coinbase

To:
Nikhil Rathi
Chief Executive Officer
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

13 June 2025

Discussion Paper on *Regulating Cryptoasset Activities*

Coinbase Global, Inc., together with its UK subsidiary CB Payments Ltd. and its other subsidiaries (**Coinbase**), appreciates the opportunity to respond to Discussion Paper DP25/1: *Regulating Cryptoasset Activities* (**Discussion Paper**) published by the Financial Conduct Authority (**FCA**).

Coinbase is the most trusted service provider of crypto trading, custody, and infrastructure in the world. Founded in 2012 and publicly listed on the NASDAQ, we offer a secure and user-friendly interface for millions of verified retail and institutional investors globally. We are committed to building an open financial system and are doing so with the strongest regulatory compliance and security protocols available.

Coinbase is committed to the UK, where we have a significant presence reflecting its importance as our largest international market outside of the US. The Government has delivered a powerful message to the market that it is open to cryptoasset businesses, giving firms like Coinbase the confidence to invest, grow in the UK. Our recent FCA VASP registration further strengthens our commitment to innovate here.

We are excited to follow the progress the UK is making in its mission to become a global centre of tokenisation and Web3 excellence, and we appreciate the thoughtful and strategic approach the FCA is taking to regulate the sector. We stand ready to support the FCA, as it develops a regulatory framework that raises standards across the industry, protects consumers, and delivers on the Government's ambitions to put the UK on a strong competitive footing in the journey towards Web3.

Yours sincerely,

Tom Duff Gordon

VP, International Policy, 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 enable people to transfer value quickly and at lower cost, particularly for cross-border transfers. Stablecoins that put fiat currencies on digital rails will drive competition in the payments space. Decentralised finance, smart contracts, and related new technologies will drive further innovation and exponentially expand opportunities for the financial system. Yet, cryptoassets are more than a financial innovation; they have the potential to transform every sector of the economy. Today's internet is dominated by a handful of companies that profit from monetising their users' personal data. The next phase of the internet's development, web3, will be owned by builders and users and will be driven by tokens, creating a more decentralised and community-governed version of the internet.

The depth and strength of the UK's capital markets, globally respected regulators, and deep talent pools all combine to present a unique opportunity for global tech and financial leadership. Now, a well-designed and implemented cryptoasset regulatory framework will put the UK at the forefront of the digital finance revolution. While the UK has already shown impressive leadership to date, other jurisdictions are making significant headway in delivering legal and regulatory certainty to the market. It is time for the UK to seize the opportunity and move quickly to bring its digital asset regulatory framework to reality; the Discussion Paper is an important step in this regard.

Overview of Key Points

We are grateful for the opportunity to respond to the FCA's Discussion Paper on *Regulating Cryptoasset Activities* and, as a general comment, believe the proposals set out reflect careful consideration of how cryptoasset markets operate in practice, as well as the feedback provided by the industry on the implementation challenges faced in other jurisdictions. The UK has a significant "second-mover advantage" and the FCA's proposals are a clear reflection of this, as the FCA is proposing a new and innovative approach to the licensing and custody arrangements for CATPs, in particular. We are grateful for this thoughtful approach.

More generally, our response focuses on five key areas:

- **The FCA's proposed licensing structure will preserve access to global liquidity to the benefit of UK customers. Providing the option for an exchange to set up a branch in the UK, alongside a consumer facing entity is an elegant solution to local regulation of digital assets markets, which are global by design.** Like with the protocols underlying the internet, permissionless blockchains have no national boundaries and can be accessed by anyone. Sending digital assets is like sending

an email – it can be to anyone, anywhere. For this reason, it is important that the value of digital assets are supported by global liquidity pools, ensuring that a local user in one jurisdiction is not disadvantaged relative to users in other jurisdictions. We believe it is important for cryptoasset service providers to continue to offer centralised order books globally, but with appropriately permissioned business models in each jurisdiction where they operate. The execution benefits of doing so will be immediately tangible to customers who would unduly suffer from any local liquidity provision requirements. We strongly support the FCA's innovative approach in this regard, as it will deliver a positive outcome for UK consumer and cryptoasset markets more generally.

- **We support trading rules that ensure UK investors have access to global liquidity and fair markets, while recognising the need for proportionate regulations that reflect the unique characteristics of the cryptoasset market.** We support rules that are proportionate to and account for unique aspects of the cryptoasset market. For example, we believe the FCA should permit matched principal trading with sufficient safeguards, as it benefits customers by enabling fast, efficient, and safe trade execution and settlement of cryptoassets. Matched principal trading carries little risk under the proper structural protections we support, including non-discretionary order execution and asset pre-funding to address credit risk where appropriate. Further, we firmly believe most risks surrounding conflicts of interest and market abuse can be sufficiently mitigated through robust internal controls, functional separation, disclosures, and other measures, rather than outright bans or legal separation (which could impair a CATP and its affiliates' ability to operate in the UK). Finally, we do not agree that best execution obligations, in the traditional finance sense, should be applied to cryptoasset intermediaries. We support prompt, fair, and expeditious execution, but for cryptoasset intermediaries we urge the FCA to consider that factors such as security, trust, and a customer's need to self custody and use the cryptoasset in a protocol is more relevant than just assessing order routing rules designed for financial instruments with no intrinsic use case. We suggest allowing reasonable assumptions about customer preferences based on observed norms to outweigh certain traditional best execution requirements.

- **We urge the FCA to move away from out-right bans on cryptoasset activities, which fail to recognise the unique characteristics of cryptoassets and their consumptive use, and send a strong negative signal to the market; instead we encourage an approach that focuses on consumer education, disclosure and informed decision making without stifling innovation or retail participation in the growing digital asset space.** With this in mind, the FCA should not introduce a ban on consumers using credit to buy cryptoassets. We note that the UK has decided

to regulate cryptoassets as a financial instrument and not as gambling; a ban on the use of credit to buy cryptoassets is akin to the ban on the use of credit in the context of gambling. In contrast, there is no ban on the use of credit to purchase financial instruments, such as shares, bonds or derivatives; retail investors can use credit facilities, including credit cards or personal loans to invest in these assets, provided they meet the lending criteria set by financial institutions. The UK should not pick and choose which rules it applies from financial services and gambling regulations, to regulate the cryptoasset sector. Additionally, we note, that many individuals in the UK currently buy cryptoassets using credit cards, given that most UK banks have put in place bans or limits on fiat transfers to cryptoasset exchanges; banning the UK of credit cards as well would almost entirely cut off the crucial on ramp from fiat to crypto.

Similarly, the FCA should not introduce a ban on the provision of cryptoasset borrowing and lending for retail consumers. The majority of the volume in these products comes from consumers who have existing cryptoasset positions and do not wish to sell them (either because they do not wish to exit their position or do not wish to crystallise a gain on their assets for tax purposes) but wish to deploy the value locked up within those assets for other means. They are not designed to increase the borrower's exposure to the crypto markets, but instead actually allow the borrower an option to reduce their exposure to the crypto markets, since they convert the consumer's position into fiat and then subject them to auto-deleveraging if the market moves against them. These products are highly beneficial to these types of borrowers as compared to traditional personal loans - they allow borrowers to deploy their cryptoassets as collateral, complete flexibility on repayment terms, and no ability to generate a negative balance against the platform which must be recovered.

On the flip side, consumers that are long term holders of cryptoasset can benefit from lending their crypto and earn interest rather than having those assets remain idle, creating a new revenue stream for those holders. Consumers can benefit from lending without having to sell their assets as it allows them to retain ownership of their assets, while still earning a yield. The over-collateralised nature of crypto lending products also provides a strong layer of security, as borrowers must typically pledge more collateral than the loan amount, safeguarding the lender's principal in case of default.

- **Staking is crucial to the consensus mechanism of proof of stake blockchains on which Web3 will likely be built. If the UK wants to become a centre of Web3 excellence, it must embrace staking as a service. This means ensuring that the regulatory regime is proportionate and commensurate to the very low risks associated with staking;** in particular, it is important that any prudential requirements associated with staking are appropriately calibrated to reflect the

extremely low risk of slashing. Moreover, given the centrality of this activity to Web3 and its low risk nature, we believe the FCA should adopt a flexible approach that encourages innovation. Examples of this could include allowing for an opt out approach (versus opt in) and recognising different models of staking including those that offer instant un-staking or early un-bonding as a convenience to customers that would like to exit the protocol lock up period early (e.g., using internal liquidity pools or a custodial netting feature to pay out instantly).

- **We agree with the FCA's proposal to keep DeFi out of scope.** To that end, we propose a number of criteria to identify decentralised protocols. We also urge the FCA to distinguish between financial services and technology services. Software providers that merely facilitate user-directed transactions on third party permissionless networks should be out of scope on the basis that their activity is not financial services activity. Getting DeFi right is crucial for the UK to become a global leader in digital assets, particularly in the area of tokenised assets where builders are increasingly turning to permissionless infrastructure.

Chapter 2 – *Cryptoasset Trading Platforms*

Location, Incorporation, and Authorisation of UK CATPs

Question 1: What are the operational and practical challenges of applying the suggested trading, market abuse, and other requirements to authorised overseas firms operating branches in the UK? Are there alternative approaches that could equally mitigate the risks?

We are supportive of the overarching goal that UK investors should be able to access global pools of liquidity. We also agree on the importance of ensuring that UK investors participate in competitive, efficient, fair, orderly and resilient markets.

We also welcome the FCA's view that international firms – including cryptoasset trading platforms (**CATPs**) – should have some choice in how they serve the UK market and the legal form of their UK presence. We strongly support FCA's proposed approach to allow CATPs to serve UK investors from a UK branch. We also appreciate the FCA's acknowledgement that direct access to CATPs is a key feature of the cryptoasset market and one that benefits users through lower costs driven by disintermediation.

