assets safe for beneficiaries and therefore would provide confidence to cryptoasset owners when placing their assets in custody with a UK custodian.

In terms of practical challenges, we note the existence of the Trustee Act 2000 which places a range of obligations on trustees of English law trusts, very few of which are appropriate for this type of trust arrangement. It is common in many traditional finance arrangements that use English law trusts to contractually disapply a wide range of obligations within the Trustee Act such that the trustee can operate as a true bare trustee; typically trustees would require beneficiaries to agree to disapply Parts I, II, III and IV of the Trustee Act and the requirement to discharge the duty of care in Section 1(1) of the Trustee Act. The Trustee Act itself allows for this disapplication to take place and therefore we would advocate for the rules relating to trusts for cryptoasset custody to not cut across this, such that custodians can operate as true bare trustees, essentially with limited obligations simply to hold title to the assets and keep them safe, with an obligation to return them to the beneficiary on request. This would meet the aims of the FCA to provide an insolvency-remote structure that is robust, without placing undue burden on the custodians to meet trustee obligations, which are not appropriate given the nature of the custodial relationship.

Related to this is the "chain of custody" where a third party is appointed by the UK custodian to hold the assets on the custodian's behalf (in line with paragraph 4.63 onwards, discussed further below). We note in paragraph 4.66 the proposed requirement for the sub-custodian appointed to acknowledge that the UK custodian holds the assets on trust for its clients; this raises the question of how the sub-custodian, if it is not UK-based, will hold the assets for the UK custodian. We strongly agree that the use of third parties for sub-custody should be allowed under the new rules, but would suggest that the UK custodian be under an obligation to ensure that it sets up its sub-custody relationships in a way that will not cut across the validity of the trust declared by the UK custodian, to avoid any conflict of law or other arrangements that could cause the UK custodian to be in breach of the trust it has established for its clients.

Another practical challenge is in relation to omnibus wallets, as further discussed below.

ii. Do you have any views on whether there should be individual trusts for each client, or one trust for all clients? Or whether an alternative trust structure should be permitted.

The FCA will of course be aware that, to establish an English law trust, the "three certainties of trust" (certainty of intention, subject matter and objects) must be satisfied. At the same time, we believe there should be as much simplicity as possible and therefore, provided that one trust for all clients within a certain product set can satisfy the three certainties, this would be the appropriate approach.

What we mean by the concept of "one trust for all clients within a certain product set" is that generally custodians will be able to define different populations of clients, which receive slightly different products or receive custodial services in slightly different ways. For example, retail customers who custody assets with an exchange will generally have their assets custodied within client omnibus wallets, whereas institutional clients that have large holdings may choose to take an individually segregated custody solution. Given that the wallet architecture underpinning each product will be different, that different sets of terms and conditions will govern these product sets, and that given that those terms are likely where the custodian would choose to declare the trust, we would therefore suggest it is sensible that different trusts be established for each individual product set, as follows:

- for omnibus clients, one trust would be established over the omnibus wallet assets, with all clients holding assets within those wallets being beneficiaries as tenants in common under that one trust; and
- for solutions where segregated wallets are used on a per-client basis, each client would have its own trust declared over the assets in the wallets attributed to that client.

In relation to the three certainties for these different options, we believe it is possible to establish certainty for each of them, although we discuss this further in relation to omnibus wallets below. Essentially our view is that, provided that the custodian's terms and conditions clearly establish a trust, that clients can be clearly identified and that books and records managed by the custodian clearly attribute assets to individual clients, then regardless of the structure operated, an effective and enforceable trust can be established.

However we would suggest that ultimately it should be for the custodian to choose how they wish to arrange the trust structure, based on their client base, wallet architecture and how they structure their legal agreements with clients. Our view is that the trust concept is sufficiently flexible to operate effectively in a wide range of different scenarios, as long as the three certainties have been appropriately satisfied; therefore we believe it would be inappropriate for specific inflexible obligations to be set by the new rules in relation to the shape or establishment of trusts over assets and instead custodians should be given flexibility to establish as they see fit to meet their own circumstances.

iii. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet?

