IRSG
INTERNATIONAL REGULATORY STRATEGY GROUP

International Regulatory Strategy Group (IRSG)

RESPONSE TO THE FINANCIAL CONDUCT AUTHORITY CONSULTATION PAPER

'STABLECOIN ISSUANCE AND CRYPTOASSET CUSTODY'

Introduction

The International Regulatory Strategy Group (IRSG) is a joint venture between TheCityUK and the City of London Corporation. Its remit is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services. It comprises practitioners from the UK-based financial and related professional services industry who provide policy expertise and thought leadership across a broad range of regulatory issues. The IRSG welcomes the opportunity to respond to the Financial Conduct Authority's (FCA) consultation paper CP25/14 'Stablecoin Issuance and Cryptoasset Custody' dated 28 May 2025 ("**the Paper**").

Key Messages

Overall, we support the FCA's work to bring qualifying stablecoin issuance and custody within the regulatory framework. A sound regulatory framework for stablecoins is essential to allow their potential to be realised sustainably, while proportionately managing the associated risks. However, our response highlights some key considerations to ensure the future framework is a proportionate, effective and globally competitive regime.

- **Proportionate application of existing frameworks and clarity on AML**
  Where appropriate, the regulatory framework for stablecoins should align with the established rules and principles governing traditional financial instruments, promoting coherence and consistency across the broader payments regulatory landscape. However, the FCA should apply existing obligations, such as the Consumer Duty and Anti-Money Laundering (AML) requirements, in a proportionate and tailored manner. Given the distinct characteristics of digital assets, overly rigid rules could stifle innovation and encourage firms to relocate outside the UK.

- **International competitiveness and interoperability**
  Other key jurisdictions, such as the US, are moving rapidly to regulate stablecoins. To remain globally competitive, the UK must move swiftly to implement an ambitious, future-looking, and internationally attractive regulatory regime. The FCA should align with international frameworks, such as the US GENIUS Act and the EU's Markets in Crypto-Assets Regulation (MiCA), to implement regulation that reflects the inherently decentralised and cross-border nature of stablecoins. This is key to support interoperability and reduce the operational burden on firms, thereby maintaining the UK's global competitiveness. The FCA should avoid imposing overly onerous rules that make the UK unattractive compared to other frameworks, such as MiCA, particularly in relation to backing asset composition and redemption mechanisms. The regime must accommodate varied stablecoin structures, including multi-currency models and decentralised arrangements, with clear guidance on redemption expectations.

- **Redemption, foreign exchange (FX) risk and use of alternatives to statutory trusts**
  Practical challenges exist with strict T+1 redemption requirements, particularly outside GBP contexts. The FCA should permit backing assets held in other currencies where the issuer has appropriate risk management in place. We do not support the mandatory use of statutory trusts; alternative protections, such as frameworks similar to the Client Asset Sourcebook (CASS) regime for holding client assets or buffers, may offer more operational flexibility.

- **Outsourcing framework**
  We support the FCA's existing rules on outsourcing, set out in the Senior Management Arrangements, Systems and Controls (SYSC) framework, which already provide a well-established framework for managing third-party arrangements. Therefore, it is unclear why the UK regime requires additional bespoke rules, specifically where an issuer uses a third party to carry out core elements of the issuance process. To avoid duplication and complexity, we suggest that the existing SYSC framework should remain the primary mechanism for regulating these arrangements, unless there is a clear and specific risk that cannot be addressed through existing rules.

- **Safeguarding**
  A consistent regulatory outcome across traditional and digital assets is vital. The FCA should align its requirements for safeguarding and segregation of client assets with the existing requirements that apply to custodians under CASS 6. The definition of "safeguarding" must reflect functional differences, and safeguards should focus on client outcomes rather than the legal form (e.g., trust vs. segregation). Liability and remediation should be contractually based and not unnecessarily extended by regulation.

- **Operational burden and proportionality in custody rules**
  Proposals around custody—especially record-keeping, reconciliation, and segregation—should be proportionate to risk and reflect how cryptoassets are held and managed in practice. Daily reconciliations and extensive notifications could impose undue burdens, particularly on smaller firms. Existing authorised custodians should benefit from streamlined authorisation processes and recognition of equivalent standards.

For further detail, please refer to the comprehensive feedback provided in the annex.

We wish to thank Clifford Chance LLP for their support in drafting this response.

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Annex: Responses to questions posed

REQUIREMENTS FOR ISSUING QUALIFYING STABLECOIN

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

We support the inclusion of stablecoin issuance within the UK regulatory regime and agree that the UK needs a clear and robust framework. We also recognise the role of the Consumer Duty in strengthening consumer protections where retail consumers are involved to ensure consistency across regulation.

