the payments association

connecting the future

Regulatory regime for systemic payment systems using stablecoins and related service providers

Discussion Paper

Bank of England
November 2023

Response from
The Payments Association
February 2024

Introduction

The Payments Association welcomes the opportunity to contribute to the BoE Discussion Paper "*Regulatory regime for systemic payment systems using stablecoins and related service providers*".

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 Riccardo Tordera, our Head of Policy & Government Relations and Robert Courtneidge, Advisor to the Board. We would also like to express our thanks to the BoE 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.

Tony Craddock
Director General
The Payments Association

Members' "responses to the questions" set out in the consultation:

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

1. **Do you agree that, to preserve the singleness of money, systemic payment stablecoins must be fully interchangeable with other forms of money at par?**

Unless systemic payment stablecoins are made legal tender (which would require legislation) they may in practice be interchangeable but not legally.

2. **Do you have views on further requirements that may be needed to ensure the singleness of money when stablecoins are traded in secondary markets?**

It is difficult to override markets when a token is available on an exchange. It may be valued higher than a BoE GBP because it has better security than, for example, commercial bank money but equally if its backing assets are challenged then it may equally de-peg. Stablecoins in general circulation today are rarely at par with their pegged currency but vary only minimally.

3. **Do you agree that the most likely, and suitable, payment systems using new forms of digital money to become systemic in the UK are sterling-denominated stablecoins which are backed by assets denominated in fiat currency?**

Although we agree that it is 'most likely' that a systemic stablecoin will be denominated in a GBP, we see no benefit in making this presumption in the framework. It is plausible that a non-GBP stablecoin could become systemic and the framework should be comprehensive enough to address this possibility. However, in the UK it is likely that a GBP-based stablecoin will be the most used as merchants will not want to take on fx risk on their transactions. Separately, our members are not sure that consumers will take much notice of what is backing the token as they will know it is regulated by BoE and hence will trust it.

4. **Do you agree with the Bank's proposed approach to assessing the systemic importance of stablecoins used for payments?**

More information would be required on what it means for the stablecoin chain to become systemic and how this would be quantified/validated, such as:

- What the transition from a non-systemic firm to a systemic firm would look like (as we do not know the exact systemic criteria), and
- Could a firm that was categorised as systemic appeal that decision and, if so, how, and what would happen during the appeal process (such as, would the firm have to suspend business?), and
- More detail on what is considered systemic e.g. an issuer or payment operator that is involved with multiple stablecoins or blockchains, or if a stablecoin itself is not systemic but a payment operator processes multiple stablecoins which, in total, may be classed as systemic.

5. **Do you agree with the Bank's proposed approach to the regulatory framework for systemic payment stablecoins, as set out in Section 2?**

No member comments received.

6. **Do you agree with the Bank's assessment of the risks posed by vertical integration of stablecoin functions? Are there other risks that the Bank should consider based on existing business models? What mitigants could be put in place to ensure that risks posed by multi-function entities are addressed?**

No member comments received.

7. **Do you agree with our approach regarding subsidiarisation of non-UK issuers? Do you agree with our approach to other non-UK elements of the payment chain? What alternative policy arrangements could be used to effectively supervise, oversee, and regulate non-UK systemic stablecoin issuers and other non-UK elements of the payment chain?**

The ability to enable non-UK issued stablecoins is key to making the UK a global hub in this area as envisaged by the government. By forcing systemic stablecoin issuers to be established in the UK in order to issue in the UK may make this unworkable. That said, it is common for international banks to have UK registered branches so there is precedent for it. On the basis that it may take some time before a non-UK stablecoin is deemed systemic in the UK, we would hope that continued evaluation of this area will enable good regulation to be created.

8. **Do you consider that the Bank's existing binding rules on governance, operational resilience and third-party outsourcing risk management are suitable for systemic payment systems using stablecoins?**

It would be logical to leverage existing policies and governance already in place.

9. **Do you consider that stablecoin issuers can exercise sufficient control over, and mitigate the risks of, public permissionless ledgers (be it via rule setting and/or the use of innovative solutions)?**

It is unclear how much control an issuer could exert over a public permissionless ledger as, by definition, they wouldn't own or control it. We do not think it is feasible for a stablecoin issuer to exercise control over such ledgers, other than to point out the potential risks that these ledgers have.

10. **How do you consider that existing and emerging stablecoin payment chains operating with a public permissionless ledger may be adapted in order to meet the Bank's expectations and international standards?**

We would expect existing and emerging stablecoin payment chains to operate with both permissioned and possibly also permissionless ledgers.