At the same time, we acknowledge the need for the FCA to have adequate supervisory powers over CATPs serving UK investors, particularly retail customers. However, we foresee two potential operational and practical challenges for the FCA to consider:

- First, while we recognise the need for a UK-based entity under FCA's proposed model, it is critical that FCA rules and regulations do not create conflicting obligations on international CATPs, particularly in areas that touch on core operational features. For example, subjecting international CATPs to FCA systems and controls requirements risks direct conflict with requirements in the CATPs' home jurisdictions. Similar concerns exist with prescriptive operating conditions (for example, if FCA were to restrict a matched-principal operating model).
- Second, we encourage the FCA to be pragmatic and proportionate in rulemaking to avoid unduly burdensome and duplicative obligations on international CATPs. Dual regulation greatly increases operational complexity for firms, even where there is no direct conflict with other jurisdictions' rules. For example, full application of the UK Admissions and Disclosures requirements to international CATPs could create a burdensome parallel process to CATPs' existing home jurisdictions' listing and disclosure process, as would imposing parallel reporting requirements. We urge the FCA to take a more principles-based and outcomes-oriented approach to regulation of CATPs, as overly prescriptive requirements carry greater risk of unduly burdening international CATPs. For example, imposing prescriptive systems and controls requirements relating to the core operations of the CATP (e.g., in

relation to its order matching technology) would risk conflict with home state regulations. On the other hand, the access controls set out in paragraph 2.25 of the Discussion Paper for CATPs providing direct access to retail customers appear sensible and should not conflict with the systems and controls of the CATPs' home jurisdictions.

We believe that many of the supervisory challenges that the FCA is looking to address can be effectively managed by the FCA: (i) applying a reasonable minimum standard that home state regulatory and supervisory standards must meet before an international CATP can access the UK market via a branch (i.e., ensuring that they broadly deliver on the same outcomes sought by the UK rules); and (ii) collaborating and cooperating with the CATPs' home regulators from both a supervisory and enforcement perspective.

By applying these conditions, the FCA will have comfort that the core operational features and systems and controls of the CATP broadly align with UK standards, and the FCA can ensure redress in the event of UK investor harm. The FCA will then be able to focus its supervisory efforts on the elements of CATPs more directly relevant to the UK customer experience (e.g., applicable conduct of business rules and e-money issuance) as well as financial crime compliance requirements when onboarding and servicing UK customers.

Question 2: What are the challenges and limitations of requiring the establishment of an affiliated legal entity for retail access to trading services by an overseas firm with a UK branch?

We fully support the proposed structure requiring a UK subsidiary to allow international CATPs with a UK branch to service UK investors. We also recognise the need for the FCA to adequately supervise CATPs serving UK investors.

That said, it is critical that the FCA clearly delineates responsibilities of the UK branch and the UK subsidiary, respectively, to avoid compounding the operational and practical challenges already present in a dual-regulation model (as highlighted in our response to Question 1). Key elements we suggest clarifying include:

- **The regulatory permissions required of the UK branch and UK subsidiary.** We would support both businesses being supervised by the FCA, but want to avoid a scenario where they are subject to overlapping or duplicative regulatory or supervisory requirements.
- **What prudential, systems and controls, and governance standards would apply to the UK subsidiary.** As the FCA outlines in paragraph 2.17 of the Discussion Paper, for the UK branch, these requirements should remain the exclusive responsibility of the UK branch's home state regulator. We would expect significant

requirements for the UK subsidiary in these areas given the branch would carry out the functions to which these regulations would apply.

- **Whether the UK branch and UK subsidiary need to be operated and governed as separate and independent businesses.** We do not foresee any significant conflicts or potential harm for customers arising from shared operational and governance processes, so would suggest that the two businesses can be run by shared teams, systems, processes, etc., to mitigate resourcing and operational overheads of the proposed model (and ensure that the UK branch has management with direct knowledge of the UK market).

We would not expect either the UK branch or UK subsidiary to be considered a "cryptoasset intermediary" under the FCA rules, as that would be inconsistent with the direct access model the FCA supports. We would expect that the conduct of business and investor protection requirements applicable to CATPs (and UK branches of CATPs) will reflect their non-discretionary nature and the self-directed nature of the order flow. As the FCA rightly notes, UK retail customers will have a choice to use a cryptoasset intermediary if they want the benefit of additional investor protection rules.

Question 3: What conditions should apply to the direct access of trading services of an overseas CATP with a UK branch?

We appreciate the FCA's acknowledgement that direct access to CATPs (including by retail customers) is a key feature of the cryptoasset market and one that benefits users through lower costs driven by disintermediation. Flexibility in the trading relationship is critical to ensure that the UK customer can directly and seamlessly access the CATP via its UK branch, thus preserving the key benefits of disintermediated access to the CATP.

We also agree that UK retail customers must have a relationship with an affiliated UK subsidiary to directly access an international CATP. The UK subsidiary should be regulated by the FCA and responsible for customer onboarding and applicable conduct of business requirements to address key retail risks. We do not believe that further conditions are necessary.

CATP Responsibilities for Direct Retail Access

Question 4: What, if any, additional responsibilities should we consider for CATPs, to address the risks from direct retail access?

We agree that CATPs should be subject to additional responsibilities when providing direct access to UK retail customers to mitigate certain key risks presented by this

segment of CATP users. We think that the list of requirements set out in paragraph 2.25 of the Discussion Paper is broadly sensible, but recommend two modifications.

First, we suggest the requirements make clear that CATPs are responsible for "designing reasonable controls" to ensure compliance with CATP rules and regulations. This modification would clarify that CATPs are not strictly liable for conduct by customers and provide an actionable and workable mandate in crafting the control environment.

Second, we suggest removing the requirement to set controls and limits for each type of customer profile. Such a requirement potentially jeopardises the benefits of direct access for certain classes of customer (e.g., retail), imposing limits that risk being arbitrary and disadvantageous, impairing equal access to the CATP.

Question 5: How can CATPs manage the risks from algorithmic and automated trading strategies?

We agree with the goal of ensuring fair access to trading and orderly markets. Because of this, we suggest FCA adopt a principles-based approach to risk mitigation, permitting UK retail customers' continued access to these trading strategies. CATPs should implement baseline controls, such as surveillance, self-trade prevention, and rate limiting, and have operational safeguards to maintain orderly market conditions. This ensures retail investors retain access to the benefits of algorithmic and automated trading strategies while maintaining orderly markets.

Use of algorithmic and automated trading strategies on CATPs (including by retail customers) is commonplace. CATPs already employ sophisticated controls and risk management processes to protect against key market integrity risks associated with this form of market access.

Rules applicable to traditional finance for these trading strategies would prevent UK retail customers' access, putting them at a disadvantage to other customers who have access to these strategies and tools. This would result in worse execution outcomes for UK retail customers (e.g., due to slower access to order books and the inability to automate execution processes).

Question 6: Do you agree that CATPs should have contractual agreements in place with legal entities operating market making strategies on their platforms? Are there alternative approaches that could equally mitigate the possible risks to market integrity?

We generally support the requirement for CATPs to have contractual agreements or other binding arrangements (e.g., rules) in place with legal entities operating formal market making services on their platforms; however, we would not support a rule requiring CATPs to identify traders that are carrying out more informal market making style trading strategies (except for those traders who are providing liquidity at the direction and instruction of the CATP itself).

In our view, the key question is how (if at all) contractual agreements with market makers should differ from the standard terms and rules applying to other CATP participants. We believe any regulatory requirements here should be grounded in promoting the FCA's objective of ensuring that CATPs provide UK investors access to liquid and orderly markets.

Prescriptive regulation of market making agreements does not necessarily achieve that objective and could actually be counter-productive. Unlike traditional markets, major CATPs have a global presence and have participants (including market markers) in multiple jurisdictions worldwide. This compares to traditional markets where market makers are typically located in the same jurisdiction as the exchange and subject to the same regulatory regime. An overly prescriptive FCA framework for market makers (for example, prescriptive obligations to provide two-way pricing in stressed market conditions) could make market makers move to other CATPs not subject to those requirements, resulting in worse liquidity on CATPs providing access to UK investors.

Cryptoassets can trade on tens or even hundreds of venues globally, meaning that market makers can easily migrate their business from one CATP to another (unlike in traditional markets where assets typically trade on a single primary exchange and perhaps a small number of other venues, meaning market makers for those assets are limited in their ability to move their business elsewhere).

Another consequence of the global nature of cryptoasset markets is that CATPs are naturally incentivised by competitive forces to have highly liquid and orderly markets, because if they don't, market participants can move their business to other CATPs. These competitive dynamics do not exist in traditional markets as market participants have far fewer choices as to where they execute their trades.

Instead of highly prescriptive regulation of market making agreements, we would support principles-based regulation of market making arrangements to protect against risks such as market manipulation, artificial inflation of trading volumes, and unfair advantages for affiliated market makers. This approach should leave open the possibility of addressing

key issues in the trading platform's rules, to which all participants are contractually bound, rather than in bilateral agreements.

Discretionary, Principal, and Matched Principal Trading

Question 7: Is there a case for permitting discretionary trading practices for CATP operators? If so, how could the above risks be appropriately mitigated?

We believe that CATPs should operate non-discretionary trading systems, and fully automated matching is already the industry norm. However, as described in our response to Question 9, this should not prevent operators of CATPs (or their affiliates) from conducting discretionary bilateral over-the-counter (**OTC**) trading with eligible customers, where it is fully disclosed that the trades are being executed OTC and the customer is not interacting with the CATP. We believe that any conflict of interest risks associated with OTC trading can be effectively managed through robust functional separation and related controls (and, where appropriate, disclosures), without requiring legal separation.

Question 8: Should firms operating a CATP be permitted to execute transactions on a matched-principal basis? If so, how could the above risks be appropriately mitigated?

We believe that CATPs should be permitted to execute transactions on a matched-principal basis. The two risks flagged in paragraph 2.46 of the Discussion Paper (Conflicts of Interest and Credit Risk) can be adequately mitigated without prohibiting matched principal trading.

Conflict of interest risks: We believe these risks can be adequately mitigated through (i) requiring CATP operators to execute all CATP orders in a non-discretionary way and (ii) preventing CATP operators from dealing in a principal capacity on their own CATP (except for acting as matched principal between two customers trading on the CATP and other limited purposes discussed in our response to Question 9).

Credit risk: CATPs typically require users to have the necessary assets in their accounts to settle transactions prior to accepting an order. Because of this, the CATP is not exposed to credit risk when executing trades as matched principal because all necessary assets are already on the platform. The CATP simply has to update their internal ledger to effect trade settlement.

Mechanically, this ledgering process often involves the use of a central clearing ledger in the name of the CATP operator, which sits in the middle of the customer accounts (as opposed to the direct transfer of assets between two customer accounts). This reflects

the complexity of matching trades across a large number of participants. Because trades may execute on a "one-to-many" or "many-to-one" basis on the CATP, the use of a central clearing ledger is a useful tool to reduce settlement and operational complexity.