At the same time, it is important that its application is proportionate and works in harmony with the specific rules the FCA is proposing for qualifying stablecoin issuers. Applying the Consumer Duty alongside detailed, product-specific requirements may create uncertainty for market participants, particularly around what additional obligations they must meet beyond those already set out. Therefore, we encourage the FCA to provide clarity on how the Consumer Duty will interact with these new rules to prevent overlap and to ensure that its implementation is appropriately tailored to the risks posed by stablecoins. An overly prescriptive or broad application of such obligations could risk driving issuers overseas and undermine UK competitiveness. The FCA should assess the application of the Consumer Duty as part of the wider review recently requested by the Chancellor as part of the 'Leeds Reforms' to ensure the proposals remain relevant.

Separately, the FCA must clarify how their proposals on stablecoin issuance would interact with the existing AML Regime, fraud liability and intersections with the previous Admissions & Disclosures and Market Abuse Regime for Cryptoassets (MARC). A notable gap in the current proposals relates to detailed AML requirements. While the FCA's Crypto Roadmap indicates that it plans to address financial crime requirements in a future consultation paper, it is crucial to clarify how AML rules will apply for digital assets, including use cases specific to stablecoins (and custody). In addition, the FCA must also provide further guidance on firms' AML responsibilities where they are safeguarding backing assets that the issuer holds in trust for unidentified beneficiaries. AML requirements should be aligned to those applied to traditional assets, for example focused on the counterparty/customer and their acquisition of the asset/funds. Providing clear guidance to this effect is a fundamental step to operationalising digital assets in the UK.

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

We agree that the FCA should hold issuers of multi-currency qualifying stablecoins to similar standards as issuers of single-currency stablecoins, unless there is a specific reason to deviate. The FCA's assessment of how multi-currency stablecoins would potentially operate on structures similar to single-currency models broadly reflects current market practice. However, additional models do exist, including decentralised and ecosystem-based arrangements that may not fit neatly within traditional frameworks. One key area where existing rules may not fully align with multi-currency stablecoins is in the treatment of redemption. The FCA's approach has some similarities with the electronic money (e-money) framework, assuming 1:1 fiat redemption from the issuer. Yet, in practice, as with other existing stablecoins, most holders of multi-currency stablecoins "redeem" their tokens by selling them at market value without recourse to the issues - i.e. they convert them to other tokens or assets, or use them directly within platforms for goods and services. Any rules should account for this, alongside strict requirements for fiat-backed redemption.

The FCA should also consider any FX exposure risks that multicurrency stablecoins and any proposal to redeem at par would introduce, alongside the possible challenges in calculating this. For example, it is unclear whether the FCA's proposed regime would result in the right to redeem the sterling equivalent at an agreed interest rate. The regulator should consider international comparisons. For example, under MiCA, multi-currency coins fall under the category of Asset-Referenced Tokens (ARTs) rather than E-Money Tokens (EMTs). Consequently, MiCA does not require redemption at par; instead, issuers may use a price mechanism to make an equivalent repayment to the market value of the assets referenced (i.e. the current value of the backing assets) or affected by delivering the referenced assets (i.e. the market impact or valuation effects that may occur during redemption) (MiCA, Article 3). This comes with some differences between the EMT/ART regime, for example, around licensing requirements.

Given the inherently cross-border nature of multi-currency stablecoins, it is essential that the UK framework aligns with international regulatory approaches. This will help ensure interoperability across jurisdictions and maintain the UK's competitiveness.

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

We broadly agree with the proposed approach and recognise the importance of ensuring that backing assets are appropriate and sufficient to meet redemption obligations. Backing assets must be appropriately structured and readily available to support redemptions when required.

Accessing a diverse range of appropriately structured and readily liquid backing assets can help to reduce concentration risk by preventing over-reliance on specific asset types. It also supports stable valuations during periods of market volatility or liquidity stress. The range of backing assets allowed is helpful in this context. However, the proposal to split backing assets into 'core backing assets' and 'expanded backing assets', with the latter only available where issuers notify the FCA of their intention to do so and demonstrating sufficient skills and competence risks introducing an additional friction which could result in legal uncertainty for individual coin issuances. It is important that the notification requirement does not become a de-facto approval process where firms are not allowed to act unless the FCA has positively confirmed to avoid this.

The FCA should clarify that tokenised assets may be used as backing assets, provided that the regulatory/legal treatment is equivalent. This is particularly important for the UK given the current exploration of digital gilts via HM Treasury's Digital Gilt Instrument (DIGIT) pilot. If the FCA does not permit tokenised assets as backing assets, this would undermine the business case for digital gilts and likely reduce demand for them. A harmonised digital assets strategy in the UK, which promotes interoperability and broader use cases, is key to reaffirm the ongoing work to promote DIGIT and the attractiveness of stablecoin issuance in the UK.