11. **Do you agree with the Bank's assessment of the important role of backing assets in ensuring the stability of value of the stablecoin?**

Yes, to ensure stability of the value of stablecoins and provide adequate consumer protection. However, stablecoins backed by 100% BoE money is too restrictive for the industry. We foresee that the restrictions linked to the backing requirements proposed by this regime will create liquidity problems for international payments systems and it may be more difficult for them to make cross-border payments, because BoE requires these providers to tie up the liquidity in BoE money (e.g. what happens if you want to send money to America, where they wouldn't have liquidity in BoE money?). In addition, liquidity and capital management will be more difficult. Furthermore, the lack of interest paid to the issuer, from backing assets held in BoE money, removes the economic model for stablecoin issuance. Unless the aim of the regime is to prevent systemic stablecoins, or to restrict competition in this space, this may have some implications:

- It would significantly restrict the issuers who could offer a systemic stablecoin to large firms with significant economic capacity.
- There may be challenges in the transition from non-systemic to systemic status as the economics may not support this change in status, creating possible disruption to a stablecoin that would large enough to be deemed systemic.

12. Do you agree that the proposed remuneration policy is consistent with systemic stablecoins being used primarily for payments?

The commercial model would need to be carefully considered – Where interest cannot be paid on the deposits, firms would be heavily constrained economically and would explore other income opportunities. Furthermore, the significant regulatory burdens need to be offset against commercial benefits otherwise it will not work. Should a systemic stablecoin issuer benefit from the UK Bank Rate for deposits held with the BoE? This could be the answer. Alternatively, the potential for other high quality high liquid assets to be made available as backing assets, with suitable over-collateralisation should be assessed. Finally, a suggestion would be to allow firms to meet the liquidity requirements by holding fiat currencies balances in other currencies and with other institutions e.g. accounts with other central banks.

13. Do you agree with the Bank's proposed requirements on the redemption process, including the role of all firms in the payment chain?

No member comments received.

14. Do you have views on requirements on redemption fees, or prohibiting these, to minimise any frictions across the redemption process?

Reduced friction in the process would be desirable, however there are broader questions around the commercial models for stablecoins – including where fees can be charged and how revenues could be made, if revenue cannot be made from backing assets. If the redemption process is to be used ordinarily by users (i.e. not just in a stress scenario), then redemption fees would be a barrier to use (e.g. non-LINK ATM cash withdrawal fees).

15. Can you identify any issues with the requirements on systemic stablecoin issuers and other relevant firms within a payment chain to cooperate and support the appointed administrators with a view to facilitating redemption or payout in the event of a firm failure?

No member comments received.

16. Do you agree that issuers should have access to customer information to be able to fulfil redemptions in the case of the failure of an entity providing the customer interface, eg a wallet provider and/or to facilitate a faster payout in insolvency?

If the issuer remains solvent and is able to fulfil the redemptions, it will need to have the necessary customer information. This may need the permission of the customer to their wallet provider for example, to release the relevant information to the issuer.

17. **Do you have views on the Bank's proposed safeguarding regime being centred on two key features (statutory trust in favour of coinholders; and safeguarding rules)?**

No member comments received.

18. **Do you think there are any other features that need to be reflected in the safeguarding regime for systemic payment stablecoins?**

No member comments received.

19. **Do you agree with the requirements for stablecoins owned by the issuers held in treasury wallets?**

No member comments received.

20. **Do you consider that the capital requirements would effectively mitigate risks that may result in a shortfall in the backing assets or that can threaten the ability of issuers to operate as a going concern?**

Yes, to protect both the firm and consumers – ensuring the capital requirements are proportionate to the risk.

21. **Do you have views on the approach (including any existing or bespoke methodologies) that should be considered for calibrating capital requirements?**

No member comments received.

22. **Do you have views on the requirement to hold reserve assets in a statutory trust, to ensure that stablecoins are fully backed and the backing assets are duly protected and available to satisfy coinholders' redemption requests at all times?**

Yes, we agree that issuers must have the right liquidity/capital in place to ensure redemption if is required that the issuer can meet the timeframe for redemption. The process allows for this to take place, with necessary financial controls in place to ensure that consumers are not put at undue risk.

23. **Do you have views on the range and quality of the assets issuers would be required to hold to mitigate shortfall risks?**

A narrow set of high-quality and highly liquid assets as set out in the proposal sounds sensible.