The use of matched principal trading enables operators of CATPs to provide users with fast, efficient, and safe trade execution and settlement. Alternative models (e.g., prohibiting matched principal trading by CATPs or requiring CATPs to "give-up" trades to an affiliate to finalise on a matched principal basis) would introduce additional operational complexity and friction for users without any clear benefit.

Question 9: Have we properly identified the risks from the operator of a CATP also being able to deal in principal capacity off platform? What is your view on these risks and whether it should be permitted or restricted for an operator of a CATP? If permitted, how should those risks be mitigated?

We agree that there are risks in allowing the operator of a CATP to deal in a principal capacity, but they can and should be appropriately managed in lieu of an outright prohibition. We strongly believe CATPs need the ability to trade as principal for various business needs that are not profit driven. A CATP may need to trade as principal for (i) operational or functional needs, such as own-account inventory management and staking services; (ii) to manage credit, market, and liquidity risks; and (iii) to complete a transaction at the direction of a customer.

Permitting these types of principal trades by CATPs benefits retail customers, for example, by allowing them to execute small orders below the minimum cross size on the CATPs' order books, and facilitating CATP "request-for-quote" services, providing a simplified trading experience for retail users.

We believe that any risks associated with limited own-account activity can be adequately addressed through customer disclosures and internal controls designed to ensure abusive principal trading does not take place. Therefore, in response to this particular question, we do not agree that CATPs should be generally prohibited from principal trading on- or off-platform. As discussed above, CATPs have legitimate needs to trade as principal.

Further, provided that appropriate functional separation and risk controls are in place, operators of CATPs (and their affiliates) should be able to engage in principal OTC trading with eligible customers. Appropriate information barriers and monitoring should be required to mitigate conflicts of interest and market manipulation risks, and adequate market and counterparty risk controls should be required to protect against resiliency risks and to protect orderly markets.

Question 10: What are the risks from an entity affiliated with the CATP trading in principal capacity either on the CATP or off the CATP? What additional requirements are necessary to mitigate these risks?

The potential risk of an entity affiliated with a CATP trading as principal on- or off-platform is that the affiliate's activity could somehow disadvantage or harm the CATP's customers. We believe that this risk can be adequately mitigated as follows:

- **Operational separation**, including separate governance, management, and/or information barriers among CATPs and affiliates trading in a principal capacity.
- **Disclosures of affiliations and potential conflicts**, including the capacity in which any contracting entity is acting, affiliates involved in a transaction, and the corporate group's overall governance structure and inter-company relationships among entities.
- **Requirements that affiliated entities treat each other no better than they would treat unaffiliated parties**, disclosed to customers, articulated in policy, and, where applicable, structurally protected by the CATP's non-discretionary trading system.
- **Articulation of the duties employees have to customers**, including policies and procedures designed to prevent favored treatment of an affiliated entity.

Issuance and Admittance of Cryptoassets for Trading

Question 11: What are the risks from admitting a cryptoasset to a CATP that has material direct or indirect interests in it? How should we address these?

We agree that certain risks can arise when a CATP admits a cryptoasset for trading in which it or an affiliate has a material interest. These conflicts can cause a real or perceived risk of detrimental activity like market manipulation or insider trading.

We do not believe that legal separation is required to mitigate these risks. Instead, CATPs can effectively mitigate these risks through:

- **Operational and functional separation** between (a) the CATP platform and other parts of the business responsible for asset issuance and (b) the parts of the business responsible for treasury management / balance sheet investments.
- **Comprehensive disclosures**, including public disclosure of cryptoassets in which listing CATPs or affiliates have a material interest.
- **Conflicts checks and monitoring** in respect of employee holdings and trading activity. Requiring employees of the CATP to only trade on the CATP allows the

CATP to monitor for any inappropriate trading, including in respect of assets that the CATP has a direct or indirect interest in.

As noted in our response to Question 39 below, conflicts of interest that arise from platform tokens can be managed using the same tools. While platform tokens do raise some unique questions, we do not believe that the existence of platform tokens in and of itself inherently increases conflicts of interest or risks. Instead, risks can arise from how platform tokens are used, and the products they may be integrated into. In our view, regulation should focus on: (i) restricting the use of platform tokens in specific circumstances (discussed further in Question 39 below); and (ii) mitigating the conflicts of interest and ensuring appropriate disclosures where conflicts do arise.

In the latter case, the same tools described above can be effective, but may need to be applied differently to operate as effective mitigants. For example, operational separation may need to be more rigid and enhanced disclosures may also be necessary, particularly where a platform token's success or failure would have a more direct impact on the market value of a CATP or its affiliates.

Credit Provision and Internalised Risk

Question 12: Are there important reasons why the same entity authorised to operate a CATP should also be able to provide credit lines or financial accommodations to the CATP's clients?

We believe it is important that affiliates of CATPs are able to provide credit lines or financial accommodations to CATPs' clients, where such activity is subject to appropriate risk management controls and regulatory oversight, where applicable. This is particularly so given that MiFID firms are able to provide credit to clients for margin trading purposes (with the appropriate permissions).

The provision of credit lines – for example, short term trade financing and settlement finance – is a key element of the cryptoasset market, particularly for professional or institutional traders. Prohibiting these arrangements for CATPs with UK participants would put these CATPs at a severe competitive disadvantage to their global peers and would risk moving institutional liquidity away from these CATPs to the detriment of UK users.

Question 13: Do you agree with our proposal to prevent CATPs from managing or internalising credit risks between counterparties trading on their platforms? If not, why not and how would you suggest the CATP manage these risks?

As stated in our response to Question 12, we support the overarching aim of the FCA that CATPs should be risk-neutral trading systems, although we suggest avoiding a blanket prohibition on internalising risk as it would create significant barriers to CATPs innovating. Provided that any internalised risk is (i) confined to clients that have been assessed as credit-worthy in advance or for hedging a CATP's own inventory, and (ii) appropriately managed such that the CATP achieves a substantially risk-neutral outcome within a reasonable timeframe, we believe it should be permissible for CATPs to provide services or products which allow for some internalisation of risk.

As described in our response to Question 8, CATPs typically require users to prefund all trades, meaning that CATP operators are generally not exposed to counterparty / settlement risk arising from transactions executed on their platforms. In limited circumstances – and as described in our response to Question 12 – we believe it is important that professional / institutional users of CATPs have access to credit lines, although these credit lines can be extended by a separate entity (e.g., an affiliate of the CATP operator) meaning that the CATP operator is not exposed to counterparty / credit risk relating to these arrangements.

We would also suggest that care should be taken to avoid any prohibition of internalisation of credit risk so that it does not prevent the creation of more complex institutional products such as cross-margining (where margin posted by a client can be used across multiple products, leading to some element of short-term credit risk).

Settlement of Transactions

Question 14: How should we interpret or define settlement for the purpose of CATP settlement rules? Would these rules be specific to CATPs or should they be extended to other trading activities?

We support the FCA's goal of ensuring that CATPs have satisfactory arrangements for securing the timely and effective transfer of control over the cryptoassets traded on their platform. We also agree that there are a range of potential approaches to this issue and the FCA should not be prescriptive on this point. But regardless of how settlement occurs, we agree that it is important that CATPs clearly inform clients of CATPs' responsibilities for settlement.

As the FCA correctly observes, many CATPs internalise the settlement process. We are strongly in favor of permitting this model. Internalised settlement is typically achieved

through pre-funding requirements, which permit CATPs to effect settlement through internal ledgering. We believe this represents a robust and efficient solution to the settlement of transactions, which does not expose the CATP to any counterparty or credit risk. Internalised settlement is broadly accepted in most major jurisdictions; requiring a different model than internalised settlement would require the development of unique UK infrastructure, reducing the competitiveness and attractiveness of the market.

As described above, in limited circumstances, we believe it is important that institutional users of CATPs have access to credit lines, although these credit lines can be extended by a separate entity so that the CATP operator is not exposed to counterparty/credit risk.

As the FCA notes, a pre-funding model introduces connections between the settlement requirements for CATPs and the custody rules for cryptoassets. We believe it is paramount that these regimes work together seamlessly to allow UK investors to benefit from the robust and efficient settlement processes CATPs provide.

We appreciate that potential conflict issues between CATP operation and cryptoasset custody will be the subject of a future consultation paper. However, we would like to flag at this stage the huge benefits to UK investors of this settlement model, and our belief that any conflict issues can be adequately addressed through customer disclosure and robust functional separation within the CATP.

Transparency and Reporting Requirements

Question 15: Do you agree that CATPs should be subject to both pre-trade and post-trade transparency requirements? Are there any reasons we should consider pre-trade transparency waivers?

We support calibrated and proportionate pre- and post-trade transparency obligations for CATPs. We agree that this will promote efficient pricing, fair markets, and a level playing field.

We broadly agree with the FCA's high-level proposals set out in paragraph 2.72 of the Discussion Paper. We support calibrated delays of post-trade data for large-in-scale trades or trades in particularly illiquid assets to protect market participants. However, given the relative scale of the cryptoasset market compared to traditional financial markets, we suggest these rules be appropriately calibrated to avoid unnecessary operational complexity for CATPs. For the same reasons, we do not support waivers for pre-trade transparency at this stage, although as the market matures and becomes more significant, waivers may become more appropriate.

We also think it is important that the FCA's requirements are broadly consistent with other transparency rules being developed in other major markets (for example, the transparency rules for trading platforms under the EU Markets in Crypto-Assets Regulation (**MiCA**)). This will ensure consistency of market data across global markets and will reduce the operational complexity for CATPs operating across multiple markets.

Question 16: Which challenges may emerge for transaction data requirements if there is direct retail participation?

We do not expect any significant challenges for CATPs in complying with transaction data requirements where no intermediary is involved. This expectation is based on the assumption that (i) the requirements around transaction data are not too onerous and (ii) the data required can be easily ascertained on an automated basis without recourse to external data sources or from customers themselves.

We also recommend that FCA consider whether CATP reporting requirements are consistent with applicable data protection rules, bearing in mind that the CATP operator may be an overseas entity. In such a case, it may be sensible to allow the transaction data to be collected and stored by the UK branch or UK subsidiary rather than the overseas CATP.

Question 17: Are there preferred standards for recording transaction data?