#	Question / Response
4	Do you have any views on our overall proposed approach to managing qualifying stablecoin backing assets? Particularly: i) the length of the forward time horizon; ii) the look-back period iii) the threshold for a qualifying error.

We support steps to ensure the effective management of stablecoin backing assets and identify and mitigate redemption risks, such as a mass redemption. This is key to preserving market confidence and broader financial stability. However, we would note that in 'business as usual' (BAU) scenarios, redemption levels will likely be extremely low, with the majority of transactions taking place in the secondary market. As such, BAU redemption levels may not provide a sufficient view of the backing asset composition required to meet spikes in redemption demand. Therefore, the FCA may wish to consider some form of stress scenario.

Additionally, the current proposals regarding the remuneration of stablecoin holders are too narrow. As currently drafted, the only restrictions are on the stablecoin issuer remunerating the stablecoin holder with proceeds from the backing asset pool. This would allow the stablecoin issuer to remunerate stablecoin holders from any other source, including potentially even cash originally derived from retained earnings on the backing asset pool. Similarly, it would allow stablecoin issuers

to arrange for third parties to remunerate stablecoin holders. To avoid immediately undermining the FCA's policy intent, the regulator should include these in the prohibition.

#	Question / Response
5	What alternative ways would you suggest for managing redemption risk, which allow for firms to adopt a dynamic approach to holding backing assets?

We recognise the challenge of incorporating dynamic asset management into a regulatory framework that ensures sufficient redemption assets are available during periods of stress. A key concern is that, in certain scenarios, the interaction between hedging strategies and the valuation of backing assets could result in insufficient assets to meet redemption obligations.

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

We support the FCA's work in clarifying when issuers may hold backing assets in currencies other than the reference currency of the stablecoin. Managing FX risk in practice may be complex and could pose challenges in ensuring sufficient redemption assets. However, regulated entities such as banks and fund managers actively manage FX exposures as part of their core operations; where such institutions act as stablecoin issuers, the FCA should permit them to manage FX risks accordingly. We recognise that non-bank issuers may face challenges in effectively managing FX risk. The FCA should introduce a set of criteria to, in principle, allow this flexibility to any entity able to demonstrate management. In addition, provided the issuer fully matches the reference basket with backing assets on a one-to-one basis, any FX risk associated with multi-currency stablecoins should fall to the redeemer who chooses the conversion, rather than the issuer.

Furthermore, if the FCA permits multi-currency backing assets, it must consider the potential financial stability or contagion risks that could arise from industry-wide concentration in the use of a particular country's sovereign debt as backing assets.

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

We do not agree with the requirement for stablecoin issuers to hold backing assets in a statutory trust. The proposal raises a number of concerns. A "one size fits all" approach would be impractical to impose and restrict market developments and competition. For example, given that not all jurisdictions recognise trusts, this could cause challenges where the issuer holds the backing assets

through a custodian in a jurisdiction where trusts are not recognised. In this case, in the event of the custodian's insolvency, the third parties may claim the backing assets, preventing the issuer from preserving them for holders as intended. In addition, given that backing assets will comprise both cash and non-cash assets, it would also be impractical to create terms for the statutory trust which are effective for the different types of non-cash assets, as well as the different internal requirements for different firms. Finally, issuers will need to back qualifying stablecoins with reserve assets when they are minted but before they are issued to a holder; this may cause a conceptual challenge in identifying the beneficiary, which is a requirement for establishing a valid trust under English law.

Therefore, the FCA should remove the requirement for a trust, statutory or otherwise, and implement more practical and outcomes-focused rules that outline the resulting protections from the arrangements for holding backing assets. For example, the issuer holds backing assets separately from its own assets and, to the extent achievable under applicable law, no party treats them as part of the issuer's estate or makes them available to its creditors. The FCA could achieve this by more general wording on segregation arrangements, for example, "legally segregated from property held for the issuers' own account", could better address the potential for variation across jurisdictions and give issuers more flexibility, whilst still maintaining appropriate levels of segregation.

This would better align with comparable rules in other parts of the FCA's rulebook. For example, the FCA does not mandate the use of a statutory trust for funds held under the Electronic Money Regulations or in the rules under the CASS for holding client assets (Art. 6.2), which have similar policy goals. Safe and effective market practices have developed around these different approaches that the FCA could draw on for the stablecoins regime. While in practice custodians typically hold assets on trust when considering custody of client assets, subject to CASS 6, the outcomes-focused approach there offers flexibility. This is important, for example, to address scenarios where issuers may be holding backing assets through firms in other jurisdictions that do not recognise trusts. In those cases, different structures could be used to achieve the same outcome, for example by establishing special purpose vehicle (SPV) companies to hold assets, to mitigate these concerns. It is important that any backing asset regime for stablecoins offers the same flexibility by not mandating the use of trusts.

