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Date: 29 May 2024

To:

Financial Conduct Authority (FCA)

Bank of England

Response to Digital Securities Sandbox joint Bank of England and FCA Consultation Paper

Coinbase Global, Inc. its UK subsidiary CB Payments Ltd. (together, Coinbase) welcomes the opportunity to respond to the consultation published jointly by the Financial Conduct Authority (FCA) and Bank of England on delivering a Digital Securities Sandbox (DSS).

Coinbase started in 2012 with the idea that anyone, anywhere, should be able to send and receive Bitcoin easily and securely. Today, we are publicly listed in the United States (US) and provide a trusted and easy-to-use platform that millions of verified users in over 100 countries rely on to access the crypto economy. Coinbase holds more than $300bn in customer assets and acts as a custodian for 8 out of 11 Bitcoin Exchange Traded Funds (ETFs) approved in the US.

The DSS is an initiative that can supercharge the City and put it on a strong competitive footing when it comes to the digitisation of financial markets. We believe the DSS should be as flexible as possible in its design in order to truly test the regulation of digital securities, so that firms can explore alternative ways of conducting activities, which will open up the market to new entrants and promote greater competition to the benefit of end-users.

Coinbase is committed to the UK, and we are actively seeking opportunities to bring new innovative products to market. We are well-placed to provide services in relation to digital securities, given our track record of operating innovative custody and exchange solutions for a wide range of crypto assets.

We stand ready to assist the UK regulators in their design of the DSS, which could pave the wave for transformative changes to UK capital markets.

Yours sincerely,

Tom Duff Gordon,

Vice President, International Policy

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Introduction

Blockchain technology and digital assets have the potential to kickstart a new wave of growth and innovation for the City of London, in the same way that digitisation and deregulation drove the growth of the City in the 1980s. New technology delivered faster and more efficient electronic trading, supercharging the City, allowing it to reclaim the title of the world's leading financial centre. Four decades on, it is a new, exciting technology that again presents an opportunity to radically transform financial services, and to put the City of London at the forefront of a new technological transformation: the tokenisation of financial and non-financial assets, and trading them on a blockchain. The opportunity for the UK is great and the DSS is a pivotal moment in this journey, where the UK can truly test new and innovative ways to deliver financial services.

Area of Interest for Coinbase

Coinbase has particular interest in the DSS with respect to tokenized money market funds. Global payments systems and digital stores of value are rapidly changing. Stablecoins already account for 15% of global crypto value and are now mature products with deep customer penetration and product market fit. Based on our work with institutional clients - many of the largest global banks, corporates, asset managers, venture funds and hedge funds - we expect the next major technology catalyst for liquidity, payments, and yield to be focused on tokenized funds, specifically tokenized money market funds.

Global money market funds hold more than $9 trillion today, and allow investors of all types to access safe, stable NAV assets, with yield generation. However, the share creation and redemption infrastructure does not currently permit funds to be used for real time global value transfer, collateral management, and transaction settlement. Tokenizing money funds would enable this, introducing tremendous efficiencies into traditional financial markets.

Coinbase has the requisite knowledge and technology to help make this happen. Bringing these well regulated, safe, yield generating assets on-chain would allow instantaneous atomic settlement and real time 24/7/365 subscription and redemption availability. As a result, institutional clients would greatly enhance their cash efficiency and reduce their counterparty exposure.

The key challenge for traditional institutions is that tokenized products will only run on blockchain rails that can scale globally to billions of digitally enabled users in a trusted and secure manner. The pace of innovation is rapidly accelerating and we expect it will remain challenging for many traditional institutions to keep pace. This is a major opportunity for new players to contribute as partners in the DSS.

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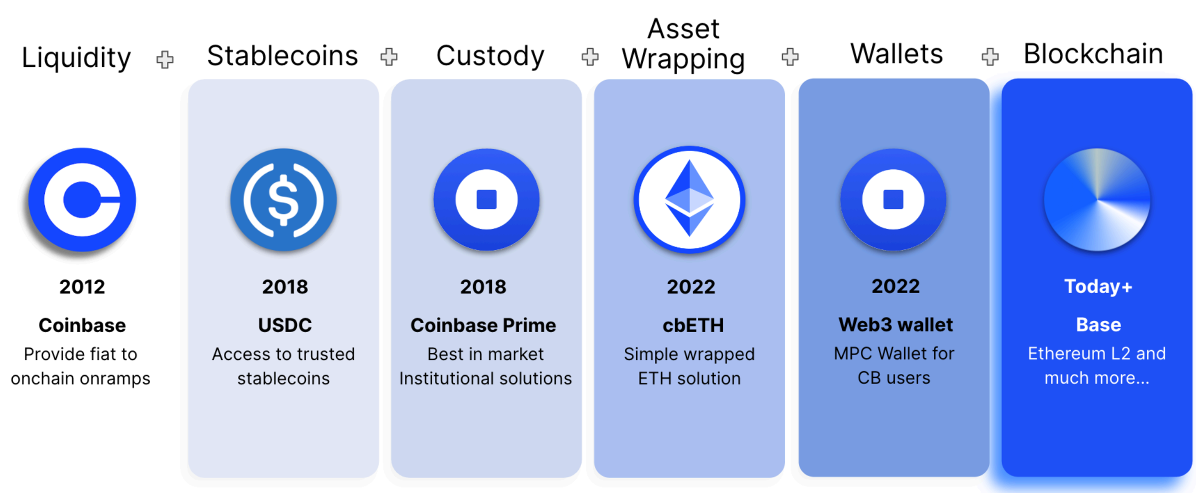
Coinbase's platform brings together the most trusted and secure technology stack at global scale allowing for the development and support of an entirely new market structure, much of which will be needed by UK banks and partners. This includes a digital asset exchange, qualified custody, smart contract development, wallet infrastructure, trade execution and order algorithms, fiat on-off ramps, and importantly a fast and low cost blockchain, BASE (see Diagram 1). Our Exchange is one of the largest liquidity venues globally for matching buyers and sellers on digital asset trading. Today, we are trusted to custody more than $300 billion in digital assets. We are proud to support more than 110 million retail and institutional customers with our wallet and custody infrastructure across more than 100 countries. With the launch of BASE, a Coinbase managed blockchain, we are now on a journey to connect the next 1 billion users globally to digital assets.