We agree with the FCA's proposed approach to impose proportionate recordkeeping requirements on CATPs and intermediaries, respectively. We recommend a structured, auditable format with high-precision timestamps for storing transaction data. However, as the Discussion Paper articulates, a requirement to receive transaction records from intermediaries would be unduly costly and risk leaking sensitive data. CATPs should be responsible for their respective role in a given transaction, not acting as a broader recordkeeping entity for the industry. We do not agree that the second proposed approach in DP paragraph 2.75 would be proportionate, efficient, or cost-effective.

Question 18: What opportunities and challenges do you see in trying to harmonise on-chain and off-chain transactions' recording and/or reporting?

We agree with the goals of effective surveillance, enhanced market integrity, and better user trust. However, we are not in favor of rules that would broadly require CATPs to monitor/police markets beyond their direct operational functions (e.g., onchain data) or to harmonise onchain and offchain transaction recording or reporting.

Blockchains are inherently transparent and allow for direct monitoring of onchain activity by anyone. As discussed above, many CATPs settle transactions through internal ledgering as opposed to onchain activity. Thus, onchain activity, in most cases, is not relevant to preventing or identifying misconduct on a CATP. This means there is limited onchain transaction data that could support transaction reporting to regulators.

Also, given that onchain data is public and immutable, we would object to any requirement that personal or identifiable counterparty data is recorded onchain to support transaction reporting. All personal and identifiable counterparty data should be securely stored and reported offchain.

Finally, requiring CATPs to monitor or harmonise their records with onchain activity would be extremely costly and resource-intensive. Ongoing monitoring of offchain activity by CATPs is, of course, appropriate, but given the shortcomings discussed above, we do not think it is worthwhile or feasible to require CATPs to harmonise onchain transaction data with offchain data for reporting purposes.

Chapter 3 – *Cryptoasset Intermediaries*

Order Handling and Execution

Question 19: What practical challenges might firms face if they are required to comply with these order handling and best execution requirements? Are there any alternative approaches that would deliver the same or better order execution outcomes for retail and non-retail customers respectively? Please explain why they may be preferable.

Order Handling

We agree with the general principle that cryptoasset intermediaries should implement procedures and arrangements which provide for prompt, fair, and expeditious execution. However, we do not agree that best execution obligations, in the traditional finance sense, should be applied to cryptoasset intermediaries. Cryptoasset markets operate very differently to traditional financial markets, in that they operate on the basis of assets being listed on a huge variety of venues, are settled in real-time and can be immediately taken off platform for consumptive use (e.g. in a protocol), and have high transparency in pricing. Furthermore, consumers do not always prioritise price over service as the core factor in deciding where to execute a cryptoasset trade. As a result, we believe requiring best execution requirements that mirror traditional finance obligations and depend on t+ netting and settlement cycles is not necessary for all cryptoasset market venues.

Should best execution requirements be imposed (which we disagree with), they should at a minimum be tailored to the unique characteristics of the cryptoasset market and reflect market norms and practices.

In particular, we disagree with framing best execution for retail customers only in terms of total consideration. Other factors may be more important depending on the circumstances, such as security and trust. For example, current market practice demonstrates that retail customers are willing to pay more to execute transactions on trusted and secure venues that offer services tailored to their consumptive use needs. Currently, the dominant retail business model is for customers to hold their assets in a CATP (or affiliate) custodial account for trading on the CATP. Execution is then intrinsically linked with other services like custody and transfers, and in particular, transfers to self-custodial wallets so that customers can use the digital assets in protocols for which they are designed. Therefore, when a retail customer uses a cryptoasset intermediary to execute a transaction, we think it is reasonable for the intermediary to consider the customer's asset location as a critical factor in execution, with a presumption that the customer would prefer to execute the transaction on the CATP that holds their assets (unless the customer indicates otherwise). This should be viewed effectively as a "specific instruction" to execute the transaction on the CATP that holds the customer's assets.

Also, as a practical matter, retail customers that hold all their assets at a single CATP are able at any time to transact on a competing platform by moving their assets to that other platform. This frequently happens and is a feature of the digital asset ecosystem that is not replicable in the traditional finance market structure. The potential loss of assets to another trading platform creates strong economic incentives for competitive pricing of CATP services. Moreover, forcing a CATP to route trades to another platform would entail real-time pricing and execution challenges as that would require an onchain transfer, introducing delays or settlement risk to the extent that an exchange be required to bridge that pricing delay.

Further, we do not support the proposal that cryptoasset intermediaries should be required to check pricing across at least three UK-authorised trading platforms. For the reasons set out above, the pre-funding model means that retail customers can only access real-time pricing on platforms where they already have assets located. Of course, as stated above, consumers are free to check prices on other platforms just like they currently do with other financial and consumer services to assess the efficacy of those services.

Application of best execution to quote-driven markets

We also do not support the blanket application of best execution obligations to all quote-driven activity. Instead, we would expect the FCA to apply a similar approach to traditional financial markets, where the key question is if the dealing firm is acting "on behalf of" the customer (which depends on the economic reality of the relationship between the firm and the customer). In circumstances where best execution does apply to quote-driven activity (for example, where the customer relies on the dealing firm acting on the customer's behalf to protect their interests in relation to trades), we reiterate the points we made above about the dominant pre-funding model for retail trading: where a retail customer accepts a quote provided by a CATP that custodies their assets, that should amount to a specific instruction that the transaction be executed on that platform.

Execution venue requirements

As described above, execution of orders in retail cryptoasset markets is intrinsically linked to asset location due to the pre-funding model. Where a UK retail customer holds their assets on a non-UK-authorised execution venue in a manner that is otherwise consistent with UK regulation, we think the customer's order may be executed on that venue. Any requirement to the contrary seems unnecessary and would in practice prevent that retail customer from engaging in any execution activity without first moving their assets to a UK-authorised execution venue. This seems disproportionate (given that in this scenario the customer is already using the services of a UK-authorised intermediary and benefits from the investor protections that provides) and inconsistent with the FCA's objective of ensuring that UK investors should be able to access global pools of liquidity.

Question 20: What benefits and risks do you see with the proposed guidance requiring firms to check the pricing for an order across at least 3 UK-authorised trading platforms (where available)?

Please see our response to Question 19 above.

Question 21: What benefits and risks do you see with the idea that best possible results should be determined in terms of the total consideration when firms deal with retail customers?

Please see our response to Question 19 above.

Question 22: Do you see any potential problems with the proposal to restrict intermediaries to offering regulated services for UK retail customers solely for cryptoassets admitted to trading on a UK authorised CATP?

In our view, it is unnecessary to require a cryptoasset to be admitted to trading on at least one UK-authorised CATP before any intermediary can deal in it for UK retail customers. Whilst as the FCA notes, such an asset would fall outside the A&D regime, the cryptoasset intermediary would be subject to Financial Promotion and Consumer Duty requirements, which should adequately address concerns related to potential retail harm and adequate risk disclosure. Additionally, this requirement would be unnecessary in many cases where a cryptoasset is already admitted for trading on a CATP in a jurisdiction with comparable or even heightened listing standards compared to the UK.

In relation to MARC, the requirement for intermediaries dealing with retail customers to only list assets that are listed on a UK-authorised CATP will likely lead to a dichotomy in treatment of retail and institutional customers in the UK, with the latter being able to access a wider variety of assets (given that institutional customers can be supported by intermediaries that source non-UK liquidity). We do not agree with prohibiting retail customers from trading certain cryptoassets while permitting professional customers to trade them.

Retail trading activities present no greater market abuse risks than professional trading activity. In fact, it is possible that professional trading activity raises greater market abuse risks due to the greater volume and risks around information and execution speed asymmetries. Further, this would lock UK retail users out of a potentially large portion of

cryptoassets and would be inconsistent with the FCA's goal that UK investors can access global pools of liquidity.

Although retail customers and professional customers may have differing suitability considerations, we believe those are best addressed by looking at the customer's specific characteristics and the nature of their transactions, rather than by a blanket prohibition. As discussed in more detail in Questions 31 and 32, below, customers may purchase digital assets for consumptive use or investment purposes, which means that traditional approaches to suitability are not appropriate.

Question 23: Are there any specific activities or types of transactions we should expressly carve out of our proposed order handling and best execution rules? If so, why?

As noted in our response to Question 19 above, customers in the cryptoasset markets will often prioritise features of an execution venue that go beyond pure price – often customers will pay a premium in order to trade on the most trusted, secure, and reliable venues available. On the other hand, customers can, at any time, choose to transact on a competing platform by moving their assets to that other platform. For these reasons, we strongly believe that requirements around best execution should give firms the option to allow for clients to provide specific instructions, which override any best execution obligations. However, given a customer's ability to easily move its assets to another platform, we do not think this optionality should be required.

To the extent that a customer is given a choice, we would agree with the FCA that the customer should have a fair choice as to whether or not they elect for a specific venue for execution, without any direction by the intermediary.

For the reasons set out in response to Question 50, we would also expect that firms that offer mere technical or communications access to third party trading solutions would not be captured by the term "intermediary" or subject to best execution requirements. These types of solutions, where direct access is given for the customer to have multiple options to trade, should not constitute an intermediary service, and not be subject to financial services regulation, including best execution obligations.

Question 24: What risks arise when specific instructions (for example, specifying which execution venue to use) from retail customers are allowed to override certain best execution requirements? How can these be mitigated?

In our view, the core risk of giving customers the ability to provide specific instructions is that they are not fully informed of what they may be missing, by not having the firm seek

best execution on their behalf. We believe this risk can be mitigated via disclosures and requirements to offer alternatives that show the customer the pricing they could achieve if they allowed the firm to seek best execution – if the customer was offered full disclosure on pricing and the different options available, that should enable the customer to make a fully informed decision as to which path to go down (and indeed, if they choose to make an election, an informed decision on which venue to choose).

Conflicts of Interest During Order Execution

Question 25: Are there circumstances under which legal separation should be required to address potential conflicts between executing own orders and client orders?

We agree on the importance of ensuring that potential conflicts of interest are managed appropriately by intermediaries executing client orders. However, we do not think legal separation is required.

As with other scenarios discussed above, firms can sufficiently mitigate conflict of interest risks through robust functional separation and related controls, including well-constructed information barriers, clear articulation of employee duties to customers, requirements that affiliated entities treat each other no better than they would treat similarly situated unaffiliated parties, and disclosures to customers (in the event that the former measures are not sufficient in preventing damaging conflicts of interest).