The FCA should also consider allowing a buffer as an alternative to a statutory trust. This could reduce the operational and cost burdens of daily reconciliations.

Finally, we cannot give a full assessment of the proposal for a statutory trust as a mechanism for safeguarding backing assets without the full details of its terms. Should the FCA proceed with this proposal despite our concerns, we would request that the regulator consult industry on the trust's terms. For example, the draft rules do not include the detailed requirements for how an issuer can satisfy the obligations it will have as trustee to holders, which the FCA sets out in detail for client money, for example, in CASS 7.11.33A and related provisions.

There is an incorrect statutory reference in the current drafting of CASS 16.5.1G as set out in Annex B, where "Section 137B(2) of the Act" should instead refer to Section 137B(1).

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

We agree in principle that qualifying stablecoin issuers should back any stablecoins they hold themselves as this provides important protection, for example, in the event of a hack. This aligns with the idea of holding a buffer. If issuers hold pre-minted coins, they can maintain an excess backing balance and use their own assets as a buffer to support redemptions. It is also important to clarify the responsibilities between holders and trustees.

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

We agree that an independent custodian for backing assets is an important requirement to ensure proper safeguards and protect stablecoin holders. It is critical that the new rules strongly protect backing assets in case of the issuer and/or custodian's insolvency and avoid material concentration risks. Generally speaking, the use of an affiliate as the holder of high-quality liquid assets (HQLA) and/or cash backing assets would only be relevant for stablecoin issuers with a regulated bank or custodian within their group, who are willing to safeguard the backing assets.

UK regulation already subjects banks or custodians to stringent prudential requirements, ensuring they protect the assets they hold for their clients. Unless the stablecoin becomes systemic, these (pre-existing) requirements should sufficiently mitigate any risk of loss to token holders. Considering the types of assets specifically, we note that for non-cash backing assets, whether or not the FCA ultimately imposes a statutory trust (see our response to question 7 above), the new rules will require the issuer to segregate the backing assets from their own assets. This ensures insolvency-remoteness at the issuer level and, in parallel, CASS rules require the custodian to have arrangements designed to ensure insolvency remoteness. Therefore, arguably, mandating a non-affiliated third party would have limited benefit, as the regime already protects the non-cash backing assets at both levels. In this context, some of our members propose that the FCA should remain open to allowing intra-group arrangements if issuers can demonstrate they have effective risk management and controls in place. Looking at other regulatory regimes, Alternative Investment Funds (AIFs) and Undertakings for the Collective Investment in Transferable Securities (UCITS) must appoint a separate depositary to hold assets, and while there are rules on who can act in this role, they do not prohibit the use of affiliates. Under the Markets in Financial Instruments Directive (MiFID) and CASS, when a custodian delegates the holding of securities to another party (similar to what a stablecoin issuer would do), it must carry out due diligence and ongoing oversight. However, this still permits the use of entities within the same group. Therefore, banning the use of affiliates in this case would be inconsistent with existing regulatory frameworks.

We recognise that there is a greater degree of risk for the cash component of stablecoin backing assets (particularly in the event of the bank/custodian's insolvency), given that banks would typically hold

such cash as banker and therefore any resulting claim in relation to such cash would only amount to a debt claim for the stablecoin issuer. Although this is the same position whether the bank is an affiliate or not, using an affiliated bank may introduce contagion risk in the event of the issuer or bank's failure. However, the following partially mitigates this risk: (i) the majority of the backing assets will be non-cash assets (the FCA is proposing that the on-demand deposit requirement or minimum floor for cash assets is set at 5%) and (ii) the recent amendments to the deposit protection framework would potentially mitigate the impact on retail stablecoin holders by allowing look through to protect retail holdings via an intermediary. Even under the client money rules, firms can hold money with group entities, although these rules impose a cap. Some of our members are therefore of the view that it would be unnecessary to require a third-party appointment even in relation to cash backing assets. Nevertheless, the FCA may consider additional risk mitigation arrangements, such as mandating a non-affiliated third-party bank in cases where the stablecoin is systemically important or its issuance is considered large relative to the size of the bank's balance sheet.

Finally, it is crucial to clarify the responsibilities between holders and trustees. Where third parties are involved, ultimate responsibility should rest with the issuer to ensure proper management and protection of backing assets.

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

We consider it appropriate to use signed acknowledgement letters referring to the trust arrangement, provided they follow a standard template. Standardised templates help reduce the need for negotiation and promote consistency across custodians. This assumes that the letter is realistically drafted and does not impose terms that custodians would be unable or unwilling to sign. We do not believe it is necessary to have separate templates or signed acknowledgement letters per asset type, as a single template can accommodate different asset classes.