Generally no, as long as the requirement of certainty of subject matter (which we believe to be the only "certainty" which may not be so obviously met in an omnibus context) is established. In practice this means ensuring that, where the assets are in an omnibus wallet, adequate books and records are maintained by the custodian to ensure that the omnibus holdings can be clearly split between the beneficiaries in accordance with their expected holdings.

In practice, our view is that the record keeping requirements should be easily met by the custodian based on existing processes, which should be well established, given that management of client assets within an omnibus account is a core function of the custodian's business. When combined with account management processes which display individual balances to clients, our view is that establishing certainty of subject matter should not be operationally complex in relation to omnibus holdings.

iv. Do you foresee any challenges with these rules with regards to wallet innovation (eg the use of digital IDs) to manage financial crime risk?

We do not foresee significant challenges with these rules regarding wallet innovation, particularly digital IDs, given that the FCA's proposed framework is outcomes-based and technology-agnostic. This flexible approach allows custodians to integrate cutting-edge digital identity solutions that enhance financial crime risk management without being constrained by restrictive technical mandates, thereby fostering innovation rather than hindering it.

Recording clients' qualifying cryptoasset holdings

Question 20: Do you agree with our proposed approach towards record-keeping? If not, why not? In particular, do you foresee any operational challenges in meeting the requirements set out above? If so, what are they and how can they be mitigated?

We agree that accurate books and records are essential for ensuring a custodian holds the correct amount of assets in custody for a client at all times, reducing opportunities for fraud and loss of assets, as well as facilitating a prompt return of assets if a firm fails. We believe that custody requirements should draw on established practices in traditional finance, with adaptations to reflect the nuances of how cryptoasset markets operate in practice. The existing CASS framework for traditional finance provides detailed requirements for firms to keep accurate books and records, including for omnibus wallets (e.g. requirement for regular reconciliations), and should be applied to cryptoasset markets, based on the "same risk, same regulatory outcome" principle.

We note that the FCA previously stated that firms could rely upon on-chain records to help meet its record keeping requirements. At the time, Coinbase responded to say that this new technology should not result in additional record keeping requirements for cryptoasset firms compared with traditional financial services firms – but that on-chain records should provide an additional layer of useful information to comply with the existing record keeping requirements under CASS. However, we note that the FCA states in this Discussion Paper that the books and records must be "maintained independently from the relevant DLT used by the firm and not supplemented by records kept by third parties or on the blockchain". We found this statement to be confusing and believe the FCA should clarify that, by this, it means there is a primary obligation on firms to run their own independent internal ledger, which can subsequently be used to reconcile against the blockchain. On-chain data provides additional and publicly and independently verifiable information that delivers enhanced disclosure relative to traditional custodial practice. The relationship between the internal ledger and verified blockchain data is crucial for the reconciliation process and reflects how cryptoasset firms operate in practice, under an omnibus wallet model.

Further, it is also critical that, where the UK-licensed entity has appointed an entity within the broader group as the sub-custodian, the obligations on the UK regulated custodian with regards to record keeping are not such that it makes sub-custody arrangement impossible in practice. The sub-custodian should be responsible for maintaining accurate books and records; however, it may be that UK customer positions are sent from the sub-custodian to the UK-licensed custodian periodically.

More generally, with respect to re-use of client assets in a retail context, we would recommend changes to CASS 6.4.1A to widen the circumstances in which retail client assets can be rehypothecated. At present only securities financing transactions are permitted for retail client assets, and we believe this is likely too restrictive in the context of cryptoasset markets, particularly when considering the possible new authorisation around cryptoasset lending that may be incoming, which could allow a properly regulated form of rehypothecation in the context of retail assets.