These mitigants can and should work alongside structural protections against unfair treatment in order execution. Specifically, discretionary trading models should not be allowed due to the complexity of ensuring fairness. Fully automated matching is already the industry norm, designed to eliminate concerns about preferential treatment such as improper prioritisation or sequencing.

Question 26: Are there any other activities that may create conflicts of interest and risks to clients if performed by the same intermediary? How can these be managed?

As discussed above, we believe cryptoasset intermediaries can effectively manage potential conflicts of interest through robust functional separation and related controls (and, where appropriate, disclosures), without requiring legal separation or outright prohibition of activities.

Blockchain technology inherently provides transparency, a single source of truth, and a distributed ledger. These features permit combinations of functions within a single intermediary or entity, with real customer benefits and fewer conflicts risks. One example

is the fast, efficient settlement capability enabled by 'prefunding' of customer assets at execution venues (described further in our responses above). Another example is the reduction in transaction costs, time requirements, and operational risks from a single entity providing execution, settlement, and custody services.

Pre- and Post-trade Transparency for Intermediaries

Question 27: What benefits does pre-trade transparency provide for different types of market participants and in what form will it be most useful for them? Please provide an analysis of the expected costs to firms for each option if available.

We believe there are number of factors that point against mandating pre- and post-trade transparency from cryptoasset intermediaries:

- There is a good level of 24/7 pre- and post-trade transparency provided by major cryptoasset exchanges globally, and a fairly well developed network of trading firms that arbitrage across these markets to ensure tight spreads, efficient markets, and good liquidity for major cryptoassets. We do not feel that mandating additional transparency from UK-authorised intermediaries will meaningfully add to transparency in the market for major cryptoassets or result in meaningfully better pricing for UK investors.
- For less liquid cryptoassets, we believe that any incremental benefit would be far outweighed by the costs of mandating pre-and-post trade transparency. Intermediaries would either stop trading those assets (limiting the execution options available to UK investors) or would widen spreads to the detriment of UK investors.
- As the FCA notes, given the relative nascency of the cryptoasset market, there is a lack of important market infrastructure such as consolidated tapes. This means there could be challenges publishing this transparency data in a fair and accessible manner to UK investors, and a risk that the data is disproportionately accessed and used by professional proprietary traders to the potential detriment of the average UK investor.

Question 28: What alternative solutions to the post-trade transparency requirements proposed above could mitigate the risks? Please provide an analysis of the expected costs to firms for each option if available.

Our view is that the cryptoasset markets have already developed sophisticated arrangements to ensure prospective traders have the necessary information to be able to understand pricing and liquidity on different markets. Further, the number of venues that customers have to choose from to trade cryptoassets (a feature of the cryptoasset market that does not exist in traditional finance to anywhere near the same extent) has led to significant competition, which has driven high levels of transparency in this sector, even in the absence of specific rules.

As a result, regulated exchanges such as Coinbase generally offer direct, public access to view order book activity so that customers are able to assess the level of liquidity, trades being placed, and prices and volumes at which trades are being executed at any time. These interfaces are sophisticated and well-established, giving customers a high level of confidence in their ability to watch and understand the market, both pre- and post-trade. Plus, types of arrangements are often mirrored by intermediaries to illustrate the level of liquidity that they are able to access.

We would therefore advocate not for specific requirements around pre- and post-trade transparency, but instead a move towards a principles-based regime that establishes the core overarching outcomes that the FCA is seeking. This will enable firms to continue to apply an approach that has been set by reference to competition in the market, which we believe leads to a better outcome for customers than prescriptive requirements which are, by definition, not as customer-led as a competition-driven approach.

Question 29: Do you believe that certain cryptoassets should be exempted from transparency requirements? If so, what would be the most appropriate exemption criteria which would best balance the benefits from transparency and costs to the firms?

As noted above, we believe that transparency should be mandated by way of principles-based regulation, designed to allow firms to follow what is currently best-in-class for pre- and post-trade transparency within the cryptoasset sector without having to adopt onerous and expensive traditional finance requirements, which in our view are not appropriate to apply to the cryptoasset market.

One result of this suggested approach is that firms generally will be able to follow existing processes around transparency that can be delivered in respect of all assets listed, meaning no exemption criteria would be required. This drives regulatory simplicity and greater competition within the market, which is particularly important for newer cryptoassets on the market where smaller firms have a significant opportunity to seek

market share. This is only possible where regulations do not make early-stage asset listing prohibitively expensive.

Question 30: What would be the most appropriate exemption threshold to remain proportionate to the size of the firm while balancing the benefits from transparency and costs to the firms?

As noted above, we do not agree with the proposal to introduce extensive pre- and post-trade transparency requirements, given that we believe the cryptoasset markets already deliver a high volume of transparency within regulated exchanges. Therefore, we advocate for a principles-based approach that does not mandate expensive pre- and post-trade transparency reporting requirements. Accordingly, if that approach was followed, there would be no need for exemption thresholds as firms could carry on existing transparency arrangements (potentially with some changes to reflect the principles the FCA will adopt).

Should exemption thresholds be required, we would suggest that those exemptions be set at levels based on volume within an intermediary's platform. Generally revenue is driven by trading volume, and therefore lower-volume, early stage assets, or exchanges that do not generate large volumes to offset the cost of reporting, should not be captured by these requirements. Therefore, setting thresholds based on volume of a particular asset within an intermediary's platform would be an appropriate way of setting an exemption threshold for that asset.

Client Categorisation / Suitability

Question 31: What are the crypto-specific risks of opting retail customers up? How should these be managed and what additional guidance on how to assess the expertise, knowledge and experience of clients can we give firms to better mitigate risks of harm?

In traditional securities markets, suitability requirements protect retail investors by matching them with appropriate investments. The crypto industry is differently situated because consumers' uses of crypto are far broader reaching. While cryptoassets may be purchased as an investment, that is not always inherent to their design; it is typically a byproduct of their anticipated future utility. For this reason, we caution against the blanket adoption of suitability requirements designed for traditional financial instruments and securities markets.

We believe suitability requirements should be limited to firms providing investment advice or portfolio management services. Applying suitability requirements when customers

purchase cryptoassets for consumptive purposes could have the result of unfairly excluding retail investors from the web3 ecosystem.

Even in the context of advice on investment activity and portfolio management, we suggest calibrating suitability/opt-up requirements to other unique features of crypto markets and the risks of the specific service provided. For example, requirements to collect information relating to a customer's suitability preferences should consider the relevant inputs for cryptoassets specifically. And, consistent with treating customer uses of crypto-assets differently than investment uses, providing educational or technical details about a specific asset, both of which are necessary to understanding the asset's utility, should not trigger a suitability assessment. Any opt-up requirements should consider these factors, while allowing retail investors to eventually meet qualitative opt-up standards by developing sufficient expertise and knowledge over time.

Question 32: What are the benefits of having quantitative thresholds when opting clients up? How should we determine any quantitative threshold? What alternative rules or guidance specific to crypto should we consider?

Where suitability requirements are appropriate (see response to Question 31), we support flexibility for opt-up possibilities to protect customers' freedom and to allow industry members to shape suitability limits based on the developing landscape. A quantitative threshold could serve as a beneficial alternative opt-up method, but the threshold should operate independently of any qualitative test (not as an additional factor as is required in some cases by COBS 3.5.3R(2)).

A customer demonstrating sufficient expertise, experience, and knowledge for making investment decisions, based on a qualitative test, should not also be subject to owning a certain amount of assets to access specific investments. Requiring both would directly oppose the crypto ecosystem's primary objective of promoting openness and autonomy for those wanting to participate.

Chapter 4 – *Cryptoasset lending and borrowing*

Question 33: Do you agree with our understanding of the risks from cryptoasset lending and borrowing as outlined above? Are there any additional risks we should consider?

We agree that the risks identified by the FCA do exist in some circumstances; however, these risks are not specific to cryptoasset lending and borrowing - they are relevant to any borrowing and lending product (including in traditional finance). Moreover, these are risks that arise from specific implementations of lending and borrowing products in the cryptoasset industry. With proper product design and clear disclosures, the risks identified by the FCA can be mitigated or avoided entirely. Moreover, the Discussion Paper does not recognise the benefits that cryptoasset lending and borrowing can deliver for consumers.

In practice, many cryptoasset lending and borrowing products are highly flexible, consumer-friendly solutions which allow lenders and borrowers a high degree of choice in how they operate. It is important to note that cryptoasset lending and borrowing products do not operate in the same way as traditional consumer fiat lending, in that generally these products are overcollateralised, have no fixed repayment schedule or closing date, and are highly transparent in their operation. The majority of the volume in these products comes from consumers who have existing cryptoasset positions and do not wish to sell them (either because they do not wish to exit their position or do not wish to crystallise a gain on their assets for tax purposes) but wish to deploy the value locked up within those assets for other means. The loan product allows them to post collateral against a loan of stablecoin, which can be paid back via partial repayments over time, or via a lump sum repayment when the borrower wishes. Collateral is usually managed by the service provider within certain overcollateralisation percentages, allowing a buffer for price volatility of the collateral without requiring margin calls or auto deleveraging.

In short, with thoughtful product design and clear disclosures, these products are highly beneficial to borrowers and lenders as compared to traditional loans accessible through traditional financial system - they allow borrowers and lenders, who already have certain crypto positions to deploy their cryptoassets, complete flexibility on repayment terms, and no ability to generate a negative balance against the platform which must be recovered. Provided that appropriate information is given to lenders and borrowers to enable them to understand the product, the implications of price movements of the collateral, and sufficient account options for them to manage their position (via notifications and account functionality to meet margin calls, auto-top up mechanisms, or to pay down loans to avoid liquidation for example), these products are of significant benefit to certain types of consumers. They are not designed to allow consumers increased exposure to the crypto markets, but instead actually allow the borrower an

option to reduce their exposure to the crypto markets, since they convert the consumer's position into fiat and then subject them to auto-deleveraging if the market moves against them.

On the flip side, consumers that are long term holders of cryptoasset can benefit from lending their crypto and earn interest rather than having those assets remain idle, creating a new revenue stream for those holders. Consumers can benefit from lending without having to sell their assets as it allows them to retain ownership of their assets, while still earning a yield. The over-collateralised nature of crypto lending products also provides a strong layer of security, as borrowers must typically pledge more collateral than the loan amount, safeguarding the lender's principal in case of default.