While the FCA already sets out the draft template for such acknowledgement letters in CASS 16 Annex 1, the regulator may need to revise this if it removes the statutory trust requirement. It currently provides a limited but sufficient set of acknowledgements – specifically, the firm holding the backing assets on trust for the benefit of token holders, as set out in CASS 16.7.

Finally, we note that the requirement to hold assets via a statutory trust significantly constrains the range of viable holding models. Specifically, issuers would not be able to hold backing assets directly in a central securities depository (CSD) and instead must use a third party. This reinforces the importance of having a practical, standardised approach to acknowledgement letters across custodians.

#	Question / Response
11	Do you agree with our proposals for record keeping and reconciliations?

N/A.

#	Question / Response
12	Do you agree with our proposals for addressing discrepancies in the backing asset pool? If not, why not?

We agree in principle with the proposals for addressing discrepancies in the backing asset pool. However, we caution that the FCA regime would require more notifications than other global frameworks. The FCA should consider whether this is proportionate to the risks, given the operational complexity these measures may introduce. This could also create a significant barrier to entry for smaller providers.

We believe introducing a buffer is a practical way to manage potential discrepancies between issued stablecoins and backing assets. We also agree with the proposal to burn tokens in the event of a shortfall. This mechanism helps to rebalance the system where issuers cannot fully meet redemption obligations, thereby maintaining overall stability.

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

We recognise the importance of timely redemption; however, there are practical challenges associated with the proposed T+1 payment order requirement. In particular, Know Your Customer (KYC) and onboarding processes – especially for non-GBP stablecoins – may present operational difficulties. These processes can be costly for issuers, and the obligation to perform KYC on every individual redeemer may create unintended incentives for the issuer to introduce delays to the onboarding process to dissuade redemption requests or encourage alternative exit routes simply to avoid ongoing compliance burdens; for example, selling on at (potentially reduced) market value. In this context, Consumer Duty obligations may also come into play. The FCA should design these rules in a way that does not incentivise such behaviour, while still protecting end users. Lengthy onboarding processes may also risk undermining users' ability to redeem in a timely manner.

We note that the FCA, according to its Crypto Roadmap, anticipates issuing a consultation paper considering financial crime requirements for Regulated Activities Order (RAO) activities, among other things, later this year. The FCA should clarify the detailed AML requirements for redemption and, in particular, whether they are in line with traditional AML.

Moreover, the FCA must consider that, in practice, holders will typically sell their holdings through exchanges or secondary markets rather than redeem directly via the issuer. The FCA's current framework, which assumes redemption always happens via the issuer, may not fully reflect how stablecoins function in practice.

Given these considerations, the feasibility of a strict T+1 redemption requirement should be reconsidered to ensure it remains workable and proportionate, without placing undue burdens on issuers or limiting user access.

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

We recognise that this proposal could raise legal questions under English law, particularly around how the transfer of a stablecoin from one holder to another affects contractual rights and obligations. One potential approach to still achieve the intended policy outcome would be using a deed poll. This is a legal document signed by one party (e.g. issuer) that gives rights, like the right to redeem stablecoins, to a group of people, even if they did not sign the document or it does not name them individually. As long as this clearly defines the group (e.g. stablecoin holders), those rights are enforceable. Deed polls must meet certain legal requirements, and the parties they protect must agree to any changes. Other financial markets already use this approach – for example, to give rights to holders of certain types of securities.

The UK Jurisdiction Taskforce's February 2023 Legal Statement on digital securities considered similar issues around privity of contract and the transfer of rights to secondary purchasers[1]. This explored the use of deed polls vs alternative mechanisms for enabling rights to transfer to third party transferees and how to satisfy relevant legal formalities.

#	Question / Response
15	Do you agree with our proposed requirements for the use of third parties to carry out elements of the issuance activity on behalf of a qualifying stablecoin issuer? Why/ why not?

We support the FCA's existing rules on outsourcing, which it sets out in the SYSC framework. These already provide a well-established framework for managing third-party arrangements. Therefore, it is unclear why the FCA needs additional bespoke rules specifically where an issuer uses a third party to carry out core elements of the issuance process. To avoid duplication and complexity, we suggest that the existing SYSC framework remains the primary mechanism for regulating these arrangements, unless there is a clear and specific risk that the FCA cannot address through existing rules.

#	Question / Response
16	Do you agree with our proposals on the level of qualifications an individual needs to verify the public disclosures for backing assets? If not, why not?

