FINANCIAL CONDUCT AUTHORITY

Consultation Paper
CP25/14***

Stablecoin Issuance and Cryptoasset Custody

May 2025

How to respond

We are asking for comments on this Consultation Paper (CP) by **31 July 2025**

You can send them to us using the form on our website.

Or in writing to:

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Email:
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- an account of the representations we receive, and
- an account of how we have responded to the representations.

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Chapter 1

Summary

Term	Definition
Cryptoasset	As defined in section 417 (definitions) of the Financial Services and Markets Act 2000.
Fiat- referenced stablecoin	Stablecoins that seek to maintain a stabilised value of the cryptoasset by reference to one or more fiat currencies, and which may include the holding of, one or more fiat currencies.
Qualifying stablecoin	The specified investment defined in the Article 88G of the Regulated Activities Order, but only including those specified investments which involve a stablecoin referencing a single fiat currency.
Qualifying cryptoasset	As defined in Article 88F of the Regulated Activities Order.
Qualifying cryptoasset custodian	A firm authorised to carry out safeguarding of qualifying cryptoassets as specified in Article 9O of the Regulated Activities Order.
Qualifying stablecoin issuer	A firm authorised to carry out activity specified in Article 9M (issuing qualifying stablecoin) of the Regulated Activities Order.

Why are we consulting

1.1 In 2023, HM Treasury (the Treasury) announced plans to legislate for a financial regulatory regime for cryptoassets. Currently our regulatory remit for cryptoassets is limited to the Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs), the financial promotions regime, and consumer protection legislation (including, the Consumer Rights Act 2015 and Consumer Protection from Unfair Trading Regulations 2008).

1.2 In April 2025 the Treasury outlined in a draft Statutory Instrument and Policy Note that the Government proposes to implement new regulated activities for stablecoins to the same timetable as the rest of the cryptoasset regime.

1.3 In this Consultation Paper (CP) we are consulting on proposed rules and guidance for the activities of issuing a qualifying stablecoin and safeguarding qualifying cryptoassets, including qualifying stablecoins. This CP follows Discussion Paper (DP23/4) on our proposed approach to regulating stablecoins, which may be used for payments.

1.4 Qualifying stablecoins, as set out in the Treasury's draft legislation, are cryptoassets which seek or purport to maintain their value with reference to a fiat currency (a government-issued currency, such as pound sterling or US dollar) by the issuer holding, or arranging for the holding, of fiat currency or fiat currency and other assets.

1.5 As set out in their Policy Note, the Treasury does not intend to bring stablecoins into the UK payments regulation at this time. The Treasury considers that stablecoins have the potential to play a significant role in both wholesale and retail payments and stands ready to respond to this as part of wider payments reforms as use-cases and user adoption develops over time. As such, this CP does not include proposed requirements for firms carrying out payments using qualifying stablecoins.

1.6 Our recent survey carried out by YouGov found that 12% of UK adults now own cryptoassets, up from 10% in previous findings. Just over a quarter (27%) of cryptoasset users who responded to this survey had bought stablecoins.

1.7 Stablecoins have developed a major role in the cryptoasset ecosystem, accounting for 42.8% of cryptoasset transaction activity in Western Europe between June 2023 and June 2024, according to Chainalysis. The majority of this involved stablecoins which seek to maintain a 1:1 peg to the US dollar. Similarly, as the adoption of cryptoassets increases worldwide, the range of services providing custody of cryptoassets for both retail consumers and institutions has increased.

1.8 Our proposals are intended to support innovation and allow cryptoasset firms that set up in the UK to compete internationally, while providing appropriate protections to consumers that allow them to access products that meet their needs and provide fair value.

1.9 Many jurisdictions have developed or are in the process of developing regulatory frameworks for cryptoasset activities, including stablecoin issuance and cryptoasset custody. Regimes are developing quickly, and use cases are evolving including those which interact with more traditional financial services. We will continue to monitor the development of cryptoasset regimes around the world and how they are responding to risks of harm.

1.10 This CP is published alongside CP25/15, setting out our proposed prudential requirements for qualifying stablecoin issuers and cryptoasset custodians.

1.11 These publications will be followed by further consultations on proposed cross-cutting conduct and firm standards requirements (eg rules on governance including Senior Managers and Certification Regime (SMCR), systems and controls including operational resilience and financial crime, our Supervision Manual, and the Consumer Duty)) that will apply to qualifying stablecoin issuers, qualifying cryptoasset custodians, and other cryptoasset firms as set out in our Crypto Roadmap. Following consideration of responses to these consultations, our final rules and guidance will be set out in Policy Statement(s) ahead of implementation.

FCA Crypto Roadmap

Not exhaustive; all timelines are subject to change according to parliamentary time and/or further steers from government

This outlines planned FCA policy publications for cryptoassets where we are seeking feedback and the content they are expected to cover.

Q1 2020

Money Laundering Regulations
legislation applies

Q4 2023

Financial Promotions
rules go live

Q4 2024

DP

Stablecoins
issuance and custody

DP

Admission and disclosures
Admission/rejection processes

Disclosures

Liability

Due diligence

National Storage Mechanism (NSM)

Market abuse
Systems and controls

Information sharing

Inside information disclosure

Q1/Q2 2025

Trading platform rules including location, access, matching and transparency requirements

Intermediation rules including order handling and execution requirements

Lending rules including ownership, access and disclosures

Staking rules including ownership and disclosures

Prudential considerations for cryptoasset exposures

DP

CP

Stablecoins
Backing assets

Redemption

Custody
Recordkeeping

Reconciliations

Segregation of assets

Use of 3rd parties

Prudential
Introduction of a new prudential sourcebook, including capital, liquidity and risk management

Q3 2025

Conduct and firm standards for all Regulated Activities Order (RAO) activities
Systems and controls including Operational Resilience and Financial Crime

Consumer Duty

Complaints

Conduct (COBS)

Governance including Senior Managers and Certification Regime (SMCR)

CP

CP

Admissions and Disclosures
As per DP

Market Abuse
As per DP

Q4 2025/ Q1 2026

CP

Trading platforms, intermediation, lending and staking
As per DP +

Resolution

Remaining material for prudential sourcebook
Groups

Reporting

2026

Final rules
All Policy Statements published

PS

Gateway readiness

Gateway opens

Regime go-live

Key

DP	Discussion Paper/s
CP	Consultation Paper/s
PS	Policy statement

1.12 Alongside DP23/4 we published a cross-authority roadmap on innovation in payments with the Bank of England (Bank) and Prudential Regulation Authority (PRA). This introduced the interaction between the FCA proposals for qualifying stablecoins, and the Bank's proposals for systemic payment systems using stablecoins.

1.13 We are working with the Bank to clarify how the transition within the regime will work in practice and how any risks can be managed. For those stablecoins that expect to operate at systemic scale, the Bank will publish a complementary consultation paper later this year. In our 'Conduct and Firm standards' CP we will set out the areas of regulation that require dual supervision or where a sole regulator is responsible once a firm has been designated as an operator or provider within a systemic payment system.

1.14 This CP sets out the risks we are seeking to mitigate, the outcomes we want for consumers, and our proposals. The majority of cryptoassets remain high risk, speculative investments and consumers should be prepared to lose all their money if they buy them.

1.15 Our proposals are different for the issuance of qualifying stablecoins compared with other activities associated with qualifying cryptoassets. Stablecoins are designed to be stable, money-like instruments and qualifying stablecoins have certain features and use cases that require protections in relation to stability. Our proposals set appropriate standards that are proportionate, and which we will expect firms to maintain. This will mean our regime will bring certainty, and that firms and consumers will be able to place trust in qualifying stablecoins.

1.16 We received 56 responses to DP23/4 from industry, trade bodies, individuals, and civil society stakeholders. Throughout this CP, we address prevalent themes in those responses, including how they have been considered and incorporated.

1.17 We support innovation that benefits consumers through our Innovation Hub. Our Regulatory and Digital Sandboxes offer firms the opportunity to test solutions in a secure environment. Through Innovation Pathways, we provide hands on support about how regulation might apply to innovative products. We welcome applications that take account of proposals in this CP.

FCA Strategy and Objectives

1.18 Our proposals have been guided by our statutory objectives (see chapter 2) and 2025-30 Strategy. They are intended to:

- **Support growth:** we want to enable cryptoasset firms to develop and innovate in a safe and sustainable way, designing a proportionate regime that allows firms that set up in the UK to compete internationally and support the growth of the UK in medium to long term.
- **Help consumers:** we want consumers to receive appropriate levels of protection. We want to ensure consumers can stay informed and have access to products that meet their needs and offer fair value.
- **Fight crime:** our proposals are intended to support firms to act as a strong line of defence against financial crime. They should focus on designing crime out

of activities relating to cryptoassets. Firms should look to minimise the use of cryptoassets for fraud, money laundering, terrorist and proliferation financing or any other criminal activities.
- **Be a smarter regulator:** in developing our regime we are making sure that our regulation is purposeful. We have considered where we can rely on the Consumer Duty instead of developing additional requirements.

Scope of this consultation

1.19 Our proposed rules and guidance cover:

- Requirements for qualifying stablecoin issuers.
- Requirements for qualifying cryptoasset custodians.

1.20 Subject to finalised legislation, issuing a qualifying stablecoin and safeguarding qualifying cryptoassets will be introduced as specified activities through amendments to the Regulated Activities Order (RAO).

1.21 Following implementation of the proposed regime, qualifying stablecoin issuers and qualifying cryptoasset custodians will be required to be authorised by the FCA to carry on these activities by way of business in the UK.

1.22 Our proposals are based on the activities as set out in draft legislation and will be subject to this legislation being finalised. We will provide guidance on these activities when legislation is made.

1.23 In Chapter 2, we set out how our proposals align with international standards (see paragraph 2.13).

What we want to achieve

Confidence in using qualifying stablecoins

1.24 Fiat-referenced stablecoins are intended to provide holders with assets which achieve stability. They present the UK market with a number of opportunities. These include:

- facilitating and settling transactions with cryptoassets
- acting as an on-ramp to or off-ramp from the cryptoassets ecosystem
- facilitating and settling institutional or wholesale transactions, including in a tokenised environment
- acting as a means of cross border payments
- in the future, serving as a means of payment for retail goods and services

1.25 Qualifying stablecoins should operate as trusted money-like instruments, where holders do not face additional barriers to obtaining the monetary value of the qualifying stablecoins they hold. Our proposals recognise and account for the multiple retail and wholesale use cases, while responding to the risks we want to reduce and, where possible, prevent. By applying clear standards to qualifying stablecoin issuers, and providing greater protections to qualifying stablecoin holders, we want to provide greater opportunities to consumers and institutions to access a broader range of regulated products, which they otherwise may not have sufficient confidence in using.

1.26 Under our proposals, qualifying stablecoin issuers will be required to:

- back qualifying stablecoins with secure, liquid assets in a statutory trust for qualifying stablecoin holders. These backing assets should be held with a third party custodian who is not in the issuer's group.
- offer redemption of qualifying stablecoins in exchange for money to all holders. Payment orders to transfer redeemed funds to qualifying stablecoin holders should be placed at the latest by the end of the next business day following receipt of a redemption request.
- clearly disclose their policy for redemption and the composition of backing assets to consumers.

1.27 Our proposals aim to provide greater confidence to consumers and the market that qualifying stablecoins are 1:1 backed, and that the issuer will be able to fulfil redemption requests. As the assets will be held with an unconnected custodian, this mitigates contagion risk should the qualifying stablecoin issuer fail. Our proposals aim to make it more likely that consumers have access to sufficient information to make decisions based on a clear understanding of their rights and the risks involved in using qualifying stablecoins.

Robust safeguarding of client cryptoassets

1.28 When engaging with a qualifying cryptoasset custodian, clients should expect that their assets will be protected. Clients should expect their qualifying cryptoassets back at any time they ask for them, as well as those assets returned as quickly and as whole as possible, if the custodian enters an insolvency process. Under our proposed rules in this CP, custodians of qualifying cryptoassets will be required to:

- segregate client cryptoassets from their own
- hold those qualifying cryptoassets on behalf of clients in a trust
- have accurate books and records of clients' cryptoassets holdings
- have adequate controls and governance to protect clients' cryptoassets holdings

1.29 In future publications, additional measures to protect qualifying cryptoassets will be proposed, including prudential and operational resilience measures.

Outcomes we are seeking

1.30 We want to create a market that works well for consumers, encourages effective competition and enhances market integrity, including:

- Effective competition that delivers high quality offerings and drives innovation in the UK cryptoasset sector.

- Products which offer fair value, are accessible, meet consumer needs and are sold fairly. Consumers get the support and information they need to make decisions for their financial future, and an appropriate degree of protection is in place.
- Cryptoassets used within our regime are not attractive for fraud, money laundering, terrorist and proliferation financing or any other criminal activities.
- The international competitiveness of the economy of the UK is supported, as well as its growth in the medium to long term, and firms are encouraged to set up in the UK to offer cryptoasset services.
- Well-run firms with appropriate standards and sufficient resources, that means they are well placed to put matters right when things go wrong, with clear and proportionate standards which can be supervised effectively.

Measuring success

1.31 We would expect to see benefits, including:

- Effective competition creating a market with integrity for cryptoasset services. We will look to measure this through the number of firms operating within the UK market.
- Increased consumer trust, with consumers accessing product and services meeting their needs. We will look to measure this through conducting research covering attitudes to cryptoassets.
- A reduction in fraud, money laundering, terrorist and proliferation financing or any other criminal activities to make the cryptoasset environment safer. We will look to monitor ongoing crime rates involving cryptoassets.
- The UK being a location in which qualifying stablecoin issuers and qualifying cryptoasset custodians choose to establish and operate from. We will look to measure this through the number of qualifying stablecoins issued from the UK and the number of qualifying cryptoasset custodians authorised under our regime and the value of qualifying cryptoassets for which they provide custody.
- Increased confidence in cryptoasset firms so that consumers have a positive experience when dealing with them and trust them to put things right when they go wrong. We will look to measure this through research.

1.32 The wider cryptoasset regime will be needed to deliver these, and other, measures of success. We intend to evaluate our regime when industry has had time to implement the rules we put in place for the regime. We plan to monitor how firms adapt to the new regime, the outcomes for consumers and other relevant factors to determine whether the regime is delivering good outcomes.

1.33 We discuss our intended improvements to consumer and market outcomes in Annex 2: Cost Benefit Analysis (CBA).

Consultation with the CBA Panel and other statutory panels

1.34 We have consulted the Cost Benefit Analysis (CBA) Panel in preparing the CBA included in Annex 2, in line with the requirements of s138IA(2)(a) FSMA. A summary of their main recommendations and our subsequent changes are in the 'Consultation with the FCA Cost Benefit Analysis Panel' section of the CBA.

1.35 We have also engaged with the Financial Services Consumer Panel, Practitioner Panel, and Smaller Business Practitioner Panel, and considered their input and views.

Who should read this Consultation?

1.36 Who needs to read this document:

- firms that issue, or are seeking to issue, fiat-referenced stablecoins in the UK
- firms that wish to make use of qualifying stablecoins within wider activities (eg retail payments or on-and off-ramping)
- cryptoasset custodians and other firms that carry out or seek to carry out safeguarding of qualifying cryptoassets
- industry groups, law firms and trade bodies representing firms in the cryptoasset sector
- auditors providing services to cryptoasset firms
- professional advisors in the cryptoasset sector
- consumer and groups representing consumer interest.

1.37 Who may be affected by the proposed rules and guidance:

- consumers and firms who do or propose to use, or interact with, qualifying stablecoins, qualifying cryptoassets or other cryptoassets.

1.38 It may also interest:

- policymakers and other regulatory bodies
- academics and think tanks
- industry experts and commentators
- issuers of electronic money and payment service providers

Next steps

1.39 We welcome feedback on our proposed rules and other issues discussed in this CP. The specific questions we want feedback on are in Annex 1.

1.40 The consultation period will end on 31 July 2025. We will consider the feedback received ahead of publishing our final rules.

1.41 You can send us your comments using the form on our website. If you are not able to use the form, contact us at cp25-14@fca.org.uk to discuss alternative ways to respond.

Chapter 2

The wider context and our objectives

How our proposals link to our objectives

2.1 Our proposals are aligned with our statutory objectives – consumer protection, market integrity, and effective competition – and advance our secondary international competitiveness and growth objective, so far as reasonably possible.

Consumer protection

2.2 We want to ensure that when a stablecoin holder redeems a qualifying stablecoin they always get back the monetary value, with redemption available at par for retail holders, not only institutional holders.

2.3 When a client entrusts a firm to safeguard their qualifying cryptoassets, our proposals are intended to ensure those assets are adequately protected, and clients are informed of the protections in place.

2.4 Our proposed prudential requirements are intended to allow firms to continue to operate in times of stress, and where failures do occur, they do so in an orderly way.

Market integrity

2.5 Our proposals intend to increase confidence in the qualifying stablecoins market, with stablecoins fully backed by secure, liquid assets, and redemption available by the end of the next business day.

2.6 Our proposed rules for qualifying cryptoasset custodians require firms to ensure client assets are adequately safeguarded when they are responsible for them. Protecting client assets is fundamental to the trust that consumers place in firms; it is at the heart of ensuring a well-functioning and robust market.

2.7 To further support the integrity of the market, we intend to consult on our approach to financial crime and market abuse in later consultations as set out in our Roadmap.

Effective competition

2.8 Our proposals are designed to enhance consumer trust and apply appropriately robust standards. This will support consumer engagement with the market and potentially enhance demand. A clear regulatory framework will provide businesses with certainty and encourage firm entry in the market. This may further support effective competition by providing consumers with alternative options to choose from and supporting innovation.

2.9 In the longer term, depending on the take up by consumers and merchants, qualifying stablecoins may become a viable option for payments and remittances, providing consumers with further alternatives.

2.10 While we anticipate increased initial costs and some barriers to entry from the introduction of new rules in this sector, we have ensured our proposals are flexible and proportionate.

Secondary international competitiveness and growth objective

2.11 Increased confidence in the market may lead to increased use by consumers or firms of qualifying stablecoins. This in turn may lead to increased innovation, the development of new products and services involving qualifying stablecoins and DLT, and the growth of the UK cryptoasset sector.

2.12 Our proposals are designed to support existing business models for firms located in the UK where appropriate. For example, our proposals will allow qualifying stablecoin issuers in the UK to use providers here and overseas to carry out elements of this activity on their behalf. And, our broader proposed range of permitted stablecoin backing assets than those set out in DP23/4, and prudential requirements which scale with the size of the firm, aim to support the viability of qualifying stablecoin issuer business models in the UK.

2.13 Aligning our regime with relevant international standards should lower compliance costs for internationally active firms through interoperability, market access and a level playing field. We are a member of global standard setting bodies, such as the Financial Stability Board (FSB), International Organization of Securities Commissions (IOSCO), and the Financial Action Task Force (FATF), which are developing a global regulatory framework for cryptoassets and their underlying technologies. The FCA led the development of the IOSCO Crypto and Digital Assets Recommendations, providing a baseline of regulation for cryptoassets around the world which facilitates competitiveness while guarding against a race to the bottom. There has also been significant work to develop international standards for stablecoins through the FSB, based on the common challenges and risks faced by regulators across the globe. We consider the proposals in this CP to be aligned with these international standards.

The harm we are trying to reduce

2.14 Some of the risks associated with cryptoassets are present in other financial sectors. However, some risks arise from the novel features and business models afforded by the technology that fiat-referenced stablecoin issuers and cryptoasset custodians use.

2.15 As set out in our Crypto Roadmap, not all risks of harm will be covered by the proposals in this CP and will be addressed through other aspects of the cryptoasset regime. Our full regulatory regime is intended to increase the likelihood that firms will have the appropriate systems, controls, processes, capital and people in place if something goes wrong.

2.16 Risks will remain in the cryptoasset sector even with more regulation. Anyone who purchases cryptoassets should be aware of these risks and the potential for volatility in the value of most cryptoassets. However, our proposals for qualifying stablecoin issuers include further rules to maintain the stability of their value and reduce the risk of harms, recognising the particular use cases of these money-like instruments.

Fiat-referenced stablecoin issuance and redemption

2.17 Were an existing stablecoin issuer to fail today, it may be unclear to its holders how they could get their money back. The contractual rights that stablecoin holders may have over any money or assets held by the issuer may vary, and the issuer may not have strictly segregated the money or assets backing the stablecoin from its own assets. Regulating fiat-referenced stablecoins will not prevent failures, but it will help to reduce the probability and impact.

2.18 Currently many issuers of fiat-referenced stablecoins only permit wholesale or institutional stablecoin holders to redeem the stablecoins directly with them. Stablecoin issuers may also charge high fees or set significant minimum withdrawal amounts which deter holders from redeeming their stablecoins should they wish to do so. In some instances, this leaves retail holders able to only trade their stablecoins on the secondary market, should they wish to exchange their stablecoins for fiat.

2.19 This issue is particularly acute if the stablecoin were to lose its value relative to the fiat currency it references. In these circumstances retail stablecoin holders may not be able to redeem at par from the stablecoin issuer and may only get a portion of their money back through trading on the secondary market. For example, when USDC, a US dollar-referenced stablecoin, de-pegged from the dollar in 2023 to a low of $0.87, retail stablecoin holders did not have the contractual right to redeem their stablecoins at par with the issuer, which direct institutional holders did. Without the ability to redeem directly, retail stablecoin holders were required to use the secondary market. Some lost money through selling their stablecoins at a price below par in fear that the value may drop further.

2.20 Poor disclosures of a firm's redemption policy can result in stablecoin holders believing that they can always redeem directly with the issuer when this may not be the case. Stablecoin holders may also believe incorrectly that they are not subject to fees, or that they can redeem any amount of fiat-referenced stablecoin. Poor disclosures of information can result in a lack of market confidence and lead to wider consequences for the stability of the fiat-referenced stablecoin. We are looking to address these issues through our regulatory regime.

Fiat-referenced stablecoin backing assets

2.21 Having the right assets in place, held in the right way, to back a fiat-referenced stablecoin is important to ensure holders can redeem the monetary value of the stablecoins they hold. Poor or insufficient disclosures about the backing assets composition and how they are held makes it difficult for consumers to understand how the stablecoin is backed. Stablecoin holders may not know whether they can promptly redeem their stablecoins at any time, including if something were to go wrong. This could negatively impact confidence in the stablecoin and the markets in which it is used. In extreme circumstances this may lead to a 'run' on the fiat-referenced stablecoin, enhancing liquidity risks, placing holders at risk of loss, and potentially bringing wider financial stability concerns.

2.22 Many issuers of fiat-referenced stablecoins hold at least part of their backing assets as deposits with banks or as other assets with custodians. This can create an interdependency with traditional finance. Events such as the temporary de-peg of USDC from the US Dollar following the collapse of Silicon Valley Bank, highlight the interlinkages and potential concentration risks between stablecoins and traditional financial services. They also show how harm to market confidence related to the backing assets can influence the stablecoin value. We set out our proposed mitigations of these risks in Chapter 3.

Safeguarding qualifying cryptoassets

2.23 If a firm safeguarding qualifying cryptoassets, including stablecoins, were to fail today, the lack of a regulatory framework focused on conduct and prudential, combined with uncertainty of treatment in failure, would likely cause harm to its customers. Without a clear framework clients' ownership rights to their qualifying cryptoassets may not be evidenced sufficiently to be protected. This could lead to delays in returning clients' cryptoassets, extra costs, or at worst, the loss of their assets. This may impact consumer confidence and disincentivise consumers from interacting with the qualifying cryptoasset market in the UK.

2.24 This has been demonstrated in recent years by failures of cryptoassets firms providing custody, such as the FTX Group, where consumers suffered loss of their cryptoassets in specie and delay in the return of the corresponding value of their cryptoassets. This failure was partly due to poor safeguarding practices, such as co-mingling of the firm's and clients' assets, lack of accurate record-keeping, and poor governance.

Other risks and harms

2.25 We will propose rules that directly address the risks below in more detail, so far as we are able to, in subsequent consultations:

- **Poor governance and conduct:** Conflicts of interest or a lack of accountability can make it less likely that firms will act in the interest of consumers.
- **Financial crime and sanctions evasion:** Cryptoassets including fiat-referenced stablecoins appeal to harmful actors who exploit their fast-moving and cross-border nature for illicit purposes, from fraud, to money laundering, to sanctions. Perceived as more stable than other cryptoassets, fiat-referenced stablecoins have become increasingly attractive to criminals who do not wish to be exposed to the market volatility of unbacked cryptoassets.
- **Fraud, scams and consumer understanding:** 'Cryptoasset' is the most searched product on our ScamSmart website and reports of crypto scams to the FCA have more than doubled since 2020.

- **Use of public or permissionless distributed ledger technologies (DLT):** The use of DLT which allow anyone to contribute and add data to the ledger presents novel risks and challenges. For example, there are challenges to ensure appropriate controls over the firms or individuals who may interact or code directly with the DLT. If these technologies face disruption it may be difficult for firms to resume service, or for consumers to access their cryptoassets which are recorded on the blockchain. It is important that firms act to reduce the risk of harm and adequately inform consumers of these risks.
- **Operational resilience:** We define operational resilience as the ability to prevent, adapt, respond to, recover and learn from operational disruptions. A disruption to a service provided by a qualifying stablecoin issuer, such as a technical disruption with redemption, may harm consumers if not remediated safely and in a timely way. Further, any operational incidents associated with the safeguarding of cryptoassets, such as loss of private keys, may result in harm to consumers and other market participants. We will cover other operational resilience risks and considerations in future consultations.

Interaction with other regimes

Payment systems using stablecoins

2.26 In November 2023, the FCA, alongside the Bank of England and the Treasury, published a cross-authority roadmap on innovation in payments. Among other regulatory areas, this set out the interaction between the FCA regime for cryptoassets, and the Bank of England's proposed regime for systemic payment systems using stablecoins.

2.27 At this time, the Bank of England also published a Discussion Paper on the regulatory regime for systemic payment systems using stablecoins and related service providers.

2.28 Under the Bank's proposals, issuers of systemic stablecoins used for payments as recognised by HM Treasury will be brought in scope of the Bank of England's regime and subject to its requirements. This will occur alongside those requirements imposed by the FCA for firms carrying out activities set out in the Regulated Activities Order, meaning that such providers will be dual regulated by the Bank and the FCA.

2.29 The Payment Systems Regulator (PSR) also has powers to regulate payment systems if they are designated under Part 5 of the Financial Services (Banking Reform) Act 2013 by the Treasury, including payment systems using stablecoins. These powers include: to give directions to participants in regulated payment systems, to require the operator of a regulated payment system to establish rules and to change them in specified ways, and to require the operator of a regulated payment system to grant access to the payment system.

2.30 On 11 March 2025 the Government announced its intentions to consolidate the PSR and its functions mainly within the FCA. This is a pragmatic next step in simplifying the regulation of payments and reflects the fact the sector has changed significantly. The transition and legislative process will likely take some time and will follow consultation.

However, the Government has been clear that there will continue to be effective regulation of payment systems and that there is an important role still to do on ensuring they are competitive, innovative and safe.

2.31 We will continue to work with the Bank and the PSR to ensure that the interaction between our regimes is clear for firms and consumers. This includes clarity on how firms may transition from one regime to another after being recognised as an operator of systemic payment systems of 'digital settlement assets' by the Treasury. Service providers may include custodians, trading platforms, and fiat-referenced stablecoin issuers (when issuers are not also the operator of the payment system). In our 'Conduct and Firm Standards' CP we intend to set out the areas of regulation that the FCA is responsible for once a firm has been recognised by the Treasury as an operator or provider within a payment system. This will include when a qualifying stablecoin has been deemed as systemic.

Payments

2.32 Stablecoins and DLT have the potential to transform the payments landscape, as set out in the Treasury's National Payments Vision. As use cases for qualifying stablecoins are developed the Treasury may bring retail payments made with qualifying stablecoins within the FCA perimeter.

2.33 Firms that play a role in facilitating transactions using qualifying stablecoins and other qualifying cryptoassets may be in scope of the new regulated activities for cryptoassets, including qualifying cryptoasset custody.

Our authorisations, supervision and enforcement approach

2.34 Currently, firms that provide cryptoasset services that come within the scope of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) must be registered with the FCA. In addition, cryptoasset businesses that wish to market to UK consumers (ie communicate their own cryptoasset financial promotions) must also be registered with the FCA under the MLRs unless their financial promotions are approved by an authorised person or otherwise rely on an exemption in the Financial Promotion Order.

2.35 Under the new regime set out in this CP, while qualifying stablecoin issuers and qualifying cryptoasset custodians will still be subject to the MLRs, they will no longer need to be separately registered with the FCA. Instead they will need to be authorised by the FCA under the Financial Services and Markets Act 2000 and once authorised, they will continue to be subject to our ongoing supervision.

2.36 We recognise that for many qualifying stablecoin issuers and qualifying cryptoasset custodians this will be the first time they will be regulated by us under FSMA. We intend to apply the same regulatory approach to qualifying stablecoin issuers and qualifying cryptoasset custodians and associated individuals as we do to other regulated firms.

2.37 For an application for authorisation to be successful, a firm must show that it satisfies, and will continue to satisfy, the minimum standards set out in FSMA. These minimum standards are referred to as the Threshold Conditions. Further information on applying for authorisation can be found on our website along with details of our pre-application support service (PASS).

2.38 Our approach to supervision seeks to be proportionate, prioritising key areas of focus and firms that pose a higher risk to meeting our objectives. In line with our Strategy 25-30, our priorities as a regulator are to support growth, fight crime, help consumers and be a smarter regulator. We intend to focus our market engagement on areas where harm is the greatest, and to take a more flexible approach, with less intensive supervision for those firms demonstrably seeking to do the right thing. We will also endeavour to make our areas of focus predictable so that firms have an earlier chance to make positive change without the need for regulatory action. In our strategy, we have committed to streamlining how we set our supervisory priorities and sharing more insights from our supervisory work. By committing to invest in our technology, people and systems, we can act faster and more assertively where harm is greatest.

2.39 Our enforcement approach intends to ensure that there are real and meaningful consequences for firms and individuals who do not follow our rules and who cause significant harm to consumers, and to markets. We consider the deterrent impact of any enforcement action we take and focus our efforts on achieving impactful deterrence aligned to the FCA's strategy. Our enforcement information guide provides an overview of our enforcement powers, our typical process for enforcement cases, and information on mediation and settlement. Our Enforcement Guide explains how we conduct a typical enforcement investigation and how we use our powers to investigate and take enforcement action. Further information about our enforcement approach can be found on our website.