Question 34: Do you agree with our current intention to restrict firms from offering access to retail consumers to cryptoasset lending and borrowing products? If not, please explain why.

We do not agree with the proposal to restrict firms from offering access to retail customers to cryptoasset lending and borrowing products.

In respect of cryptoasset borrowing products, please see our response to Question 33 above. Our view is that properly designed borrowing products, with sufficient disclosures provided to consumers on the features and risks of the product, actually provide a high level of flexibility to UK consumers that wish to borrow against their cryptoassets. As noted in the response to Question 33, cryptoasset borrowing products are generally accessed by UK consumers that have longer-term exposure to the cryptoasset markets, rather than being a product that is accessed and used by mass-retail consumers that are not familiar with cryptoasset markets or managing the risk of volatility.

The FCA specifically raises a concern in relation to consumers suffering losses in a short space of time when the value of their collateral securing the loan reduces. It is accurate to say that there will be a reduction in value of the collateral in this case but as noted above, collateralised borrowing products are generally adopted by customers that already have crypto and wish to borrow against it in order to realise fiat value without a disposal of their assets. Accordingly, these customers would experience a reduction in the value of their assets in any event as the market reduces, even if they had not borrowed against the asset - their exposure to market conditions remains the same whether they have borrowed against the asset or not. We would contrast this point above with un-collateralised lending products, where we agree that the risks of loss to customers due to market volatility does exist, since they are taking on net-new exposure. For that reason we believe it may be appropriate to explore a restriction on un-collateralised lending for retail customers.

Taking all of this into account, it would be disproportionate to restrict access to these types of products when considering the risk posed by them - instead firms should be required to adopt appropriate risk disclosures and product information in order to allow consumers to make informed decisions in relation to their engagement with these products, and for firms to ensure that consumers are given sufficient notice around price movements and impending actions that may be taken in relation to their collateral, to ensure they can effectively manage their borrowing position.

We note that consumers in the UK are able to access DeFi borrowing and lending products, through non-custodial services (and this ability will not be impacted by the FCA's proposed approach to DeFi). Allowing firms to offer such products to their retail customers (for example, through integration of software solutions and integrations in retail platforms) would positively impact consumer protection. Firms which are subject to FCA supervision would (as we note above) be required to put in place appropriate risk disclosures and product information in respect of such DeFi integrations. This should be encouraged as a way to "de-risk" DeFi borrowing and lending, rather than prohibiting it (which would push consumers to entirely unsupervised DeFi solutions), and considering it in along with discussion of DeFi intermediaries in general (see Question 50, below) rather than placing obligations/restrictions as if the intermediary were providing centralised lending/borrowing services.

Question 35: Do you agree that applying creditworthiness, and arrears and forbearance rules (as outlined in CONC) can reduce the risk profile for retail consumers? Could these be practicably applied to existing business models? Are there any suitable alternatives?

Where the cryptoasset borrowing product is fully collateralised and designed with appropriate controls and disclosures, we do not consider it necessary to apply creditworthiness, arrears and forbearance rules. This is because cryptoasset borrowing products are invariably fully collateralised with an effective title transfer arrangement over the collateral, which enables the lending platform to carefully manage its exposure to the borrower on an automated basis. No consideration of affordability is required because the borrower is posting cryptoassets as collateral, which is affordable and not a necessity (in comparison, for example, to a consumer losing their car or house as is the case with many collateralised personal loan products), and which can be used by the platform to satisfy the debt if necessary. A properly designed cryptoasset borrowing product will also not allow a borrower to go into arrears, as a result of auto-deleveraging mechanisms to sell out collateral to manage debt exposure - meaning arrears and forbearance rules are not necessary. Accordingly, provided that a cryptoasset borrowing product is fully collateralised and does not allow a borrower to go into arrears, in our view there is no need to apply creditworthiness, arrears and forbearance rules.

This illustrates the positive nature of these products, which are in many cases much more flexible and beneficial for consumers than traditional finance lending products. Traditional finance lending products have highly inflexible repayment schedules, possibility of arrears and subsequent debt-collection, the need to post real-world assets as collateral (which could be life-affecting for the borrower if foreclosed upon), and the potential for borrowers' credit scores to be negatively impacted if the lending is not managed by the borrower appropriately. In contrast, properly designed cryptoasset borrowing products avoid the vast majority of these risks.

Question 36: Do you agree that the proposed restrictions for collateral top ups would reduce the risk profile for retail consumers? Are there any suitable alternatives?

We do not believe that there should be restrictions on collateral top-ups; e.g., requiring express consent from consumers or limiting how much a borrowing firm can automatically top up a customer's collateral. One feature of cryptoasset borrowing products is the need for the platform to be able to dynamically manage the collateral, to manage the risk for the lender. Accordingly, for these products to be effective and for firms to be able to manage risk in relation to them, auto-top up and auto-liquidation processes must be able to operate quickly as the market moves.

We believe that notification processes can be built in a way to protect borrowers from unexpected auto top-up or liquidation events, alongside consumer education and disclosure during the process of the borrower securing the loan. Firms should be required to actively disclose the auto-top up and auto-liquidation processes to customers during the lending process, and then provide notifications to customers on an ongoing basis when prices are approaching a point at which an auto-top up or auto-liquidation may occur, so borrowers have the ability to be able to make informed choices on their next steps to accept the auto top-up or liquidation (i.e., do nothing), actively repay a portion of the loan to increase their collateral ratio, or top-up their collateral. However, firms should not be under an obligation to seek specific consents for individual top-up or liquidation events, as this would make the product unviable from a risk perspective in times of significant market movement.

Question 37: Do you consider the above measures would be proportionate and effective in ensuring that retail consumers would have sufficient knowledge and understanding to access cryptoasset lending and borrowing products?

We believe that appropriate disclosure obligations around risks and product features in advance of the borrower entering into the lending arrangement, express consent to enter into the lending arrangement, and automated notices to warn of potential auto top-up or auto liquidation events, will sufficiently protect consumers from potential harm. By allowing consumers enough information to make an informed decision, and helping them with warnings when the market is moving, consumers should be able to access these types of products without exposing them to significant risk that they were not aware of, or could not understand.

Participants should have the information necessary to make informed choices. As a general point, however, we caution jurisdictions against applying suitability requirements. Given the other measures proposed by the FCA in relation to disclosures and express consent, and given that (as we describe in our response to question 33 above) these products are inherently suitable for those persons that would generally want to make use of them (as they already own cryptoassets and wish to borrow against them), we do not think this is necessary.

In relation to appropriateness assessments, as noted in our response to question 35 above, collateralised cryptoasset borrowing products are generally entered into by customers that already have exposure to the market, and by entering into a borrowing product, are not accepting any net-new exposure to market volatility. Therefore the need in terms of customer awareness for these products should centre around deleveraging / auto top-up processes when the market is moving, rather than on exposure to price movements generally. In our view this customer awareness is best achieved not by requiring the customer to demonstrate knowledge in advance (i.e., via an appropriateness assessment), but instead for the platform to provide education, disclosure and other materials in advance of the customer providing their express consent, including illustrations on how auto top-up and deleveraging processes work in different price movement scenarios, so that fully informed consent can be given in advance of the product being accepted by the customer.

Question 38: What benefits do platform tokens provide to consumers?

Platforms issue their own tokens to power and support their internal ecosystems. They can be used for a variety of functions to the benefit of the consumer including paying transaction fees, accessing premium services, earning rewards or participating in governance within the platform.

Platform tokens are a modern evolution of customer engagement strategies, which are enabled by blockchain technology similar to airline loyalty programs or in-game

currencies or credits. Unlike traditional loyalty programs, platform tokens have the added benefit of being tradable, making them tools for community building and platform adoption. Platform tokens also unbundle services. Instead of locking consumers into long-term subscription plans, users can buy tokens as needed, access specific features, and trade any unused tokens. This model empowers consumers to try different platforms without incurring high switching costs, enhancing both choice and competition.

There should not be any restrictions on platform tokens per se; platforms should be allowed to issue and list their own token, in the same way that the London Stock Exchange is able to trade its own stock and manage the conflicts of interest associated with this. Indeed, legitimate conflicts of interest and the associated risks posed to consumers should be capable of being managed to allow consumer choice.

Question 39: How can conflicts of interest be managed for platform tokens to reduce the risk profile for retail consumers?

As noted above, we do not believe that the existence of platform tokens in and of itself creates unmanageable conflicts of interest or risks - instead it is how they are used, and the products they may be integrated into, which can cause risk and conflicts. Regulators should focus on (1) restrictions on their use in specific circumstances and (2) mitigating the conflicts of interest and ensuring appropriate disclosures where conflicts do arise.

For the former, we believe that there are some uses of platform tokens which can lead to an excessive level of risk for customers, for example in cryptoasset lending and borrowing. As noted in the Discussion Paper, platform tokens often derive their value from a direct or indirect exposure to the health of the platform itself. Therefore, if the platform is offering the ability to use their platform tokens for collateral or yield generation purposes, this could lead to excessive risk being accepted by the customer as a result of their borrowing from the platform against an asset that the platform can control the price of. This type of activity, where a platform allows customers to use their own platform tokens as collateral, or borrow in the platform token, should be restricted. Excluded from this should be platform tokens that are stablecoins, since their value should derive from the value of the underlying reserve rather than from the health and activities of the platform itself.

On the second, provided that the activity is not restricted (as above), appropriate disclosures around the conflicts, functional separation and remuneration policies internally should be capable of managing any potential conflicts that may arise. Generally, platform tokens are a legitimate aspect of the ecosystem provided that there is full

disclosure to the customer of the link between the platform token and the platform and any potential conflicts of interest, and provided that the platform is set up to ensure that it is not incentivised to exploit its position to the detriment of the customer.

Question 40: Do you consider that if we are to restrict retail access to cryptoasset lending and borrowing, an exemption for qualifying stablecoins for specific uses within the cryptoasset lending and borrowing models would be proportionate and effective in reducing the level of risk for retail consumers?