[1] UK Jurisdiction Taskforce, 'Legal statement on digital securities' (February, 2023), available at: https://lawtechuk.io/ukjt/legal-statement-on-digital-securities/

We agree that an independent person who is qualified as an auditor in the UK or a relevant overseas jurisdiction should verify public disclosures on backing assets. This helps to ensure the information is reliable and meets a consistent standard.

#	Question / Response
17	Do you agree with our proposals for disclosure requirements for qualifying stablecoin issuers? If not, why not?

We broadly support the proposed disclosure requirements, as they promote transparency and help build trust in the stablecoin ecosystem.

However, the proposals to require disclosure of stablecoin numbers and the value and breakdown of backing assets on the basis of when this data becomes inaccurate could lead to complexity. Without clear parameters from the FCA on the degree of inaccuracy or the frequency, market practices could vary significantly, while immaterial changes in the value of backing assets could cause a high frequency of updates. Requiring daily disclosure could simplify compliance and align with reconciliation requirements.

Furthermore, the FCA should set out more specific requirements for a more granular disclosure of the asset types in the backing pool. The current proposals require that this disclosure give value and percentage by asset. However, it is unclear what granularity is meant by the asset type, for example, whether this just means “cash” and “short-dated sovereign bonds”, or if there should be a breakdown by the issuing sovereign and the remaining tenor on the bond. Including this degree of breakdown would be helpful to promote trust in the stablecoin and support the singleness of money.

REGULATING CUSTODY OF CRYPTOASSETS

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

Please refer to our response to question 1. Introducing the Consumer Duty alongside specific requirements may create uncertainty for market participants, as it is not clear what additional obligations they would need to fulfil.

#	Question / Response
19	Do you agree with our proposed approach towards the segregation of client assets? In particular: i. Do you agree that client qualifying cryptoassets should be held in non-statutory trust(s) created by the custodian? ii. Do you foresee any practical challenges with this approach? iii. Do you have any views on whether there should be individual trusts for each client, or one trust for all clients? Or whether an alternative trust structure should be permitted. iv. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet? v. Do you foresee any challenges with these rules with regards to wallet innovation (e.g. the use of digital IDs) to manage financial crime risk?

We do not support the Paper's approach to qualifying cryptoasset safeguarding in all cases. The FCA should align their requirements for safeguarding and segregation of client assets with the existing requirements that apply to custodians under CASS 6. Rather than require firms to use trusts to hold client assets, CASS 6 states that firms must "make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the firm's insolvency, and to prevent the use of safe custody assets belonging to a client on the firm's own account except with the client's express consent". This approach balances client interests with firms' need for flexibility to achieve outcomes suited to their business models. Therefore, the FCA should apply the same approach for safeguarding qualifying cryptoassets.

As with question 7, while custodians holding assets under English law are likely, in practice, to use non-statutory trusts to protect client assets in the event of insolvency, alternative methods and structures for holding assets can serve the same purpose. The imposition of a non-statutory trust could pose challenges for firms that wish to use sub-custodians in overseas jurisdictions that do not recognise trusts. In particular, the requirement for a firm to act as a "bare trustee" seems unnecessary, considering that there are limited functions of a bare trustee under English law, which could restrict business models.

In addition to the trust, we are also concerned that the proposed new rules are not properly drafted for the new regulated activity, which is much wider than the existing regulated activity of safeguarding and administering securities. The Paper proposes that the new rules would cover the safeguarding of qualifying cryptoassets or relevant specified investment cryptoassets on behalf of another. The proposed new rules do not adequately reflect that, unlike with securities, the proposal for the new regulated activity does not mention administration and defines "safeguarding" very broadly as, “circumstances in which a person (“C”) has control of the cryptoasset through any means that would enable C to bring about a transfer of the benefit of the cryptoasset to another person, including to C”. Therefore, a firm that is safeguarding cryptoassets might simply have control of some form (e.g. under a power of attorney), or a contractual obligation to transfer cryptoassets to the client rather than "holding" cryptoassets in the traditional sense.

Various of the proposed obligations do not work well given this wide definition of safeguarding. For example, the proposed obligation for firms to "safeguard qualifying cryptoassets…as a trustee" (17.3.2R) cannot apply if the firm is not holding cryptoassets but only has control or contractual obligations to deliver. In addition, the requirement for adequate arrangements to safeguard a client's rights to qualifying cryptoassets in circumstances including the custodian's insolvency (17.2.2R(1)) only makes sense where a firm is holding cryptoassets, and not where it has a contractual obligation to deliver them.

In other cases, the proposals seem to unnecessarily distinguish between the roles of custodians of securities and cryptoassets. This creates unnecessary rules and conflicts with the ‘same risk, same regulatory outcome’ principle.