Equality and diversity considerations

2.40 Overall, we do not consider our proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 (in Northern Ireland, the Equality Act is not enacted but other antidiscrimination legislation applies). We are aware that certain demographic segments are overrepresented in cryptoasset ownership. We do not have specific data for fiat-referenced stablecoins ownership for these characteristics, however, they are a subset of cryptoassets. Based on analysis from our Financial Lives Survey (2024) which is reflected in our Consumer Research series on cryptoassets (2024), cryptoasset owners are:

- around 3 times more likely to be men.
- more likely to be younger, with 18–34-year-olds accounting for 41% of all cryptoasset owners.
- more likely to be from a minority ethnic, which may in part be driven by the lower age profile of cryptoasset owners and greater ownership in London compared with other regions.
- more likely to have a higher-than-average household income.

2.41 While these groups are currently overrepresented in their ownership of cryptoassets, we expect that all consumers who interact with cryptoassets will benefit from a regulatory regime for qualifying stablecoin issuers and qualifying cryptoasset custodians.

Digitally excluded consumers

2.42 In our latest Financial Lives Survey 2024, 2% of adults were digitally excluded. We do not envisage our proposals will have a direct impact on the digitally excluded population as many digitally excluded consumers do not interact with cryptoassets or the digital services required to purchase them.

2.43 Cash remains particularly important for consumers with vulnerable characteristics and many small businesses. We do not envisage the proposals in our CP will have a direct impact on those that use cash or led to lower rates in the use in cash. Our work on Access to Cash (PS24/8) ensures that while the increasing range of digital services and payments options can make life easier, for many, the ability to withdraw cash is still vital.

2.44 As we set out our final rules and develop our regime, we will continue to consider if our work could affect the make-up of consumers of qualifying stablecoins and qualifying cryptoasset custody, or otherwise impact on equality and diversity. We also believe that our proposals will not negatively impact financial inclusion and may support it through facilitating the development of new innovations which increase the accessibility of products and services.

Chapter 3

Requirements for issuing qualifying stablecoin

3.1 This chapter sets out our proposed requirements which qualifying stablecoin issuers will need to comply with when issuing a qualifying stablecoin. In this Consultation Paper (CP) the rules we are consulting on are for issuers of qualifying stablecoins referencing a single fiat currency. We are also seeking views on how rules should be applied to issuers of qualifying stablecoins referencing more than one fiat currency (see paragraph 3.15). Our proposals are designed to make sure that issuers have the right resources, processes and controls in place to promote the stability, transparency, and reliability of qualifying stablecoins.

3.2 In this chapter, references to an 'issuer' are to a qualifying stablecoin issuer.

3.3 As set out in our Crypto Roadmap, in this CP we are not consulting on all rules that will apply to qualifying stablecoin issuers. The rules set out in this chapter will be in addition to broader 'Conduct and Firm Standards' rules applied to qualifying stablecoin issuers that will be set out in a future consultation, and prudential requirements set out in CP25/15 published alongside this CP.

3.4 In line with our commitment to the Prime Minister in January 2025 we have carefully considered where we may be able to rely on the Consumer Duty in place of new rules. Our conclusion is that this CP's requirements are needed in addition to the Consumer Duty to achieve the outcome of qualifying stablecoins being trusted, money-like instruments, and to address the unique features of qualifying stablecoins. We believe specific conduct requirements are necessary for this activity, to provide sufficient clarity to firms on the standards we will expect them to uphold when issuing qualifying stablecoins.

3.5 We will set out our approach to the Consumer Duty in our 'Conduct and Firm Standards' CP and will invite feedback in that consultation on whether and how the Duty is applied the cryptoasset sector.

3.6 Our proposed requirements for issuers relate to the offer and redemption of qualifying stablecoins, the holding and management of qualifying stablecoin backing assets, and key information that issuers will need to disclose about their qualifying stablecoins.

3.7 Chapter 2 sets out harms that can arise from stablecoins. To prevent and reduce these harms, qualifying stablecoins must maintain their value relative to their reference currency or currencies and the issuer must offer redemption at par value to all holders. We propose to impose a statutory trust over backing assets held by the issuer for the benefit of stablecoin holders. We also propose to require that the issuer must appoint an independent third party, which is not part of the issuer's Group to safeguard backing assets. An issuer must make sure these backing assets are managed appropriately and that qualifying stablecoins are 1:1 backed at all times.

3.8 We understand that qualifying stablecoin issuers may seek to use third parties to carry out elements of the regulated activity on their behalf. Under our proposed requirements, the issuer will remain responsible for complying with our rules, including in cases where third parties act on their behalf. This chapter includes proposals on due diligence and contractual arrangements that qualifying stablecoin issuers will need to put in place between themselves and any third parties they use to make sure issuers can meet their regulatory obligations. We also propose to require issuers to make sure that payments of funds for the purpose of issuing a qualifying stablecoin are made directly to the issuer, even in cases where the offer of qualifying stablecoins is carried out by third parties acting on their behalf.

3.9 Our proposals cover the full lifecycle of a qualifying stablecoin. The table below sets out definitions of processes referred to in this chapter.

Concept	Definition
Issuing	Carrying on the regulated activity of issuing a qualifying stablecoin in the United Kingdom.
Creating	Includes the technical design of a qualifying stablecoin.
Minting	The minting of a qualifying stablecoin such that it first exists as an identifiable asset on the blockchain in a transferrable form.
Burning	The process by which a cryptoasset is permanently removed from circulation on the blockchain.

Question 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?**

Summary of proposed provisions for qualifying stablecoin issuers

3.10 The key features of our proposals for issuers of qualifying stablecoins are:

- Qualifying stablecoins are designed and built with risks addressed.
  - Requirement to understand and manage risks associated with the design and build of a qualifying stablecoin before it is issued.
- Qualifying stablecoins are fully backed at all times.
  - Requirement to maintain the value of qualifying stablecoins by always holding backing assets in amounts equivalent to the value of the stablecoins that have been minted.

  - Requirements to make sure qualifying stablecoins that have been minted are backed (with an exception for stablecoins which are redeemed, where we propose that issuers must count these stablecoins as part of the stablecoin pool which must be backed within 24 hours, or take them permanently out of circulation).

- Qualifying stablecoin backing assets are managed in a prudent manner.

  - Requirements for issuers to structure their backing pool so that it contains only certain asset classes; this includes on demand deposits; and government treasury debt instruments that mature in one year or less. In certain circumstances; public debt of a longer residual maturity; assets, rights or money held as a counterparty to a repurchase agreements or reverse repurchase agreements; and some limited money market funds. The composition of the backing asset pool must be able to meet requirements for redemption at all times and ensure that the qualifying stablecoin maintains stability.
  - Restriction on passing interest earned on backing assets to qualifying stablecoin holders.

- Qualifying stablecoin backing assets are safeguarded effectively.

  - Requirement for issuers to hold backing assets on behalf of stablecoin holders under a statutory trust, with the issuer as trustee and a fiduciary duty between the issuer and stablecoin holders.
  - Requirement to promptly segregate backing assets on receipt, and place these with an independent third party not connected with the issuer's Group. We propose that issuers can only accept money or qualifying stablecoins issued by FCA-authorised firms, in exchange for qualifying stablecoins they issue.
  - Requirements to carry out reconciliations of backing assets at least daily and to ensure shortfalls are topped up and excesses removed, or that qualifying stablecoins are minted or burned to ensure parity is maintained.

- Redemption of qualifying stablecoins is guaranteed by the issuer at par (subject to specific exemptions).

  - Requirement to make redemption available to all qualifying stablecoin holders, with no minimum redemption amount of stablecoin per redemption request.
  - Requirement for redemption of a qualifying stablecoin to always be at par, taken to be the value of one unit of the reference currency, multiplied by the number of stablecoins being redeemed, irrespective of the value of the backing assets.
  - Requirement for payment orders of redeemed funds to an account in the name of the holder to be placed by the end of the business day following receipt of a valid redemption request.
  - Requirement to make sure any fees charged for redemption are commensurate with the operational costs incurred for executing redemption. In all cases fees must not exceed the value of the stablecoins being redeemed, or pass on costs and losses arising from the sale of assets in the backing asset pool.

- Third parties appointed to act on behalf of qualifying stablecoin issuers are used responsibly, with the qualifying stablecoin issuer remaining responsible for compliance with our rules.
  - Requirement to carry out adequate due diligence and have comprehensive contractual agreements with third parties acting on behalf of a qualifying stablecoin issuer. Such arrangements must include sufficient information sharing with the issuer to make sure the issuer can comply with requirements, and to allow for ongoing monitoring of the third party by the issuer.
- Disclosures are accurate and accessible.
  - Requirement to publish the number of stablecoins and the backing asset composition at least once every three months.
  - Requirement to publish and update other important information about the qualifying stablecoin (eg technology used, third parties carrying out parts of the activity on behalf of the issuer, or the process of redemption).
  - Requirement that these disclosures are clear, fair and not misleading.

The scope of the issuance activity

3.11 The Treasury has published draft legislation including a new activity of issuing a qualifying stablecoin, to be set out in Article 9M of the Regulated Activities Order (RAO). We will provide guidance on these activities subject to final legislation.

3.12 Issuers of qualifying stablecoins established in the UK will be required to obtain Authorisation from the FCA to carry on this activity by way of business in the UK.

3.13 While stablecoins are similar in some respects to other financial instruments and specified investments, subject to finalised legislation, we intend to regulate them as money-like instruments rather than as investment products. This means we would expect qualifying stablecoin issuers to offer all holders the right to redeem at par value, and the redemption value should not fluctuate in line with the performance of the underlying backing assets as is the case with a fund. We also propose to prohibit issuers from passing interest on the backing asset pool to qualifying stablecoin holders, further distinguishing qualifying stablecoins from funds or other investment products. The draft legislation published by the Treasury sets out that issuing a qualifying stablecoin is separate from the operation or management of a Collective Investment Scheme or Alternative Investment Fund, of which Money Market Funds are a subset. We will consult on guidance on the differences between Collective Investment Schemes or Alternative Investment Funds, and qualifying stablecoins once legislation is made.

3.14 Under the draft legislation, qualifying stablecoins are also separate and distinct from e-money. If a firm seeks to issue both e-money and qualifying stablecoins, they need permission for both activities (ie being authorised to issue qualifying stablecoins will not allow the firm to issue e-money, and vice versa). Unlike e-money, qualifying stablecoins form a subset of qualifying cryptoassets. Qualifying stablecoins have a secondary market value, and the issuer can mint tokens before receipt of funds from token holders.

These features and their use case in cryptoasset trading distinguish stablecoins from e-money. We will consult on guidance further clarifying the differences between e-money and qualifying stablecoins in PERG once legislation is made.

Multi-currency qualifying stablecoins

3.15 The rules we are consulting on will apply to issuers of qualifying stablecoins which seek or purport to maintain their value relative to a single fiat currency. The Treasury has set out that the scope of the draft definition of qualifying stablecoin includes stablecoins that are referenced to more than one fiat currency. This could include the issuing of stablecoins referenced to a pair of fiat currencies, or a 'basket' of several currencies.

3.16 We have yet to see a significant presence of multi-currency stablecoins in the current stablecoin market, either for cryptoasset trading or as a means for payment. We are not aware of any multi-referenced stablecoins issued in the UK and are keen to understand further how multi-currency stablecoins may be structured to ensure stability against multiple currencies. Based on our current understanding, multi-currency stablecoins may be structured in the following ways:

- They could reference a currency pair or a basket of several currencies.
- They may be represented by a summed value exchanged into a single currency or use a model of multilateral exchange rates.
- They could use a fixed *amoun*t of each currency as the reference or a fixed *percentage* of each currency.

3.17 Multi-currency stablecoins could bring the following benefits:

- Expanding the choice of regulated products available to UK consumers.
- Multi-currency stablecoins could facilitate foreign exchange and trade with fewer frictions than traditional international payment rails. They could be used to facilitate exchanges between both common and less common trading pairs.

3.18 Multi-currency stablecoins could also bring the following risks and challenges:

- The absence of clear business models or an established presence of multi-currency stablecoins in the market makes the development of regulation challenging.
- Multi-currency stablecoins could bring foreign exchange and liquidity risks that are inherent by design, due to the necessity of exposure to multiple currencies and the exchange rates between them.
- It is difficult to determine what 'par' value would be for a multi-currency stablecoin, given the value of a currency basket when converted to any single currency would likely fluctuate with exchange rates.

3.19 We believe issuers of multi-currency qualifying stablecoins should be held to standards similar to those applied to issuers of single-currency qualifying stablecoins unless there is a specific reason to deviate from this. This includes ensuring that holders have a direct right to redemption, and that backing assets are held under a statutory trust and are prudentially managed. We are aware that this CP's rules may not be appropriate for multi-currency stablecoins and invite industry's views.

3.20 We see these stablecoins as bringing additional considerations for our regulation. This includes the risks arising from exposure to multiple currencies, and the value of stablecoins being tied to changing exchange rates. We welcome views on the questions below and if adjustments to our rules may be required.

Question 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.

Creating a qualifying stablecoin

3.21 When qualifying stablecoins are created by or on behalf of the issuer, they may be issued using all forms of DLT, including on private, public, permissioned or permissionless blockchains. The technical design of a qualifying stablecoin (including its underlying coding) must (i) be robust, (ii) enable the qualifying stablecoin to function, and (iii) allow the issuer to fulfil its regulatory requirements. We propose that the technical design of a qualifying stablecoin allows for innovation. Where appropriate, technology should be used to improve the functionality of the stablecoin and restrict its attractiveness for illicit purposes.

3.22 We propose that issuers must identify and manage the risks associated with the design and build of a qualifying stablecoin before it is issued. This includes analysing the risks of the underlying DLT and making sure they can manage potential disruptions.

3.23 We intend to use our future consultations to propose how firms should apply our existing Consumer Duty, and our rules and guidance within our Systems and Controls sourcebook. This includes having a robust operational resilience framework, when creating, distributing and maintaining a qualifying stablecoin.

Managing qualifying stablecoin backing assets

3.24 As discussed in DP23/4, issuers must maintain the value of a qualifying stablecoin by always holding fiat currency and permitted assets, in amounts equivalent to the value of minted qualifying stablecoins. We refer in this CP to 'backing assets', as those assets in the 'backing asset pool'.

DP23/4 responses

3.25 In DP23/4, we set out our proposed approach towards the management of backing assets for qualifying stablecoins. We asked respondents to consider our proposals for the backing asset composition, the denomination of the backing assets and whether issuers may pass interest earned from backing assets to consumers.

3.26 Most respondents broadly supported our suggested approach to backing assets. They recognised the importance of robust backing asset requirements in enhancing the integrity of fiat-referenced stablecoin markets and protecting consumers who choose to hold qualifying stablecoins.

3.27 Respondents supported introducing requirements for issuers to hold a highly liquid and stable backing asset pool in line with the amount of stablecoins in circulation. They agreed that these backing assets should be safeguarded under an adapted CASS regime. However, most respondents opposed our proposal to limit acceptable backing assets to government treasury debt instruments (with maturities of one year or less) and short-term cash deposits. These respondents were concerned that such a restriction was not in line with current business models and may impact the commercial viability of fiat-referenced stablecoin issuers. They also argued the restriction could limit the sources of liquidity and diversification available to fiat-referenced stablecoin issuers, which may pose risks to both the stablecoin and traditional financial markets.

3.28 We received mixed feedback on the prospect of backing assets being held in a different currency from the denomination of the underlying fiat-referenced stablecoin. Roughly half of respondents argued that holding multiple currencies in the backing asset pool posed significant additional risk in terms of market and foreign exchange exposure so should not be permitted. Supportive respondents argued that permitting multiple currencies could reduce concentration risk and support the commercial viability of stablecoin issuers by providing additional revenue streams.

3.29 Most respondents agreed that issuers should be allowed to retain the revenue derived from the returns generated by the backing assets, as this is the main source of revenue. However, some respondents expressed concern about our proposal to disallow fiat-referenced stablecoin issuers from paying part of this income or interest to consumers. They argued that permitting issuers to distribute part of the revenue to consumers would encourage competition, create incentives for using stablecoins and improve consumer outcomes.

Our proposals

Composition of backing assets

3.30 In DP23/4, we proposed that issuers should secure their stablecoins with short-term cash deposits and government treasury debt instruments that mature in 1 year or less. Our position remains that the backing asset pool must be composed of assets that are low risk, secure and sufficiently liquid. They must facilitate smooth and timely redemption and be able to accommodate asset liquidations with minimal price impact.

3.31 By default, an issuer will only be able to hold 'core backing assets', comprised of short-term deposits and short-term government debt instruments. However, reflecting on the feedback to DP23/4, we will expand the range of permissible backing assets for qualifying stablecoins to additionally include:

- longer term government debt instruments that mature in over one year
- units in a Public Debt CNAV Money Market Fund (PDCNAV MMF)
- assets, rights or money held as a counterparty to a repurchase agreements or a reverse repurchase agreements (subject to conditions as set out in our rules in CASS 16)

3.32 Assets or money raised via entering to a repurchase or reverse repurchase agreement cannot be reused for other repurchase transactions or for other investments in the backing assets. Issuers are prevented from borrowing to raise funds in the backing asset pool except for where they enter into a repurchase transaction.

3.33 However, we propose that issuers wishing to include these 'expanded backing assets' must notify us of their intention to do so before expanding the backing asset pool, and make sure they have the right skills and competence to do this. Under our proposals, issuers will also be required to put in place appropriate backing asset risk management tools and comply with the backing assets composition ratio (BACR), as explained below.

3.34 We will not prescribe specific compositions of assets. Instead we will allow firms to determine their own compositions, based on factors including the redemption modelling they undertake on an ongoing basis. An appropriate backing asset composition will be driven in part by the maturity and liquidity of the underlying assets. This will be set against the requirement for firms to place a payment order for redeemed funds by the end of the business day following receipt of a valid redemption request (see section on 'Qualifying stablecoin redemption' below).

3.35 Finally, the proposals we are consulting on would not allow issuers to use backing assets that are not in the same denomination as the reference currency or currencies as the qualifying stablecoin. However, we recognise that supporting the appropriate use of foreign currency may allow issuers to serve customers in the UK and overseas more effectively. We are inviting views on how and whether risks could be effectively managed.

On-demand deposit requirement

3.36 We believe that all issuers should hold a minimum proportion of on-demand bank deposits as part of their backing pool. Even where the historic experience of a given coin only shows a relatively minimal level of redemptions. This is to avoid an issuer placing over-reliance upon immediate access to the markets (including where looking to sell short-term government debt).

3.37 We therefore propose to apply a minimum 'floor', known as the on-demand deposit requirement (ODDR), for the proportion of backing assets that must be held in bank deposits that are available on-demand. The ODDR is set at 5% and will apply to all stablecoin issuers - both those who only use core backing assets and those who opt-up to use expanded backing assets.

Using a wider range of backing assets

3.38 As outlined above, expanded backing assets will only be permissible to issuers that have sufficient systems and controls, skills and expertise in place to mitigate risk stemming from any expansion. Issuers will be required to notify the FCA of their intent to expand their backing asset pool beyond cash deposits and short-term government debt instruments. As part of the notification, they will need to attest to meeting additional qualitative and quantitative requirements set out below. Additionally, firms must continue to give regard to the prudential requirements outlined in CP25/15, particularly the minimum liquidity requirement for issuers, as holding longer-term government debt in the backing asset pool may result in increased highly liquid assets needing to be held by the issuer themselves.

Backing assets risk management

3.39 The business model of an issuer will hold inherent liquidity risk due to differences in asset liability mismatches leading to funding risks. While these risks are still present when only holding a narrow range of backing assets, these are increased with expanded backing assets. We have considered what governance and procedures an issuer should have in place. We consider a robust risk management framework for the backing assets, which would include liquidity planning, a crucial element to operating a successful and well-managed stablecoin.

3.40 The scale and complexity of the risk management should be proportional to the risks posed. This risk management framework should cover strategies, policies, processes and systems that enable it to identify, measure, manage and monitor risks in the backing pool. These would need to be clearly documented and owned by the governing body of the issuer. Our proposed rules would require issuers to incorporate the following into their backing asset risk management framework: a liquidity risk management policy, a contingency funding plan and a custody policy.

3.41 The liquidity risk management policy should include the issuer's risk appetite, any limits, and select drivers of risk for monitoring liquidity positions, needs and availability of the backing assets. This should have a focus on meeting potential redemption requests by holders and be linked to the backing asset composition ratio (BACR), which is explained in the following sub-section. Firms should also consider relevant stress scenarios and how this may impact liquidity needs at any given point.

3.42 While the broader liquidity risk management policy should provide common expectations on day-to-day liquidity management, firms should also have regard to contingency funding arrangements in events where the firm no longer has liquid assets available to meet its ongoing obligations. The purpose of the contingency funding plan (CFP) would be to set out adequate strategies and proper implementation measures on how additional liquidity would be sourced for meeting redemption needs. This should be for both on-going compliance with BACR requirements and in wider stress events. Given the dynamic nature of a firm's liquidity and funding sources the CFP should be subject to at least annual testing and review by the firms governing body. The plan should cover a range of different stress events and how the issuer may survive them – especially given that the issuer's own financial resources will need to be deployed to allow the backing pool to support redemption at par if needed.

3.43 A custody policy must ensure that there is prompt access to the backing assets as part of the arrangements with third parties. Additionally, concentration of backing assets should be avoided where possible, and issuers should have policies in place that ensure a prudent diversification of custodians. This should be considered alongside the general concentration risk monitoring obligation under our CRYPTOPRU proposals covered in CP25/15.

Backing Asset Composition Ratio (BACR)

3.44 The backing asset composition ratio (BACR) is only applicable to issuers that intend to utilise expanded backing assets (see paragraph 3.33). As set out above, such firms must notify the FCA of their intent to do this, before they do so. This requirement is supplementary to a firm's overall backing asset risk management framework.

3.45 The aim of the BACR is to help ensure that, where an issuer has opted to use expanded assets, there is still sufficient liquidity in the backing pool to meet redemption requests within the timeframes proposed under our CRYPTO 2 rules. It also helps to minimise the need for forced sale of assets under stress. There is a risk that firms could seek to maximise revenues from the returns of investing in expanded backing assets over more prudent risk management. The BACR helps to avoid this conflict by introducing a minimum composition which must be in core backing assets. The BACR must be met alongside the ODDR for firms using expanded backing assets (see paragraphs 3.67-3.69 below on the interaction of the BACR with the ODDR for how this would operate).

3.46 We recognise that the amount of immediate access to cash or other liquid assets an individual issuer may need to hold for any given coin will vary. This is reflected in the varied proportions of both cash and short-term government debt held among coins we have observed in the market to date. The extent to which an issuer will be exposed to asset-liquidity mismatches should be driven by their individual understanding of redemptions needs. Therefore, apart from the ODDR (see above) we are not intending to set a fixed, minimum percentage of core backing assets that must be held within each backing pool. Instead, where a firm opts-up to use expanded backing assets we propose a more dynamic measure, the BACR. Under which an issuer will calculate the minimum proportion of the total backing pool that needs to be held in core backing assets for any individual coin issuance.

3.47 The intention is that core backing assets should be sufficiently liquid to meet redemptions within the T+1 timeframe. Accordingly, in this context, short term deposits must be repayable on demand or have an immediate break clause attached to them. Issuers should ensure that they manage the portion of government debt instruments used to meet the BACR in a way that meets their redemption obligations.

Calculating the BACR

3.48 The risk of not meeting redemptions is best mitigated through effective management by the issuer, especially when using expanded backing assets. The BACR underpins this, through calculating an individual regulatory minimum on the composition of backing assets that must be held in core backing assets for any given coin. This is necessary given our proposed permissive approach to extending the range of backing assets (compared to DP23/4). And reflects the importance of meeting redemptions and therefore maintains confidence in the stablecoin.

3.49 The BACR makes use of the issuer's own estimates of gross daily redemptions over the near term, and how actual redemptions then subsequently compare to those. The issuer must be able to settle its peak estimation for redemptions as they occur. We considered what data points we could reasonably expect an issuer to have that would provide an understanding of the drivers of redemptions. We believe that the occurrence of both significant (in relative terms) and frequent under-estimations of redemptions are important inputs in helping to address the risk. These are all indicators that management should be considering as part of their daily business in operating a stablecoin. Together they will help determine the proportion of core backing assets that may be needed to be held to protect against higher levels of redemptions.

3.50 It is possible for an issuer to choose to be open to process redemption requests on what might otherwise be deemed a non-business day (eg on a Saturday or Sunday). Therefore, for the purposes of the BACR, we have introduced the concept of a 'redemption day' as a proposed defined term. This covers both business days and any other day of the year on which the issuer completes or proposes to complete redemptions as set out in its liquidity risk management policy. Note that where a firm chooses only to complete redemptions on a business day then in practice its redemption days will only comprise of business days.

3.51 We propose that the BACR is calculated as:

- the sum of:
  - the peak estimated daily redemption amount (DRA) (see paragraph 3.54); and
  - a 'core backing asset requirement' (CBAR) (which takes account of the variance between estimated and actual redemptions – see paragraph 3.56)
- divided by the total value of assets in the backing pool, and then expressed as a percentage.

3.52 This will arrive at a minimum proportion of the backing asset pool that an issuer will need to hold as core backing assets for any given coin.

3.53 The BACR must be calculated periodically, which we propose would be every 14 redemption days. This is to match the required estimation period outlined below. This will ensure that it is kept up to date, but without requiring more frequent rebalancing of the composition of the backing pool which could otherwise occur if there was a shorter period between calculations.

The peak estimated daily redemption amount

3.54 To perform the calculation issuers must estimate the DRA for each of the next 14 redemption days. The peak estimated DRA would be the highest amount in this period.

3.55 We take the view that a 14-day estimation period strikes the correct balance between providing a realistic forward horizon while minimising the burden of these requirements. We welcome feedback on the suitable length of the estimation horizon.

The core backing asset requirement (CBAR)

3.56 The CBAR component of the BACR requires issuers to subtract their estimated DRA from actual DRA that occurred for each day over a 180-redemption day preceding period. And identify the maximum absolute daily error across those 180 days, which is the largest positive value (for actual DRA less forecast DRA).

3.57 The required data will be built over time by the 14 redemption day DRA estimates (as outlined above) and the issuer's daily record of the actual DRA subsequently experienced. We believe that 180 business days is an appropriate observation period, to take account of actual experience while not placing reliance on past events for too long.

3.58 The greater the extent of poor experience where actual redemptions exceed expected redemptions, the less confidence there may be that holding an amount of core backing assets of no more than the peak estimated DRA will prove sufficient. We therefore propose to increase the CBAR through an 'error addend'. The error addend is based on the number of errors in daily estimates over the preceding 180 redemption days. However, we recognise that arriving at estimations will not be exact, and that it would not be appropriate to count days where only relatively minor errors occur. To address this, we introduce the concept of a 'qualifying error'. The error addend will only count qualifying errors, which is where the actual DRA is at least 110% of the forecast DRA.

3.59 In summary, the CBAR is determined as the maximum absolute error multiplied by an error addend. The full details of the calculation are set out in the detailed rule proposals in Appendix 1.

3.60 The following is a worked example of calculating the CBAR and its use in arriving at the BACR:

- Assume a coin with 100m in the backing pool. The issuer predicts a peak estimated redemption amount over the next 14 redemption days of 2m.
- Looking back over the past 180 redemption days, the maximum positive absolute daily error was 8m (eg actual redemptions of 10m compared to that day's estimate of 2m). And qualifying errors occurred on 45 of the 180 redemption days over the observation period.
- The CBAR = 14m (which is 8m x 1.75 as the error addend for 45 days).
- The BACR = 16% (which is the peak estimated DRA of 2m + the CBAR of 14m = 16m, divided by the backing pool of £100m, which equals 0.16 and is then expressed as a percentage = 16%

3.61 This means that in this example at least 16% of the backing pool must be held in core backing assets.

Issuers that have not built up 180 redemption days of data

3.62 We have considered the situation of where an issuer has not yet built up 180 redemption days' worth of historic data for both forecast and actual DRA figures. To encourage new entrants while they gain experience, it should still be open to such a firm to opt-up to invest in assets beyond cash and or short-term gilts as part of their backing pool. In such cases however, we propose that the issuer be subject to an alternative set of requirements for the 180 redemption days following the opt-up.

3.63 For the first 90 redemption days following the opt up the issuer shall be restricted to holding only core backing assets in the backing pool. After which, from the 91st to the 180th days following the opt-up, the minimum proportion of core backing assets in the backing pool shall be calculated as the larger of:

- the BACR requirement but calculated with a modified error addend, where the number of qualifying errors that occurred in the days following the opt-up is multiplied by 180 divided by the number of days since the firm opted-up; and
- a given but reducing proportion, starting at 85% (of the pool) and which reduces by 15% every 14 redemption days (i.e. at each calculation date).

3.64 We would generally expect that an issuer would be collecting redemption data during the first 90 redemption days (during which only core backing assets may be held). And be able to include this data within the total number of redemption days until it reaches 180 redemption days. From the 180th redemption day following the opt-up the standard BACR requirement will apply.

3.65 Further detail on the requirement for issuers that opt-up but do not have 180 days of data can be found in our proposed rules (Appendix 1).

BACR breach

3.66 If an issuer ceases to meet the BACR or alternative requirement, it must promptly notify the FCA of the breach and submit an action plan to achieve compliance within 1 business day of the notification. The action plan should outline the steps the issuer intends to take to meet the BACR or alternative requirement as soon as reasonably possible.

Interaction of the BACR with the ODDR

3.67 All issuers must satisfy the ODDR. Those who opt-up to use expanded backing assets must also satisfy the BACR.

3.68 The ODDR must be met through holding on demand bank deposits. These bank deposits count as core backing assets. We propose that issuers will be allowed to also count them simultaneously towards meeting the ODDR and the BACR. Where the BACR is higher than the ODDR percentage, the issuer must then hold further core backing assets – which may comprise additional bank deposits or short-term government debt - to meet the BACR.

3.69 The following is an example of the interaction of the BACR with the ODDR for an issuer that uses expanded backing assets:

- Assume an issuer has calculated a BCAR of 16%, which means that 16% of backing assets must be held as core backing assets.
- The issuer must satisfy the ODDR, by ensuring that (at least) 5% of the backing assets are held as on-demand bank deposits.
- The issuer also needs to hold an additional amount of 11% of core backing assets, to ensure it meets its minimum BACR of 16%. It may do this through holding further amounts in on-demand bank accounts and/or by holding short-term government debt.

Remuneration

3.70 Our position from DP 23/4 remains unchanged regarding the ability for issuers to retain but not to pass down interest, or other benefits (eg dividends) from the backing asset pool directly or indirectly to consumers. For example, issuers that make interest from the backing asset pool also must not pass the interest revenue to a third party and then onto consumers.

3.71 As outlined in this CP, it is important that qualifying stablecoins are treated as a money-like instrument and not as investments. We believe that passing down interest from the backing asset pool will blur this line from both a legal and regulatory perspective.