Specifically, with regards staking, we note that when a token owner participates in the proof-of-stake consensus mechanism, the staked assets are, for the duration of the process, delegated to a validator node. However, during this period, the ownership rights of staked assets remains unchanged. This process is unparalleled in traditional securities markets and, although we do not consider delegation of assets to a validator to be rehypothecation, its regulatory treatment would benefit from an express carve-out from the provisions of CASS 6.4 for clarity. Staking is critical to the operational infrastructure of the underlying blockchain and it should be made clear that staking can be appropriately performed by custodians without having to follow the requirements of CASS 6.4 (which are not appropriate in the context of staking).

Today, many crypto service providers offer staking as a service in exchange for a fee. This service can be structured such that customers instruct their custodian to stake their assets for the purpose of validating transactions, but throughout the process the customer retains full ownership over their staked assets. During this period the client agrees to lock-up assets and temporarily give up potential alternative uses (an opportunity cost). In exchange, the proof of stake protocol pays an award for the validation service, and from this award a fee is paid to the service provider.

In this context, the custody rules should make clear that a custodian may receive an ancillary instruction to stake custodied assets, while holding customer keys. Carrying out this instruction may require the custodian to perform ancillary technical functions beyond merely custodying the asset. Accordingly, we believe that the service of staking should not be considered as rehypothecation activity or other "right of use" for a custodian, and the regulations should make that clear.

Question 21: Do you agree with our proposed approach for reconciliations? If not, why not? In particular:

i. Do you foresee operational challenges in applying our requirements? If so, please explain.

We agree with the proposals set out. CATPs should be required to regularly perform internal reconciliations to ensure accuracy of the internal ledger and to identify and resolve any discrepancies that arise. The standards applied to digital assets custodians should track those required of traditional financial firms – the internal ledger should keep track of internal customer holdings (i.e., what is ledgered to the individual customer accounts) and transaction history, and the reconciliation process should ensure that the sum of the internal ledger equals the sum of funds reflected for the omnibus addresses on the blockchain.

We note that the FCA is no longer proposing to require custodians to conduct reconciliations of each client's cryptoassets "on a real-time basis" to identify and resolve discrepancies; this is positive, as real-time reconciliation is neither necessary nor practically possible. Broadly, we agree that reconciliations should take place "each business day" for all cryptoassets; we understand this to mean that the reconciliation process should take place by T+1, consistent with existing standards in traditional finance. Importantly, the reconciliation process cannot take place "within" the business day (i.e. T+0) as there needs to be sufficient time for the transactions to settle, to collect data and undertake reconciliations and further checks.

ii. Do you foresee challenges in applying our proposed requirements regarding addressing shortfalls? If so, please explain.

We disagree with the requirement to notify the FCA if a shortfall is unlikely to be resolved by the next reconciliation (i.e. the next business day), particularly given that this notification requirement includes setting out details of why the shortfall has arisen, the extent of the shortfall, number of clients affected, and the firm's expected timeframe for resolving the shortfall. This approach does not work in practice as there are often shortfalls for non-critical reasons, largely due to timing differences between transactions being processed on-chain versus on the internal ledger, which can represent valid payment controls and transaction validation. Daily rebalancing resolves any shortfalls, eliminating the risk to clients; reconciliation resolution processes investigate and resolve breaks within standard operating timeframes. In this context, it is important that the FCA determines what it deems to be a “shortfall” such that it requires FCA notification. We note three challenges with the proposals in this regard.

First, it is not practical to require firms to notify the FCA of every shortfall, regardless of the materiality. For example, there may be instances where the reconciliation difference may be for a non-critical reason (as mentioned above) or to the value of only a few pounds-worth and is therefore non-material. As a result, reporting the shortfall may be a larger operational lift than fixing the issue; it is therefore critical that the reporting requirement is commensurate with the risk posed and the potential impact. To reflect this, the FCA should allow firms to assess the materiality of the shortfall (i.e. within an agreed risk policy tolerance) in order to decide whether to notify the supervisor.