At times, the Paper also conflates the concepts of segregation and holding on trust. While a firm can separate assets from its own without creating a trust, under English Law the trust, rather than segregation, protects those assets in insolvency. To assess a trust's effectiveness, one must consider who is segregating the assets, what they are segregating, where and how the segregation occurs, and whether this provides certainty of the trust's subject matter.

The proposal for segregation of qualifying cryptoassets (17.3.4R(4)) lacks clarity on the definition and implementation of segregation. This ambiguity could lead to misinterpretation and imposing unreasonable or impractical requirements. This could include expecting all sub-custodians (and their delegates and sub-delegates) to hold trust assets for the firm separately from "all other assets", such as by requiring maintenance of a separate distributed ledger technology (DLT) address for assets the firm holds on trust for clients. This does not appear to be the proposal's intent.

The Paper (17.3.7G(1)) offers guidance on settling and operating separate trusts. However, this fails to reflect that, under English law, a firm holding cryptoassets on multiple trusts cannot combine the assets from different trusts in one client account with a sub-custodian or in the same wallet. This is because holding in that manner would cause uncertainty around which assets belong to each trust.

Furthermore, the requirement for a firm to hold its contractual rights against a third party on trust (17.3.7G(5)(a)) should only apply if a firm holds cryptoassets for its client, and delegates the holding

(not other safeguarding functions) to a third party. In this case, the firm should hold all the rights against that third party (not just contractual rights) on trust.

Finally, the need for existing custody firms to apply for authorisation to provide custody for cryptoassets, and to demonstrate compliance with both CASS 6 and CASS 17, including audits, could discourage existing custody firms from offering these services. Existing custody firms will be integral to supporting the market's resilience and achieving good outcomes for customers. To support this, the FCA should establish a streamlined authorisation process for existing custodians and adopt a degree of substituted compliance for those sections of CASS 17 which overlap with CASS 6.

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

The proposed provisions on record-keeping would apply broadly to any firm "when it is safeguarding qualifying cryptoassets" (17.5.1R). However, these requirements are not appropriate in the context of all safeguarding services and should apply more narrowly only to firms which are holding cryptoassets for a client.

In addition, the FCA should clarify:

- The wording of 17.5.2R. It refers to records which distinguish cryptoassets the firm holds for one client from those it holds for other clients, as well as from assets which the firm is not 'safeguarding'. However, the reference to assets which the firm is not safeguarding should instead be to assets which the firm "is not holding for clients".

- The requirement to identify to clients "the nature of the client's claim against the firm in respect of" under 17.5.4R(3)(b), as it is unclear what this refers to.

- The requirement to notify clients regarding third parties "involved" in safeguarding under 17.5.4R(3)(c). This is too broad; firms should only apply this to third parties to whom they have delegated the holding of client cryptoassets.

#	Question / Response
21	Do you agree with our proposed approach for reconciliations? If not, why not? In particular: i. Do you foresee operational challenges in applying our requirements? If so, please explain. ii. Do you foresee challenges in applying our proposed requirements regarding addressing shortfalls? If so, please explain.

We foresee two key operational challenges in applying these requirements. Firstly, while, as drafted, the proposed reconciliations requirements apply broadly to any firm "safeguarding qualifying

cryptoassets", in reality they are not appropriate in the context of all safeguarding services. Therefore, similar to record-keeping, these requirements should only apply to firms that are holding cryptoassets for a client. Secondly, the requirement for reconciliations "at least once each business day" (17.5.10R) is much more onerous than the equivalent requirement for securities custodians, which only mandates internal custody record checks as regularly as necessary and at least once a month (CASS 6.6.11R), with a similar obligation for external custody reconciliations (CASS 6.6.37R). The justification for increasing the frequency of reconciliations for qualifying cryptoassets is unclear. Implementing such measures would undermine the principle of technology neutrality and impose excessive operational and cost burdens, potentially discouraging firms from offering cryptoasset custody services in the UK.

Regarding the proposed requirements for addressing shortfalls, the definition of "shortfall" aligns with use in the context of securities custody, where it refers to any amount by which a firm's safeguarded cryptoassets fall short of the firm's obligations to its clients. This excludes decisions made under CASS 17.5.14R(3)(d). Whether a shortfall exists and whether the firm is responsible for it depends on the firm's obligations to its clients, as set out in the relevant contractual terms (including any limitations of liability) alongside FCA rules. To assess responsibility for a shortfall, the FCA should add a specific reference to considering any contractual limitation of liability in the list in 17.5.15R(4). Similarly, the regulator should include a specific reference in 17.5.15R(4)(b) to considering relevant provisions of contracts, such as liability or remediation processes, between the firm and its client or any third party.

