the payments association

connecting the future

Managing the failure of systemic digital settlement asset (including stablecoin) firms: Consultation

HM Treasury May 2022

Response from The Payments Association

Introduction

The Payments Association welcomes the opportunity to contribute to the *'Managing the failure of systemic digital settlement asset (including stablecoin) firms'* Consultation by HM Treasury

The community's response contained in this paper reflects views expressed by our members and industry experts recommended by them who have been interviewed and who are referenced below. As The Payment Association's membership includes a wide range of companies from across the payments value chain, and diverse viewpoints across all job roles, this response cannot and does not claim to fully represent the views of all members.

We are grateful to the contributors to this response, which has been drafted by Robert Courtneidge, The Payment Association's policy advisor. We would also like to express our thanks to HMT for their continuing openness in these discussions. We hope it advances our collective efforts to ensure that the UK's payments industry continues to be progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.

With special thanks to Nilixa Devlukia – Founder, Payments Solved – for her useful comments.

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Director General
The Payments Association

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The section numbering below corresponds to the numbering of the ‘questions for respondents’ in this paper.

1. Do you have any comments on the intention to appoint the FMI SAR as the primary regime for systemic DSA firms (as defined at para 1.8) which aren’t banks?

2. Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the PESAR, to apply solely to systemic DSA firms?

3. Do you have any comments on the intention to provide the Bank of England with the power to direct administrators, and to introduce further regulations in support of the FMI SAR to ensure the additional objective can be effectively managed, or what further regulation may be required?

4. Do you have any comments on the intention to require the Bank of England to consult with the Financial Conduct Authority prior to seeking an administration order or directing administrators where regulatory overlaps may occur?

Summary of Response

Overall The Payments Association (“TPA”) concurs with HMT on this consultation. TPA believes that getting regulation in place along the lines of the existing SARs for FIs and EMIs is key to ensuring consumer confidence and protecting consumers from the potential adverse effects of a failing stablecoin like the recent UST crash which led to extraordinary losses[1]. TPA believe this is a role for BoE, given the potential effect on the UK’s financial stability of a systemic failure of a GBP stablecoin in the UK market (however, determination of whether a DSA is systemic is going to be key). Whilst TPA agrees that the protection of consumers is paramount (indeed issuers, wallet providers and payment systems are solely consumer-facing) and hence an FCA role within the SAR is sensible, it should not slow down the process by being required to have prior consultation.

Finally TPA asks the question of whether this consultation would benefit from being joined to the consultation on the ‘Payments Regulation and the Systemic Perimeter’, which appears to overlap with this consultation.

[1] https://newsletter.banklesshq.com/p/ust-luna-meltdown-what-happened

1. Do you have any comments on the intention to appoint the FMI SAR as the primary regime for systemic DSA firms (as defined at para 1.8) which aren't banks?

TPA considers that the FMI SAR is the most appropriate starting point for DSA firms because it is administered by the BoE and has its primary aim of keeping the DSA working. Unlike electronic money, stablecoin is not redeemed when it is spent; it stays in circulation like physical cash. As such, providing a solution (PESAR) that simply gives holders of stablecoin the ability to convert their tokens at par would just kill the stablecoin and cause fear and distrust in stablecoins. This would not fulfil the government's commitment to:

"to place the UK's financial services sector at the forefront of cryptoasset technology and innovation"

As such, TPA endorses the HMT approach but also believes some adaptation of the FMI SAR is needed to address the unique qualities of stablecoin.

2. Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the PESAR, to apply solely to systemic DSA firms?

In respect of adding a focus on return or transfer of customer funds, TPA is not sure this is in the best interests of avoiding the failure of a systemic payment system, defined as:

"A payment system may be designated as systemic where deficiencies in its design or disruption to its operation may threaten the stability of the UK financial system or have significant consequences for businesses or other interests."

If it is systemic, then to liquidate it and, in effect, burn the stablecoin and return fiat funds to end users in an account could cause significant damage to the UK financial system which could be avoided by simply taking over the running of the stablecoin and ensuring it is properly funded and run. In this way, its pegging to the GBP could be cemented and faith restored in the stablecoin. This, in the TPA's view, is the best outcome for the UK financial services industry.