Second, we disagree with the proposal that the cryptoasset firm should inform customers of a reconciliation difference if the shortfall is not resolved by the next reconciliation, for all the reasons set out above. Again, there are potential timing and data flow issues that can occur, which may not be resolved by the next reconciliation, but which do not mean the clients’ assets are not secure. Alarming customers in these instances is unnecessary, (particularly where the shortfall is covered with firm assets), and potentially harmful. Customer notification of a material shortfall in assets is considered to be an existential event for crypto firms and ambiguity in this disclosure could significantly increase risk of a mass exodus of customer deposits, compounding problems and significantly impacting the firm and markets.

Finally, where a firm determines that the shortfall is material and the FCA should be notified, it is unlikely the cryptoasset firm will have all the information, set out as part of the required notification process, at its disposal within one day. We strongly believe that where the cryptoasset firm notifies the FCA that there has been a material shortfall prior to the next reconciliation, it does so with a view to returning to the FCA with further information once a full investigation has been undertaken to understand the reason for the shortfall, the extent of the impact and a plan for resolving the shortfall. Investigations and addressing shortfalls can take more than one day.

Minimising the risk of loss or diminution of clients’ qualifying cryptoassets

Question 22: Do you agree with our proposed approach regarding organisational arrangements? If not, why not?

We would note that limited information has been provided in the Consultation Paper on specific arrangements to be implemented here, although we understand that the FCA intends to broadly implement the position described in Chapter 6 of DP23/4 on *Regulating Cryptoasset Phase 1: Stablecoins*. In our response to DP23/4 we broadly agreed with the concepts described in Chapter 6 but now believe more information is required on the FCA's intended approach to cryptoasset custodians.

One additional point to raise in this context is the FCA's proposal to allow custodians to be able to appoint third parties to support with custodial activities, subject to certain requirements. As noted below we strongly agree with this approach and would therefore urge the FCA to take this concept into account when designing the rules relating to organisational requirements, to ensure that the rules are not so onerous as to make use of third parties impossible in practice, or to impose operational rules on the UK firm which would need to be flowed down to third parties that may operate under third country regulatory obligations.

In relation to wider potential restrictions on assets held in custody, if the CASS framework is applied, the custodian should be allowed to use assets in certain, limited circumstances. With express client consent, we believe there are some appropriate use cases where client assets (including retail client assets) may be rehypothecated safely and for the benefit of the client, for example crypto lending activity to the extent the firm is authorized under the UK's future cryptoasset regulatory framework to do so.

Question 23: Do you agree with our proposed approach regarding key management and means of access security?

We are strongly supportive of the FCA's technology-agnostic and outcomes-based approach to key management, requiring firms to have adequate organisational controls and arrangement, including to make sure that private keys and the means of access to cryptoassets are generated, stored and controlled securely throughout their lifecycle.

We believe that it is important that the proposals on key management work in the context of the FCA's broader proposals that allow for the UK-licensed custodian to appoint a sub-custodian within the group, including those outside the UK. This means that it should be the responsibility of the UK-licensed entity to ensure, through appropriate due diligence, that the sub-custodian meets the necessary high standards for key management and security. We believe the FCA should go further than its proposals and require that any appointed third party for cryptoasset custody should be a regulated entity within its jurisdiction. However, it is also important that the FCA does not impose specific operational requirements that may conflict with the sub-custodian's own regulatory obligations.

Importantly, we note that current security and resilience best practices mandate separating, storing, and operating wallet key materials across different locations and time zones. Geographic separation of human capital, wallet operations infrastructure, and cryptographically enforced consensus eliminates the ability to compromise the safeguarding of assets through a single point of failure and minimizes the potential damage of an isolated security breach within any single jurisdiction. Any requirement for specific human or technical resources to be exclusively located in the UK could materially undermine the availability and resiliency of secure wallet operations.

Requiring a custodian to localize operations in each jurisdiction it operates within undermines both customer protection and efficiency. Notably, it would require custodians to build redundant infrastructure – opening additional attack vectors – and split resources across jurisdictions – thereby significantly lowering economies of scale. More generally, any requirement or incentive to limit the ability of a custodian to realize economies of scale could result in an underinvestment in security and technology best practices.