Additionally, it is unclear why the proposed shortfall provisions (17.5.14R to 7.5.18R) are more detailed than those for traditional securities (see CASS 6). The proposed obligation to notify the FCA where the firm considers neither it nor a third party is responsible for a shortfall, with no 'de minimis' threshold[2] is unreasonable and likely to be expensive and operationally burdensome for both firms and the FCA. Similarly, requiring resolution and notification to occur "immediately" rather than "promptly," as under CASS 6, is disproportionate and may not be operationally feasible in many cases.

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

The Paper proposes that a firm must introduce adequate organisational arrangements to minimise the risk that the firm loses or diminishes qualifying cryptoassets it safeguards due to the misuse of the qualifying cryptoassets, fraud, poor administration, inadequate record-keeping or negligence (17.2.3 R). The FCA must consider this obligation alongside the broad definition of safeguarding, as we have outlined above. A requirement to minimise the risk of loss would be inappropriate in a situation where the firm is not holding any cryptoassets but just has control or contractual obligations to deliver.

[2] i.e. the amount considered minor enough to exclude from the rule's scope.

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

The FCA should clarify in 17.4.2R(1) that this only applies where a firm holds or controls a client's cryptoasset private key, and excludes other control arrangements, such as where a firm instructs another entity, which holds or controls private keys for the client, through a mandate

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

We broadly support firms disclosing the liability they accept, rather than these rules imposing a specific required level of liability for the firms. However, the FCA should ensure that custodians are liable only to the customers or clients they deal with directly, and only where the loss results from the custodian's own actions. Similarly, Custodians cannot have AML/KYC obligations to end-users that they do not have visibility of, for example, end-users interfacing with Crypto-Asset Service Providers (CASPS) only.

The FCA must also ensure that any further rules regarding disclosure of liability for loss in client terms do not seek to restrict freedom of contract, as the Paper sets out in paragraphs 4.57 – 4.62. This dictates that, unless the regulator imposes additional liability on the safeguarding firm, the liability of firms providing safeguarding services will depend on the contractual terms agreed with clients, as well as general legal principles (such as negligence, except where the firm has validly limited its liability) and the available protections regarding breach of FCA rules.

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

The FCA should remove the reference to arranging in the statement of application (17.6.1R) to prevent confusion between a firm delegating safeguarding services to a third party (where the third party serves the firm) and the firm arranging safeguarding services by a third party (where the third party serves the client). This would achieve the FCA's apparent intention, ensuring that CASS 17.6 applies only to delegation, given that CASS 17.7 addresses arranging safeguarding.

We also do not support the reference to arranging in 17.6.2G(5). In traditional finance, where a custodian holds securities for a client and delegates the holding of the securities to a sub-custodian (or nominee or settlement system, the custodian provides safeguarding and administration to its client and is subject to regulation for these activities. The custodian does not need to meet

requirements for arranging safeguarding and administration, since the sub-custodian provides services to the firm rather than to the client. To ensure consistent treatment and uphold the principle of technology neutrality, the FCA should align the rules for safeguarding cryptoassets with comparable requirements for safeguarding traditional assets. Therefore, where a firm appoints a third party to provide cryptoassets safeguarding services to the firm, this should constitute delegation or sub-contracting of such services, but the FCA should not regard this as arranging in this context.

Similarly, we are concerned that the conditions for appointing a third party to provide safeguarding services to the firm (17.6.3R, 17.6.4R, 17.6.5G) are much more restrictive than the rules regarding the appointment of sub-custodians in CASS 6.3. The FCA should not limit a firm to appointing a third party where this is "necessary" and only where this is in the best interests of its client. As drafted, the rules are very restrictive regarding what constitutes “necessity”, which would be too limiting on businesses and harm the UK’s competitiveness. The best interests requirement is also impracticable, given that firms would need to make decisions regarding the use of third parties at a business level rather than by reference to a specific client. Approval for third-party use should follow the relevant firm's business processes, whether by its "governing body" or another method.

The FCA should remove:

- The rules under 17.6.9R, which contain constraints on delegation by a third party that the firm appoints. There is no equivalent in CASS 6, and such a restraint on commercial activities is inappropriate.

- The detailed list of preconditions under 17.6.6R. This is unnecessary given that a firm is subject to an obligation to "exercise all due skill, care and diligence in the selection, appointment and periodic review" of third parties.

To further strengthen these requirements, the FCA should clarify:

- That the requirements for "segregation" of assets when a firm appoints a third party (17.6.7R(5)(a) and (b)) mean that firms should maintain separate records in the books of the third party to reflect the cryptoassets that the third party holds for the appointing firm.

- The meaning of the requirement for a third party to notify the firm where cryptoassets "are no longer subject to the terms of the agreement for any reason" (17.6.7R(6)).

COST BENEFIT ANALYSIS

N/A.