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

Question 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.**

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

Question 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?**

Safeguarding qualifying stablecoin backing assets

3.72 We want to make sure that qualifying stablecoins are always fully backed so stablecoins can be redeemed in a timely manner.

3.73 A mismatch could arise between the backing assets and the qualifying stablecoins that have been minted. This could occur if, for example, the value of the backing assets falls, technology errors occur, there is internal or external fraud, extended lags in payment timings or a third party holding the backing assets fails. Additionally, this could lead to a 'run' on the stablecoin causing the secondary market value to further decrease and result in consumer losses and disruption in both the cryptoasset and traditional finance markets.

3.74 To address these risks of harm, we have proposed rules for the safeguarding of qualifying stablecoin backing assets which build on our Client Assets regime (CASS). These rules aim to make sure an issuer takes appropriate measures to protect backing assets when it is responsible for them and allow for the assets to be returned as quickly and as whole as possible if the issuer enters an insolvency process.

3.75 We plan to consult separately on proposals for managing cryptoasset firm failure, including qualifying stablecoin issuers, in line with our Crypto Roadmap.

DP23/4 responses

3.76 In DP23/4 we proposed several approaches to achieve an effective safeguarding regime. This included requiring a statutory trust for backing assets, full 1-to-1 backing of the qualifying stablecoin at all times, daily reconciliations and the appointment of a CASS oversight officer. We also outlined two possible models for how the backing assets of a qualifying stablecoin could be safeguarded, which we revisit in paragraph 3.91. We asked for feedback on these proposals, in particular on the feasibility and suitability of the requirements.

3.77 Respondents generally agreed that a statutory trust requirement would help protect backing assets, particularly upon issuer failure. Some respondents were concerned that this would not align with FCA requirements for e-money issuers and that it could present complexities for issuers. For example, being both the trustee and beneficiary where they hold their own qualifying stablecoins.

3.78 Most respondents agreed that issuers should fully back all qualifying stablecoins they mint. Those that disagreed felt that an issuer minting stablecoins before public issuance (without the requirement to back them) was integral to operational efficiency - some respondents suggested alternatives to our proposed approach which allowed for partial backing.

3.79 On the proposed models for safeguarding qualifying stablecoin backing assets, respondents were generally supportive of an issuer appointing an independent custodian but were not in favour of making it a mandatory requirement. They stated that issuers should be able to decide the most appropriate way to safeguard backing assets and an independent third-party custodian may not always be the best option, as it could give rise to counterparty risk. Respondents also noted concentration risk in the event of firm failure, if a small number of custodians were safeguarding backing assets for a large portion of the market. They suggested that regulated issuers could partner with multiple independent custodians to address this risk.

3.80 On the requirement to perform daily reconciliations, respondents were concerned that it could result in the unnecessary capture of market noise in the fluctuations of circulating stablecoin quantities. A few respondents suggested that issuers could face large costs with minimal benefits. Other respondents requested guidance on our expectations for both internal and external reconciliations. On the requirement to remove excesses from the backing asset pool by T+1, respondents agreed with the risk of over collateralising the backing assets but noted it could have an impact on liquidity and there may be a potential cost burden on issuers.

3.81 Respondents broadly supported our proposed oversight measures. For example, a requirement for issuers to appoint a CASS oversight officer, conduct a client asset audit and to submit a CMAR-type regulatory report to us. They were particularly supportive of an annual CASS audit, and some stressed the importance of more regular disclosures to regulators in the form of a CMAR regulatory return, citing the benefits of disclosure for transparency and confidence for consumers.

Our proposals

Segregation and the statutory trust

3.82 We proposed in DP23/4 that an effective safeguarding regime needs to be based on segregating client assets from an issuer's own assets and holding them on trust for the benefit of qualifying stablecoin holders.

3.83 We have considered the feedback and continue to propose that backing assets are held in a statutory trust for the benefit of qualifying stablecoin holders. This is to help ensure qualifying stablecoins are always fully backed, providing a level of protection for stablecoin holders. We are proposing rules for the trust to help distinguish between an issuer's obligations and the rights of any stablecoin holder (which might include the issuer themselves).

3.84 We are proposing that the backing assets will be held by the issuer subject to a statutory trust on the following terms:

- for the purposes of the backing asset rules which set out the safeguarding regime; and
- for the holders of a qualifying stablecoin, according to their respective interests in it.

3.85 We will consult on distribution rules in a later consultation as set out in our Crypto Roadmap.

3.86 The trust seeks to provide protection for stablecoin holders, who would be the principal beneficiaries. As a trustee, the issuer would have well established fiduciary duties, such as acting in the best interests of the beneficiaries. This could be particularly important if an issuer experienced financial difficulties as it should protect and ringfence the assets held on trust from being subject to creditor claims or from being used for the issuer's own interests.

3.87 If an issuer issues more than one qualifying stablecoin product, we propose that they must ensure that the backing assets for each stablecoin product are held separately and under separate trusts for the benefit of each separate group of stablecoin holders for each corresponding qualifying stablecoin pool. This is to prevent co-mingling of backing asset pools across different qualifying stablecoin products and to minimise contagion risk which could arise due to a lack of clarity on what assets are held to whose benefit if several backing pools were combined. There may also be circumstances where an issuer issues more than one qualifying stablecoin and one is more popular, resulting in the less favoured qualifying stablecoin being more expensive to maintain. This segregation requirement seeks to mitigate such risks.

3.88 Issuers may mint and hold their own qualifying stablecoins. These qualifying stablecoins are fungible with other issued qualifying stablecoins. We proposed in the DP that issuers would also be required to back these stablecoins in the same way as they would any other minted qualifying stablecoins. This would help to ensure that, in the case of a hack, unbacked qualifying stablecoins do not make their way into the cryptoasset ecosystem.

3.89 Minting qualifying stablecoins prior to public issue can provide operational efficiencies. We do not propose to restrict this practice. However, we want to mitigate the risk of harm of unbacked qualifying stablecoins being released into the cryptoasset ecosystem. Specifically, that the qualifying stablecoins in issuance exceed the value of backing assets such that the one to one backing (eg the peg) is not maintained, hence the qualifying stablecoin's value is diluted and holders may not be able to redeem at par. So we are continuing to propose that all minted qualifying stablecoins must be fully backed, including those held by the issuer for their own benefit. Additionally, where an issuer is also a custodian and holds its own qualifying stablecoins for its own use, we would expect these to be held in a wallet segregated from client qualifying stablecoins in line with our cryptoasset custody segregation requirements. We detail this in Chapter 4.

3.90 There may also be circumstances where an issuer is holding unbacked qualifying stablecoins because they have been redeemed. In these circumstances, we propose that qualifying stablecoin issuers must either re-back those qualifying stablecoins or burn them within 24 hours.

Question 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.

Question 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.

Requiring an unconnected third party to safeguard qualifying stablecoin backing assets

3.91 In DP23/4, we set out two models for how an issuer could safeguard qualifying stablecoin backing assets. The first is where the issuer appoints a third party (eg a credit institution or a custodian) to hold those assets, but the issuer continues to be legally responsible for making sure those assets are safeguarded appropriately. The second is where the issuer appoints an independent institution to take on the safeguarding responsibility and day-to-day administration of the qualifying stablecoin backing assets (ie, an independent custodian). In this model, the independent custodian would be legally responsible for making sure those assets are safeguarded appropriately. This is similar to the independent depositary model that exists for regulated funds.

3.92 We have considered the feedback on this proposal, and the possible implications requiring an independent custodian would have on an issuer's ability to meet our other requirements for the backing asset pool. We are now proposing that an issuer must appoint third parties which are unconnected to the issuer, or any of the issuer's group to safeguard backing assets. This proposal differs from the independent custodian model in that the issuer would, as trustee, remain legally responsible for the backing assets, including addressing discrepancies and managing redemption requests for stablecoin holders.

3.93 This proposal seeks to proportionately manage the risk of harm from group conflicts of interest, reducing the possibility of fraud or misuse, particularly if the issuer's group is experiencing financial difficulties. This would also limit intra-group contagion risk and potentially enable the qualifying stablecoin to continue should the issuer or its group fail. However, there are trade-offs where the reduction in certain risks could introduce others, such as wider contagion risk if there are a small number of third parties offering these services. We do not propose to restrict the number of third parties who the issuer may choose to appoint to safeguard the backing asset pool.

3.94 In selecting third parties to hold backing assets or funds, we propose the following requirements for qualifying stablecoin issuers, in line with existing CASS requirements:

- exercise all due skill, care and diligence in their selection of third parties that safeguard the backing assets.
- make sure terms are included in the written agreement with those third parties on the provision of information to enable the issuer to comply with our proposed rules (particularly in relation to reconciliations).

- regularly review its arrangements with those third parties.
- periodically review whether it is appropriate to diversify (or further diversify) the third parties it has appointed to safeguard the backing assets.
- keep records on these appointments and any periodic reviews.

3.95 We propose that issuers get signed acknowledgment letters from each appointed third party, acknowledging that safeguarded qualifying backing assets are held on trust for the benefit of stablecoin holders (rather than for their client, the issuer acting as trustee). This provides an additional layer of protection for stablecoin holders.

Question 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?**

Question 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?**

Record-keeping and reconciliations

3.96 Accurate books and records are essential to make sure an issuer is holding the correct amount of qualifying stablecoin backing assets for all the qualifying stablecoins which have been minted. These records can help to reduce opportunities for fraud, misuse and loss of backing assets, in turn providing greater confidence to stablecoin holders and the financial markets that the stablecoin remains fully backed.

3.97 Reconciliations compare records to ensure their accuracy, and to identify and resolve any discrepancies. Unlike in traditional finance, an issuer, or a third party holding qualifying stablecoin backing assets, will not necessarily know who owns each coin. So, we propose that issuers record the number of qualifying stablecoins minted rather than keep a client-specific record. To conduct a reconciliation, the issuer would compare their internal records of the number of qualifying stablecoins minted against the value of qualifying stablecoin backing assets and against the records of all third parties with whom the qualifying stablecoin backing assets are being held.

3.98 In the DP we considered the following requirements for issuers on at least a daily basis:

- conduct internal and external reconciliations.
- validate whether the expected number of qualifying stablecoins minted was accurately reflected on the blockchain(s) or other DLT used to issue the coins.
- to value the backing assets in the reference currency.

3.99 We consider the benefits of daily reconciliations to outweigh any concerns raised in responses (as outlined in paragraph 3.80). So we are continuing to propose at least daily reconciliations. This will ensure the backing assets held for a qualifying stablecoin accurately reflect the reference value of the amount minted. We would expect that depending on the backing asset composition, if there is significant market volatility where the backing asset pool is exposed, issuers should reconcile more frequently. We also propose that an issuer must:

- keep records it needs so that it can promptly distinguish the total amount of backing assets it should be holding relative to the qualifying stablecoins minted.
- conduct and record daily valuations of the backing asset pool (using an appropriate market value) in the reference currency to which the qualifying stablecoin is pegged.
- maintain records that are accurate at all times and set out all activity relating to the backing asset pool, including records on the changing daily valuations of the backing assets, to enable verification of the value of backing asset pool.

3.100 An issuer may engage several third parties to hold different components of the backing asset pool. For example, a credit institution to hold deposits, and a custodian to hold assets. In these scenarios, we would expect all third parties appointed to be unconnected to the issuer and the issuer's group. However, those third parties could be connected to each other. When appointing multiple third parties, the issuer would need to make sure any appointment allows them to meet the record-keeping and reconciliation requirements above. For example, by ensuring the provision of information between parties at least daily.

3.101 These proposals can provide greater certainty that a qualifying stablecoin remains backed one to one, in turn supporting consumer confidence and market integrity.

Addressing discrepancies: removing excesses

3.102 A reconciliation by the issuer may identify that the backing assets are greater in value than required. In this scenario, we proposed that any excess or growth in the value of the backing asset pool should not be passed on to stablecoin holders but instead retained by the issuer as their own assets. This would require transferring any excess from the relevant backing asset account to the issuer's own accounts within 1 business day, and treating it as the issuer's own assets from that point.

3.103 This was to reduce the risk of polluting the backing asset pool. Comingling 'firm' and 'client' assets could potentially expose the backing assets to creditor claims in the event of issuer failure.

3.104 We consider the requirement to remove any excesses within 1 business day to be proportionate to the risk of harm. So we are continuing to propose that where an excess in the backing asset pool is identified, an issuer must arrange a transfer of the value of this excess to their own account promptly and at most within 1 business day. Or, address the excess by minting more qualifying stablecoin to match the value of the backing asset pool.

Addressing discrepancies: topping up shortfalls

3.105 A reconciliation may identify a shortfall in backing assets. In this case, we proposed in DP23/4 that issuers should 'top up' shortfalls within 1 business day from their own liquid resources. DP23/4 also considered a requirement to notify the FCA where there is an unresolvable shortfall to allow supervisors to engage directly with qualifying stablecoin issuers and identify an appropriate way to address the shortfall. Supervisors and the issuer could then work together to assess any appropriate market disclosure requirements (such as those proposed in DP24/4) for the shortfall on an ad hoc basis.

3.106 These proposals intended to address the following risks of harm related to unresolved shortfalls:

- Some holders may redeem their qualifying stablecoins from the issuer, withdrawing their full value from the backing asset pool. This could further concentrate the shortfall on a smaller number of holders ('first mover advantage').
- Should the market become aware of the shortfall, increased consumer concern about the status of the backing assets could create a 'run' on the qualifying stablecoin. This could lead to the issuer's failure if the issuer must deploy their own resources to offer par redemption.
- Issuers could take advantage of their knowledge of the shortfall and expectations around remedying it, at the expense of holders. For example, selling their own qualifying stablecoins on secondary markets at par value or buying up qualifying stablecoins at below par.

3.107 We acknowledge that our proposals address the risks of harm in different ways and by protecting against some risks, others may be exacerbated. The balance between these trade-offs will have to be assessed on a case-by-case basis by firms, depending on their circumstances. As a minimum, to protect the backing asset pool being complete and maintaining value with the qualifying stablecoins in issuance, we are continuing to propose that issuers must resolve shortfalls within one business day. If issuers are unable to do this, they must notify the FCA the following business day.

Question 11: **Do you agree with our proposals for record keeping and reconciliations?**

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

CASS oversight officer, client assets audit and reporting

3.108 In DP23/4, we proposed requirements for a stablecoin issuer to appoint a CASS oversight officer, conduct a client asset audit and submit a Client Money and Assets Return (CMAR) regulatory return to the FCA. These proposals are in line with the approach taken in traditional finance.

3.109 We are looking to implement these proposals, and will consult on rules relating to a CASS oversight officer and client assets audit in the conduct of business and firm standards consultation paper. Reporting will be consulted on in the trading platforms, intermediation, lending and staking consultation paper.

Qualifying stablecoin redemption

3.110 Redemption is the process by which a holder of a qualifying stablecoin can return it to the issuer in exchange for fiat currency. The process of executing a redemption starts from the point at which the holder makes a formal request to redeem their qualifying stablecoin with the issuer, to the point at which a payment order for the redeemed stablecoins has successfully been submitted to the holder's desired account (eg a bank or payment account).

3.111 The ability to redeem a qualifying stablecoin at par value regardless of the performance of the backing asset pool is a key principle. It ensures the value of qualifying stablecoins held by customers is maintained, and qualifying stablecoins are treated as money-like instruments rather than funds. A clear right to redemption is likely to support stability and confidence in the qualifying stablecoin and the wider market.

3.112 We propose to require issuers to:

- redeem qualifying stablecoin of any amount by placing a payment order for redeemed funds within one business day of receiving a valid redemption request.
- return funds to the holder equivalent to the reference value of the qualifying stablecoins being redeemed.
- provide holders with the right to redeem in the same currency as that to which the qualifying stablecoin is referenced.
- ensure that any fees charged for redemption are commensurate with the costs incurred for executing redemption requests and are never greater than the value of qualifying stablecoins being redeemed. We intend to consult on the application of the Consumer Duty, including the Price and Value Outcome, in our 'Conduct and Firm Standards' CP as set out in the Crypto Roadmap.

DP23/4 responses

3.113 In DP23/4, we set out our proposed approach towards redeeming qualifying stablecoins. We asked respondents to consider if there were any operational challenges to redemption by the end of the business day, outsourcing of redemption, restrictions to redemption and costs of this function.

3.114 While most respondents supported the broader framework and the principles behind our approach, and recognised the importance of timely redemption at par, they were concerned with some of our proposals.

3.115 In particular, many respondents were concerned with the requirement for issuers to redeem directly to stablecoin holders by the end of the next business day. These respondents argued that this may be operationally impractical and would create excessive burden on issuers, particularly under stressed market conditions. They also suggested that the proposal did not account for varying business models, such as those with overseas operations, and dependencies on a variety of different payment rail systems with varying timelines for settlement. Our proposals below have considered this feedback, including the elements of a redemption process that are within the issuer's control, and scenarios where it may be legitimate for redemption to be carried out within a different timeframe.

3.116 Some respondents, however, argued that redemption by the end of the next business day would be feasible where an issuer's pool of backing assets is appropriately liquid. They also pointed to the UK's Faster Payments Service as an example of real time payments being made with funds becoming available almost immediately.

3.117 Most respondents believed that issuers should be able to involve a third party in delivering redemption. It was suggested that using outsourcing and third parties can improve efficiency and reliability, and this would be in line with current business models in both the cryptoasset industry and comparable activities in traditional finance.

3.118 On restrictions to redemption, some respondents suggested that we allow issuers to gate redemptions under certain circumstances, similar to how gating and fund suspensions are permitted for certain investment funds during adverse market conditions. It was argued that gating redemptions would allow for the orderly liquidation of assets and support an issuer's ability to redeem at par and prevent a run on a stablecoin.

Our proposals

Offering redemption at par value for all holders

3.119 We propose to require issuers to provide holders with the right to redeem qualifying stablecoins at par value with the reference currency, irrespective of the value of the backing assets portfolio, with a payment order placed to an account in the name of the holder at the latest by the end of the business day following receipt of a valid request.

3.120 A redemption request would be valid when the following conditions are met:

- it is made by the holder of a qualifying stablecoin or an agent acting on behalf of a holder as principal.
- it is made in a manner which meets any terms and conditions set out between the issuer and the holder. This may include a requirement for the qualifying stablecoins being redeemed to be received by the issuer before a redemption is processed.
- the issuer has received any information required from the holder to meet any obligations under financial crime legislation (see 3.140 below).

3.121 We recognise that there may be legitimate reasons for the time limits for redemption to be breached. We propose to disapply the 'next business day' requirement in the following circumstances:

- Where the completion of the redemption request by the end of the next business day would breach a legal requirement or court order. For example, this would include where the firm reasonably suspects that a redemption would breach requirements under financial crime legislation (see paragraph 3.143 below).

- Where the holder requests redemption in a currency other than the reference currency of the qualifying stablecoin, if the currency exchange required would take longer than executing a redemption in the reference currency. In these cases, we are proposing to require the issuer to have made clear the likely timeframe within which the redemption request will be executed, at the point at which the holder enquires about redemption.

3.122 Under these proposals, it will be a breach of our rules should an issuer fail to meet the requirement to place a payment order to an account in the name of the holder by the end of the business day following receipt of a valid redemption request.

3.123 We propose to require issuers to make sure appropriate information is provided to holders when they enquire about redemption and before any request is executed. This includes:

- information on the payment methods available to the holder for receipt of their redeemed funds.
- the likely timeframes within which redemption will be completed using these payment methods.

3.124 This information will ensure holders are able to make informed choices on payment methods by making clear when they can expect to receive the monetary value of the qualifying stablecoin.

3.125 We would require issuers not to impose conditions for redemption that are onerous or difficult for a holder to meet, such as requirements to hold an account with a particular UK bank.

3.126 We propose that issuers must make sure there is a contract between qualifying stablecoin holders and the issuer which clearly states the conditions of redemption. This would include a condition that the issuer may charge a fee for redemption, where applicable.

3.127 When a qualifying stablecoin is transferred from one holder to another, it is important that the right to redeem the stablecoin at par value, and the other contractual obligations that the issuer owes to the holder, are effectively transferred in law to the new holder along with the qualifying stablecoin. We are seeking views on how issuers may meet this requirement, including where qualifying stablecoins are transferred between holders on the secondary market.

3.128 Holders of qualifying stablecoins should be able to promptly receive funds for their qualifying stablecoin with equal treatment regardless of use case. This aligns with our view that qualifying stablecoins should be treated like money-like instruments. We propose to require that the right to redeem qualifying stablecoin is available to all holders:

- at par value.
- regardless of whether the holder is a retail or non-retail client.
- whether or not the holder is based in the UK.

- in return for money, rather than other assets including other qualifying cryptoassets, to make sure that holders get the monetary value of the qualifying stablecoin.

3.129 We also propose to require redemption requests to be completed in an order that is fair and objective under normal circumstances. While we are not proposing to set a prescriptive order of redemption, holders of qualifying stablecoins should not be disadvantaged based on the type of holder they are or the size of their request.

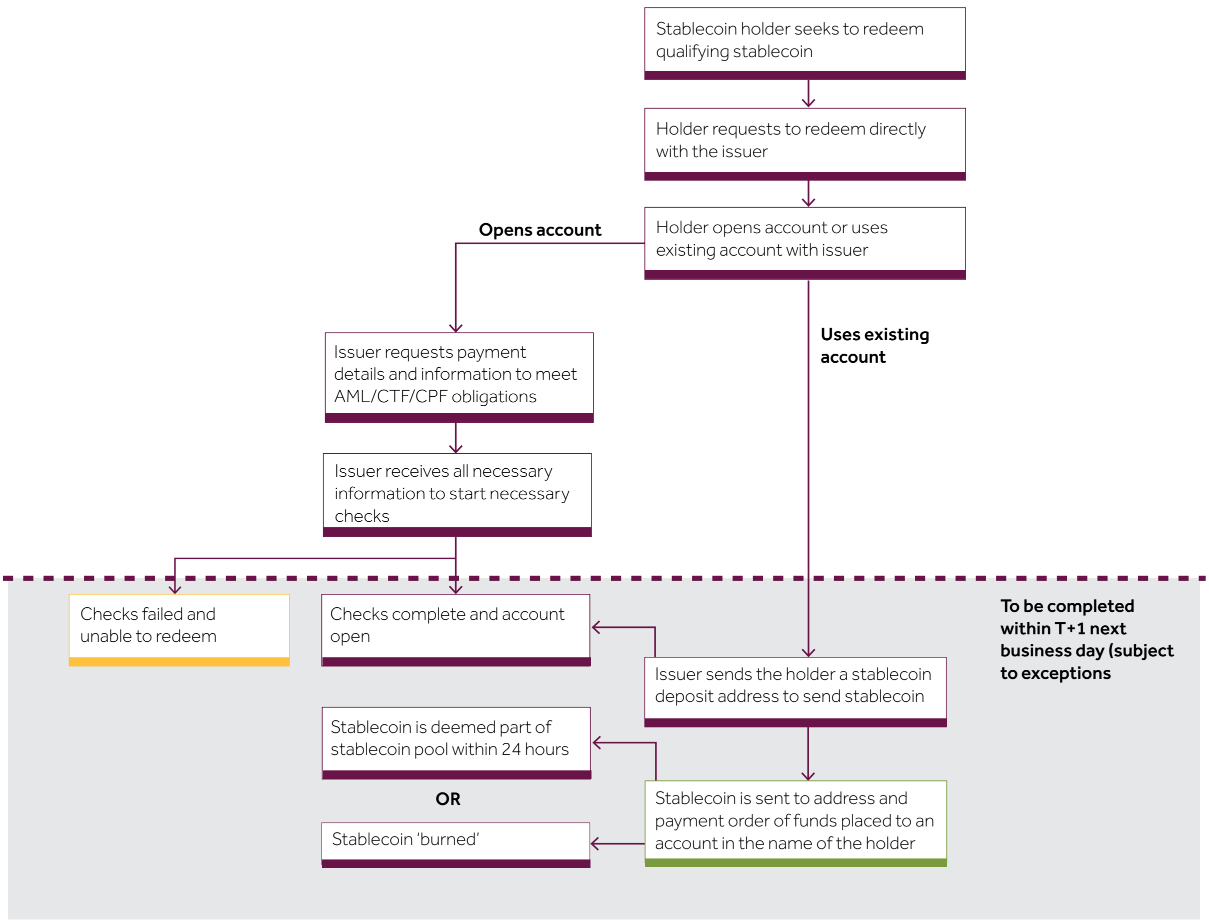
3.130 We recognise that issuers and third parties acting on their behalf may incur costs for executing redemptions, including network or transaction fees. To provide fair value to consumers and other holders of qualifying stablecoin, we propose to require that any fees charged for redemption are commensurate with the operational costs incurred by the redemption provider in respect of that redemption. To ensure that holders do not incur unnecessary costs when redeeming stablecoins, we propose that fees must not exceed the value of the stablecoins being redeemed, and issuers must not pass on any costs or losses arising from the sale of assets in the backing asset pool as a fee (for instance resulting from a bid-ask spread). This is important to ensure that qualifying stablecoins operate as money-like instruments. We will consult on how issuers may pay regard to the Price and Value Outcome under the Consumer Duty in later consultations.

3.131 Whether or not an issuer supports redemption in a currency other than the currency the qualifying stablecoin is referenced to is for the issuer to decide. However, we propose that holders of qualifying stablecoins must be offered redemption in the reference currency of the qualifying stablecoins, unless they explicitly request otherwise. Where redemptions are carried out in a currency other than the reference currency, an issuer may only disapply the requirement to place a payment order of redeemed funds by the end of the following business day if:

- the holder has requested that the redemption is made in a different currency; and
- the currency exchange required would take more time than meeting a request in the reference currency; and
- the firm has made the likely redemption timeline clear to the holder at the point at which the holder enquired about redemption.

3.132 We also propose that holders have a right to receive money in return for qualifying stablecoins they redeem, rather than other types of assets including other qualifying cryptoassets.

Figure 1: Qualifying stablecoin direct redemption process



Managing the backing asset pool following redemption

3.133 Where qualifying stablecoins are burned they should no longer be backed by an equivalent amount of assets in the backing asset pool. We are aware there are cost implications associated with a requirement to 'burn' all redeemed stablecoins, removing them permanently from circulation. We do not propose to mandate this burning process, allowing qualifying stablecoins to be 'reissued' by the issuer or third parties acting on their behalf.

3.134 Where qualifying stablecoins are not burned at the point of redemption, we propose that they must be included in pool of stablecoins which must be backed within 24 hours or must otherwise be burned. These proposals aim to maintain parity between the backing asset pool and qualifying stablecoins in circulation.

Exemptions for suspending or delaying redemption

3.135 Holders of qualifying stablecoin must have confidence in their continued ability to redeem at par value. However, there may be exceptional cases where an issuer needs to suspend or delay the right to redeem to avoid further harm. This could include the failure of the issuer or a third party, a technological problem with the underlying DLT, or a sudden loss of confidence in the qualifying stablecoin.

3.136 We propose that issuers must suspend all redemptions in exceptional circumstances which threaten the integrity of the qualifying stablecoin or the interests of holders, when the issuer has taken reasonable steps to avoid suspending redemption, and concludes that suspension is necessary to protect the rights of holders or the integrity of the stablecoin. Exceptional circumstances are likely to include:

- where there is a failure in the underlying distributed ledger technology or other infrastructure on which a qualifying stablecoin relies.
- the insolvency of the issuer.
- a sudden loss in confidence in the qualifying stablecoin such that an exceptionally high number by volume or value of redemption requests is received.

3.137 The suspension of trading of the stablecoin on a secondary market, in itself, is unlikely to represent an exceptional circumstance, unless this is also caused by a sudden loss of confidence in the qualifying stablecoin. This position reflects the importance of making sure redemption continues to be available, as far as possible, when secondary market trading is not available to a holder.

3.138 We propose that an issuer that temporarily suspends redemptions must notify us immediately of this, the period of time for which it anticipates that redemptions will be suspended, and the reason for the suspension.

3.139 Issuers will need to act promptly to make sure that redemptions can be resumed as quickly as possible, while ensuring the risk of subsequent harm has been reduced as far as possible. We propose that an issuer who has suspended redemption must:

- Notify us that it intends to restart redemption, with at least 5 working days' notice, unless otherwise agreed with the FCA. This notification must include the proposed date on which redemption will be restarted, and the actions that have been taken and will be taken to make sure the risk of additional harm is minimised
- Notify us again to confirm that redemption has restarted.

Complying with AML (Anti-Money Laundering), CTF (Counter-Terrorist Financing), and CPF (Counter-Proliferation Financing) obligations

3.140 Issuers will need to comply with relevant legal requirements under financial crime legislation, including but not limited to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ('MLRs'), the Terrorism Act 2000, and the Proceeds of Crime Act 2002. To meet the necessary anti-money laundering, counter-terrorist financing, and counter-proliferation financing obligations, issuers will need to have appropriate systems and controls for financial crime.

3.141 Accordingly, subject to finalised legislation, issuers will need to comply with relevant customer due diligence (CDD) requirements. For example, during customer onboarding and when a qualifying stablecoin is redeemed, including when the holder has acquired the qualifying stablecoin on the secondary market. Under financial crime legislation, an issuer will also be required to monitor its business relationships, and apply a risk-sensitive approach to maintain an accurate and up to date understanding of the stablecoin holder and associated risks.

3.142 Feedback to DP23/4 noted that some issuers may struggle to complete the required redemption process within 1 business day. In particular, where enhanced CDD (EDD) checks are required for holders seeking to redeem for the first time with the issuer. Issuers may need to gather the necessary, updated or additional information from holders. For example, when a stablecoin has been purchased from a party other than the issuer, or where the stablecoin was purchased from the issuer a significant time ago. To accommodate this process, we propose that the next business day redemption requirement should be calculated from the later of either the point at which the issuer has received a valid redemption request, or the point at which the issuer has received all information required for them to carry out CDD or EDD checks as required.

3.143 If a transaction or a redemption request has indicators of suspicious activity, linkages to money laundering, terrorist or proliferation financing, or other illicit activities, firms should follow relevant requirements in legislation, such as the Terrorism Act 2000 and the Proceeds of Crime Act 2002. As with other financial institutions, issuers or third parties will need to have the necessary systems in place to make reports to relevant law enforcement agencies and to comply with any legal directions on law enforcement action. We would expect issuers to ensure 1:1 backing is maintained while complying with orders or directions from law enforcement.