We have observed that some jurisdictions have imposed operationally prohibitive localisation requirements on custodians, which includes requiring storage of digital assets (keys) and/or custodial personnel to reside within a jurisdiction. We believe the better approach is for jurisdictions to accommodate global models that - due to their distribution (i.e. reducing concentration risk) - deliver best in class security arrangements. What remains is to ensure that customers have appropriate legal protections, and in particular, priority over all other creditors in the event of insolvency of the relevant intermediary or platform.

One example of this, Coinbase Japan Exchange was required for all wallet operations to have localized approval, which unnecessarily created a delayed access experience for Coinbase Japan Exchange clients. Notably, crypto markets are 24/7/365. However, having only Japan domiciled employees available to perform hot wallet liquidity approvals during local business hours created service level agreement ("SLA") delays for wallet operations. Due to labor laws, we were only able to perform transactions on a "best effort" basis and rely on voluntary availability of authorized approvers outside of normal business hours. This localization requirement also lowered our ability to ensure Coinbase Japan Exchange's business continuity. The requirement for Coinbase Japan approvers created a business continuity risk for the Coinbase Japan exchange where, in the case of a critical business disruption in Japan (e.g. due to technical and/or natural disasters), liquidity would necessarily freeze for the Coinbase Japan exchange until authorized approvers were back on-line.

Our strong view is that best practices for secure processing centers and storage locations for custody solutions should be designed, from first principles, to be geographically distributed across multiple time zones and continents, and regulators should refrain from specific human and technical resource localisation requirements.

coinbase

Question 24: Do you agree with our proposed approach to liability for loss of qualifying cryptoassets? In particular, do you agree with our proposal to require authorised custodians to make clients' rights clear in their contracts?

We are supportive of the UK's proportionate approach to liability, whereby the Treasury's draft legislation does not seek to impose full, uncapped liability on the custodian in the event of a malfunction, hack or other loss that was not within the custodian's control. The regulatory standard of care applicable to cryptoasset custodians should be consistent with the existing CASS framework applicable to traditional financial instrument custodians; it should be fault-based (rather than strict liability), holding firms to account for their gross negligence and failures to maintain adequate systems and processes. We believe the FCA's proposed liability regime that recognises the limitations in what a custodian can be responsible for, is the right approach.

In terms of current practice, Coinbase establishes with our clients a contractual obligation to exercise reasonable skill and care under our terms and conditions, and where we do not fulfill this requirement or fall short of this standard, Coinbase is liable to reimburse customers. For example, if there is an issue at protocol level, this is outside of the custodian's control and therefore does not give rise to liability for Coinbase, as opposed to mis-management of private keys for which Coinbase would be liable. We believe that this approach is in alignment with the proposals by seeking to impose liability where events causing loss are as a result of the custodian's failure to exercise reasonable skill and care.

We further agree with the FCA's approach that the UK-licensed custodian should retain liability for losses (subject to the limitations set out) even where third parties are used , and also agree that the assignment of liability then between the UK custodian and the sub custodian should be determined by contractual arrangements which are a matter of negotiation and agreement between regulated UK custodian, the sub-custodian.

We note that the FCA will consult on proposed rules relating to how firms ensure that clients' rights are clear in their contracts, including setting out their safeguarding obligations and when the qualifying cryptoasset custodian (or any third party) would be liable for any losses. We suggest that the FCA applies different disclosure requirements based on whether the client is retail or institutional, reflecting that institutional investors are more sophisticated.

Governance and control over safeguarding arrangements of clients' qualifying cryptoasset holdings

Question 25: Do you agree with the requirements proposed for a custodian appointing a third party? If not, why not? Do you consider any other requirements would be appropriate? If not, why not?