We do not believe that there should be restrictions on retail access to cryptoasset lending and borrowing. We note that the majority of the volume in these products comes from consumers who have existing cryptoasset positions and do not wish to sell them (either because they do not wish to exit their position or do not wish to crystallise a gain on their assets for tax purposes) but wish to deploy the value locked up within those assets for other means. The loan product allows them to post collateral against a loan of stablecoin, which can be paid back via partial repayments over time, or via a lump sum repayment when the borrower wishes. Collateral is managed by the platform within certain overcollateralisation percentages, allowing a buffer for price volatility of the collateral without requiring margin calls or auto deleveraging. In short, these products are highly beneficial to the types of borrowers and lenders that seek this service, as they allow borrowers to deploy their cryptoassets as collateral, complete flexibility on repayment terms, and no ability to generate a negative balance against the platform which must be recovered.

Chapter 5 – *Restrictions on the use of credit to purchase cryptoassets*

Question 41: Would restrictions on the use of credit facilities to purchase cryptoassets be effective in reducing the risk of harm to consumers, particularly those vulnerable? Are there alternative approaches that could equally mitigate the risks?

The FCA should not introduce a ban on consumers using credit to buy cryptoassets. We urge the FCA to move away from blanket bans - which send a strong, negative signal to the market - to an approach that focuses on consumer education, disclosure and informed decision making, without stifling innovation or economic participation in the growing digital asset space.

We note that the UK has decided to regulate cryptoassets as a financial instrument and not as gambling. However, a ban on the use of credit to buy cryptoassets is akin to the ban on the use of credit for gambling purposes; incidentally but notably, the National Centre for Social Research, in an evaluation of the effectiveness of the ban on use of credit for gambling, found that there was no significant change in borrowing behaviour among high risk gamblers post implementation of this ban. In contrast, there is no ban on the use of credit to purchase financial instruments, such as shares, bonds or derivatives; retail investors can use credit facilities, including credit cards or personal loans to invest in these assets, provided they meet the lending criteria set by financial institutions.

The UK should not pick and choose which rules it applies from financial services and gambling regulations, to regulate the cryptoasset sector. Indeed, the onus should be on the financial institution or bank to determine whether an individual should be given a loan based on an evaluation of the applicants' creditworthiness and ability to repay. Moreover, consumers use credit cards for a number of different reasons, for example to build credit history, to collect rewards or "points", or for additional protections (i.e., insurance). In other words, people use credit cards not just for short term financing but as a tool to manage money, earn rewards, and establish financial credibility. Given this, banning individuals from buying cryptoassets using credit would be disproportionate. Additionally, we note, that many individuals in the UK currently buy cryptoassets using credit cards, given that most UK banks have put in place bans or limits on fiat transfers to cryptoasset exchanges; banning the UK of credit cards as well would almost entirely cut off the crucial on ramp from fiat to crypto.

Finally, a ban on the use of credit to purchase cryptoassets, similar to that for gambling, suggests that the FCA sees cryptoassets only as speculative investments. Further, by proposing to carve out stablecoins from the ban, this suggests that the FCA is distinguishing between the risks associated with "backed" and "unbacked" cryptoassets. We see two challenges with the approach posed. First, treating cryptoassets only as

speculative investments (treated in the same way as gambling) fails to recognise the inherent utility of many cryptoassets (e.g., a consumer may seek to purchase ETH to participate in the Ethereum network to pay gas fees), and their role as consumer products, whereby blockchains like Ethereum, Solana and Polygon are powered by their respective native/base-layer tokens for Web3 development in the UK. Secondly, "unbacked crypto" is not a monolithic bucket; it includes base-layer tokens, utility tokens, meme-coins and others; drawing a line between "backed" (i.e., stablecoins) and unbacked cryptoassets (all others) creates a false dichotomy for regulatory purposes, and does not reflect the different risk profiles within the category of "unbacked" cryptoassets.

Chapter 6 - *Staking*

Question 42: Do you agree that firms should absorb retail consumers' losses from firms' preventable operational and technological failures? If not, please explain why? Are there any alternative proposals we should consider?

Making CATPs absorb slashing losses

While network penalties in the form of "slashing" are possible (i.e., if the validator validates incorrect transactions), they are extremely rare. Even taking into consideration the performance of home stakers and across all "staking as a service" providers, slashing is very rare with less than 0.01% of all staked ETH lost to slashing on Ethereum due to validator/operator errors.[1] However, if there is slashing, Coinbase fully reimburses any network penalties imposed due to Coinbase's operational error. Coinbase has offered staking services since 2019, and no customer has ever lost their assets. As a result, any prudential requirements - considered in the broader context of prudential requirements for a CATP - should reflect the low probability of slashing, and staking activity more generally.

We agree that CATPs should make customers whole if slashing occurs as a result of a preventable error by the CATP or their third party validator. CATPs' commitment to replace the customer's assets due to slashing should be subject to the following carveouts: (i) protocol-level failures caused by bugs, maintenance, upgrades, or general failure; (ii) customer acts or omissions; (iii) acts or omissions of any third party service provider (other than preventable error of the CATP's third party validator); (iv) the occurrence of a force majeure event; (v) acts by a hacker or other malicious actor; or (vi) any other events outside of the CATP's reasonable control.

Risks to consumers

Regarding the risks to consumers identified, we note that the Discussion Paper states that "reliance on third parties could increase any inherent technological risks". To the contrary, we believe that engaging third party validators can reduce concentration risk and increase operational resilience, subject to these third parties being carefully selected and subject to relevant due diligence processes.

Further, we note that the Discussion Paper reflects on safeguarding risks, and states that "inadequate segregation between the staked consumers' cryptoassets and other consumers' cryptoassets risks all consumers' cryptoassets being inadequately ringfenced in the case of insolvency or hacking". To the contrary, we note the use of different wallets for staked versus unstaked assets does not impact the identification of

[1] Calculated from network data on the Ethereum protocol provided by Rated.network

assets held on trust for consumers in the event of insolvency, provided there is appropriate ledgering at the custodian, nor does it provide measurable additional security in the event of hacking (staking does not increase cybersecurity risk in itself). We disagree with the premise that asset segregation between staked and unstaked assets will ensure that "retail consumers will be better protected from the risks of asset losses caused by technological and counterparty risks".

Making the UK a Centre of Web3 Excellence

Finally, we believe it is an important objective to support the "growth of the staking market in the UK"; indeed, staking is crucial to the consensus mechanism of proof of stake blockchains on which Web3 will likely be built. If the UK wants to become a centre of Web3 excellence, it must embrace staking as a service. This means ensuring that the regulatory regime is proportionate to, and commensurate with, the very low risks associated with staking. This includes ensuring any prudential requirements associated with staking are appropriately calibrated.

Question 43: Do you agree that we should also rely on the operational resilience framework in regulating staking, including the requirements on accountability?

We believe the key areas of focus for operational resilience in regulating staking should:

- Begin with best-in-class key storage and reliable cryptoasset custody. We do not believe that the FCA should mandate segregation of client assets for staking; whether the assets are staked or not should have no bearing on the custody solution deployed.
- Require firms to oversee operational performance to ensure validator nodes are operating correctly to reduce / avoid slashing risk.
- Require firms to carry out appropriate due diligence on validator node operators before selecting them to provide staking services (noting the potential benefits of using third party validators in terms of reducing concentration risk and providing contingency).
- Diversify vendor, hardware, and software selections to reduce concentration risk and the risk of overlapping failure points. This reduces the risk of downtime or network penalties. To be clear, the risk of such penalties is already very small at the protocol level.
- Ensure the firm takes commercially reasonable efforts to protect any staked assets from slashing, however, in the event they are, the staking firm should absorb the customer losses. A CATP's commitment to replace the customer's assets due to

slashing should be subject to the following carveouts: (i) protocol-level failures caused by bugs, maintenance, upgrades, or general failure; (ii) customer acts or omissions; (iii) acts or omissions of any third party service provider (other than preventable errors of a CATP's third-party validator); (iv) the occurrence of a force majeure event; (v) acts by a hacker or other malicious actor; or (vi) any other events outside of the CATP's reasonable control. We note that Coinbase's customers have never lost any assets to slashing since Coinbase launched its staking services nearly six years ago.

- Transparently and proactively communicate the terms of engagement and risks associated with staking to customers.

Finally, it is critical that the regulatory regime for staking is commensurate to the very low risks associated with staking.

Question 44: Do you agree that firms should have to get express consent from retail consumers, covering both the value of consumer's cryptoassets to be staked and the type of cryptoassets the firm will stake, with each cryptoasset staked by the consumer requiring its own consent?

Generally, when a CATP holds assets in custody, the client should be required to instruct the CATP to stake, and therefore affect the instruction on their behalf. This is the case for Coinbase - staking of a client's assets is initiated by a specific client instruction, and results in corresponding activity on the blockchain.

However, in the future, it may be deemed appropriate for CATPs to adopt an "opt out" policy for staking for a number of reasons:

- The risks associated with staking are extremely low;
- "Flexible staking" models (see answer to Question 45) ensure consumers' assets are not "locked up" or inaccessible, depending on staking service offered;
- CATPs may be required to indemnify losses from slashing; and/or
- Participation in staking delivers benefits to consumers in the form of rewards in the blockchain's native token, as well as to the broader ecosystem by contributing to the validation process.

For the reasons set out above, we think it is premature for the FCA to require express consent from retail consumers to stake their assets - it should be open-minded to the opportunities and benefits of a different approach. Even in an "opt out" approach, staking providers should expressly and plainly disclose in its terms of service that users are opted in, and provide straightforward procedures for users to opt out.

Question 45: Do you agree that firms should provide a key features document as outlined above to retail consumers? If not, please explain why? What other means should be used to communicate the key features and risks of staking to consumers?

Yes, CATPs should provide disclosures on the staking services offered to retail consumers, covering off the core features of the staking product, including:

- The recent staking reward rate, expressed as a percentage range - we warn against inclusion of an "expected" reward rate, as this is determined by the protocol and not by the staking provider
- The frequency with which rewards are paid to the customer, and how they are paid
- The provider's fee
- Any "lockup" or other period which may apply before the consumer's assets can be unstaked

We believe this information should be provided not via a "key features document", but instead by making it available to the client within the staking workflow on the CATPs platform, and then available to be viewed in the user's account for the duration of any staking activity. For example, it is impossible to provide a static "expected reward" within a key features document; the reward rate varies and is determined by the protocol, i.e., it cannot be influenced by the staking provider.