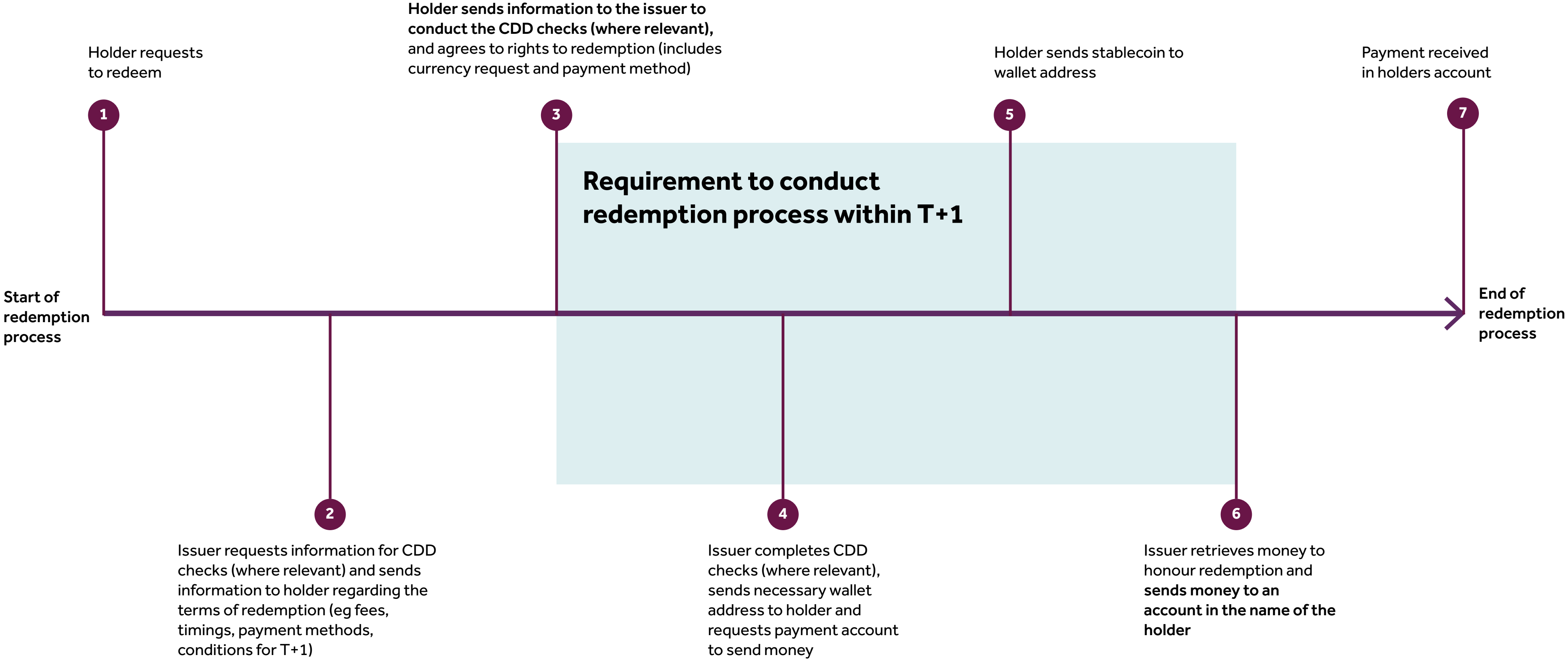
Question 13: **Do you agree with our proposed rules and guidance on redemption, such as the requirement for a payment order of redeemed funds to be placed by the end of the business day following a valid redemption request? If not, why not?**

Question 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?**

Figure 2: Qualifying stablecoin redemption timeline

*The process for redemption is for illustrative purposes only, some of the steps below could be taken in different orders

Conditions where T+1 may not need to be met:
- Where redemption has been suspended in an exceptional circumstance which threatens the rights of holders or the integrity of the stablecoin
- Where carrying out redemption would be in breach of financial crime obligations
- Where fulfilling a redemption request in a different currency, at the holder's request, would take longer than T+1



Using third parties to carry out certain elements of the regulated issuance activity

3.144 Many stablecoin issuers rely on third parties to carry out elements of the activity for which we are proposing requirements. Under our regime, qualifying stablecoin issuers may seek to use third parties to carry out elements of the issuance activity, which the third parties would then carry out on their behalf. We propose to allow such arrangements to support operational flexibility.

3.145 In all cases, we propose that the issuer will remain responsible for complying with all relevant regulatory requirements, and would be liable if something were to go wrong when a third party is acting on their behalf.

3.146 In our Handbook, general outsourcing rules and guidance are set out in our Senior Management Arrangements, Systems and Controls Sourcebook (SYSC). We intend to set out how SYSC applies to cryptoasset firms, including issuers, in our 'Conduct and Firm Standards' CP. Our proposals in this CP are separate from general outsourcing rules and guidance, and set specific requirements when an issuer uses a third party to carry out the core elements of issuing a qualifying stablecoin. This includes when an issuer uses a third party to sell qualifying stablecoins to holders, redeem qualifying stablecoins for holders, or manage qualifying stablecoin backing assets on behalf of the issuer.

3.147 In these cases, we propose rules in our CRYPTO 2 sourcebook which the issuer will need to comply with:

- The issuer must carry out due diligence on third parties before using them, taking reasonable steps to make sure any third party they appoint has sufficient experience and competence to carry on the activity.
- The issuer must have a contract with third parties that sets out clear roles and responsibilities between them and ensures sufficient information sharing arrangements to allow the issuer to comply with our rules.

3.148 These proposals are designed to ensure that the use of third parties under the issuance activity reduces the risk of harm to consumers and the integrity of the qualifying stablecoin.

3.149 We propose that the information sharing agreements set out in contracts must allow the issuer to receive and request necessary information. For example, when a third party redeems qualifying stablecoins on behalf of the issuer the issuer will need to receive information on the amount of stablecoins redeemed so that it can comply with proposed rules.

3.150 To ensure that the issuer's assessment of the third parties it uses remains accurate, we propose that the issuer must review their arrangements with third parties at least annually, and keep records of these reviews. Our proposals are intended to align with our separate requirements for the appointment of third parties to provide custody of stablecoin backing assets (see 3.94).

3.151 Issuers would not be limited to using authorised firms as third parties. However, depending on the activities third parties carry out on behalf of an issuer, they may be in scope of other regulated activities that require FCA authorisation. These may include, but are not limited to, safeguarding qualifying cryptoassets, dealing in qualifying cryptoassets, or arranging deals in qualifying cryptoassets.

3.152 In the sections below, we break down the specific considerations that the issuer would need to account for when third parties carry out different elements of the issuance activity.

Requirements when a third party sells qualifying stablecoins on behalf of the issuer

3.153 When third parties sell qualifying stablecoins on behalf of an issuer, we propose to require that the issuer receives incoming funds directly into an account in its own name. The arrangements with the third party must ensure that all proceeds from selling qualifying stablecoins are treated in this way, and that it does not receive any of the funds itself. This is to make sure counterparty risk is reduced as far as possible, and that backing assets are protected under the statutory trust of which the issuer is trustee.

Requirements when a third party redeems qualifying stablecoins on behalf of the issuer

3.154 It is common practice for stablecoin issuers to use third parties to carry out redemption on their behalf. Allowing these arrangements may support issuers in meeting our requirements to offer redemption at par to all holders. It is important that risk is effectively managed, and the use of third parties does not bring holders' rights to redeem into question. As above, the issuer would remain responsible for compliance with all redemption requirements.

3.155 In the contractual arrangements between the issuer and third parties, the third party would need to agree to provide information to the issuer on redemption amounts and volumes among other necessary information. This is to make sure the issuer has accurate, up to date information to comply with our rules.

3.156 While it may be appropriate to use third parties for redemption, the decision to suspend redemption should be reserved to the issuer. This is because of the significant effects suspending redemption can have on the rights of holders and potential impacts to the market. We propose that any suspension of redemption must be approved by the issuer, and that the issuer must report the suspension or delay to the FCA itself. Under our proposals, the issuer will be responsible for having a plan for resuming redemption approved by the FCA (see 3.138)

Requirements when a third party manages the backing asset pool on behalf of the issuer

3.157 Third parties may also manage the backing asset pool on behalf of the issuer. The contractual arrangements between the issuer and the third parties in these cases would need to set out how information should be shared with the issuer to allow it to comply with our requirements.

3.158 We propose that some aspects of this activity would need to be carried out by the issuer directly. In all cases the issuer would remain the trustee of the statutory trust over the backing asset pool. It would need to carry out the selection and appointment of unconnected third parties holding backing assets itself. In our view this is appropriate to ensure that these critical protections and responsibilities remain the role of the firm authorised to carry out the issuance activity.

Question 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?

Communicating information to consumers

3.159 The information that issuers publish or provide to holders, or potential holders, is key to equipping consumers with the information they need to make appropriate decisions.

3.160 We propose that issuers must publish and keep up to date information that will allow holders, or potential holders, to understand and make informed decisions when buying, selling, or requesting to redeem a qualifying stablecoin. In line with DP23/4, we propose that the information issuers must publish about their stablecoins under these rules must be clear, fair and not misleading.

3.161 We also intend to consult on other disclosure obligations for qualifying stablecoin issuers as part of our future CPs on 'Conduct and Firm Standards' and 'Admissions and Disclosures and Market Abuse'.

3.162 All information must be published online so that stablecoin holders, or potential holders, can find and access relevant information, regardless of how they come to acquire a qualifying stablecoin. Issuers may also wish to use additional communication channels to communicate information on their qualifying stablecoin to holders or potential holders. It is important that any way in which a holder, or potential holders, can acquire information on a qualifying stablecoin (for example directly with the issuer), they are always able to access it easily.

3.163 We propose to give issuers some choice around how to present the information that they must publish. An issuer may wish to use different forms of information to help support a reader's understanding such as infographics, illustrations or frequently asked questions (FAQs).

3.164 Alongside specific disclosures, issuers can choose to display more information. However, this should support a reader's understanding and not obscure the information that must be disclosed. This information may include how a qualifying stablecoin is removed from circulation, or risks and mitigations that could affect the stability of the qualifying stablecoin or the backing asset pool. However, information that must be published should be easy to locate and access, and should not be unnecessarily complex to understand.

3.165 Issuers will also need to consider and comply with other law that applies to their business, including existing consumer protection legislation such as the Consumer Rights Act 2015 (CRA). The CRA requires terms in consumer contracts and in consumer notices to be fair and transparent.

Disclosures on backing assets, redemption policies, and third parties acting on behalf of issuers

3.166 We believe that accurate and clear disclosures can build greater consumer and market trust in qualifying stablecoins. We propose that disclosures must be published online, at a minimum, for the public to access. Publishing this information can improve consumer and market confidence and allow holders or potential holders to make informed decisions.

3.167 This information should be up to date, and our baseline proposal is that information will need to be updated whenever it becomes inaccurate.

3.168 However, we recognise that some important information to communicate to consumers may change quickly, while other information will remain more static. For example, it may not be proportionate to update information on the number of stablecoins issued, or the size of the backing asset pool, every time a change occurs. To reflect how different sets of information may need to be updated at a different frequency, we are proposing requirements that set out information that must be updated whenever it becomes inaccurate, and other information that must be updated at least once in every three-month period.

3.169 While qualifying stablecoins that are minted but not yet in circulation may not be formally issued, minted stablecoins must still be accounted for in the backing assets (paragraph 3.89), and we propose that they must be reflected in public disclosures.

Information that must be updated when it becomes inaccurate

3.170 The information that will need to be updated whenever it becomes inaccurate includes:

- a description of the technology used for the qualifying stablecoin (eg the blockchain which the qualifying stablecoins is issued on).
- the potential fees for, and the steps involved in, processing a redemption request
- the names of any third parties who have arrangements with the issuer to carry on part of the issuing activity.
- the names of any firms who provide the issuer with a backing funds account or backing asset account.

3.171 Issuers must have systems in place to review and update this information as soon as reasonably practicable.

Information that must be updated at least once in every three-month period

3.172 The information that must be updated at least once in every three-month period includes:

- the value and percentage breakdown of the assets comprising the backing asset pool.
- the total number of stablecoins that have been minted and issued.
- a statement that confirms that the issuer is meeting the requirement for the stablecoin pool to be backed 1:1 by assets in the backing asset pool.

3.173 Issuers can choose to update this information more frequently, particularly if the information about the number of stablecoins or backing asset composition changes in a way that would assist a holder, or potential holders, or the market, to make better informed decisions. For example, this could be a substantial increase in the number of stablecoins (compared to the previously disclosed information) or a substantial shift in the composition of the backing assets over a short period of time.

Redemption information

3.174 As noted in paragraph 3.170, we propose that information on the redemption process must be included in public disclosures and updated whenever it becomes inaccurate. To make sure consumers and qualifying stablecoin holders fully understand their rights to redemption and the process of redemption, we propose that issuers must publish:

- an explanation of any redemption fee that may be payable by a holder, including how such a fee will be calculated.
- the steps that a holder must take to redeem the qualifying stablecoin, including a list of any information that a holder may be asked to provide as part of a redemption request.
- a summary of the steps that will be taken by the issuer or other parties involved in the redemption process following a request to redeem.
- the payment methods the issuer will make available for redemption.

The use of third parties

3.175 It must be clear to consumers and the market when a third party is carrying out elements of the issuance activity on behalf of a qualifying stablecoin issuer. As noted in paragraph 3.170, we propose that issuers must disclose to consumers and the market if any part of the issuance activity is being carried out by a third party on their behalf to differentiate from other activities carried out on the secondary market. This information must be updated whenever it becomes inaccurate.

Verification of the 1:1 ratio for stablecoins and backing assets

3.176 We also propose issuers undertake an independent review at least annually to verify that the statements made in the previous 12 months in relation to the 1:1 ratio between the stablecoin pool and the backing asset pool were accurate.

3.177 We propose that an individual who undertakes this review must be independent from the firm and have the following qualifications:

- the person is eligible for appointment as an auditor under chapters 1,2 and 6 of Part 42 of the Companies Act 2006.
- the person has otherwise been appointed as an auditor under another enactment, and the person meets the requirements for appointment under that enactment.
- if overseas, the person is eligible for appointment as an auditor under any applicable equivalent laws of that country or territory.

3.178 We propose that issuers must disclose:

- confirmation that the review took place.
- the name of the person who undertook the review and confirmation that they are independent and appropriately qualified.
- the overall outcome/findings of the review.
- the date when the independent review was conducted.

3.179 We propose that issuers will have discretion to undertake this independent review alongside, or as part of, any future proposed CASS audit requirements. We will set out how this proposed review will interact with any proposed CASS audit requirements in our CP on 'Conduct and Firm Standards'. However, issuers will need to make the outcome of the independent review publicly available.

Question 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?**

Question 17: **Do you agree with our proposals for disclosure requirements for qualifying stablecoin issuers? If not, why not?**

Chapter 4

Regulating custody of cryptoassets

4.1 This chapter sets out our approach to regulating the safeguarding of qualifying cryptoassets or their means of access, such as private keys. We are focusing on situations where a firm safeguards qualifying cryptoassets on behalf of their clients ('cryptoasset custody'). The draft statutory instrument prepared by the Treasury does not bring consumers holding cryptoassets directly ('self custody') within the regulatory perimeter of safeguarding qualifying cryptoassets.

4.2 The proposals in this chapter apply to a firm that is authorised to safeguard qualifying cryptoassets. Where firms are providing multiple services in addition to custody, such as operating a trading venue or staking, we will consider how the proposed rules in this chapter will interact with the rules for the other cryptoasset activities following feedback from the Discussion Paper (DP25/1). We will consult on the application of the rules set out in this chapter to firms which offer multiple cryptoasset services in the 'Trading platforms, intermediation, lending and staking' CP.

4.3 Specified investment cryptoassets, such as security tokens, may have features consistent with both traditional finance and cryptoassets. So, we also plan to consult on proposals relating to custody of these cryptoassets in the 'Trading platforms, intermediation, lending and staking' CP.

What is custody?

4.4 In financial services, the term 'custody' broadly refers to a firm holding an asset, such as a security or a contractually based investment, on behalf of another. In traditional finance, consumers and firms rely on custodians to access global markets and hold their assets to reduce the risk of loss. Our Client Assets regime, sets out detailed rules a firm must follow when it holds or controls client money or safeguards custody assets as part of its business, as set out in the Client Assets Sourcebook (CASS). These rules aim to make sure the custodian takes appropriate measures to protect its clients' assets when they are responsible for them. They also allow for the assets to be returned as quickly and as whole as possible to clients if the custodian enters insolvency. Throughout this chapter, we refer to 'clients' and 'client assets' to reflect both the existing CASS regime and our proposed regime for the custody of qualifying cryptoassets.

4.5 The CASS regime supports our statutory objectives and underpins Principle 10 of the Principles for Businesses, which requires firms to arrange adequate protection for client assets when they are responsible for them. Protecting client assets is fundamental to the trust that consumers place in firms; it is at the heart of ensuring a well-functioning and robust market.

What cryptoasset custody involves

4.6 There are a number of firms in the cryptoasset market offering custody services. This service allows access to, and provides storage of, assets that clients may feel custodians are better placed to safeguard. Custody of cryptoassets is conceptually similar to custody in traditional finance in that a custodian holds themselves out as being responsible for the safekeeping of an asset for a client. However, cryptoasset custody operates differently from traditional finance custody arrangements in some important ways:

- Cryptoasset custody involves taking control over a client's cryptoassets, often by holding or storing the means of access to the cryptoasset, namely a private key used to access those qualifying cryptoassets.
- In traditional finance, external third parties such as central securities depositories, register the ownership of assets, enabling the verification of ownership of these assets. There are no external third parties that verify the ownership of qualifying cryptoassets in the same way, which along with the fungibility of qualifying cryptoassets, can make determining and evidencing clients' ownership rights legally challenging.

4.7 Cryptoasset firms are often vertically integrated, providing custody alongside other services, such as operating as a trading platform (ie exchange) and lending. 72% of cryptoasset users in the YouGov survey (2024) said they store their cryptoasset with the exchange they bought it from. This is an increase from 59% in 2021 and 69% in 2022. This makes determining exactly when a custody service starts and finishes particularly important and challenging. This differs from traditional finance custody, whereby such services are not typically vertically integrated.

4.8 The generally irreversible, immutable nature of cryptoasset transactions contained in 'finalised blocks' makes the role of custodians in protecting against unauthorised access to private keys especially important.

4.9 There are a variety of business models emerging for cryptoasset custody. We want to develop a suitable framework which accounts for different business models now and in the future.

4.10 Considering these differences, the Treasury has proposed a definition of the regulated activity of safeguarding qualifying cryptoassets and specified investment cryptoassets in the draft Regulated Activities Order that consists of the following concepts:

- Control of the cryptoasset on behalf of another, which allows the qualifying cryptoasset custodian, through any means, to bring about a transfer of the benefit of the cryptoasset to another person. This can include:
  - holding or storing the means of access, or part of the means of access (including a private cryptographic key)
  - appointing one or more other persons to hold or store the means of access, or part of the means of access, to the cryptoasset

- 'On behalf of another' includes where the client:
  - has both legal and beneficial title
  - holds the beneficial title only; or
  - has a right against the firm for the return of a qualifying cryptoasset or relevant specified investment cryptoasset

4.11 This definition seeks to address not only the differing nature of cryptoasset custody (for example, including the concept of private keys), but also the challenges in determining ownership rights in this space. The definition achieves this by including when assets are held *on behalf* of clients, rather than only where assets belong to clients, which is the position in Article 40 RAO for traditional finance custody. This has shaped our proposed regulatory approach, detailed below.

What happens if a qualifying cryptoasset custodian fails?

4.12 In DP23/4 we set out the risks of harm if a qualifying cryptoasset custodian were to fail in the absence of a clear regulatory framework. These risks include delays in the return of assets, extra costs or, worst of all, loss of clients' assets, or inaccurate recording of their entitlements, as has occurred in the failures of firms such as Celsius Network LLC and Mt.Gox. According to its bankruptcy filing, at the time of its insolvency, Celsius owed $4.7bn worth of assets to clients.

4.13 We want to mitigate these risks of harm through our proposed cryptoasset custody rules. We plan to separately consult on rules that would apply once a cryptoasset firm has failed. This will include how we can make sure it winds down in an orderly manner or enters insolvency in a way that minimises harm to clients and the market. We plan to continue engaging with international regulators and insolvency practitioners as our thinking develops.

Proposed regulatory approach

4.14 Our overarching objective is to ensure adequate protection of clients' cryptoassets where a qualifying cryptoasset custodian is responsible for them, and that those assets are returned as quickly and wholly as possible to clients if a qualifying cryptoasset custodian enters an insolvency process.

4.15 In DP23/4, we proposed an outcomes-based, technology-agnostic approach to regulating cryptoassets. We considered using the existing CASS framework as a basis to design bespoke requirements for the safeguarding of qualifying cryptoassets, in line with the 'same risk, same regulatory outcome' principle. We said that existing CASS provisions, where properly implemented, can give appropriate levels of protection and confidence to consumers, as applies in traditional finance today. Respondents supported this approach.

4.16 We are broadly continuing with this approach, and are proposing rules on the following core components:

- adequate arrangements to protect clients' ownership rights to their qualifying cryptoassets.
- adequate organisational arrangements to minimise risk of loss or diminution of clients' qualifying cryptoassets or the rights in connection with those qualifying cryptoassets.
- accurate books and records of clients' qualifying cryptoasset holdings.
- adequate controls and governance to protect clients' qualifying cryptoasset holdings.

4.17 Where necessary, we propose amendments to existing CASS provisions, to ensure we accommodate the unique characteristics of cryptoasset custody outlined above. We have considered feedback from DP23/4 and other publications. These include the IOSCO Policy Recommendations for Crypto, the Law Commission's final report on digital assets and the Property (Digital Assets Etc.) Bill which clarifies that certain digital assets, such as crypto-tokens, can be recognised as property even if they do not fit into the two traditional categories of personal property in the law of England and Wales.

4.18 The rules set out in this chapter will be in addition to broader 'conduct and firm standards' rules applied to a firm authorised to conduct the safeguarding activity for qualifying cryptoassets. This will be set out in a future consultation, and prudential requirements are set out in CP25/15 published alongside this CP. In line with our commitment to the Prime Minister in January 2025 we have carefully considered where we may be able to rely on the Consumer Duty in place of new rules. Our stance in this CP is that it will not be sufficient to solely rely on the Consumer Duty and that some additional requirements will be necessary for qualifying cryptoasset custodians. We will set out our approach to the Consumer Duty in the 'Conduct and Firm Standards' CP and will invite feedback on whether and how the Duty is applied to firms in the cryptoasset sector.

Question 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?

Safeguarding clients' rights to their qualifying cryptoassets

Recording ownership

4.19 In traditional finance, ownership of clients' custody assets can be verified through external means like Central Securities Depositories (CSDs) and operators of collective investment schemes, alongside the custodian's books and records. By contrast, proprietary claims to cryptoassets are not evidenced by independent, verifiable sources. While DLT can provide a generally immutable record of on-chain transactions (eg on-chain transactions are processed and recorded by the blockchain), it does not provide a definitive record of the beneficial owners of cryptoassets.

4.20 Custodians verify cryptoasset ownership through the contractual terms they have with their clients, and how those assets are held and recorded by the firm. This reliance on the firm's books and records and contractual terms alone presents a significant risk of harm. In particular, in insolvency where, for example, the records may not accurately reflect clients' ownership rights at the point of failure, and courts are therefore required to undergo extensive legal inquiry to ascertain ownership and proprietary interests. Clients may experience significant delays in getting their assets back, or may lose them entirely, if they are treated as unsecured creditors of the custodian.

4.21 The legal uncertainty around ownership rights of cryptoassets has resulted in different outcomes for clients in court, following cryptoasset custodian failures, as demonstrated in the cases of Cryptopia Limited [2020] NZHC728 and Re Gatecoin Ltd [2023] HKFCI 914. Terms and conditions of firms can help courts determine whether the proprietary interests of clients are protected or whether clients become ordinary unsecured creditors in the event of a firm's insolvency, but because these terms and conditions, along with the conduct of the firm, are for the Courts to interpret, the Court's eventual judgment may not be in line with what clients expected.

4.22 We want to ensure a baseline standard of protection for all clients and minimise the associated risk of harm. In this section, we are proposing how a qualifying cryptoasset custodian must adequately safeguard clients' ownership rights to their qualifying cryptoassets by segregating assets held on behalf of clients in a trust, given the challenges identified.

Segregation of client assets

4.23 In traditional finance, custodians are required to segregate client assets from their own assets so that in the event of insolvency, client assets are adequately ringfenced and protected from any other creditors' claims against the failed custodian's estate.

4.24 In DP23/4, respondents generally agreed with our proposal that firms should segregate clients' qualifying cryptoassets from their own qualifying cryptoassets. Some suggested that firms should be able to hold a de minimis amount of firm qualifying cryptoassets in client wallets to facilitate services such as prime financing. This could enable trade execution with delayed settlement for qualifying cryptoassets held in cold storage, as well as to help settle transaction fees. We plan to explore such scenarios and the rules that may apply to an authorised qualifying cryptoasset custodian that provides other services in the 'Trading platforms, intermediation, lending and staking' CP.

4.25 In instances where a qualifying cryptoassets firm is only providing custody, we want to make sure clients' qualifying cryptoassets remain segregated from the firm's own assets at all times. To achieve this, in DP23/4, we asked whether individual client wallet structures should be mandated for certain situations or activities. Respondents generally disagreed, noting that this should be at the firm's discretion. Some said that omnibus wallets could better protect clients by:

- reducing the security risks from on-chain movement of assets which would be required if each client had an individual wallet.
- being more cost-effective, due to lower transaction fees from on-chain movements, with savings potentially passed onto clients.
- having a simpler setup of the wallet, which enables faster transaction execution and allows firms to scale into new markets quickly.

4.26 We are proposing to permit the use of both individually segregated and omnibus wallets to safeguard clients' qualifying cryptoassets.

4.27 Given the challenges we have since identified in evidencing ownership rights for cryptoassets, we now propose that clients' qualifying cryptoassets are held in trust. This would help better protect clients' rights to their assets, in the event of a qualifying cryptoasset custodian's insolvency. It would also provide a clear and consistent basis for firms to segregate clients' qualifying cryptoassets from their own.

4.28 We have considered whether this protection ought to be achieved through a statutory or non-statutory trust. A trust is a way of safeguarding assets for clients in a way that is legally remote from the assets of the firm providing the custody service. A statutory trust could be created through FCA rules setting out the terms of the trust, including how qualifying cryptoassets should be held for what clients (beneficiaries). A statutory trust regime would need to specify whether there is an individual trust for each client, or one tenants in common trust for all clients in relation to qualifying cryptoassets of a particular type, and whether these are segregated using individual or omnibus wallets. Given the nascency of the market, we have decided to propose that custody firms should safeguard qualifying cryptoassets using non-statutory trusts. We want to hear from industry participants how a trust arrangement could be best executed and welcome views from firms on how they are, or how they propose to hold assets on trust for their clients.

4.29 At this stage, we propose that firms must put in place a non-statutory trust for the qualifying cryptoassets they hold on behalf of clients. The relevant rules will require:

- firms to hold clients' qualifying cryptoassets as a bare trustee upon receipt. Given the feedback on wallet structures, at this stage, we propose that these can be held in either an individual or omnibus client wallet (in either case distinct and separate from the firm's own qualifying cryptoassets). We welcome views on whether requirements for wallet structures should be reconsidered, following the requirement for a trust.
- firms to ensure they hold the correct amount of qualifying cryptoassets for the correct clients in the trust at all times.
- firms to ensure they keep and maintain adequate books and records at all times to meet the requirements above. Assets held on trust in an individual client wallet address must be recorded by the firm in the name of that client in the firm's internal records. Assets held on trust in an omnibus 'client wallet address' must be recorded as such in the firms' internal records.

- firms to choose an approach to settling and operating trusts which is suitable for their business model, client base and the types of qualifying cryptoassets it will provide services for. A firm may choose to operate separate trusts for each client, for each class of qualifying cryptoasset, for different virtual addresses or for holding all cryptoassets safeguarded by a qualifying cryptoasset custodian.

4.30 Most qualifying cryptoassets operate as fungible assets, particularly where omnibus wallets are being used. Often custodians will allocate a proportion of those assets to their clients, as opposed to returning a specific cryptoasset, or transferring a specific cryptoasset elsewhere at the request of that client. Our proposed rules will not prevent this continuing if the firm has chosen to operate a tenants in common non-statutory trust.

4.31 At this stage, we propose that qualifying cryptoassets must be held by the firm as trustee for as long as the firm is safeguarding them. There may be other instances where firms receive qualifying cryptoassets on behalf of clients, which may not be compatible with a trust arrangement. For example, where clients give consent for their qualifying cryptoassets to be reused, and/or they no longer remain the beneficial owners of their assets. These examples are discussed below. We plan to consult on potential rules when clients' qualifying cryptoassets exit the trust environment, or where the firm's activities are not reconcilable with a trust arrangement, following Discussion Paper (DP25/1) feedback on other activities, such as staking and lending. These proposals will be set out in the 'Trading platforms, intermediation, lending and staking' CP.

Question 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? Do you foresee any practical challenges with this approach?
ii. 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?
iii. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet?
iv. Do you foresee any challenges with these rules with regards to wallet innovation (eg the use of digital IDs) to manage financial crime risk?

Reuse of client qualifying cryptoassets

4.32 In traditional finance, custodians are generally prohibited from using client assets held in custody for their own, or another client's, benefit. This is to preserve clients' ownership rights and protect their assets at all times. In some instances, custodians are permitted to use custody assets for other purposes, providing the client has given express prior consent. Use is restricted to the specific terms to which the client consents and custodians are required to report certain uses of assets to clients.

4.33 Separately, where a client transfers their assets to a firm for collateral purposes, these are subject to our collateral rules. In these traditional finance arrangements, clients generally do not remain the beneficial owners of these assets. If the firm entered insolvency, clients would become unsecured creditors of the firm and would be unlikely to get their assets back as they would then belong to the firm (and would likely be liquidated as part of the custodian's estate).

4.34 In the cryptoassets market, firms such as exchanges, are often vertically integrated, providing multiple services to their clients in addition to custody. These include staking, holding cryptoassets as collateral, or in some instances lending cryptoassets to other clients. Responses from DP 23/4 outlined that custodians should be permitted to use a client's qualifying cryptoassets for these purposes. In some of these circumstances, respondents said that clients' qualifying cryptoassets should no longer be held in trust and there should be enhanced client disclosures.

4.35 We continue to believe there are risks of harm from these arrangements if clients do not remain the beneficial owners of their assets under a trust. We also recognise that qualifying cryptoasset custodians may lose revenue if they are no longer permitted to use clients' qualifying cryptoassets for other purposes and may decide to change their business models. We will consider our approach to the reuse of client qualifying cryptoassets following feedback on DP25/1 and any rules or restrictions relating to these activities will be consulted on in the 'Trading platforms, intermediation, lending and staking' CP.