Sub-custody is a common practice in traditional finance and firms should be permitted to use third parties to provide custody services that are subject to rigorous due diligence and third-party risk management standards. The same approach should be taken for crypto asset custody. We agree with the proposal to allow custodians to use third parties to support custody activities; this affords the benefits of firms seeking best in class, mature, global custody infrastructure arrangements, whilst aligning with the provisions set out in CASS in a traditional finance context. We believe that this is a strong positive step, which differentiates the UK's proposed regime from the EU's MiCA, within which custodial arrangements have been designed in an unduly restrictive way which significantly limits the operational flexibility of firms, and increases costs to clients. Specifically, we welcome the proposal that allows firms to appoint sub-custodians to hold cryptoassets of the firm's clients. The sub-custody concept is one already well established within the UK's CASS rules and therefore we believe it is positive that it should be carried across into the UK cryptoasset regime, in line with the "same risk, same regulatory outcome" principle.

Permitting the appointment of a sub-custodian that is not UK-based can strengthen the regulatory objectives of preventing misuse of client assets and making sure that client funds remain protected at all times, including in the event of insolvency. This is important to UK clients; they should have access to a network of reputable custodial platforms, including those outside the UK. It is also critical that UK custodians are able to utilize technology and infrastructure from third parties under appropriate outsourcing arrangements (which should not be considered sub-custody), to ensure they are able to provide best-in-class custody services. Offshore sub-custodians are widely used in traditional financial markets, and this practice is expressly permissible under the existing financial services framework for financial product custody arrangements.

Proper safeguarding of customer assets is critical to consumer protection and ensuring trust in the industry. We agree with the FCA that it is imperative that the UK-licensed custodian is satisfied that the sub-custodian can perform its safeguarding duties to a high standard and that there are potential risks associated with appointing a third party custodian; key to addressing these risks, we believe, is ensuring that the UK-licensed custodian can only appoint a sub-custodian that is licensed to perform this activity in its home jurisdiction.

Security & Operational Requirements In Sub-Custody Arrangements

We believe it will be common for firms to operate a UK-regulated custodial entity, and then appoint a sub-custodian within its group, in another jurisdiction. Importantly, where there is the appointment of a sub-custodian in a different jurisdiction, it is critical that the FCA does not impose operationally prohibitive localisation requirements on custodians. Current security best practices involve separating, storing, and operating wallet key materials across different locations and time zones. Any requirement for specific human or technical resources to be exclusively located in the UK could materially undermine the availability and resiliency of secure wallet operations, and undermine the FCA's approach to sub-custody.

As a further point, there is a risk that local operational requirements may be imposed in a way that prevent firms from being able to sub-custody effectively; for example, if the UK's regime requires very specific and onerous key management obligations (for example), that would require the third country regulated custodian to adopt UK requirements such that the UK-regulated custodian can meet its regulatory obligations. This leads to a conflict of obligations for the sub-custodian, which will have its own regulatory requirements to uphold which may be different to the UK requirements. Therefore, we urge the FCA to ensure that the rules on custody in the UK take into account the practical realities of sub-custody and allow the UK firm to meet its obligations through principles-based requirements, which can be reviewed for compliance through due diligence, and satisfied by third country firms without them having to meet specific, strict UK requirements.

Sub-custody vs Technical Service Provision

It is important to recognize the difference between a genuine sub-custody arrangement and the outsourcing of technical and operational arrangements to allow for custody of crypto assets. Both are important. We believe that crypto-asset custodians should be able to utilize technology and infrastructure from third parties through suitable outsourcing arrangements, without involving the transfer of assets into the custody of a third party. This will improve custodians' operations, systems and controls, providing greater protection to clients' crypto assets.

We recommend that the concepts around sub-custody used in CASS 6 are reviewed and updated to reflect this difference so that there is clarity around what arrangements are genuinely sub-custody and therefore are required to be operated in accordance with CASS 6 requirements, and what is a technical service that should be considered an outsourcing arrangement. The latter should not be considered sub-custody arrangements.