24. **Do you agree that, at least during a transition, limits would likely be needed for stablecoins used in systemic payment systems, to mitigate financial stability risks stemming from large and rapid outflows of deposits from the banking sector, and risks posed by newly recognised systemic payment systems as they are scaling up?**

Yes, we would encourage limits to mitigate stability risk and broader risks of disintermediation, especially at times of financial stress. A broad risk is that if there are no limits in place, then the outflow of deposits could have a material impact on balance sheets, especially those who have certain funding requirements (i.e. Building Societies). We would welcome low limits, especially in the first instance while this is embedded and the full risks and impacts can be understood. If there are no limits in place, then a broader risk is that the outflow of deposits could have a material impact on balance sheets, especially those who have certain funding requirements (i.e. Building Societies).

Note: If limits are to be used for systemic stablecoins, then regulations need to cover how these limits would work with the digital pound. I.e. the risk of outflows would double if a user can hold both the digital pound and regulated stablecoins.

25. Do you have views on the use, calibration and practicalities of limits?

The alignment of a holding limit to a Digital Pound makes sense, albeit the holding limit is too high (the same point we continue to make on the Digital Pound holding limit). We question the feasibility of being able to enforce this limit as stablecoins could potentially be held in wallets in any jurisdiction. Any holding limit needs to be properly calibrated against the risk it seeks to address. Finally our members have concerns that if limits were too heavy/restrictive, it could push consumers to 'non-regulated' coins.

26. Do you have other views on the Bank's proposals for requirements for systemic stablecoin issuers, as set out in Section 5?

No member comments received.

27. Considering the requirements for issuers in Sections 4 and 5, how might business models need to change in order to retain commercial viability from those in the market today?

Broader commercial model considerations given to firms who choose to become stablecoin issuers/providers is required, as if they move from non-systemic to systemic the difference will likely kill their base commercial model. The implication of not earning interest on assets which are required to back coins will require firms to think about the broader commercial model and how offering these services could benefit the firms and their customers.

28. Do you agree with our proposed expectations for custodial wallet providers for systemic stablecoins (including when provided via exchanges) and how we propose applying them in a systemic stablecoin payment chain?

No member comments received.

29. Do you consider that unhosted wallets could operate in a way that the systemic stablecoin payment chains can meet the Bank's expectations (including for the issuer to deliver against the Bank's requirements set out in this Discussion Paper)?

No member comments received.

30. Do you agree with the Bank's proposal to regulate off-chain ledgers operated at systemic scale under the same requirements otherwise applicable to systemic payment systems?

Consistency between the two would seem logical, albeit greater clarity on the primary differences and therefore risks would be welcomed.

31. Do you agree with the Bank's approach to regulating service providers to firms operating in systemic stablecoin payment chains?

We welcome regulation and oversight of firms operating in systemic stablecoin payment chains. However there is a need to ensure clarity on regulation scope between firms and for clear rules/standards to be agreed in order to demonstrate where different organisations fall in the regulatory world and by which standards they are therefore regulated.

32. The Bank will have due regard to the public sector equality duty, including considering the impact of proposals for the design of the regulatory framework for systemic payment stablecoins on those who share protected characteristics, as provided by the Equality Act 2010. Please indicate if you believe any of the proposals in this Discussion Paper are likely to impact persons who share such protected characteristics and, if so, please explain which groups of persons, what the impact on such groups might be and if you have any views on how any impact could be mitigated.

No member comments received.

About The Payments Association

The Payments Association (previously the Emerging Payments Association or EPA) is for payments institutions, big & small. We help our members navigate a complex regulatory environment and facilitate profitable business partnerships.

Our purpose is to empower the most influential community in payments, where the connections, collaboration and learning shape an industry that works for all.

We operate as an independent representative for the industry and its interests, and drive collaboration within the payments sector in order to bring about meaningful change and innovation. We work closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

Through our comprehensive programme of activities for members and with guidance from an independent Advisory Board of leading payments CEOs, we facilitate the connections and build 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 our annual conference PAY360 and PAY360 Awards dinner, CEO round tables and training activities.

We run seven stakeholder working Project groups: Inclusion, Regulator, Financial Crime, Cross-Border, Digital Currencies, ESG and Open Banking. The volunteers within these groups represent the collective view of The Payments Association members at industry-critical moments and work together to drive innovation in these areas.

We also conduct exclusive industry research which is made available to our members through our Insights knowledge base. These include monthly whitepapers, insightful interviews and tips from the industry's most successful CEOs. We also undertake policy development and government relations activities aiming at informing and influencing important stakeholders to enable a prosperous, impactful and secure payments ecosystem.

See www.thepaymentsassociation.org for more information.

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