Recording clients' qualifying cryptoasset holdings

Accurate books and records

4.36 In DP23/4, we outlined how accurate books and records are essential for ensuring a firm correctly identifies the owners and amounts of assets held in custody at all times. These records can help to reduce opportunities for fraud and loss of assets and facilitate a prompt return of assets if a firm fails.

4.37 For qualifying cryptoasset custody, we considered requiring a record of ownership, including identifying the means of access held to qualifying cryptoassets (eg private keys). We explored permitting the use of on- and off-chain records in our requirements, provided the firm:

- kept records as necessary to enable it to, at any time, distinguish qualifying cryptoassets held for one client from qualifying cryptoassets held for any other client, and from the firm's own qualifying cryptoassets.
- maintained records in a way that ensured their accuracy and that they may be used as an audit trail.
- maintained a client-specific qualifying cryptoasset record.

4.38 Most respondents agreed with our proposal, though they did request clarification on how these requirements should be met, including whether specific technologies should be used, and whether outcomes could differ between public and private blockchains.

4.39 We have considered the challenges of demonstrating ownership rights for cryptoassets, and the differences between on- and off-chain records. We want to make sure that firms maintain accurate and up-to-date client-specific qualifying cryptoasset records to correctly identify for each client the firm provides safeguarding services:

a. the type of qualifying cryptoasset.
b. the quantity of the qualifying cryptoasset.
c. which blockchain address each qualifying cryptoasset is held in.
d. the nature of an individual client's claim to the qualifying cryptoasset.
e. where there are other parties that have the capacity/control to affect a transfer of the qualifying cryptoasset, who those parties are.

4.40 We propose that a firm should keep client specific qualifying cryptoasset records that meet the outcomes identified above. These records must be maintained independently from the relevant DLT used by the firm and not be supplemented by records kept by third parties or on the blockchain. These records should be kept in a way that a firm is able to evidence a client's claim to any qualifying cryptoasset which the firm is safeguarding at any time.

Question 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?**

Reconciliations

4.41 Reconciliations are checks undertaken by firms, comparing different sets of internal and external books and records to ensure accuracy, and identify and resolve any discrepancies. Reconciliations help custodians check they are safeguarding the right amount of custody assets for the right clients, and that they are segregating clients' assets from their own at all times.

4.42 In traditional finance, an internal reconciliation involves a firm checking the record of what client assets should be held, against the record of what client assets are being held. An external reconciliation involves a firm checking their own internal records against those of relevant third parties. In doing so, firms use both internal and external reconciliations to evidence the accuracy of their systems and controls, including those needed when appointing third parties and, if necessary, identify and resolve any discrepancies.

4.43 In DP23/4, we sought views on requiring custodians to conduct reconciliations of each client's qualifying cryptoassets on a real-time basis to identify and resolve discrepancies promptly. We also considered requiring custodians to take appropriate steps to make good any shortfalls if discrepancies were not resolved following reconciliations.

4.44 Respondents broadly agreed with our proposals. Some were concerned by the proposal to perform reconciliations on a real-time basis, claiming it was an unnecessary deviation from the approach in traditional finance, where internal reconciliations are required each business day, and external reconciliations are required as regularly as necessary, but allowing no more than 1 month to pass between each external custody reconciliation.

4.45 We have considered the feedback and propose that custodians carry out a qualifying cryptoasset reconciliation each business day. Firms will be required to check the total amount of each qualifying cryptoasset recorded in their client specific qualifying cryptoasset records against the content of the wallet addresses controlled by the firm and (where relevant) against any qualifying cryptoassets held by third parties. This is to confirm that the firm's records of the qualifying cryptoassets it holds are equal to the amount of qualifying cryptoassets that it does hold, thereby meeting its obligations to its clients, as is the case in traditional finance custody of safe custody assets. For the qualifying cryptoasset reconciliation to achieve this, the client specific qualifying cryptoasset records used in the reconciliation process must be maintained independently of any other information source used in the qualifying cryptoasset reconciliation. We propose requiring qualifying cryptoasset custodians to notify the FCA where they are unable to meet proposed reconciliation requirements or maintain accurate records – this is in alignment with rules set out for traditional finance custodians in CASS 6.

4.46 These checks should enable a firm to confirm they are suitably segregating qualifying cryptoassets they hold on behalf of clients from their own, and to resolve any discrepancies by (a) removing any excess if not held on behalf of clients, or (b) addressing any shortfalls as required in the proposed rules.

4.47 On identifying a shortfall, we propose that qualifying cryptoasset custodians must decide whether (a) the firm will resolve the shortfall itself, (b) in the circumstances where a third party has been appointed, the firm will procure the third party to resolve the shortfall, (c) whether a combination of (a) and (b) will be used, or (d) the firm is justified in concluding that no party is responsible for the shortfall. Where a firm cannot justify that neither party is responsible, then we are proposing that the firm is required to resolve the shortfall. We are proposing that firms notify the FCA if that shortfall is unlikely to be resolved prior to the next reconciliation setting out details of:

- **a.** why the shortfall has arisen,
- **b.** the extent of the shortfall,
- **c.** the number of clients affected by the shortfall and
- **d.** the firm's expected timeframe for resolving that shortfall.

4.48 Where the firm is justified in concluding that neither it nor any third party that it has appointed is responsible for a shortfall that has arisen, we propose that the qualifying cryptoasset custodian is required to notify both the FCA and affected clients and make them aware of their revised balances as a result of this shortfall. The firm will need to consider the cause of the shortfall carefully as well as its rationale for reaching such a conclusion. In a shortfall situation, it is possible that the question of liability may be litigated as a matter of private law, and that the situation may develop into a corporate insolvency (in which case the FCA would have its usual supervisory powers under FSMA at its disposal).

Question 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.

Minimising the risk of loss or diminution of clients' qualifying cryptoassets

Adequate organisational arrangements

4.49 Organisational arrangements relate to how a firm organises its operations, systems and controls. Inadequate organisational arrangements by cryptoasset service providers, including poor record-keeping practices, and weak systems and controls, have contributed to hacks and thefts of clients' cryptoassets. This has resulted in significant financial losses to clients.

4.50 To address this risk of harm, in DP23/4 we sought views on requiring qualifying cryptoasset custodians to have adequate organisational arrangements to minimise risk of loss or diminution of clients' qualifying cryptoassets due to misuse, fraud, poor administration, inadequate record-keeping, or negligence. Most respondents were supportive.

4.51 We are continuing with this proposal, which includes requiring qualifying cryptoasset custodians to have policies and procedures that are reviewed regularly and amended as required.

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

Private key management and security

4.52 There are a variety of methods to exercise control of cryptoassets, with private keys being the primary way in which firms access wallets that hold clients' cryptoassets. The generally irreversible, immutable nature of cryptoasset transactions that take place on a permissionless blockchain means that preventing unauthorised access to those assets is particularly important. 49% of cryptoasset users in the YouGov survey (2024) said that safety and security was the most important factor they consider when storing their cryptoassets.

4.53 Keys can be compromised if they are not generated robustly, are incorrectly used, inappropriately stored, or managed manually, which can introduce human error or a single point of failure. This can lead to loss of clients' cryptoassets, weakening consumer protection, and reducing trust and confidence in the cryptoasset market.

4.54 We want to maintain a technology-agnostic and outcomes-based approach and understand that firms may employ a range of methods to mitigate the above risks of harm. So, at this stage, we are proposing that firms have adequate organisational controls and arrangements to make sure:

- private keys and the means of access to qualifying cryptoassets are generated, stored, and controlled securely throughout their lifecycle.
- firms maintain accurate and verifiable 'key-mapping' records which detail the qualifying cryptoassets safeguarded, the relevant wallets in which those qualifying cryptoassets are held, the means of access to those qualifying cryptoassets, and how they correspond to the relevant clients.
- firms implement strategies to mitigate loss or compromise of the means of access to qualifying cryptoassets, including arrangements for secure back-ups.
- firms maintain accurate and up-to-date records of their policies and procedures for wallet/means of access management.

4.55 The proposed requirements aim to ensure greater operational security, reducing the risk of loss of qualifying cryptoassets, and establish clear records to promote faster distribution in the case of insolvency.

4.56 We plan to consult on wider operational resilience requirements, including in the case of disaster recovery, separately as part of the 'Conduct and Firm Standards' CP.

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

Liability for loss of cryptoassets

4.57 Any particular standard of civil liability (under which someone is legally responsible) for authorised qualifying cryptoasset custodians would generally be set in legislation rather than in FCA rules. In the absence of a standard of civil liability set out in legislation, civil liability is often determined by the terms and conditions between contracting parties.

4.58 We noted in DP23/4 that the Treasury proposed to take a proportionate approach to qualifying cryptoasset custody. This approach may not impose full, uncapped liability on the qualifying cryptoasset custodian in the event of a malfunction, hack or other loss that was not within that qualifying cryptoasset custodian's control. In line with this, we proposed a requirement for qualifying cryptoasset custodians (and third parties holding qualifying cryptoassets on behalf of those custodians, if applicable) to disclose their safeguarding controls and liability if at fault for the loss of clients' qualifying cryptoassets explicitly in client agreements.

4.59 The assignment of liability in a third-party arrangement would depend on the terms of the contract between the third party and the authorised custodian, and between the client and qualifying cryptoasset custodian.

4.60 Respondents broadly agreed with our proposal but felt strongly that qualifying cryptoasset custodians should not be held strictly liable for events outside their control. Some said firms should be held accountable for gross negligence, rather than technological disruptions. Respondents did query the definition of 'not within the custodian's control'.

4.61 The Treasury's draft legislation continues the government's proposal to not impose full, uncapped liability on the qualifying cryptoasset custodian. With that being the case, the qualifying cryptoasset custodian may still be held liable for loss of qualifying cryptoassets due to, for example:

- Negligence or breach of contract – subject to the contract with the customer, duties of care under the general law, and existing statutory liability regimes.
- Breaches of FCA rules – subject to the exercise of powers under FSMA 2000 to make those rules, and then the possibility of claims from private persons arising in relation to those rules under s.138D FSMA (which, in line with the usual approach in CASS, we are not proposing to disapply in this CP), as well as the application of the dispute resolution (DISP) sourcebook in relation to complaints which may be adjudicated by the Financial Ombudsman Service.

4.62 We will consult on proposed rules relating to how firms ensure that clients' rights are clear in their contracts, including setting out their safeguarding obligations and when the qualifying cryptoasset custodian (or any third party) would be liable, for any loss or diminution of clients' qualifying cryptoassets in the 'Conduct of business and firm standards' CP.

Question 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?**

Governance and control over safeguarding arrangements of clients' qualifying cryptoasset holdings

Use of third parties

4.63 In traditional finance, firms can use third parties to provide custody services, providing those appointments comply with our CASS rules. There are several reasons why these appointments are used in traditional finance, including to serve a particular market or jurisdiction where custodians do not themselves operate or to benefit from additional services or features provided by that third party.

4.64 In cryptoasset custody, we understand that firms use third parties to improve the security and/or efficiency of their services, whether through technology infrastructure, specialist expertise or storage facilities, to help safeguard clients' cryptoassets. Examples include:

- Key sharding, where a private key is divided into distinct shards or segments that must be re-combined to sign transactions. This seeks to minimise the risk of loss of cryptoassets from a single point of failure such as a cyber-attack or

malfunction. It also can provide flexibility, scalability, and operational resilience to both the network and participants.
- Multi Party Computation (MPC), a zero-knowledge method where transactions are signed by parties holding valid key shards, without the private key ever recombining.
- Hardware Security Modules (HSMs), which are physical computing devices that manage private keys and perform encryption and decryption functions for digital signatures.

4.65 Using third parties in cryptoasset custody arrangements can however expose clients to a risk of loss, or delay in the return, of their cryptoassets, if, for example, the third party:

- has weak or inadequate systems and controls.
- conducts fraudulent activity.
- enters insolvency and clients' ownership rights are not protected (eg, if the third party is in a jurisdiction that does not recognise clients' proprietary rights as our CASS rules and UK insolvency law intend).

4.66 In DP23/4, we considered permitting qualifying cryptoasset custodians to use third parties. Respondents agreed, citing the benefits to clients. Given the different use cases and risks of harm we have identified for third parties in cryptoasset custody, we now propose that qualifying cryptoasset custodians must satisfy itself of the following in appointing third parties to safeguard qualifying cryptoassets:

- Any appointment of a third party must be in the best interests of the client, and necessary for safeguarding, which firms must evidence in a written policy.
- The firm has undertaken due diligence in the selection and will undertake periodic reviews of the third party.
- The firm has considered the expertise and market reputation of the third party, including security, market infrastructure and any legal requirements related to holding qualifying cryptoassets which could negatively impact clients' rights.
- The firm will ensure that any qualifying cryptoassets held by a third party are identifiable separately from the assets belonging to the custodian and qualifying cryptoassets belonging to the third party.
- Has a written agreement when custodians place qualifying cryptoassets, or the means of access to them, with a third party. We propose that this agreement must include, but is not limited to:

  - Details of the service(s) that the third party is contracted to provide.
  - A requirement for the third party to notify where qualifying cryptoassets are no longer subject to the terms of the agreement (where relevant).
  - Details of the third party's liability in the event of the loss of a qualifying cryptoasset.
  - An acknowledgment from the third party that the qualifying cryptoassets are held by the firm on trust for the firm's clients.
  - An acknowledgment from the third party that they are not entitled to exercise any right of set-off or counterclaim against the qualifying cryptoassets for any debt owed to it or to any other person.

- Any appointment must be approved by the governing body of the qualifying cryptoasset custodian.

4.67 These requirements aim to ensure that clients and the market benefit from the use of third parties for safeguarded qualifying cryptoassets, while minimising the risks of harm that can arise.

Question 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?**

Client disclosures and statements

4.68 In traditional finance, custodians are required to provide disclosures to clients about their safeguarding arrangements. This includes how certain arrangements may give rise to specific consequences or risks. Custodians must also provide periodic statements to each of their clients of the assets they hold for them.

4.69 In DP23/4 we considered requiring qualifying cryptoasset custodians to give clients a statement of account, with information on their qualifying cryptoasset holdings and transactions, including whether to include Proof of Reserves (PoR). PoR is a cryptographically proved, independent audit process that cryptoasset custodians can use to verify that the amount of client cryptoassets held in custody matches the assets they are holding in reserve on behalf of those clients.

4.70 Seven respondents supported requiring firms to provide a statement of account to clients. They also supported disclosures on wallet structures, including why firms had chosen them, and the risks associated with them. However, they noted that PoR can be manipulated and would not be a reliable means of verifying the amount of client qualifying cryptoassets held in custody. Additionally, it would be challenging for firms to conduct a PoR audit currently due to an inconsistent industry approach.

4.71 Taking into account this feedback, we are considering rules which prevent asymmetrical information amongst clients. This includes considering whether qualifying cryptoasset custodians should provide clients with access to an online system where up to date statements can be found, reflective of deposits and withdrawals, or at a minimum, provide a statement of account to each client at least once a year in a durable medium. These statements may include details of a client's qualifying cryptoasset holdings, including the type and value of that asset, confirmation that those assets are held in a trust for the benefit of the client, and what type of wallet those assets are stored in (hot, warm, cold, individual or omnibus).

4.72 We are considering whether qualifying cryptoasset custodians should also comply with the following client disclosure requirements:

- Disclose in their custody agreement the wallet structures they have chosen to hold qualifying cryptoassets on behalf of clients, and why.

- Disclose to their clients any changes in how their qualifying cryptoassets are being held since the last disclosure.

4.73 We do not propose to mandate PoR at this stage.

4.74 We will consult on proposed rules relating to the client disclosure and statements requirements in the 'Conduct of business and firm standards' CP.

CASS oversight officer

4.75 In traditional finance, firms are required to appoint an individual responsible for the operation and oversight of CASS compliance. This includes reviewing processes and controls, and overseeing third-party providers (CASS oversight officer). This requirement was introduced to enhance firms' focus on client asset protection, increase regulatory accountability, and ensure proper and timely monitoring of relevant systems and controls.

4.76 In DP23/4 we considered requiring qualifying cryptoasset custodians to appoint a CASS oversight officer who would be accountable for overseeing the custody arrangements. Respondents agreed with this requirement as it can help to increase accountability of a firm's safeguarding function and protect client qualifying cryptoassets.

4.77 We will consult on proposed rules relating to this requirement in our 'Conduct and Firm Standards' CP.

Client assets audit

4.78 In traditional finance, authorised custodians are required to provide us with an annual audit, carried out by an independent external auditor, on how they comply with the CASS rules (subject to limited exceptions). CASS audits facilitate oversight and assurance of firms' controls, with a view to making sure a firm has the necessary systems and controls to protect client assets at all times. They also provide firms the opportunity to gather, review and interrogate CASS data and remedy weaknesses in their systems and controls. There is no requirement to make this report public or make it available to the custodian's clients. They also provide firms the opportunity to gather, review and interrogate CASS data and remedy weaknesses in their systems and controls.

4.79 In DP23/4 we considered how to apply this requirement to qualifying cryptoasset custody, and what additional controls may be needed to ensure the quality of audits.

4.80 Respondents generally supported a requirement for qualifying cryptoasset custodians to complete an independent annual audit on CASS compliance. There was a suggestion that the audit be done through existing external review schedules such as the Service Organisation Control (SOC) Reporting Framework to reduce costs. Some respondents said the lack of a current auditing standard for cryptoassets could lead to inconsistency in audits, but that industry best practice would develop over time, and principles of traditional finance could be applied to this asset class.

4.81 We will consult on proposed rules relating to this requirement in the 'Conduct and Firm Standards' CP.

Regulatory reporting

4.82 CASS medium and large firms are required to submit a monthly Client Money and Assets Return (CMAR) to us. The CMAR gives an important overview of a firm's client asset arrangements and industry trends which are used to assess risks, develop policy, and set supervisory priorities.

4.83 In DP23/4 we considered requiring qualifying cryptoasset custodians of all sizes to report similar information on their clients' qualifying cryptoasset holdings to us monthly. Respondents broadly agreed with this proposal. There were suggestions that we adjust the frequency of submission to every 6 months, specify a more targeted set of information to be reported/included and adopt standardised templates and reporting tools, and vary frequency based on firm size.

4.84 We will consult on proposed rules relating to this requirement in the 'Trading platforms, intermediation, lending and staking' CP.

Ancillary activities to qualifying cryptoasset custody

Custody-like activities conducted within centralised cryptoasset exchanges

4.85 Many cryptoasset firms provide ancillary services, such as operating a trading platform, brokerage, market-making, margin trading, lending, and staking, in addition to custody. As part of this vertical integration, firms may hold qualifying cryptoassets on behalf of clients.

4.86 DP23/4 outlined our concerns around potential conflicts of interest that may arise, and the challenges of distinguishing between clients' qualifying cryptoassets and the firm's own because of this vertical integration. We considered requiring qualifying cryptoasset exchanges to operate a separate legal entity for custody-like activities to provide the strongest level of protection of client assets.

4.87 Respondents cited concerns over higher costs and the reduction in speed of transactions from mandating a separating legal entity. In light of this feedback, we have been considering whether the introduction of a trust arrangement and segregation of assets held in this way could adequately manage conflicts of interest. We are currently not proposing that firms are required to separate their service lines using separate legal entities. However, given the interaction with other activities, including the use of settlement wallets, we plan to revisit this proposal, following feedback on DP25/1 and consult on any proposed requirements (as necessary) in the 'Trading platforms, intermediation, lending and staking' CP.

Client money safeguards

4.88 There may be instances where a firm may hold client money that arises in connection with regulated activities involving qualifying cryptoassets held in custody. For example, where fiat currency is held for the purpose of purchasing qualifying cryptoassets on behalf of clients (eg on or off ramping) or when a client's qualifying cryptoasset holding changes and fiat is involved.

4.89 In DP23/4, we considered whether to apply our client money rules in CASS 7 in these instances, and how to ensure adequate protection of such client money at all times and to protect the interests of clients. Responses broadly supported applying CASS 7 with some asking for consideration of modifications in light of business models. Our expectation is that where client money is held by firms, CASS 7 will apply. We will consider the circumstances where client money is held by qualifying cryptoasset firms with a view to applying these provisions in the 'Conduct and Firm Standards' CP.

Chapter 5

Next steps

5.1 As noted in Chapter 1, this CP is part of a series of consultations within our Crypto Roadmap. Throughout 2025 – Q1 2026 we will aim to consult on:

- Conduct and firm standards for all cryptoasset regulated activities
- Admissions & Disclosures and Market Abuse Regime for Cryptoassets
- Trading platforms, intermediation, lending and staking
- Remaining proposals for our prudential sourcebook

5.2 Not all the consultations will be relevant for qualifying stablecoin issuers and qualifying cryptoasset custodians. But we urge firms to continue to engage with the proposed policy. In developing the policy in this CP, we have considered where future rules and guidance may apply to qualifying stablecoin issuers and qualifying cryptoasset custodians. For example, requirements set out in the Consumer Duty, or requirements to have adequate systems and controls in our operational resilience rules.

5.3 We intend to use our Conduct and Firm Standards CP to consult on areas of our Handbook that will apply to any firm carrying out a cryptoasset regulated activity set out in the Regulated Activities Order. This will include firms that carry out the draft activity specified in Article 9M (issuing qualifying stablecoin) and/or the safeguarding of qualifying cryptoassets as specified in Article 9O. We will consult on relevant areas of our Handbook that may be applicable to cryptoasset firms, and will set out whether these areas are applicable or if necessary changes may be required.

5.4 Firms undertaking multiple activities should also consider our policy for the interaction between custody-like activities and other cryptoasset activities (including trading venues, staking and lending) in our CP on trading platforms, intermediation, lending and staking due to be published in Q4 2025/Q1 2026. Furthermore, qualifying stablecoin issuers may also be interested in our Admissions & Disclosures and Market Abuse Regime for Cryptoassets CP, particularly when seeking to admit their qualifying stablecoin to a UK Cryptoasset Trading Platform.

5.5 Alongside our final policy statements, we may also consider publishing further non-Handbook guidance that will help support cryptoasset firms with the rules and guidance we set out. We will use feedback from consultations to help guide where further information is needed.

5.6 As noted in Chapter 1, firms that currently provide cryptoasset services that come within the scope of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) must be registered with the FCA. In addition, cryptoasset business that wish to market to UK customers (ie communicate their own cryptoasset financial promotions) must also be registered with the FCA under the MLRs unless their financial promotions are approved by an authorised person or otherwise rely on an exemption in the Financial Promotion Order. Prior to our wider cryptoasset regime being implemented, firms should consider the existing coverage of these requirements. As we set out our final rules through Policy Statements, we will provide further guidance on how firms already doing business in the UK should prepare for the transition to our authorisation regime, where they are in scope of the new regulated activities for cryptoassets.

5.7 As set out in Chapter 2, we will continue to work with the Bank and the PSR to ensure that the interaction between our regimes is clear for firms and consumers. This includes clarity on how firms may transition from one regime to another after being recognised as an operator of a systemic payment system of 'digital settlement assets' (systemic or otherwise recognised) by the Treasury. Service providers may include custodians, trading platforms, and fiat-referenced stablecoin issuers (when issuers are not also the operator of the payment system). In our 'Conduct and Firm Standards' CP we will set out the areas of regulation that FCA is responsible for once a firm has been recognised by the Treasury as an operator or provider within a payment system, this will include when a qualifying stablecoin has been deemed as systemic.

5.8 Below we have provided an information graphic aiming to guide which consultations qualifying stablecoin issuers and qualifying cryptoasset custodians will be relevant. The areas in grey are publications that have already been published, areas in blue are future publications that will be of interest.

FCA Crypto Roadmap

This outlines planned FCA policy publications for cryptoassets where we are seeking feedback and the content they are expected to cover.

Not exhaustive; all timelines are subject to change according to parliamentary time and/or further steers from government

Q1 2020

Money Laundering Regulations legislation applies

Q4 2023

Financial Promotions rules go live

Stablecoins issuance and custody

DP

Q4 2024

DP

Admission and disclosures
- Admission/rejection processes
- Disclosures
- Liability
- Due diligence
- National Storage Mechanism (NSM)

Market abuse
- Systems and controls
- Information sharing
- Inside information disclosure

Q1/Q2 2025

Trading platform rules including location, access, matching and transparency requirements

Intermediation rules including order handling and execution requirements

Lending rules including ownership, access and disclosures

Staking rules including ownership and disclosures

Prudential considerations for cryptoasset exposures

DP

CP

Stablecoins
- Backing assets
- Redemption

Custody
- Recordkeeping
- Reconciliations
- Segregation of assets
- Use of 3rd parties

Prudential
Introduction of a new prudential sourcebook, including capital, liquidity and risk management

Q3 2025

Conduct and firm standards for all Regulated Activities Order (RAO) activities
- Systems and controls including Operational Resilience and Financial Crime
- Consumer Duty
- Complaints
- Conduct (COBS)
- Governance including Senior Managers and Certification Regime (SMCR)

CP

CP

Admissions and Disclosures
As per DP

Market Abuse
As per DP

Q4 2025/ Q1 2026

CP

Trading platforms, intermediation, lending and staking
- As per DP +
- Resolution

Remaining material for prudential sourcebook
- Groups
- Reporting

2026

Final rules
All Policy Statements published

PS

Gateway readiness

Gateway opens

Regime go-live

Key

DP	Discussion Paper/s
CP	Consultation Paper/s
PS	Policy statement

5.9 We welcome feedback on the impact of our policy proposals on business models, domestic and international market participants, and the market. We also welcome suggestions on any other relevant market developments that we have not considered or unintended consequences on our proposals. This CP identifies areas of our approach to qualifying stablecoin issuers and qualifying cryptoasset custodians where detailed rules will be consulted on in later consultations. We have included questions which seek to gather views as we finalise our policy approach and we will ensure that all areas of our new regime are subject to consultation.

5.10 Following publication of this CP, we will engage with a wide range of stakeholders to gather feedback alongside responses. We will consider the feedback received for our new Handbook rules, and any alternatives put forward. Our finalised rules will be set out in policy statements, which we intend to publish in 2026 as per our Crypto Roadmap. These will bring together all relevant rules for cryptoasset firms and be implemented to the same timetable.

Annex 1

Questions in this paper

Question 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?

Question 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.

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

Question 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.

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

Question 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?

Question 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.

Question 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.**

Question 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?**

Question 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?**

Question 11: **Do you agree with our proposals for record keeping and reconciliations?**

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

Question 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?**

Question 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?**

Question 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?**

Question 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?**

Question 17: **Do you agree with our proposals for disclosure requirements for qualifying stablecoin issuers? If not, why not?**

Question 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?**

Question 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? Do you foresee any practical challenges with this approach?
ii. 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.
iii. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet?
iv. Do you foresee any challenges with these rules with regards to wallet innovation (eg the use of digital IDs) to manage financial crime risk?

Question 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?

Question 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.

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

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

Question 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?

Question 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?

Question 26: **Do you agree with our assumptions and findings as set out in this CBA on the relative costs and benefits of the proposals contained in this consultation paper? Please give your reasons.**

Question 27: **Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?**

Annex 2

Cost benefit analysis

Introduction

1. The Financial Services and Markets Act (2000) requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. As set out in the draft legislation, the Treasury has proposed to introduce the following activities into our regulatory perimeter:

- **Custody of Cryptoassets:** Firms safeguarding qualifying cryptoassets on behalf of others in the UK or for UK consumers will require authorisation by the FCA and will need to comply with our rules for custody.
- **Issuing a Qualifying stablecoin:** Firms issuing a qualifying stablecoin in the UK will require FCA authorisation. This activity covers the issuance of stablecoins which reference any fiat currency or fiat currencies, and which seek or purport to maintain a stable value through the holding of fiat currency (such as GBP, USD, EUR, etc), or fiat currency and other assets.

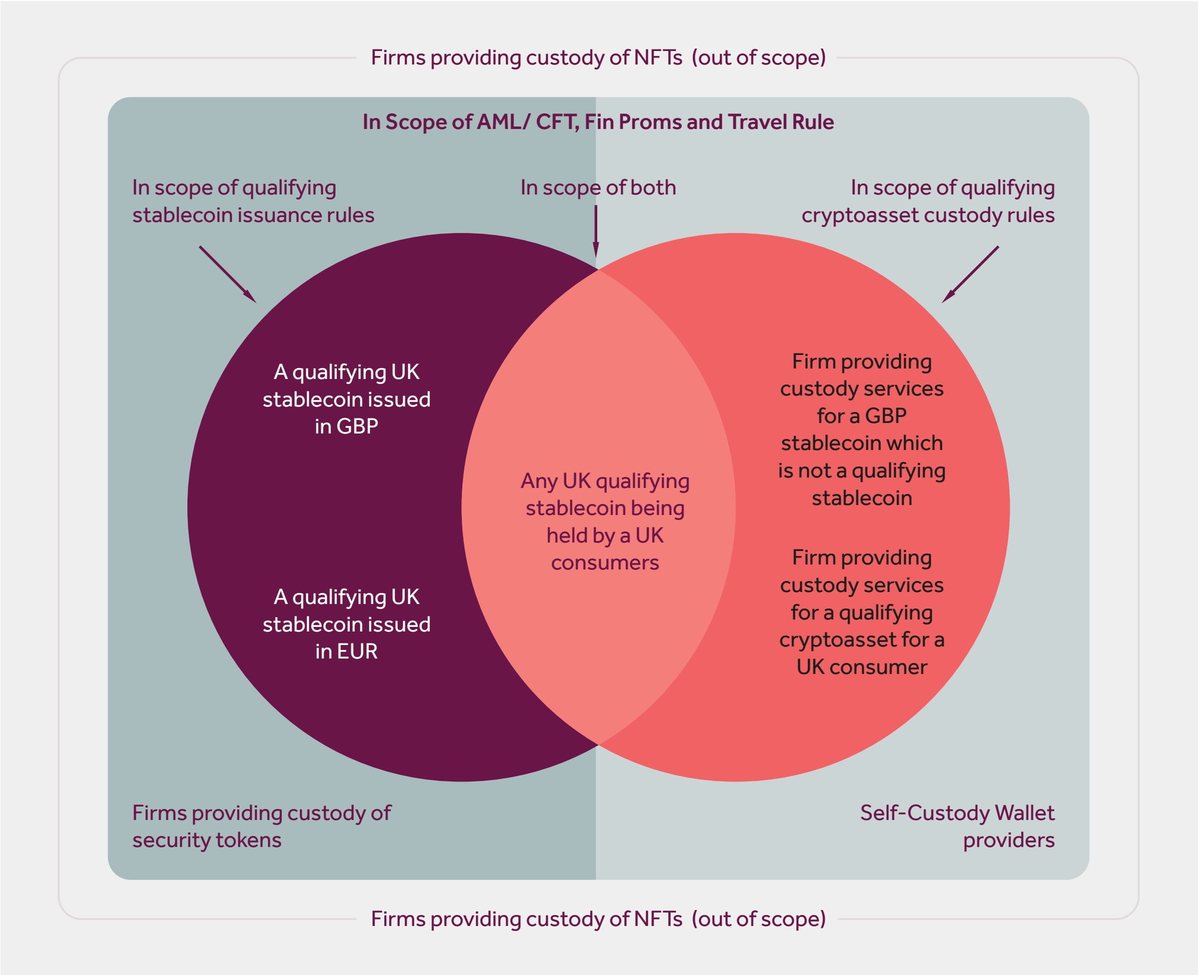
3. We also intend to create new prudential requirements through through new FCA sourcebooks 'CRYPTOPRU' and 'COREPRU'. This will set out prudential requirements for firms carrying out the issuance of a qualifying stablecoin and/or custody of cryptoasset activities. These requirements will support market stability and minimise harm associated with disorderly firm failure. Only part of the prudential requirements for issuers and custodians will be published in this CP with the remaining requirements following later.