We are supportive of the FCA's and Bank of England's approach to allow new players to experiment and innovate in the DSS. However, when firms like Coinbase are performing non-DSS activities (e.g. by providing custody services) they are required to act in line with existing rules and regulations, including having the relevant regulatory permissions. We believe this is a missed opportunity. For example, in the US context, Coinbase operates as a custodian for 8 out of the 11 Bitcoin ETFs that have been approved, demonstrating that new players can safely and securely support digital asset products, in the traditional finance space. As such, we request that the FCA allows for greater flexibility - possibly as part of a second phase - by allowing non-DSS entrants to interact with digital securities, as issued or traded using DSS infrastructure, with the benefit of certain regulatory derogations (subject to appropriate oversight). We believe this will encourage the growth of a digital assets ecosystem and facilitate real-world adoption in due course.

Diagram 1: Full product suite offered by Coinbase



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Comments on the Design of the DSS

The introduction of the DSS is an important recognition of the innovative potential of blockchain technology for financial markets, but also that existing financial market rules may be difficult or impossible to apply in a DLT context. We welcome moves by the UK to test and make changes to these rules to accelerate the technological transformation of financial markets but highlight the following areas where we believe further consideration is needed:

Settlement assets

- The consultation paper indicates that the Bank will adopt a restrictive approach to settlement assets, permitting only “commercial bank money with little or no credit or liquidity risk, or equivalent private forms of money, to be used as a payment asset within the DSS”, excluding e-money or stablecoins.

- We disagree with this approach for two reasons. First, it strikes us as unduly prohibitive to only allow tokenized forms of commercial bank money to be the only form of on-chain settlement asset – this stifles innovation and places firms without deposit-taking licenses at a significant competitive disadvantage, given the success of a digital FMI will, to a large extent, be dependent on its use of on-chain settlement mechanisms. Second, we see the restriction on stablecoins as out-of-step with the objectives of the DSS, which is to encourage innovation in financial markets. Third, and most importantly, stablecoins are already the dominant settlement asset globally for all things digital, and if the DSS prevents their use, it could render the sandbox obsolete for digitally-native institutions that are on chain. We believe that greater flexibility should be provided, with the ability to test and scale stablecoin solutions within the DSS, subject to appropriate regulatory oversight.

Permissionless systems and the PFMIs

- The consultation paper indicates that DSS entrants may use different technological approaches in their FMI designs, including using permissionless blockchains. We are encouraged that the Bank has stated it is open to the use of permissionless blockchains – we also note that the PFMIs continue to be referenced as a key touchstone for assessing their safety and stability. In that context, we would be grateful for further guidance on what sorts of risks concern the Bank in relation to permissionless systems, and the legal or operational mitigants it might expect to see (if any) in relation to those risks.

- If permissionless systems are to be allowed in the DSS – and we think they should be, given the potential significant benefits they can offer – then we request that the FCA and Bank takes a holistic view of which rules currently impede their use, with a view to relaxing them for the purposes of the DSS where possible. For example, we understand that the Basel rules for the prudential treatment of cryptoasset exposures may not permit digital assets recorded on permissionless blockchains to be included in 'Group 1' for prudential capital purposes. If so, those digital assets would be categorised as 'Group 2', meaning participants dealing in those digital assets (including through the DSS) would be subject to punitive capital requirements. That treatment could disincentivize participation in, and endanger the commercial viability of, permissionless FMI and stifle innovation.

- For these reasons, we believe digital assets traded through permissionless digital FMI should be treated as Group 1 digital assets, at least for the duration of the DSS. We understand the consultation paper refers to prudential treatment issues being considered by the PRA separately to the DSS, but believe they will need to be considered in order for permissionless systems to be able to compete on a level playing field to permissioned implementations.

Retail participation

- From HM Treasury's prior consultation response, we understood the Government would not rule out retail participation, but would not be proposing amendments to facilitate retail participation expressly (e.g. by disapplying or modifying Articles 53(3) and 19(2) of MiFID II (for MTFs) and Articles 2(1)(19) of CSDR and Article 2(f) of SFD (for DSDs)). We have not identified further statements in the consultation paper as regards whether retail participation will be permitted for DSS participants, and we believe this should be clarified for the market.

Limits for MMFs and other funds

- We note that the consultation paper includes aggregate and firm-level limits for certain types of asset classes – e.g. for corporate bonds, the firm-level limit is stated to be £900m. However, no limits are stated in relation to money market funds or other types of funds – instead, the consultation paper states that the Bank will consider appropriate limits when firms approach it with their proposed activity. We also see the Bank will consult firms and carry out further work on assessing whether and what aggregate limits are appropriate in relation to fund tokenisation activity. We understand that the imposition of limits has proven to be a point of contention for potential DSS entrants generally, not least because the notion of aggregate limits means the DSS' capacity will depend on the number of entrants that are accepted and the allocations those entrants are given (which is outside of the control of any individual DSS entrant). We would encourage the Bank to consider whether the limits can be made more flexible, with any financial stability concerns being addressed through other means.