A key part of this is ensuring that consumers have relevant information on lock-up periods. Some blockchains enforce lock-up periods at the protocol level, meaning once staked, assets are locked and cannot be withdrawn immediately, and the lock-up periods for staked cryptoassets vary depending on the blockchain or staking method. For example, Ethereum (ETH) has no fixed lock-up, but un-staking/un-bonding takes time (typically a few days to weeks, depending on exit queue congestion), the un-bonding period for Polkadot (DOT) is 28 days, and 2-3 days for Solana (SOL). Moreover, individual CATPs have different lock up terms, with some offering fixed terms (30/60/90 days) with higher rewards but consumers' crypto is locked up for the duration. Others offer flexible staking, which allows consumers to un-stake at any time but with lower yields. Finally, liquid staking tokens, which represent a claim to underlying staked ETH, allow holders of the token to sell, transfer or otherwise use the token off the exchange's platform without any un-staking period.

It is therefore critical that there are appropriate platform disclosures so that consumers are made aware of these lock-up periods, prior to them entering into any staking arrangement.

Question 46: Are there any alternative proposals we should consider to minimise the risks of retail consumers' lack of understanding leading to them making uninformed decisions?

We note that there are different models of staking that have different features.

In a typical staking model, the custodian stakes customers' assets in accordance with the relevant protocols' bonding and un-bonding periods. If a customer wanted to un-stake their assets, they would have to wait for the protocol's specified un-staking period to expire, which varies between assets and could range from 2 to 28 days, because the staking platform does not provide early un-staking. The key issue here is that a customer's assets may be locked up for a period of time; the timeframe during which assets are locked up will vary depending on the protocol. This is critical information to be disclosed via the mandated information disclosure requirements discussed in question 45.

Alternatively, CATPs offer instant un-staking or early un-bonding as a convenience to customers that would like to exit the protocol lock up period early. Customers under that model can request to un-stake and receive their assets immediately. CATPs that offer early un-staking typically use internal liquidity pools or a custodial netting feature to pay out instantly while they wait out the protocol un-staking period in the background. By providing this solution, consumers no longer have to wait for the expiration of lengthy un-staking periods, delivering instant liquidity.

Finally, liquid staking (e.g., Lido) provides consumers with liquidity by issuing a liquid token (e.g., stETH) that represents a consumers' staked ETH.

All these models should be allowed, to provide consumer choice, but there should be disclosure to consumers on the staking service offered to ensure consumers' have sufficient knowledge to make this assessment.

Question 47: Do you agree that regulated staking firms should be required to segregate staked client cryptoassets from other clients' cryptoassets? If not, why not? What would be the viable means to segregate clients' assets operationally?

The FCA notes that staked assets are sometimes pooled with other custodied client cryptoassets within an omnibus wallets - and is proposing to require staked client cryptoassets to be segregated in a separate wallet from unstaked cryptoassets, as well as from firm cryptoassets to prevent "comingling". We make a few points in this regard:

Firstly, broadly speaking, for operational and technical reasons, in many cases staked assets do not sit within the same wallets as other custodied client cryptoassets. However, we disagree with the premise set out by the FCA that segregation of staked versus

unstaked assets is necessary to address conflicts of interest, support accurate record keeping and for safeguarding reasons, to reduce the risk of hacking. It is unclear to us what conflicts of interest the FCA sees or is seeking to address, nor why this supports accurate record keeping, when the FCA recognises that internal books and records (i.e., internal ledgers) play a crucial role in identifying individual client's entitlements and therefore their beneficial ownership of their assets for omnibus wallets. We do not believe this should be a regulatory requirement; rather, a decision on whether to hold staked assets in a separate wallet to un-staked assets should be determined by the staking provider based on maximising operational efficiencies.

Finally, 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. However, as contemplated in the FCA's consultation paper on regulation of stablecoin issuance and cryptoasset custody, there are operational reasons why a de minimis amount of firm originated assets should be allowed to be held within customer omnibus wallets; such practices are also allowed CASS 6.2.6 for traditional finance in limited circumstances.

Instances when this is allowed should include, for example, receiving fees dominated in the form of the crypto for which it was earned before sweeping these house assets ("in flight cryptoassets") out of the client omnibus wallet - and this should also apply for commission paid in crypto for staking services. 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, real-time 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 at a regular cadence, in a batch process, and at a rate determined by permissible thresholds of omnibus house assets.

Question 48: Do you agree that regulated staking firms should be required to maintain accurate records of staked cryptoassets? If not, please explain why?

Accurate books and records are critical to preserving ownership rights and play a crucial role in identifying individual client's entitlements and therefore their beneficial ownership of their assets. This should include accurate records of cryptoassets staked, including who the cryptoasset is being staked on behalf of, and actual distribution of rewards based

on customers' staked allocation (i.e., not "expected rewards," since rewards are distributed by the protocol and exact rates cannot be anticipated by providers), as well as custody records of consumers' original cryptoassets (i.e., the principal the customer staked).

Question 49: Do you agree that regulated staking firms should conduct regular reconciliations of staked cryptoassets? If not, please explain why? If so, what would be the appropriate frequency?

CATPs should be required to regularly perform internal reconciliations (covering in particular offchain transactions) to ensure accuracy of the internal ledger and to identify and resolve any discrepancies that arise – this should apply to both staked and unstaked assets. 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.

In its recently published consultation paper on regulating stablecoin issuance and cryptoasset custody, we noted that the FCA will not 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. We agree that reconciliations should take place daily for all cryptoassets, including staked cryptoassets and covering any rewards and penalties, consistent with existing standards in traditional finance. The same requirements should apply to both staked and unstaked assets. Even without the imposition of real-time reconciliation, it is important to recognise that onchain data provides additional and publicly verifiable information that delivers enhanced disclosure relative to traditional custodial practice.

Chapter 7 - *DeFi*

Question 50: Do you consider the proposed approaches are right, including the use of guidance to support understanding? What are the effective or emerging industry practices which support DeFi participants complying with the proposed requirements in this DP? What specific measures have you implemented to mitigate the risks posed by DeFi services to retail consumers?

We welcome the FCA's decision to keep decentralized finance (DeFi) out of scope of the proposed new rules. Not only is this good policy– as DeFi is fundamentally different from centralized digital asset markets– it is also critical to the UK's goal of becoming a global digital asset hub. Participants in the digital economy are increasingly looking to unlock the promise and potential of DeFi and engage in peer-to-peer transactions without the need for intermediation (including through DeFi pools). Top developer talent and high quality DeFi teams are already active in the UK, and the UK financial services industry has expressed great interest in leveraging the potential of DeFi and permissionless infrastructure.

For these reasons, we appreciate the FCA continuing to engage with developers and market participants to understand core features of DeFi and we stand ready to support that conversation. In that spirit, we propose a mental model to help distinguish among various types of activities occurring onchain for purposes of applying appropriate regulation.

Decentralization of Protocols

First, we welcome the FCA's invitation to provide further feedback on how to assess centralisation and decentralisation for DeFi protocols and recommend that the FCA consider the following principles as indicative of decentralization:

- The protocol is truly permissionless and does not empower any person or group of persons under common control with unilateral authority, via operation of the protocol or participation in the protocol's governance system, to restrict or prohibit use of the protocol, including, but not limited to: (i) using or transmitting a digital asset; (ii) deploying software that uses or integrates with the protocol; (iii) operating any client, node, validator, or other form of computational infrastructure with respect to the protocol; or (iv) participating in any decentralised governance system.

- The protocol: (i) functions without the requirement of human intervention in accordance with pre-established, transparent rules encoded within the source code of the protocol; and (ii) no person or group of persons under common control have the unilateral ability, via operation of the protocol or participation in the protocol's governance system, to: (a) determine the final outcome of decisions

relating to the development, provision, publication, management, or administration of the protocol; (b) determine the final outcome of decisions relating to the openness, functionality, autonomy, permissionless nature, distribution, credible neutrality, or economic independence of the protocol; (c) unilaterally alter the rules of consensus or agreement of the decentralised governance system; or (d) unilaterally confiscate a user's assets controlled in or by the protocol without the user's permission in a way that is not part of protocol rules or expected protocol operations.

- The source code of the protocol does not empower specific persons with private permissions, hard-coded privileges, or similar rights over other similarly situated persons.
- The protocol is non-custodial.
- The protocol's source code is freely and publicly available and is recorded for execution by clients on a blockchain.

Self-Hosted Wallets and User Interfaces

While the above principles will help to distinguish between decentralized activity and centralized activity, not all instances of centralisation merit the application of financial services regulation. This is often the case when it comes to software service providers – for example, technology firms that offer self-hosted wallets or non-custodial user interfaces. These service providers should not be considered financial services intermediaries unless they have discretion with respect to the execution of user transactions on behalf of users (i.e., the transactions are not self-directed by the users), the software confers any unilateral control over user assets, or the software provider holds itself out as a financial services intermediary with fiduciary duties to its users.

More specifically, a core feature of DeFi is that users in a DeFi ecosystem do not rely on intermediaries acting in a fiduciary capacity with respect to DeFi transactions. Instead users' interactions with the blockchain are self-directed and self-controlled. Users do not need anyone to perform broker-style services on their behalf because they hold and control their own assets. The software provider who deploys instances of code to create DeFi services and products does not recommend or provide advice as to assets or transactions, or otherwise have discretion over a user's ultimate decision to engage in a particular transaction. In such circumstances there is no need to apply a fiduciary safekeeping obligation or other regulation with respect to the use of DeFi services and products.

Centralized Onchain Financial Services

We agree with the FCA's view that centralised protocols should not be excluded from regulation where they provide financial services. However, we do not believe that onchain financial services activity should in all cases be subject to the same regulation as centralised activity taking place off chain; rather the FCA should be focused on achieving the same regulatory outcomes. We therefore urge the FCA to remain open to how the unique features of blockchain technology and permissionless networks implicate the regulatory framework.

Permissionless infrastructure and open source code offers distinctly different opportunities in terms of competition, innovation, and access. It is crucial to understand those distinct features, including the benefits they can offer to UK industry and users. In particular, the interplay between tokenisation and permissionless networks (regardless of whether they meet the criteria for decentralization) offers a unique chance for the UK to reinforce its position as a global financial hub.

Timing is crucial; the UK can build a competitive edge alongside the US - which is already actively developing a framework to capture the promises of tokenisation and permissionless networks. We urge the FCA to keep an open mind on DeFi and a close eye on international developments in this area to make sure it achieves the right balance between innovation, competitiveness and other regulatory outcomes.