4. The draft legislation requires issuers of qualifying stablecoins established in the UK, and firms providing custody of qualifying cryptoassets in the UK or to UK consumers, to comply with our rules. "Stablecoins" 'which are not UK-issued 'qualifying stablecoins' are treated in the legislation the same as any other qualifying cryptoasset e.g. Bitcoin.

5. An illustration of how we anticipate firms to be affected by the scope of the Treasury legislation and thereby our proposed rules is set out below. Any firm providing custody services of a qualifying cryptoasset in the UK or to UK consumers will be in scope of the custody regime. This will include 'overseas stablecoins' which are not subject to our stablecoin rules. Any firm issuing a qualifying stablecoin from an establishment in the UK in any fiat currency will be in scope of the Treasury legislation and subject to our issuance rules. Certain activities, such as such as provision of Self-Custody Wallets or issuing overseas stablecoins outside of the UK, are out of scope of the Treasury regulated activities of stablecoin issuance and cryptoasset custody (and our associated rules) but may still be available to UK consumers. Proposed rules which will apply to firms providing

custody of specified investment cryptoassets, such as security tokens, will be consulted on at a later date, and are not part of this cost benefit analysis.

Figure 3: All Cryptoasset Custody and Stablecoin Activities



6. Since Jan 2020, persons offering services of a cryptoasset exchange provider or custodian wallet provider by way of business in the UK must register with the FCA and comply with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs). Since September 2023, this has included the 'Travel Rule', which requires registered cryptoasset firms to collect, verify and transfer information about the owner or beneficiary of a cryptoasset when it is transferred. Since October 2023, firms that wish to communicate financial promotions for qualifying cryptoassets must also comply with the FCA's financial promotions rules.

7. We intend to introduce rules related to all new regulated activities specified by HM Treasury in its draft RAO SI. This CBA focuses on two of these activities; qualifying stablecoin issuance and qualifying cryptoasset safeguarding. A later CBA will cover the remaining regulated activities proposed to come into the FCA's remit. For firms affected by the proposed interventions set out in this CP, they may also be impacted by additional requirements, including Senior Managers and Certification Regime (SMCR), Redress, Operational Resilience and Resolution. The impact of these additional requirements will also be assessed in future consultation papers and cost benefit analyses. The FCA's Cryptoasset Roadmap sets out our schedule of planned publications.

8. This analysis presents estimates of the significant impacts of our proposals for qualifying stablecoin issuance and custody of qualifying cryptoassets. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide a qualitative explanation of their impacts. Our proposals are based on weighing up all the impacts we expect and reaching a judgement about the appropriate level of regulatory intervention.

9. The CBA has the following structure:

- The Market
- Problem and rationale for intervention
- Options assessment
- Our proposed intervention
- Options assessment
- Baseline and key assumptions
- Summary of impacts
- Benefits
- Costs
- Competition assessment
- Wider economic impacts
- Monitoring and Evaluation

10. This CBA assesses the combined impacts of our proposed qualifying stablecoin issuance and qualifying cryptoasset custody rules, in addition to the prudential requirements for firms conducting these activities. These proposed requirements are set out in two separate CPs, and this CBA is included in the annex of both (and is identical in both).

The Market

11. In this section, we describe the market for cryptoassets (both globally and within the UK) and trends we have observed in recent years. We outline unique aspects of cryptoassets, and the key role custodians play within the sector. We also consider the current market for stablecoins and potential future use cases.

Cryptoasset products and the global market

12. The term "Cryptoassets[1]" refers to a variety of 'cryptographically secured' non-tangible assets in digital form. These include assets such as Bitcoin, Ether, stablecoins, and other commodity or utility tokens. As a new technology, the primary innovation of cryptoassets is their use of cryptographically secured "distributed ledgers" (DLT

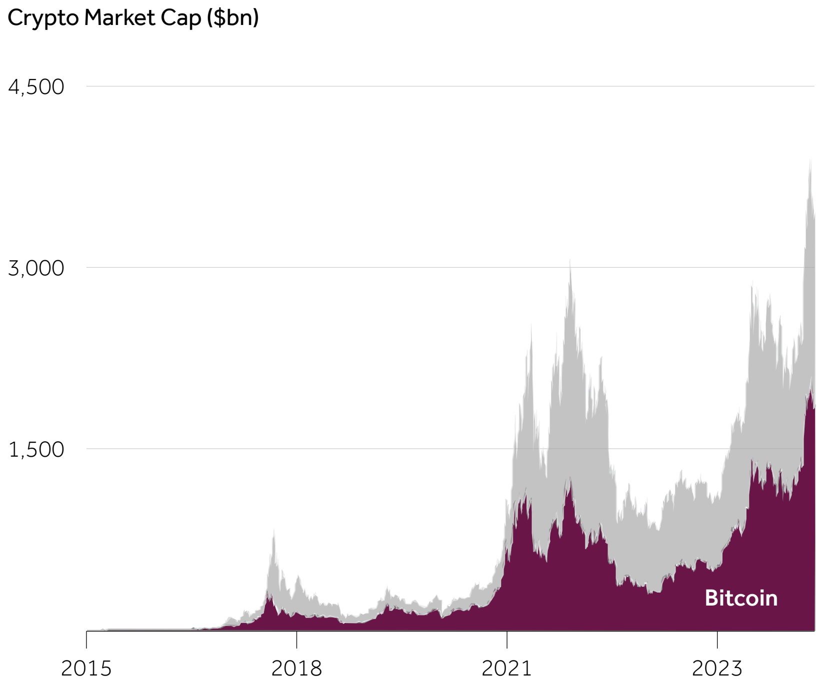
1 Cryptoassets are sometimes referred to as "cryptocurrencies", "digital assets" or simply "crypto". We avoid using the term "cryptocurrency" as crypto products do not share characteristics with other currencies (used as means of payments, low volatility) and so the term "cryptoasset" is more appropriate.

or "blockchains"), a database which is append only and immutable, while also often being publicly available. New entries to the ledger are verified through a process called validation. The Bitcoin blockchain is a well-known use of DLT, providing a record of all previous Bitcoin transactions.

13. While initially popular with privacy advocates as an alternative to fiat currency, the cryptoasset market has changed significantly since its inception. Our recent consumer research[2] suggests the most common reason UK consumers purchase cryptoassets is "as part of a wider investment portfolio" (36% of consumers). Cryptoassets are traded in a highly interconnected global market, which operates continuously (ie 24/7). Cryptoasset prices can demonstrate high volatility, partly due to low liquidity, which can result in large price swings from single orders.

14. As of December 2024, the size of the global cryptoasset market was reported as $3.4trn[3], based on market capitalisation at current prices. A small number of the most popular assets make up the majority of this total capitalisation (as demonstrated below). Based on ownership rates and average holdings (as estimated through FCA surveys) we estimate UK consumer share of the global cryptoasset market as being 0.6%. In addition, the UK market includes institutional investors, with some reports indicating the UK has the 3rd largest market globally for raw cryptoasset transaction volumes (behind U.S. and India)[4].

Figure 4: Cryptoasset Market Capitalisation



Source: CoinMarketcap.com

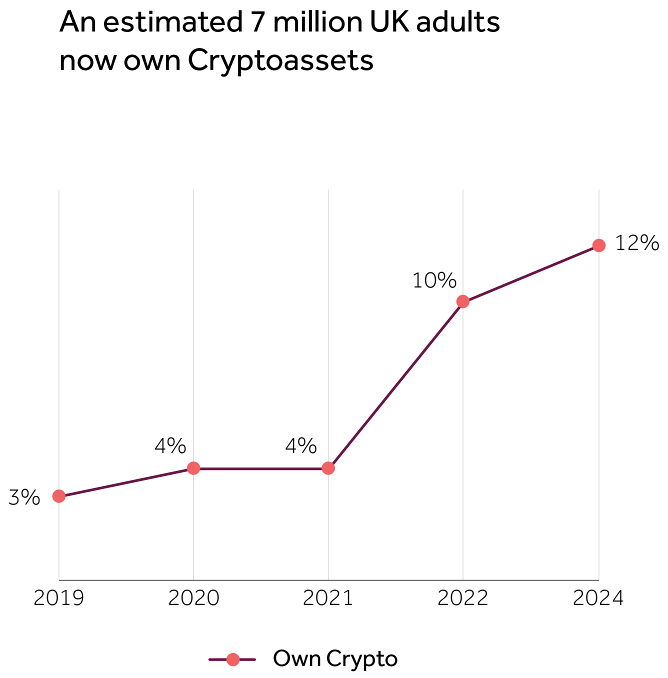
2 https://www.fca.org.uk/publication/research-notes/cryptoasset-consumer-research-2024-wave-5.pdf
3 As reported by https://coinmarketcap.com/
4 https://www.cityam.com/uk-remains-worlds-third-largest-crypto-economy-and-biggest-in-europe/

The UK cryptoassets market

15. UK demand for cryptoassets has increased sharply in recent years. FCA survey data indicates that ownership rates among UK adults have more than doubled since 2020, with our Consumer Research series estimating 7 million cryptoasset owners across UK adults as of August 2024 (12% of adult population).

Figure 5: Cryptoasset ownership among UK adults

Trend in UK Cryptoasset ownership rates

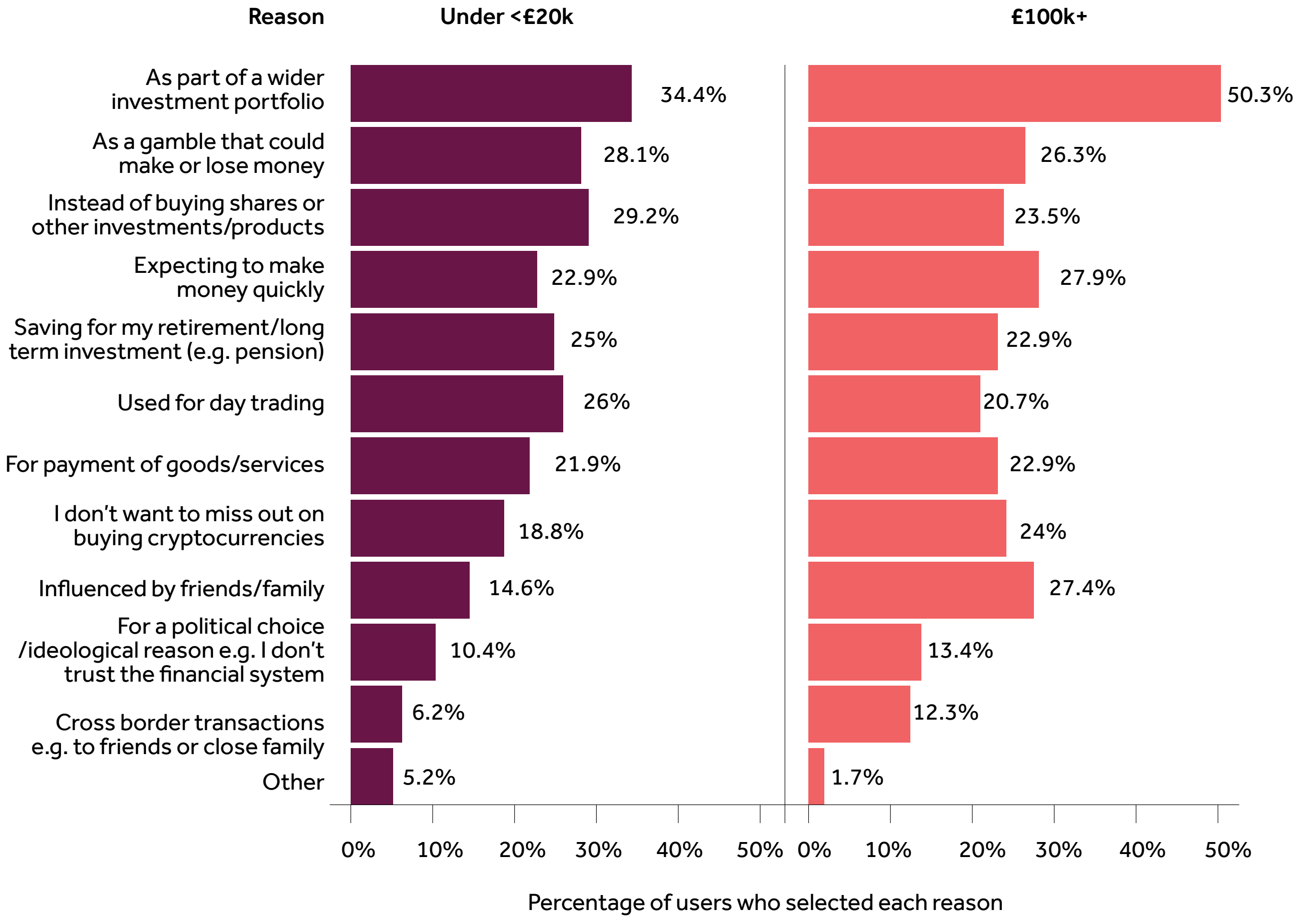


Source: Cryptoasset Research Note (Wave 5)

16. The most common reasons stated for owning cryptoasset are as "part of a wider investment portfolio" and "as a gamble that could make or lose money". Research conducted through the Digital Regulation Cooperation Forum (DRCF) highlighted the financial returns as the primary motivator for UK consumers to buy cryptoassets.

17. This research and our survey data also underlined the importance of word-of-mouth recommendations for driving demand for cryptoassets among UK consumers, with people typically relying on recommendations from friends and family, and undertaking limited research prior to purchase. Our consumer research also highlights that online forums such as Reddit and social media are among the most common way people first hear about cryptoassets. High-income and low-income households tend to have similar reasons for choosing to invest, although lower income households are more likely to buy cryptoassets for day trading.

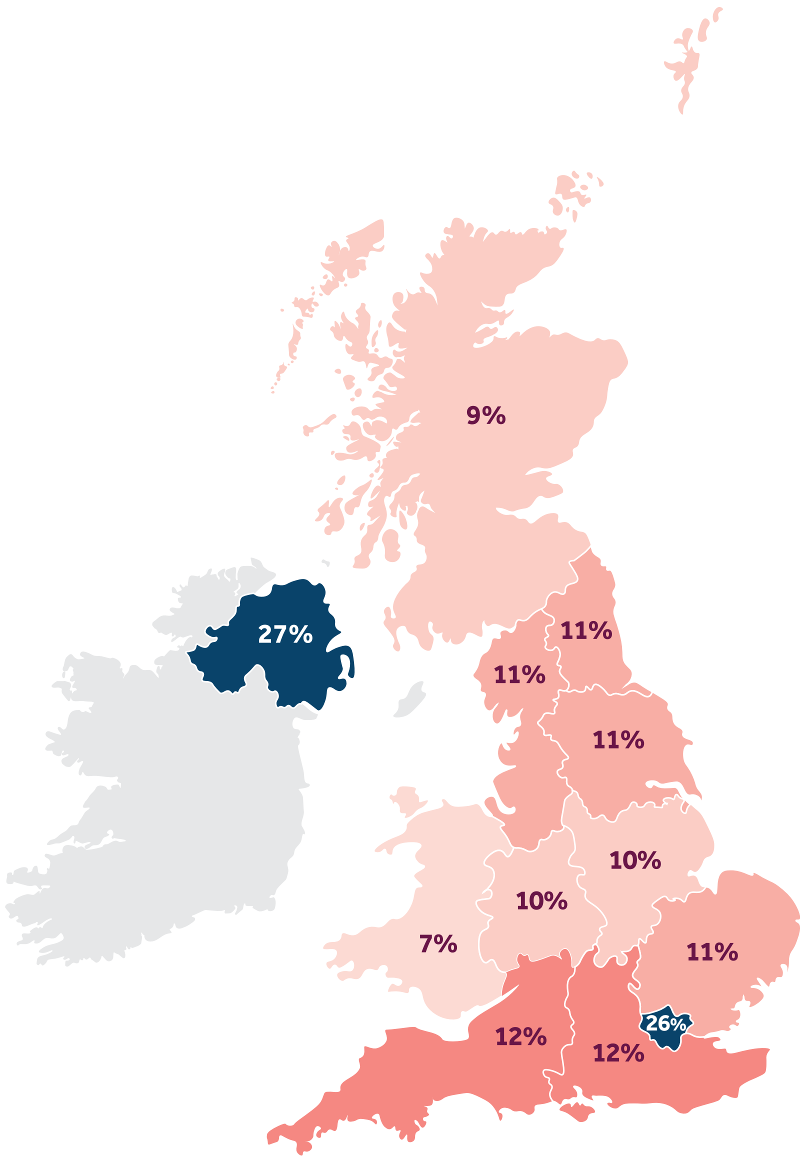
Figure 6: What were the main reasons for buying cryptoassets?



Source: Cryptoasset Research Note (Wave5)

18. As of August 2024, UK cryptoasset consumers on average hold £1,850 worth of cryptoassets, although the distribution is skewed - the majority own less than £1,000 while a smaller group hold above £5,000. Cryptoasset consumers tend to be younger, male and come from higher socioeconomic backgrounds. Our survey data further suggests ownership rates are higher in London and Northern Ireland relative to the rest of the UK.

Figure 7: Crypto ownership rate by UK region



Source: Cryptoasset Research Note (Wave 5)

19. The global cryptoasset market is currently characterised by limited regulatory oversight, with firms operating in the sector currently subject to little regulation relative to equivalent products in traditional financial markets. Recent FSB[5] publications indicate that, while some jurisdictions have introduced regulation (including outright bans on retail ownership such as China and Kuwait), most IOSCO members are in the process of developing and implementing further regulation in the market over the coming years.

20. Limited regulation of cryptoassets has resulted in poor outcomes for consumers, with scams and frauds common (and our research suggests consumers consider these accepted features of the market). Cryptoassets are the most searched product on

5 Financial Stability Board

our ScamSmart website and reports of cryptoasset scams to the FCA have more than tripled since 2020. There were an estimated 9,000 cryptoasset scams or frauds in both 2022 and 2023 in the UK, compared to approximately 3,000 in 2020. 9% of UK Cryptoasset holders say they have personally been a victim of a crime, scam or fraud involving cryptoassets, with social media scams the most common.

21. Other than fraud, some firms have relied on unsuitable business models or have taken excessive risks, as demonstrated in the recent market crash in 2022. Despite this disruption, there is limited evidence of activity in cryptoassets negatively affecting the wider financial system, although recent research conducted by the Bank for International Settlements suggests that interconnectedness may be increasing[6].

Custody of Cryptoassets

22. "Custody of cryptoassets" refers to the method that holders of cryptoassets choose to store their assets and their means of access to them. Across the variety of different types of cryptoassets available, there are 3 broad options cryptoasset owners have when storing their tokens:

- Self-Custody: This approach typically involves software that allows the cryptoasset owner to interact directly with the blockchain or can include hardware on which the means of access (including a private cryptographic key or seedphrase) are stored (known as a wallet). This gives complete control over their assets and is typically low cost. However, this approach can be complex and high-risk as if the wallet owner forgets or loses their keys/password to the wallet, the assets will be irrecoverable. Our survey data suggests 9% of UK cryptoasset holders have forgotten their private key and as a result lost access to their wallet.
- Cryptoasset Custodian: Alternatively, a cryptoasset owner could rely on a firm to directly manage the storage of their cryptoassets and hold the means of access. The firm may use various methods to ensure cryptoassets remain secure while also maintaining ease of access. This custody method can significantly reduce administration and risk of asset loss to the cryptoasset owner, although custodians will charge a fee and so is higher cost than self-custody solutions.
- Custody at a Trading Platform: Firms operating as a cryptoasset custodian may also provide other services, such as operating as a trading platform (TP). These platforms are where most cryptoasset trading takes place and so can be a convenient solution for consumers who value ease of access and the ability to buy and sell quickly. Using a TP for custody is usually free for consumers. Custody of customer's cryptoassets is done collectively by the platform, which will then maintain a secondary record or ledger of individual customers rights to these cryptoassets.

23. Currently, there is no regulation in the UK which sets standards for firms providing custody of qualifying cryptoassets for UK consumers. Cryptoasset custodians are only registered by the FCA under the Money Laundering Regulations (MLRs) and are required to conduct money laundering and financial crime checks on customers, but in contrast

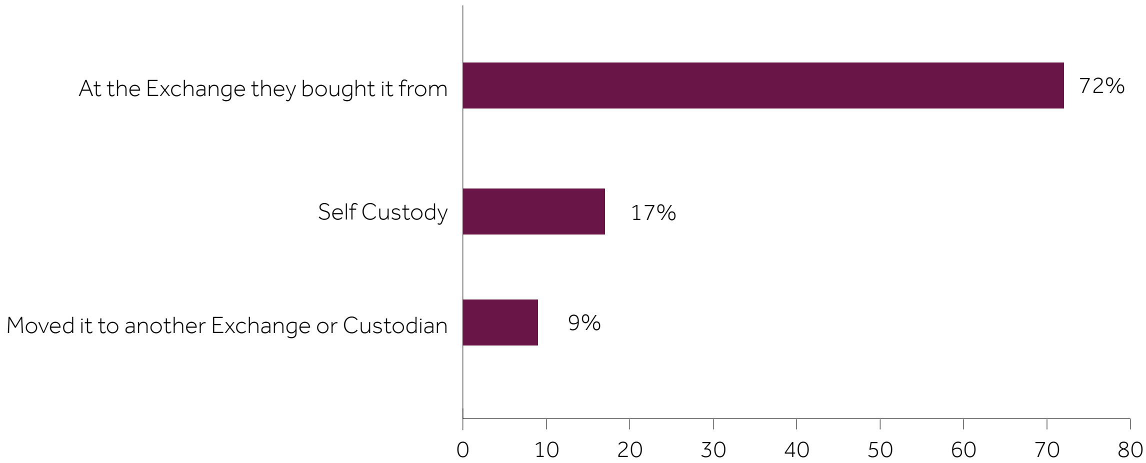
6 https://www.bis.org/publ/othp72.pdf (Section 3.2.3)

to custody of traditional financial assets, do not currently face any requirements on how they safeguard any cryptoassets they are holding on behalf of clients.

24. The size of the retail UK consumer market is estimated at £12.6bn. This is based on 12% of UK adults (7 million individuals) holding an average of £1,800 in value. Relative to international peers, the UK has a similar ownership rate, although the average portfolio is significantly smaller compared to Canada (£45,000[7]) and Australia (£10,000[8]).

25. Within the UK, 72% of consumers choosing to store their cryptoassets on the TP they purchased their cryptoasset from. Consumers typically choose their TP based on word-of-mouth recommendations from friends or family. Our qualitative interviews suggest that UK consumers found self-custody options overly complex and did not see risks with relying on TPs they were familiar with.

Figure 8: How do UK consumers custody their cryptoassets?



Source: Cryptoassset Research Note (Wave 5)

26. In terms of competition within the custody market, consumers tend to hold their cryptoassets on the platform they originally purchased them on, which is usually decided based on a recommendation of a friend or family member. Our consumer research suggests that this is based on strong user satisfaction with these TPs. This means that TPs, which are the primary entry point for most consumers, also serve as the primary custodians for the UK cryptoasset market and may further benefit from strong network effects.

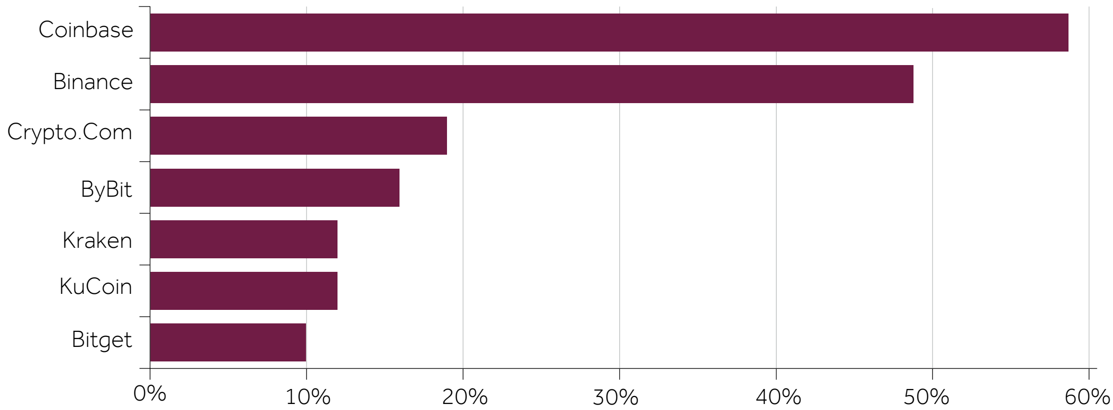
27. Our assessment of market dynamics is that consumers are reluctant to change platform once they have selected a TP, and so firms primarily compete in attracting new cryptoasset consumers. Firms largely offer homogenous products, so clients choose which firms they use based on trust, experience and advice from peers.

7 https://www.osc.ca/sites/default/files/2023-12/inv-research_20231129_crypto-asset-survey-2023.pdf Page 5 reports ownership rate of 10% in 2023, with average holdings of $82,998 (converted to GBP at CAD$1:£0.55 exchange rate).

8 https://www.finder.com.au/finder-au/wp-uploads/2024/05/Consumer-Cryptocurrency-Report-2024-3.pdf Pages 3-4, 9% Ownership rate in 2024, with average holdings of $21,426 (converted to GBP at AUD $1: £0.48

28. The chart below illustrates the most popular TPs among UK consumers.

Figure 9: UK crypto consumers who have used selected Trading Platform



29. Our survey data indicates that security is the most important factor to UK consumers (49%) when deciding where to store their cryptoassets, with consumers who own higher values (>£1,000) more likely to regard security as the most important consideration (63% compared to 43% for those with less than £1,000 in cryptoassets). Ease of access was the next most important factor (17%), followed by cost (9%). 12% of cryptoasset users said that they did not consider where their cryptoassets were being stored.

30. As most UK consumers custody at TPs, and the most popular TPs are all based overseas, this means most cryptoassets owned by UK consumers are currently being custodied outside of the UK.

Stablecoins

31. Stablecoins are a unique form of cryptoasset which have their value linked to an underlying reference asset. As a result, unlike other cryptoassets, which have fluctuating prices, stablecoins are intended to maintain a fixed value relative to a reference product.

32. There are various types of cryptoassets that try to claim a form of stability. Typically, fiat-referenced stablecoins are cryptoassets which link their value to an underlying currency (ie 1 token = $1).

33. In the case of fiat-referenced stablecoins, price stability may be sought through maintaining a pool of backing assets equal in value to the outstanding tokens.

- **Upward Pressure:** If the token falls below its reference value (ie 1 US dollar-referenced stablecoin is trading at $0.98), then market participants could purchase on secondary markets and redeem at the issuer to capture the profit.
- **Downward Pressure:** If the token rises above its reference value (ie 1 US-dollar referenced stablecoin is trading at $1.02 on secondary markets), then market participants could purchase stablecoins from the issuer and sell them at a higher price and capture the profit until the market adjusts.

34. Stablecoins are currently primarily used for trading purposes within the cryptoasset sector, providing holders of cryptoassets an opportunity to convert their holdings into a less volatile portfolio, without off-ramping into fiat currency. They can also be used to provide liquidity to the cryptoasset market, by allowing pairings in trades for more niche cryptoassets. Some fiat-referenced stablecoins are also used in transactions, including to purchase goods and services. They can also potentially be used as a wholesale settlement asset in traditional finance transactions and used as collateral between parties.

35. As of May 2025, the aggregate value of the global stablecoins market was ~$240bn. Stablecoins cumulatively represent around 6.5% of the total cryptoasset market, and are primarily purchased by consumers through TPs, rather than directly from the issuer. Stablecoin issuers generally face no restrictions on how they safeguard their backing asset pool or allow access to redemptions, resulting in variety of business models in operation.

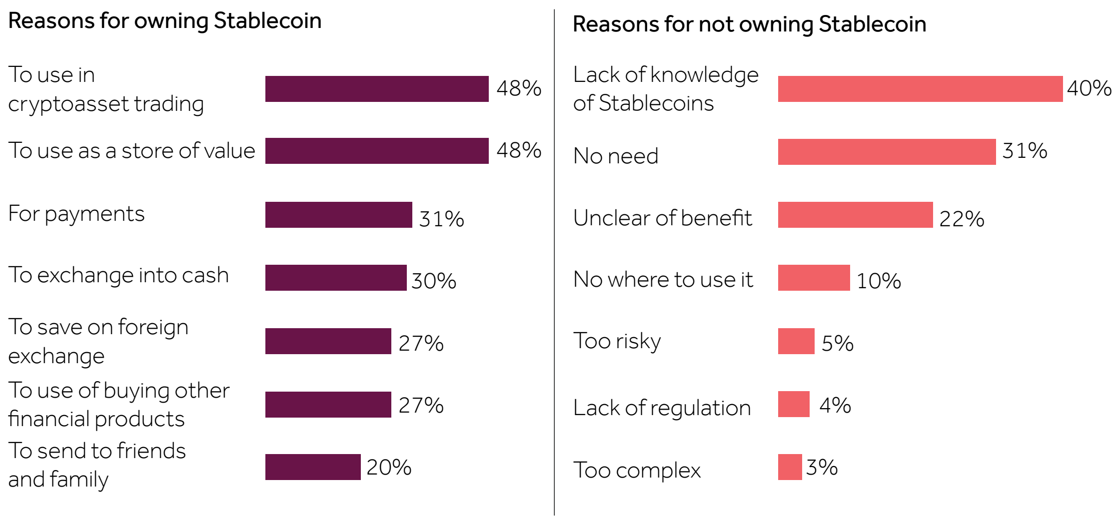
36. The most common form of stablecoins are fiat-referenced, with their value linked to the US dollar. This business model involves issuing stablecoins and receiving fiat currency in exchange and maintaining a backing asset pool. The issuer may generate income from the backing assets they hold, which also aim to be liquid enough to allow redemptions and ensure price stability through 1:1 backing. The stablecoin issuer may also earn income on the transaction fees.