3. Do you have any comments on the intention to provide the Bank of England with the power to direct administrators, and to introduce further regulations in support of the FMI SAR to ensure the additional objective can be effectively managed, or what further regulation may be required?

TPA fully support HMT's approach to follow the FMI SAR and introduce further regulations to recognise the unique position of stablecoin. This includes the fact that stablecoin is held by end users in their offline wallets or custodial wallets run by third parties. Stablecoin is more akin to physical money but, unlike physical money, it can be tracked and source of funds dealt with using chain analysis.

The Custodians of wallets are like FMIs as they, under new regulations, should be responsible for any loss of stablecoin in their wallets. But, specifically in respect of the need for an SAR, the key factors to bear in mind are:

- How to ensure the stablecoin peg is not lost – this can be done by ensuring the right levels of liquidity and follows the well-trodden path of the ETF (exchange traded fund) market today;
- How to stop a run on the stablecoin – as the stablecoin can only be burned (redeemed) with the issuer, then is it easy to limit burn rate at any time when more than 'x'% of total stablecoin in circulation are being requested to be burned;
- Stablecoin issuers make little money through transactions so need to offer VAS (value added services) to enable profits – this may, inter alia, be in the form of defi products or exchange services[2];
- Need to be aware of new market structure players of wallet issuers, crypto exchanges and market makers rather than the exist one in payments;
- Collateral liquidity for a stablecoin should be predominantly held in cash at bank, HQLA[3] and short term commercial paper.

Any further regulations should cover all of the above.

[2] It is important to bear in mind when drafting the core stablecoin regulations that the risk profile of a stablecoin issuer will be affected by the types of VAS it offers and any third parties providing such VAS.

[3] High Quality Liquid Assets

4. Do you have any comments on the intention to require the Bank of England to consult with the Financial Conduct Authority prior to seeking an administration order or directing administrators where regulatory overlaps may occur?

TPA thinks this is sensible in circumstances where the stablecoin issuer is akin to electronic money or a payment services, and where the impact is on the wider consumer audience is clear, but that it should not be the default position but one used in specific circumstances. In the majority of cases, the need will be to move fast to avoid economic consequences of a failing stablecoin on the UK market – this will require swift action from the BoE. There can always be post-SAR consultations with key stakeholders like the FCA on how to run the SAR but TPA believes the idea of making it a pre-condition of an SAR is not realistic and could lead to delays which could have adverse effects.

In respect of directing administrators where there may be regulatory overlap, TPA believes this should be kept to a minimum and that such potential overlaps can be dealt with at this stage. To the extent that there is an adverse effect on consumers, then it is important to give the FCA a role in managing this to ensure they are properly protected from the effects of a failing stablecoin issuer, but keeping the stablecoin pegged and live is the best result for the consumer. The consequent liquidation of the coins where it cannot be saved will require the FCA to take all necessary steps to ensure the consumer receives funds at as close to par as possible with the value of the fully pegged stablecoin.

About The Payments Association

The Payments Association (previously the Emerging Payments Association, or EPA) is a community for all companies in payments, whatever their size, capability, location or regulatory status. Its purpose is to empower the most influential community in payments, where the connections, collaboration and learning shape an industry that works for all. It works closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the PSR, Pay.UK, UK Finance and Innovate Finance.

Through its comprehensive programme of activities and with guidance from an independent Advisory Board of leading payments CEOs, The Payments Association facilitates the connections and builds the bridges that join the ecosystem together and make it stronger. These activities include a programme of monthly digital and face-to-face events including an annual conference, PAY360, The PAY360 Awards dinner, CEO round tables and training activities. The Payments Association also runs six stakeholder working project groups covering financial inclusion, regulation, financial crime, cross-border payments, open banking and digital currencies. The volunteers in these groups represent the collective views of the industry and work together to ensure the big problems facing the industry are addressed effectively. The association also conducts original research which is made available to members and the authorities. These include monthly whitepapers, insightful interviews, and tips from the industry's most successful CEOs.

See https://thepaymentsassociation.org for more information. Contact malik.smith@thepaymentsassociation.org for assistance.