37. In terms of competition, stablecoins may compete across several dimensions such as the stability of the backing asset pool, redemption fees and any interest offered to holders. The global market is dominated by two USD-referenced stablecoins, which collectively represent 90% of the market. These firms benefit from name recognition, with our research suggesting UK consumers place value in firms' ability to survive in the cryptoasset market for an extended period.

38. UK demand for fiat-referenced stablecoins is lower than other forms of qualifying cryptoassets. Just over half of cryptoasset users are aware of stablecoins (53%), and around 25% of UK cryptoasset owners have purchased a stablecoin (equivalent to 3% of adults). The most common reason for purchase is to use stablecoins as a store of value or when buying or selling other cryptoassets (48%). The most popular fiat-referenced stablecoins by UK cryptoasset consumers are Tether (18%) and USDC (9%).

39. Our research suggests the limited demand for fiat-referenced stablecoins relative to other qualifying cryptoassets is driven by a lack of understanding of their purpose. This is consistent with consumers primarily purchasing cryptoassets to earn financial returns, which stablecoins do not support. However, this research did highlight UK consumers would be more interested in purchasing stablecoins if they could be used more widely and had increased regulatory protections.

Figure 10: Reasons for owning stablecoins



Cryptoasset Research Note (Wave 5)

40. Currently there are no fiat-referenced stablecoins issued from the UK. Furthermore, our analysis of the market suggests that as of April 2025, there are no fiat-referenced stablecoins issued in GBP globally. A previously circulating fiat-referenced stablecoin, Poundtoken was issued in GBP from the Isle of Man and not regulated by the FCA. Historic data suggests Poundtoken reached a market cap of up to £2.3m in May 2023, with blockchain analysis suggesting there were approximately 2,000 wallet addresses currently holding Poundtoken. However, the token no longer appears listed on exchanges and the issuer's website is no longer available.

41. While current use cases for fiat-referenced stablecoins are mostly limited to trading within the cryptoasset sector, they have been highlighted as having a strong potential in the payments sector and remittances as they rely on DLT, which may increase efficiencies relative to legacy systems.

Problem and rationale for intervention

42. In this section we discuss the harms that our proposals are seeking to address and the underlying drivers (or market failures) of these harms.

Harms associated with custody of qualifying cryptoassets

43. When relying on a third party such as a cryptoasset custodian or exchange custodian to safeguard their cryptoassets, the primary risk consumers are exposed to is a loss of timely access to their cryptoassets, particularly if that firm enters an insolvency process. Recent failures by cryptoasset custodians suggest this can occur for several reasons, including:

- **Mismanagement and/or inadequate safeguarding:** We have observed repeated instances of consumer harm materialising from firms providing custody of cryptoassets, with much of this materialising due to poor management practices within the firm. Even when firms look to adequately safeguard the cryptoassets of their clients, there are still risks associated with custody which can result in consumer harm. Inadequate safeguarding can result in custodians with fewer assets than liabilities, with consumers having limited possibility for recourse (particularly if the custodian firm fails). Recent examples include including:

  - *Failure to disclose losses to consumers:* MT Gox, a popular cryptoasset custodian suffered hacks and repeated losses of client assets between 2011 and 2014. The firm failed to disclose this to consumers and continued to accept cryptoassets while being insolvent.
  - *Inadequate internal controls:* Cryptopia, a New Zealand based exchange lost approximately 10% of its cryptoassets in 2019 after they were stolen directly from a company wallet, following the private key becoming compromised. Many involved in the firm have alleged the theft was likely undertaken by an employee due to the nature of how the assets were accessed and stolen.
  - *Single Point of Failure:* Quadriga, a Canadian exchange relied on a private key to the firm's wallets holding clients' assets which was known only by the firm's CEO. The CEO's unexpected death in 2018 led to clients losing access to their assets with no possibility of recourse.
  - *Losing access to private keys:* Prime Trust, a US-based custodian declared in 2023 that it had lost access to private keys for certain wallets, meaning any funds sent to those wallet addresses were effectively lost. This resulted in the firm entering receivership, with $85m owed to clients.
  - *Losses due to hacks:* Chainalysis, a cryptoasset data firm has estimated that in 2024 approximately $2.2 billion worth of cryptoassets were lost due hacks, across 303 separate incidents.
  - *Co-mingling of accounts:* If a firm does not adequately segregate client assets from its own, then clients may be at risk, particularly in the event of firm failure. In such an event, client assets may be considered part of the general estate of the firm and used to settle the firm's liabilities in the event of bankruptcy. Clients may face delays in the return of the cryptoassets (such as in the case of FTX), reductions in the value of this return due to the period of time it takes to suitably allocate those assets between clients, or at worst, a total loss of assets.

44. The risk of harm may be greater for qualifying cryptoassets than in custody of traditional finance due to unique features associated with cryptoassets, including:

- **Geographical scope:** The extra-territorial scope of services provided by firms to UK consumers for qualifying cryptoassets presents an increased risk that those firms will establish their place of business outside of the UK. This creates a risk of harm in the event of insolvency- while it may be possible for an insolvency application to be made to a UK Court, it is more likely that an overseas firm will be subject to the insolvency regime and procedures of the firm's home state. This is further complicated by issues associated with evidencing ownership rights, vertical

integration, the nascency of the market resulting in firms having a lack of familiarity with financial regulation.
- **Legal uncertainty:** There is greater legal uncertainty around ownership and location of cryptoassets compared to custody assets in traditional finance. There is no generally accepted legal definition of cryptoassets, or whether cryptoassets qualify as property (though the Law Commission concluded they likely do) and therefore are subject to ownership rights.
- **Digital Nature of Assets:** The pseudonymity of wallet addresses, append-only nature of many blockchains and consensus mechanisms for validations mean that, once cryptoassets are moved to particular wallets, it is almost impossible to access them without the wallet's private key. This can mean, unlike traditional financial assets such as stocks or property where possession can be re-established, cryptoassets may be irrecoverable following a hack or the loss of a private key.

45. When the above harms do materialise, they can have a significant adverse effect on holders of cryptoassets. Our recent consumer research suggested that 13% of cryptoasset consumers would feel less financially stable if they lost access to their cryptoassets, while 6% said they would struggle to pay bills and day-to-day essentials. Losses may also result in negative wellbeing impacts to consumers, particularly if outcomes are uncertain and they are required to participate in bankruptcy proceedings to recover their assets.

46. Beyond the initial impact of the loss of their cryptoassets, consumers may also experience loss of confidence in the cryptoasset market or financial services more broadly, which may cause further harm.

Harms associated with stablecoin issuance

47. The primary harm we have identified with consumer use of fiat-referenced stablecoins is when a fiat-referenced stablecoin deviates from its reference value on the secondary market and redemption is limited with the issuer. In these scenarios, consumers can be exposed to financial loss if they can only exchange at below par value on the secondary market (i.e. and not redeem directly with the issuer). This can arise due to how a fiat-referenced stablecoin is managed, with the key risk being:

- **Failure of the stabilisation mechanism:** A fiat-referenced stablecoin maintains its reference value through a "stabilisation mechanism" which aims to keep its price fixed. For fiat referenced stablecoins, this is typically through holding sufficient liquid backing assets and allowing redemptions of tokens with the issuer, ensuring price fluctuations are minimal.
  - Currently, many issuers of fiat-backed stablecoins restrict redemption to institutional users such as TPs –either directly, or indirectly, where restrictions (such as high fees or minimum withdrawal amounts) function as a deterrent. This can result in retail consumers only able to trade their stablecoins in secondary markets, should they wish to exchange for fiat.
  - If a stablecoin were to deviate from its reference value, a retail consumer may be unable to request to redeem their stablecoin at par. In 2023, following

widespread media coverage of the failure of Silicon Valley Bank (SVB), USDC, briefly de-pegged from the dollar to a low of $0.87. SVB was a counterparty to the backing asset pool and the de-pegging was related to the potential contagion between SVB and USDC. Utilising a wholesale operation model, the issuer (Circle) was able to offer redemption at par to their direct clients. However, this was not available for retail clients (who did not have contractual recourse to the issuer), and some may have lost money if they chose to sell their stablecoins on the secondary market at below par price during the market turbulence.

48. Even consumers who don't own stablecoins may still experience harm from the failure of a fiat-referenced stablecoin, due to how they are used within the cryptoasset sector. Specifically, the failure of a fiat-referenced stablecoin can lead to wider cryptoasset market movements, which may result in significant price volatility and firm failure, as illustrated below:

- **Contagion and cryptoasset system failure:** Fiat-referenced stablecoins are widely used within the cryptoasset sector as a means of providing liquidity, on and off ramping between cryptoassets and fiat currency, and converting from one cryptoasset to another. Due to this functionality, fiat-referenced stablecoins play a critical role within cryptoasset markets, and are treated as risk-free assets by market participants. The failure of a prominent fiat-referenced stablecoin due to inadequate controls or backing assets could have a significant adverse effect on the market, leading to contagion and system failure, potentially impacting consumers of other cryptoasset products (ie through asset price decline or firm failure).

  While we do not know the scale of UK consumer harm associated with this stablecoin failure contagion, our qualitative consumer interviews provide an indication of how consumers may react to these market events. One individual interviewed indicated they had specifically purchased a cryptoasset marketed as a stablecoin as they had observed a 99% price decline and were anticipating a sharp recovery. This anecdote is further supported by research by BIS, which identified that retail consumers lost significantly more than wholesale market operators during a market downturn. This was as retail consumers were more likely to buy cryptoassets as their prices declined due to expectations of a sharp recovery.

49. For UK-issued fiat-referenced stablecoins, these harms are theoretical, as there are currently limited to no stablecoins being issued from the UK. However, if UK-issued fiat-referenced stablecoins did become widely used for payments, cross-border transactions or other purposes, then in the absence of sufficient regulation, the above harms could materialise.

Harms associated with disorderly firm failure

50. Many of the harms associated with stablecoins and inadequate safeguarding have occurred due to disorderly firm failure. Disorderly failure can cause harm through:

- Consumer Impact: Consumers may suffer financial losses, loss of access to services, or loss of confidence in the financial system. This can lead to a reduction in consumer participation in the market.
- Market Impact: Disorderly firm failures can disrupt market stability and functioning. This can result in market inefficiencies, reduced market participation, and a loss of confidence among market participants.
- Wider Economic Impact: The failure of a firm can have broader economic implications, potentially affecting the stability of the financial system and the wider economy. This can lead to systemic risks that impact other firms and sectors. Any stablecoins widely used for payments and considered "systemic" will be regulated by the Bank of England as outlined in their discussion paper.
- Operational Impact: The failure of a firm can disrupt the operations of other firms and market participants, leading to operational challenges and increased costs for those affected.

51. These harms can materialise when firms do not adequately set aside funds to mitigate their risks. As outlined in our cryptoasset roadmap, we intend on consulting on our proposed framework for firm failure in a later CP.

Drivers of Harms

52. As outlined in our DP 23/4, we believe these harms can materialise due to negative incentives and feedback loops within cryptoasset markets. The drivers of harm are market failures which include information imbalances and optimism bias, common to both fiat-referenced stablecoins and qualifying cryptoasset custodians:

- **Asymmetric information:** Cryptoasset custodians and stablecoin issuers have better information on their business models and policies than consumers, including their safeguarding practices and composition of the backing assets. Introducing higher standards would benefit consumers and mitigate this imbalance but will increase firms' costs. Due to this asymmetry of information, consumers are not always aware of the lack of protection (or its quality) when relying on custodians for safekeeping their assets, particularly for ownership rights to their assets or in the event of theft or firm failure. Similarly, consumers may be unaware of how a stablecoin issuer composes the backing asset pool, and the potential risk it is exposed to. This can mean UK consumers are sold unsuitable services or products, with poor transparency.
- **Behavioural Biases:** Cryptoasset prices have risen significantly in recent years, and this appreciation has led to a "fear of missing out (FOMO)" within the sector. Research we published in May 2024 highlighted a strong culture of optimism amongst UK cryptoasset consumers, with previous recent asset price rises used as an expectation for future growth. Consumers also demonstrated evidence of herding behaviour, relying on the activities of their peers to support their decision making. Due to these biases, consumers may underestimate the likelihood of harm and engage in unintended or inappropriate levels of risk-taking.
- **Inadequate or Misaligned Incentives:** Some of the more popular stablecoins are highly restrictive in their redemption policies, while certain large cryptoasset

custodians have been opaque in their approach to disclosing their safeguarding arrangements. While consumers would benefit from a more transparent and risk-mitigating approach, firms may face weak incentives to do so, as it would likely increase their costs and they face limited competitive pressure. As noted above, cryptoasset consumers exhibit evidence of "herding behaviour" by relying heavily on advice from peers and conduct limited research prior to investment. This has resulted in demand concentrated in key products and firms, creating weak competitive pressures and incentives for those firms to adopt business practices that may benefit consumers but increase their costs.

- **Regulatory failures:** The absence of applicable regulation today means the risks of harm are more likely to occur. Custodians may not introduce appropriate systems and controls, due to inadequate incentives and weak competitive pressure to do so. Similarly, fiat-referenced stablecoin issuers may not introduce redemption policies for retail clients or sufficiently liquid backing asset pool to ensure 1:1 backing is always in place.
- **Externalities:** Fiat-referenced stablecoins are widely used within the cryptoasset sector and play a critical role within cryptoasset markets, treated as safe, risk-free assets, often used for collateral or to allow asset holders to minimise their risk exposure. The failure of a prominent fiat-referenced stablecoin due to inadequate controls or backing assets could have significant effect on the cryptoasset market, leading to contagion and system failure, potentially impacting other consumers of cryptoasset products. In terms of wider financial sector impacts, the Bank's Financial Policy Committee has reported that although these risks are currently not assessed as systemic, interconnectedness between cryptoassets and the wider financial sector is growing[9].

53. As set out in the Treasury's draft legislation, we will only introduce rules for issuers of qualifying stablecoins from an establishment in the UK. Qualifying stablecoins are qualifying cryptoassets referencing a fiat-currency that seek or purport to maintain a stable value in relation to the referenced currency by holding or arranging for the holding of fiat currency or fiat currency and other assets. Many of the above drivers will continue to exist for overseas fiat-referenced stablecoins, which will remain available to UK consumers after our intervention (although our disclosures regime may help mitigate information asymmetries). Consumers will remain at risk of harm from externalities associated with prominent stablecoins issued outside the UK.

54. In addition, any stablecoins considered systemic and issued from the UK will be regulated separately by the Bank, as set out in their Discussion Paper.

55. While global regulation of cryptoassets is increasing and may partially mitigate some of these failures, these are likely to continue to materialise and negatively impact UK consumers. This harm may increase further if UK demand for cryptoassets or interconnectedness with traditional finance continues to rise, as observed in recent years. Similarly, if firms were to issue fiat-referenced stablecoins from the UK, consumers may be further exposed to the above harms in the absence of a UK cryptoassets regulatory regime. Some of these harms may be partially addressed through wider consumer education and international regulation. However, most

9 https://www.bankofengland.co.uk/financial-stability-in-focus/2022/march-2022

international regimes will take several years to be fully implemented and would be unlikely to significantly reduce the risk of harm to UK consumers without a UK-regime in place. The FCA, through its experience regulating cryptoassets for AML/CTF and financial promotions, is best placed to deliver a new regime for cryptoassets which can mitigate harms to consumers, while being proportionate to firms and encouraging future financial innovation.

Options Assessment

56. Our analysis considers the costs of and benefits of regulating cryptoasset firms in line with the FCA's statutory objectives. Our proposed intervention looks to achieve these objectives through following the principle of **"Same Risk, Same Regulatory Outcome"** for cryptoasset regulation. While we do not think we can necessarily achieve the same outcomes as in traditional finance for the unbacked cryptoassets market, we anticipate we will be able to achieve a higher-level of consumer protection for stablecoins (relative to other qualifying cryptoassets) due to it being able to be a money-like instrument that may be used for payments. This overall approach aligns with recommendations from IOSCO and Financial Stability Board (FSB) to regulate cryptoassets the same as traditional financial products which share similar characteristics.

57. As outlined, this approach is technology agnostic while also considering whether the technology, or its use, gives rise to additional risks. This does not mean exactly the same form of regulation, as the features and use of cryptoassets may require a different regulatory method, but the aim is to achieve the same or similar regulatory outcome where possible.

58. Before arriving at this approach, we considered alternative policy options for regulating cryptoasset firms. We set these out below, in addition to their relative limitations that led us to dismiss them.

59. To support our approach to regulation of cryptoasset activities and assess the trade-offs across options, we identified several strategic outcomes that our cryptoasset regulations should deliver against, outlined below:

- **Consumer protection:** achieve an appropriate degree of protection for the public regarding cryptoasset products and services.
- **Market integrity:** the integrity of global financial systems is protected and enhanced.
- **Effective competition:** Effective competition that delivers high quality offerings in the cryptoasset market.
- **International competitiveness and growth:** facilitate the international competitiveness of the economy of the UK and its growth in the medium to long term, as appropriate aligning with international standards.
- **Sustainable system:** achieve sustainable stability economically, financially and environmentally.
- **Accessibility:** access to appropriate financial products and services that meet consumer needs and offer fair value.

60. These outcomes are not all equal, with the first three being primary, followed by our Secondary Objective, and the final two being further strategic considerations we considered.

61. Our rationale for intervention is in mitigating the harm we observe in cryptoasset markets, as outlined in the previous section. We consider options from the perspective of:

- How effectively they would meet our strategic outcomes.
- Any unintended consequences they could create.
- Constraints and delivery risks
- Below is a summary.

Alternative Option: Regulate to minimise or ban retail access.

62. One alternative option would be for the UK to introduce strong restrictions on UK retail access to cryptoasset products. Given current limited use cases, this could likely reduce consumer harm in the short term, without negatively affecting market integrity or adversely impacting UK growth.

63. However, this option would involve high enforcement and monitoring costs, and consumers may still look to access cryptoasset markets through overseas providers. As such, this option would be challenging to effectively implement and may not effectively reduce consumer harm in practice.

64. This option may also result in the UK losing out on future growth opportunities cryptoassets could provide through innovation in financial markets. For example, if the UK had a small domestic market for cryptoassets due to strict regulatory controls, firms may be less likely to use cryptoasset technology for new products and innovation due to insufficient expertise, uncertainty in relation to regulatory barriers and limited consumer demand.

65. Relative to our proposed rules, we anticipate the costs of this option to be higher, as firms face increased compliance costs and FCA would be required to undertake significant monitoring and enforcement action.

66. In addition to delivery challenges, this option could also create a strong risk of unintended consequences through restricting retail access to the cryptoasset market. For example, existing UK cryptoasset consumers could substitute their demand for cryptoassets with other high-risk investments, such as CfDs or mini-bonds, which could create additional risks of harm. This option would also align poorly with our strategic outcomes, as it could make the UK an outlier in terms of international standards.

Alternative Option: Delivering entirely through prescriptive rules

67. Another approach would be to develop prescriptive rules to firms providing custody of cryptoassets or issuing qualifying stablecoins. This approach, which would be less outcomes focused, could provide increased regulatory clarity. However, a fully prescriptive approach would limit firms' abilities to innovate and given the fast-evolving

nature of the cryptoasset market, may result in rules that are not fit for purpose. This could hamper innovation and may not lead to better outcomes for consumers and market integrity.

68. We anticipate this option would result in similar costs to firms as our proposed rules. However, we also expect this option would result in lower aggregate benefits, with an outcomes-based approach being more effective at driving the business model changes required in the highly dynamic cryptoasset market.

69. This option would mostly align with our objectives and through creating prescriptive rules, could avoid unintended consequences in the short-term. However, in the longer-term, the prescriptive nature of the rules could create unintended constraints on the business models of firms and reduce innovation in the sector.

70. A summary of our options analysis is presented below:

Option	Benefits	Costs
Restrict retail access to Cryptoassets	✓ Minimise harm to consumers ✓ Limited short-run impacts on economy	✕ Delivery challenges, as difficult to enforce in practice ✕ Potential loss of opportunities from innovation due to cryptoasset products
Prescriptive Rules	✓ Increased regulatory clarity ✓ Reduced likelihood of unintended consequences	✕ Risk of becoming obsolete ✕ Reduced opportunity for innovation in products
Same Risk, Same Regulatory Outcome **(Proposed option)**	✓ Consistent with global financial system approach ✓ Reduces harm while also creating some opportunities for innovation	✕ Risk of "Halo effect" of regulation ✕ Risks to consumers are reduced but not eliminated

Our Proposed Intervention

71. We are designing a regime based on our operational and strategic objectives, with a view to mitigate the risks that qualifying stablecoin issuers and cryptoasset custodians may present. These risks include inadequate backing assets for stablecoins, insufficient information available to consumers, and poor safeguarding arrangements of the cryptoassets (and the assets backing the stablecoins).

72. In addition to mitigating the risks, our intervention also furthers our Secondary International Competitiveness and Growth Objective, through creating a well-

functioning cryptoasset market, which allows firms to innovate within a regulatory framework. Our intervention is not seeking to encourage UK consumers to purchase cryptoassets and instead ensure those engaging with the sector can do so with appropriate regulatory protections in place.

73. Our proposed intervention aims not to disproportionately burden firms, and instead provide the appropriate levels of consumer protection we believe necessary to foster further growth in the market. We believe a certain level of consumer protection and market integrity are required to build trust and participation in the market, which increase growth and competition.

74. Our intervention is based on draft legislative amendments to the Regulated Activity Order (RAO) expanding the scope of the FCA's perimeter to include the following activities:

a. Issuance of a qualifying stablecoin in the UK. This will include stablecoins issued in the UK which reference a fiat-currency (GBP, USD, EUR, etc) and which seek or purport to maintain stability through the holding of fiat currency or fiat currency and other assets. Our requirements will include rules about redemption, disclosures, and the management and safeguarding of the stablecoin backing asset pool.

b. Custodians of Cryptoassets in the UK or to UK Consumers. Firms safeguarding "qualifying cryptoassets" on behalf of another in the UK or for UK consumers will need to comply with our custody rules relating to qualifying cryptoassets. These rules are similar to the framework for safeguarding of traditional finance assets (CASS), which have been modified to account for the unique nature of cryptoassets.

75. Firms will also need to comply with our prudential requirements, as specified through our new sourcebooks, CRYPTOPRU and COREPRU. This will include an "Own Funds" requirement and a basic liquidity requirement for qualifying cryptoasset custodians and qualifying stablecoin issuers, in addition to an issuer liquid asset requirement for qualifying stablecoin issuers. These are intended to minimise the harms associated with disorderly firm failure.

76. As noted above, it is our intention that qualifying stablecoin issuers and qualifying cryptoasset custodians will face further requirements associated with our cryptoasset regime which have not been included in this CP but will be included in future interventions. This will include rules relating to our senior managers regime, operational resilience requirements, dispute resolution, resolution and application of The Principles[10], including the consumer duty. Further detail is outlined in our Crypto Roadmap, and we will assess the impact of these additional proposed requirements in future CBAs.

77. Fiat-referenced stablecoins issued from outside the UK will not be within scope of our issuance rules. These overseas stablecoins will continue to be available to UK consumers if admitted as a "qualifying cryptoasset" to UK cryptoasset TPs. If these qualifying cryptoassets are safeguarded by a firm in the UK, or to UK consumers, the firm providing this service will be within scope of our cryptoasset custodian regime. Our

10 https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html

intervention will not address any harms associated with issuing overseas stablecoins and is instead pre-emptive to minimise harm from any future UK-issued stablecoins.

Causal chain

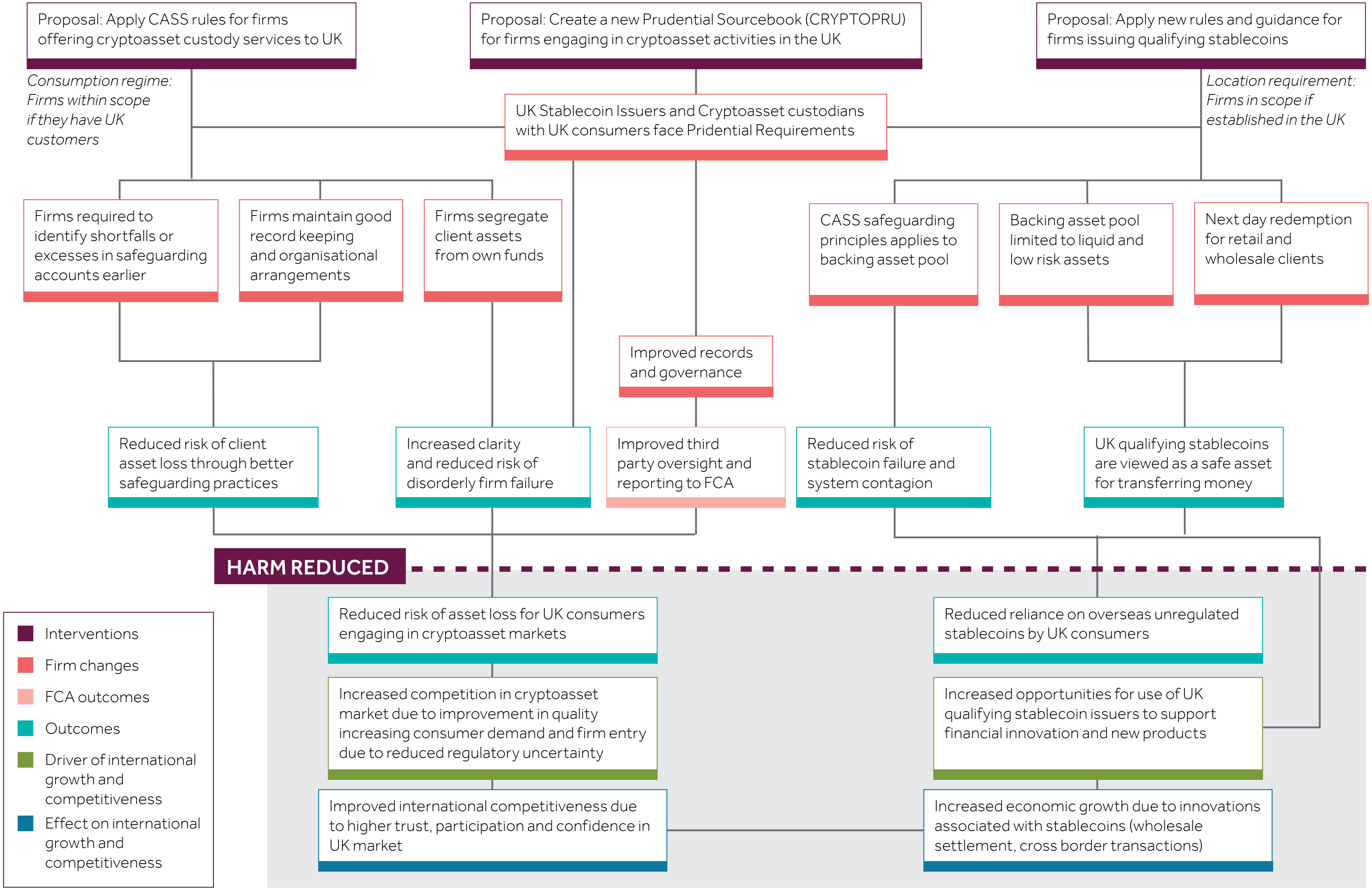
78. The below figure presents the causal way we expect the above changes will achieve our outcomes aligned with FCA Objectives and our strategic outcomes. Our interventions seek to reduce harm to consumers and the wider markets that arise from firm failures, rather than operate a zero-failure regime. In addition, we assume that our intervention results in fiat-referenced stablecoins being issued from the UK, which creates positive opportunities and outcomes for consumers and businesses.

79. Our causal chain demonstrates how our regulatory intervention can result in changes in the market having knock-on effects which ultimately result in reduced harm for consumers. Nodes within the chain have been informed from relevant academic literature[11] and our understanding of consumers through our surveys and firm engagement.

80. Our key assumptions are:

- Firms change their behaviour as a result of our intervention, including adjusting business models in line with our proposed requirements. The benefits of our proposals derive from changes in behaviour, particularly in relation to safeguarding of client cryptoassets.
- Introducing regulation provides greater clarity and regulatory certainty to firms. As a result of this certainty, firms enter to market to issue fiat-stablecoins from the UK.
- Prudential requirements reduce the likelihood of firm failure and further ensure that when firms fail, they do so in an orderly manner and have enough liquidity to meet ongoing obligations. This can result in minimal implications for market integrity or loss of client funds, making market participation more attractive for firms and consumers.
- Consumers use disclosures to make more informed decisions when choosing how to custody their cryptoassets or purchase a qualifying stablecoin.

11 Including "Makarov & Schoar , 'Blockchain Analysis of the Bitcoin Market, , NBER, 2022" which provides detailed assessment and information about the behaviour of the main market participants, and "Gornelli, "Crypto shocks and retail losses", BIS, 2023", which outlines how consumers react to negative market events.


Proposal: Apply CASS rules for firms offering cryptoasset custody services to UK
Proposal: Create a new Prudential Sourcebook (CRYPTOPRU) for firms engaging in cryptoasset activities in the UK
Proposal: Apply new rules and guidance for firms issuing qualifying stablecoins
Consumption regime: Firms within scope if they have UK customers
Location requirement: Firms in scope if established in the UK
UK Stablecoin Issuers and Cryptoasset custodians with UK consumers face Prudential Requirements
Firms required to identify shortfalls or excesses in safeguarding accounts earlier
Firms maintain good record keeping and organisational arrangements
Firms segregate client assets from own funds
CASS safeguarding principles applies to backing asset pool
Backing asset pool limited to liquid and low risk assets
Next day redemption for retail and wholesale clients
Improved records and governance
Reduced risk of client asset loss through better safeguarding practices
Increased clarity and reduced risk of disorderly firm failure
Improved third party oversight and reporting to FCA
Reduced risk of stablecoin failure and system contagion
UK qualifying stablecoins are viewed as a safe asset for transferring money
HARM REDUCED
Reduced risk of asset loss for UK consumers engaging in cryptoasset markets
Reduced reliance on overseas unregulated stablecoins by UK consumers
Increased competition in cryptoasset market due to improvement in quality increasing consumer demand and firm entry due to reduced regulatory uncertainty
Increased opportunities for use of UK qualifying stablecoin issuers to support financial innovation and new products
Improved international competitiveness due to higher trust, participation and confidence in UK market
Increased economic growth due to innovations associated with stablecoins (wholesale settlement, cross border transactions)
Interventions
Firm changes
FCA outcomes
Outcomes
Driver of international growth and competitiveness
Effect on international growth and competitiveness

Our Analytical Approach

81. We assess the impacts of our proposed new rules against a baseline, or 'counterfactual' scenario, which describes what we expect will happen in the cryptoasset market (both domestic and international) in the absence of our proposed policy change. We compare a 'future' under the new policy, with an alternative 'future' without the new policy.

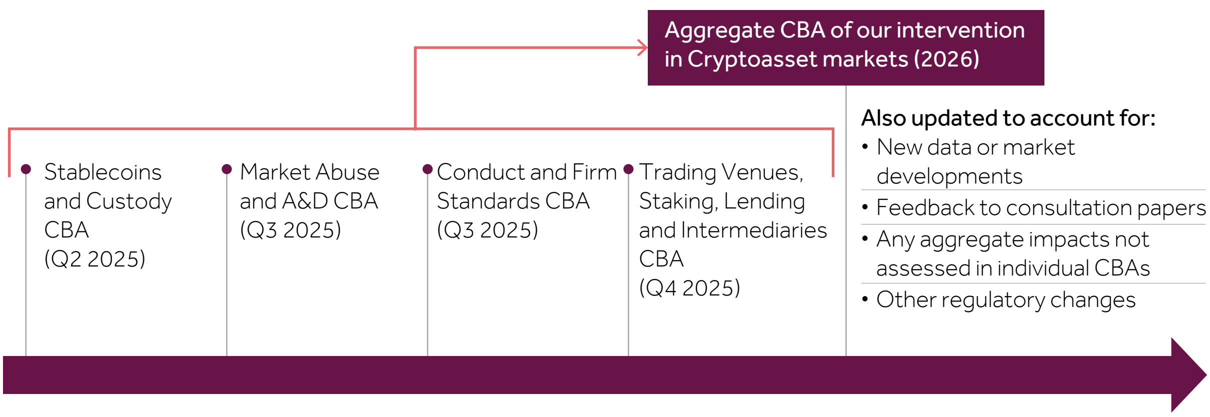
82. We constructed this baseline by looking at evidence of the current situation in the sector and extending this into the future. Our counterfactual is based on evidence from the following sources, which we discuss in more detail in the following subsection:

- Surveys and engagement with cryptoasset firms.
- Consumer data.
- Market data, including pricing, assets available and historical firm failures.
- Our experience and knowledge of the costs associated with regulation, including using our Standardised Cost Model.

83. As noted, we are consulting on our rules through a staged approach, with future planned consultations outlined in our cryptoasset roadmap. Our intention is that rules for our aggregate cryptoasset regime will go live at the same date, to avoid inconsistencies or opportunities for regulatory arbitrage. For the purpose of our analysis, we consider only the rules that will be implemented through our proposed intervention in this CP (i.e. requirements for issuers of qualifying stablecoins and qualifying cryptoasset custodians). Aggregate impacts of our proposed cryptoasset regime will be assessed through a future CBA accompanying our Policy Statements.

84. We recognise potential limitations of this approach, which include risks of double counting costs and benefits across our CBAs or needing to account for additional regulatory changes in between our interventions. We will ensure our individual CBAs are the most accurate assessment of the incremental impact of our intervention, with a final CBA assessing the aggregate impact and accounting for any market changes or further data. The figure below outlines how we anticipate this will work over the course of our cryptoasset CBA publications.

Figure 11: CBA roadmap



85. We consider the impact of our proposals over a 10-year period with costs and benefits occurring from the assumed time of implementation. We account for any costs and benefits arising from moving between the interim and end-state rules. When estimating net present value of costs and benefits, we use a 3.5% discount rate as per The Treasury's Green Book. Prices are given in 2025 figures.

Surveys and engagement with firms

86. In February 2023 we sent cost surveys to firms we identified as having potential interest in either providing custody of cryptoassets to UK consumers or issuing a stablecoin from the UK. In total we received:

- 80 responses to our custody survey, of which 8 firms indicated they were looking to become a regulated cryptoasset custodian.
- 65 responses to our issuance survey, of which 2 firms indicated they were looking to issue a UK stablecoin.

Both groups provided detailed cost estimates for the impact of our proposed interventions.

87. In addition to these cost surveys, we conducted further surveys of payments firms and wholesale banks which are used to supplement our analysis. We have also engaged with industry participants through several roundtable discussions. We currently supervise 47 crypto firms under the MLRs and are continually engaging with them throughout supervision to improve our understanding of the UK cryptoasset market.

88. Our Discussion Paper (DP23/4) included a short assessment of the market failures we believed were present within the market, and the types of costs and benefits we anticipated to materialise following our regulatory intervention. Firms largely agreed with our assessment of the type of costs which would materialise, including both direct compliance costs and business model changes. Several respondents noted the impact regulation will have on competition, through causing concentration or raising barriers to entry. We have looked to update our approach to the CBA in line with responses, such as including a dedicated competition assessment on the impacts of our proposals.

Consumer data

89. Since 2019, the FCA has published a regular series of cryptoasset research notes based on survey data of UK cryptoasset consumers. Our most recent publication (Wave 5, with fieldwork taking place in August 2024) involved over 3,000 respondents and provides us with the opportunity to identify trends in consumer behaviour. We use this survey data for estimating the current baseline in terms of the size of the market, and how demand for products could expect to change following our regulation.

90. Additionally, in May 2024, in conjunction with the Information Commissioner's Office (ICO) through the DRCF we published a research note on consumer attitudes towards cryptoassets. This research was based on interviews conducted with UK cryptoasset consumers. This qualitative research further strengthens our understanding of the baseline, the behavioural biases of consumers and the likely demand-side response to our proposed intervention.

Data Limitations

91. Our surveys and firm engagement have helped us in better understanding of how the cryptoasset sector currently operates within the UK, and the potential costs and challenges which may arise because of our proposed intervention. This is particularly true in our understanding of retail demand for cryptoasset, where our various research outputs have provided us strong insight into how and why UK consumers engage with cryptoassets.

92. However, in gathering our data to assess the impact on firms, we faced several limitations which affect our analysis, namely:

- **Cryptoasset sector is new and fast-evolving:** Many firms who will be in scope of Treasury legislation and thereby affected by our rules are currently outside our regulatory perimeter and may have limited experience of the regulation our proposed intervention would introduce. Similarly, as of April 2025 there are currently no stablecoin issuers located in the UK. This makes estimating impacts uncertain, particularly where our regulation will result in significant changes to business models.
- **Limited responses to our cost surveys:** While we received responses to our cost surveys from firms, the volume of responses was lower than we typically receive from surveys of this kind, partly due to the small number of cryptoasset firms currently registered by the FCA under the MLRs and challenges in identifying and reaching firms that are not currently regulated by the FCA that would be caught by Treasury legislation for the future FSMA regime. While the cost estimates provided are used in our analysis, the smaller response rate makes aggregating responses for the "average" firm or identifying outliers more challenging.

93. We have taken several steps to address any adverse impact of these limitations. To better understand costs to firms, we undertook a comprehensive review of cryptoasset related cost-benefit analyses (or equivalent) published by international regulators and used these to inform our evidence base. We have also engaged with academics to help correctly identify the magnitude of potential costs and benefits from our intervention.

94. When assessing the impact of our proposed rules for qualifying cryptoasset custodians and qualifying stablecoin issuers we have used data from previous FCA CBAs for similar interventions to support our evidence base. Reliance on these previous CBA estimates may result in additional uncertainty for our cost estimates, as it requires us to assume cryptoasset firms will incur costs at a similar rate as traditional finance firms.

Baseline for Cryptoasset Custody in UK

95. We assume that absent our proposed intervention, the harm we outlined earlier in this document will continue harming clients to the same degree over the next 10 years. In practice, it is difficult to identify with certainty how harm could be expected to materialise in the absence of our proposed intervention.

- **Potential for harm reduction:** As the cryptoasset sector continues to mature and develop, there may be a reduction in the frequency and scale of harm relative to what we have observed in recent years. Harm may be further reduced through international jurisdictions introducing regulatory regimes which reduce risk-taking and unsustainable business models.
- **Potential for harm increase:** The harms we have observed associated with cryptoassets in recent years have been mostly confined to the cryptoasset sector. However, if interconnectedness between cryptoassets and traditional finance continues to grow as we have observed, then there is increased risk of negative market events in the cryptoasset sector impacting the wider economy. The 2023 failures of Signature Bank and Silicon Valley Bank, who both had significant exposure to the cryptoasset industry, had limited impact on the wider financial system. However, this could be more significant in the future if interconnectedness continues to increase.

96. The harm our intervention aims to minimise is in relation to custody of cryptoassets by firms offering these services in the UK or to UK consumers. Our intervention will also impact non-UK consumers if served by a firm established in the UK. While we recognise the potential for harm to increase/ decrease over our appraisal period, for our baseline, we assume harm remains similar to what we have observed in recent years.

97. Our consumer research indicates that demand for cryptoassets within the UK is concentrated as a speculative asset which provides high returns in short time periods. Most consumers conduct limited research and have low understanding of the risks associated with custody. Consumers who own cryptoassets exhibit high degrees of trust towards cryptoasset firms. Consumers also rely significantly on advice from friends and family and demonstrate optimism bias and herding behaviours. Consumers primarily purchase cryptoasset as an investment with the expectation that it will increase in price.

98. Non-UK based trading platforms are the most common way for UK consumers to store their cryptoassets, with most choosing to keep their cryptoassets at the exchange they originally purchased from. These exchanges are the primary entry point for new consumers and are dominated by small number of larger firms.

Baseline for issuing a qualifying stablecoin in the UK

99. Use and knowledge of stablecoins is low. Consumers who do purchase stablecoins overwhelmingly choose the most popular products (Tether and USDC). Use cases are primarily limited to storing value on TPs or as a means of exchange and settlement in cryptoasset trading.

100. Although there are currently no firms issuing a fiat-referenced stablecoin from the UK, we assume that over the course of our appraisal period, 10 UK fiat-referenced stablecoin issuers emerge. We assume the wider stablecoin market remains static throughout our appraisal period, with the 2 major issuers remaining dominant and not conducting this activity from the UK.

Key assumptions

101. In this section, we outline the key assumptions underpinning our CBA.

Assumptions on firms' business models

102. We assume full compliance with our new rules by qualifying stablecoin issuers and cryptoasset custodians. Other than the minority of those who choose to self-custody, we assume UK consumers only custody their cryptoassets with UK authorised custodians who comply with our rules for client assets.

103. We assume cryptoasset custodian firms continue to offer services to the UK market, following our intervention. Over time, following our intervention, we expect that greater regulatory clarity results in increased entry by firms into the UK cryptoasset custodian market. We assume firms will change their behaviour and business models in order to be compliant with our rules.

104. Survey responses (when used for estimating compliance costs) are assumed to be representative of the total (current and future) population of firms affected.

105. As there are currently no fiat-referenced stablecoin issuers located in the UK, we assume clarity of regulation set out in this publication will result in market entry. Costs to firms issuing a qualifying stablecoin are therefore elective for issuers.

106. We assume costs estimated for firms to comply with FCA regulation in previous FCA CBAs are reasonable approximations for the costs cryptoasset firms will incur to comply with similar regulatory requirements. Additionally, we assume standardised cost model outputs are applicable to cryptoasset firms.

Assumptions on number of firms affected

107. We anticipate that firms of different sizes will incur different costs. We categorise firms as Large, Medium or Small based on our Standardised Costs Model (SCM). Firm populations are based on survey responses (both consumers and firms), in addition to our review of cryptoasset firms currently registered with the FCA and which may seek to provide cryptoasset custody services or issue a qualifying stablecoin from the UK[12]. These populations also account for expectation of how attractive our rules will be to firms and business model restrictions they will place.

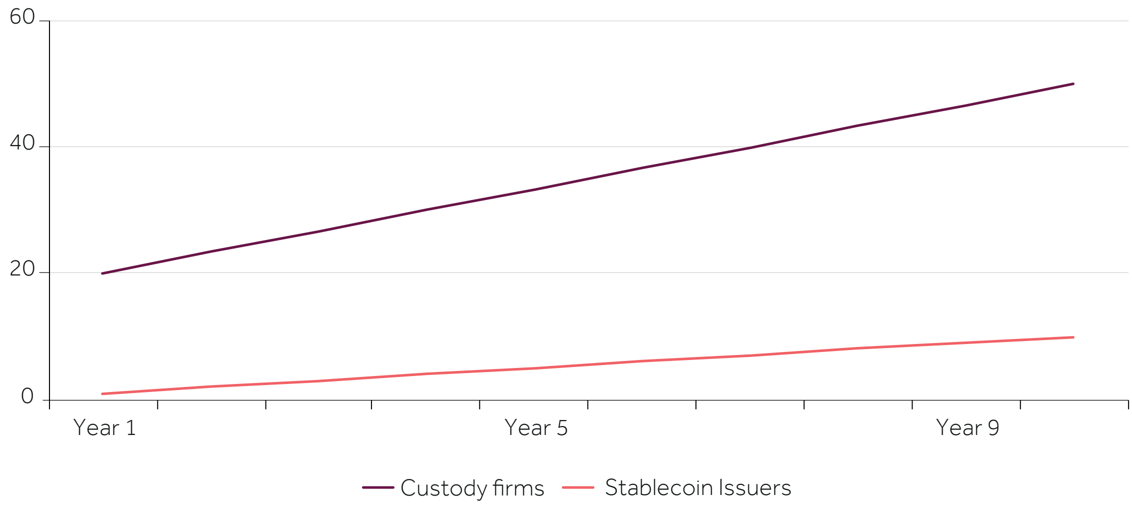
12 https://register.fca.org.uk/s/search?predefined=CA

Firm Type	Small	Medium	Large	Total
Stablecoin Issuers	10	0	0	10
Cryptoasset Custodians	0	48	2	50
Total	10	48	2	60

108. We assume all cryptoasset custodians affected by our regime will be either medium or large, based on their relative importance in the cryptoasset sector. For qualifying stablecoin issuers, we assume all firms will be small relative to other fiat-reference stablecoin firms based overseas. Our estimated size and number of stablecoin issuers is based on responses to our firm surveys, although is subject to significant uncertainty, and it is possible that larger firms enter the market to issue qualifying stablecoins following our intervention.

109. For fiat-referenced stablecoin issuers, we assume firms will enter the UK qualifying stablecoin market as they become familiar with our rules, with the number of firms gradually increasing over the course of our appraisal period. For cryptoasset custodians, we assume immediately after our intervention, the larger custodians, and firms providing custody services and already registered with the FCA for MLRs, are within scope of our new rules. We estimate this to initially be 20 firms. We assume the population of firms gradually increases, as additional firms enter the market over the course of our appraisal period.

Figure 12: Assumed UK firm population following our intervention

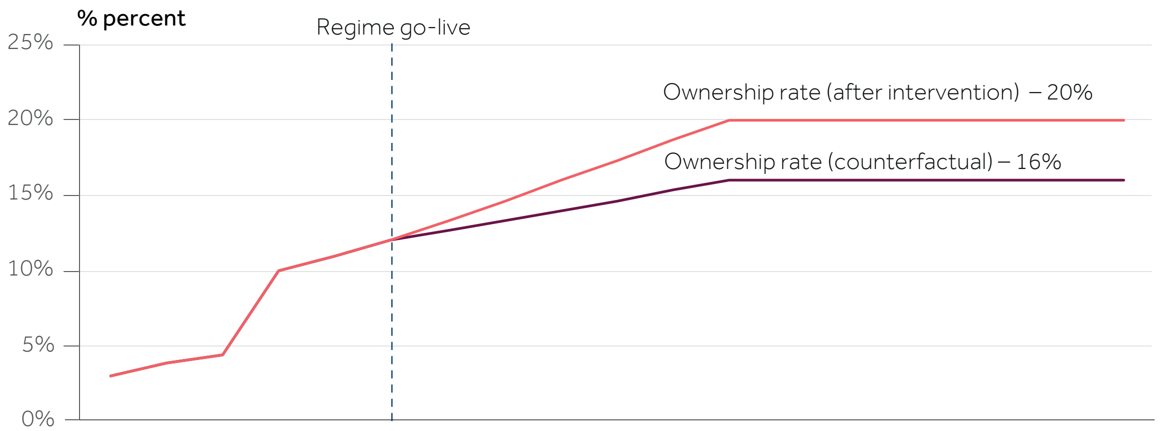


Assumptions on Consumers

110. The baseline for our proposed change is for cryptoassets to remain popular with UK consumers but demand would likely plateau in the coming years, as more risk averse individuals do not enter the market without some level of regulatory protections. We assume ownership rate would level off slightly above the current ownership rate (similar to levels observed currently in the US (16%)).

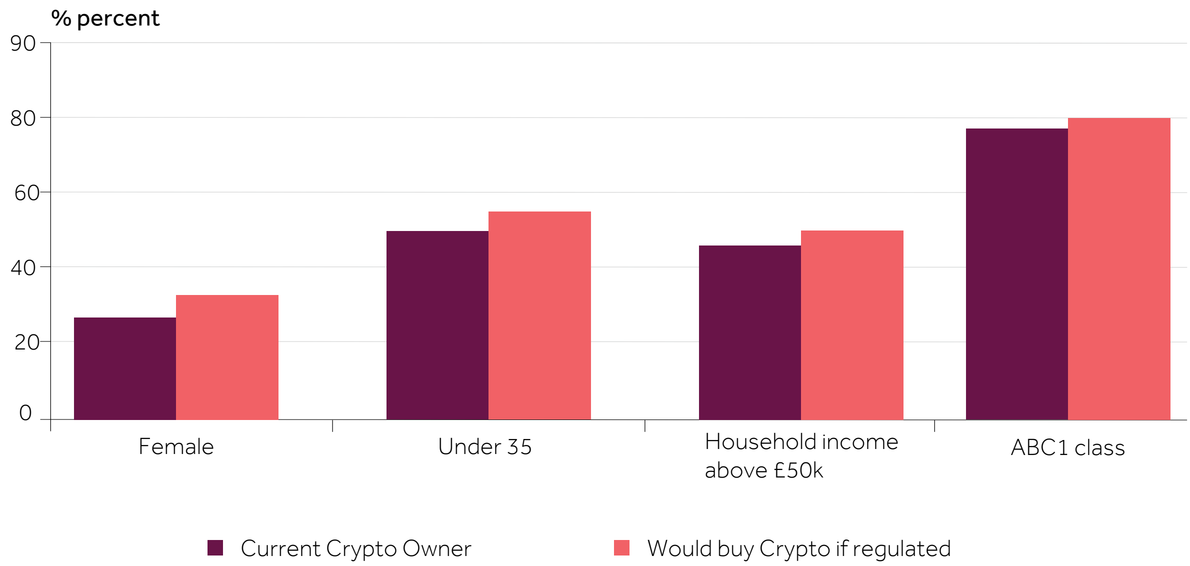
111. Following our intervention, we assume demand for cryptoasset increases moderately. As outlined in our consumer research, a significant share of non-cryptoasset owners would purchase cryptoassets if it had some regulatory protections. Estimated demand is outlined below:

Figure 13: UK Crypto Ownership rate



112. The type of users may also change due to our intervention, as outlined below. We assume any new users in the market hold similar portfolios as existing users, in both our proposed option and counterfactual.

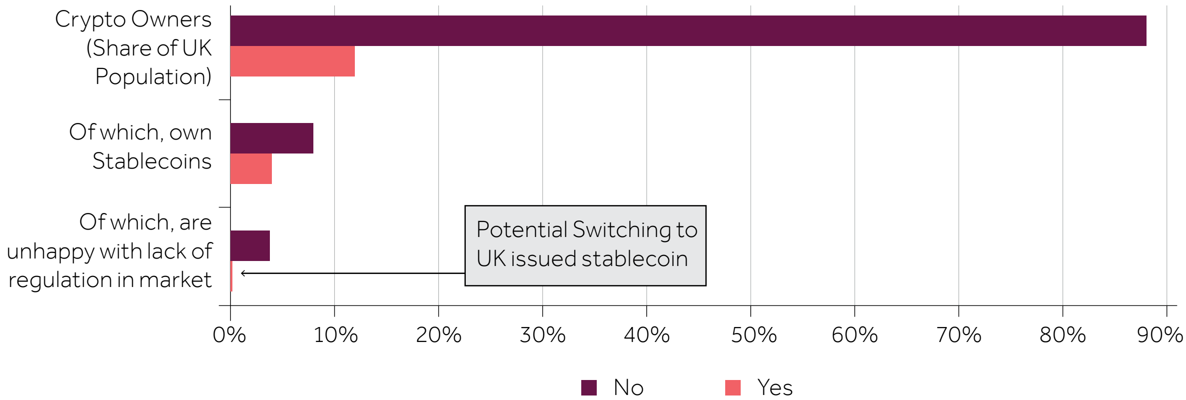
Figure 14: How our intervention would effect UK ownership of crypto



113. We assume non-UK issued fiat-referenced stablecoins (overseas stablecoins) will be available to UK consumers through regulated TPs. We assume these overseas stablecoins remain popular with UK cryptoasset consumers for the purposes of exchanging cryptoassets. Many of the consumer harms related to overseas stablecoins will not be directly addressed in this CP (but will be acknowledged by future CPs). As current demand for fiat-referenced stablecoins within the UK is low, we anticipate the primary impact of our rules for qualifying stablecoins will be to shape the parameters of an emerging market, rather than substantially alter the global market for fiat-referenced stablecoins.

114. We assume some switching from overseas stablecoins to UK-issued stablecoins, due to preferences to hold regulated assets, as outlined below. Beyond switching, consumer research by Mintel suggests up to 23% of UK cryptoasset consumers would be interested in a qualifying stablecoin. We note that interest in a qualifying stablecoin is not equal to interest in switching, and consumers may instead have both qualifying stablecoins and overseas fiat-referenced stablecoins.

Figure 15: Demand for UK issued Stablecoins (from existing stablecin holders)



115. The FCA may also undertake additional actions such as improving consumer education in conjunction with our partners and enforcement within our current powers. These may impact the market and alter consumer or firm behaviour. However, in the absence of regulation, we do not believe these actions alone will be able to reduce the harm we observe in the market.

Assumptions on the wider cryptoasset market

116. Our survey data indicates most firms used by UK consumers for cryptoasset custody or which issue stablecoins are based internationally. This makes the incremental impact of our regime dependent on rules applied in other jurisdictions. Given the considerable uncertainty as to when international regimes will introduce regulation, and if they do so whether that will introduce any protections for UK consumers of those overseas products or services, we assume any standards introduced internationally will not apply similar levels of protection for UK consumers relative to our proposed intervention.

117. For the purpose of this CBA, we assume cryptoasset prices remain in line with their levels as of December 2024. The primary purpose of this assumption is in estimating the benefits of our custody proposals and costs of our prudential requirements, which require that the assets that are being safeguarded to have a nominal value.

118. In terms of interactions with the wider economy, we assume introducing rules for issuing a qualifying stablecoin will result in increased opportunities for use cases of qualifying stablecoins, particularly in their use for cross-border transactions and wholesale settlement. There may be increased links between cryptoasset firms and traditional finance, particularly if qualifying stablecoin issuers hold backing assets at UK institutions. Cryptoasset custodians and qualifying stablecoin issuers may choose to establish subsidiaries in the UK, which could result in small labour market impacts due to increased demand for certain workers.

119. We also make the following assumptions:

- Benefits result from imposing new requirements to firms that fall within the FCA's regulatory perimeter and not subject to what other jurisdictions impose elsewhere.
- Cryptoasset firm insolvencies in our appraisal period follow the trend of custody in the period Q1 2014 – Q4 2023
- The overall regulatory treatment of qualifying stablecoin issuers and cryptoasset custodians broadly aligns with other main jurisdictions (eg IOSCO, FSB recommendations) in the long-term. Therefore, the risks related to regulatory arbitrage are low.

120. And use the following terms:

- Unless stated otherwise, all references to 'average' are the mean average.
- All price estimates are nominal.

121. We note that the per-firm estimates we set out in this CBA have been generated to increase the robustness of industry-level estimates. Per-firm cost estimates correspond to the mean cost, and do not capture the potentially wide range of costs that a particular firm may incur. For the avoidance of doubt, individual firms may in practice bear costs greater or lower than the per-firm averages used to estimate overall costs to the industry. This will depend, among other things, on the firm's individual size, makeup, and current practices. Firms should consider our proposals in relation to their specific operation and provide feedback on this basis, supported by evidence where they believe costs differ.

Summary of Impacts

122. Over our 10-year appraisal period we estimate £406m (PV-adjusted) benefits and £250m (PV-adjusted) costs for our safeguarding proposals, leading to a net PV-adjusted benefit of £157m. Benefits materialise due to avoided losses to consumers as a result of improved safeguarding arrangements. While we do not quantify their individual impact, these benefits are supported by our prudential requirements, which will reduce the incidence of disorderly firm failure.

123. For our qualifying stablecoins rules, we estimate aggregate costs to our population firms being £8.9m PV, the majority of which will be associated with our prudential requirements. We estimate approximately 280,000 UK adults will benefit directly due to having access to a new product that aligns with their preferences. Furthermore, if qualifying stablecoins could be used for a small volume of cross-border transactions (relative to current cross-border transaction alternatives), the potential for reduced fees is estimated at £11.2m PV.

<table>
<tr><th></th><th>PV Benefits</th><th>PV Costs</th><th>Net Present Value</th></tr>
<tr><td>Total Impacts</td><td>£406m</td><td>£250m</td><td>£157m</td></tr>
<tr><td>-of which Custody (Non-Prudential)</td><td rowspan="2">£395m</td><td>£153m</td><td rowspan="2">£154m</td></tr>
<tr><td>-of which Custody (Prudential)</td><td>£87m</td></tr>
<tr><td>-of which Stablecoins (Non-Prudential)</td><td rowspan="2">£11.2m</td><td>£1.8m</td><td rowspan="2">£2.3m</td></tr>
<tr><td>-of which Stablecoins (Prudential)</td><td>£7.1m</td></tr>
<tr><td>-other unquantified impacts</td><td>Increased legal certainty

Opportunity to use qualifying stablecoins for wholesale settlement</td><td>“Halo effect” of regulation of stablecoins</td><td></td></tr>
</table>

Custody Regime (Non Prudential)

Group Affected	Item Description	Benefits (One-off)	Benefits (Ongoing	Costs (One-off)	Costs (Ongoing)
Firms	Familiarisation with new rules			£0.5m	£0
	Segregation of Client Assets			£20.1m	£11.8m
	Organisational Arrangements			£3.2m	£8.9m
Consumers	Reduced Risk of Asset Loss		£45m		
Total impacts			**£45m**	**£23.8m**	**£20.7m**

Custody Regime (Prudential)

Group Affected	Item Description	Benefits (One-off)	Benefits (Ongoing	Costs (One-off)	Costs (Ongoing)
Firms	Familiarisation with new rules			£0.4m	£0
	Own Funds Requirement			£41.9m	£3.8m
	Basic Liquidity Requirements			£22.3m	£0
Consumers	Reduced Risk of Asset Loss		As above		
Total impacts				£64.6m	£3.8m

Qualifying stablecoins regime (Non-Prudential)

Group Affected	Item Description	Benefits (One-off)	Benefits (Ongoing	Costs (One-off)	Costs (Ongoing)
Firms	Familiarisation with new rules			£0.1m	£0
	Managing of the Backing asset pool			£0.1m	£0.2m
	Providing redemptions by next business day			£0.7m	£0.1m
	Opportunity to use qualifying stablecoins for wholesale settlement		Reduced settlement fees/ increased efficiencies		
Consumers	Increased opportunities for qualifying stablecoins		£2.5m		
Total Impacts			£2.5m	£0.9m	£0.4m

Qualifying stablecoin regime (Prudential)

Group Affected	Item Description	Benefits (One-off)	Benefits (Ongoing	Costs (One-off)	Costs (Ongoing)
Firms	Familiarisation with new rules			£70k	£0
	Own Funds Requirement			£5.1m	£450k
	Basic Liquidity Requirements			£850k	£0
Consumers	Reduced Risk of Asset Loss		As above		
Total impacts				**£6.1m**	**£0.45m**

Estimated Annual Net Direct Cost to Business (EANDCB)

Group Affected	Benefits	Costs
Cryptoasset Custodians		£23.1m
Qualifying stablecoin issuers		£0.9m
EANDCB	£24m	

Benefits

124. In this section, we set out how we expect each of our proposed rule changes will benefit consumers and firms. Where possible, we have quantified these benefits using our market and consumer data.

Benefits to Consumers

125. The primary benefits to consumers relate to reduced incidence of harm, through increased regulatory protections. In addition, consumers may benefit from increased choice within the market for certain products. We expect our proposals will result in benefits to consumers in two primary ways:

- Significantly reduced risk of asset loss due to improved safeguarding of client cryptoassets.
- Opportunity to use a qualifying stablecoins which may potentially offer lower costs when making payments or sending money internationally.

Improved Safeguarding of client assets (due to our custody rules)

126. Treasury legislation will result in firms providing cryptoasset custody services in the UK or to UK consumers needing to comply with our safeguarding rules. We anticipate that this will result in a significant improvement in standards across the sector as firms segregate client assets from their own funds, conduct reconciliations and keep regular records which are reported to us and audited.

127. The primary benefit of introducing these interventions will be reduced risk of client asset loss due to poor safeguarding practices. Over our appraisal period, we expect significantly fewer cryptoassets held by UK consumers at regulated custodians to be lost due to inadequate safeguarding than would be the case absent our intervention. The benefit consumers receive is the avoided losses they would incur if our safeguarding regime were not in place.

128. To estimate the scale of avoided loss, we reviewed custodian failures of cryptoassets over the period Q1 2014 – Q4 2023. Our list is not exhaustive and there may be other cryptoasset custody failures that we have not identified and included in our analysis. Our analysis suggests that poor organisational arrangements and hacks are the most frequent reason for harm associated with custody failures. Across the period measured, an average of 0.7% of the market value of cryptoassets were lost due to custody failures within a year (this does not account for losses in DeFi[13]).

Figure 16: Crypto Custody Failures (Global)

Source: FCA review of cryptoasset custody failures

129. We assume that absent our intervention, safeguarding failures over the next 10 years will occur at the same frequency and feature the same characteristics and causes. Extrapolating, we assume that over our appraisal period, an average of 0.7% of

13 Decentralised Finance, is a term commonly used in the industry to market a range of financial services that have a high degree of automation, and do not necessarily involve traditional financial intermediaries.

cryptoassets will be lost due to safeguarding failures each year. This data is based on global markets which we assume is representative of the UK market (which represents around 0.6% of global demand for cryptoassets).

130. We assume our safeguarding rules reduce 60% of the losses consumers experience due to failures, as a result of better standards and safeguarding of client cryptoassets in compliance with our proposed rules. This figure is based on:

- Our assessment of the causes of custody failures (with many being the result of hacks, which we expect to be significantly reduced but continue to a degree)
- A recognition that custody failures do not always result in losses to consumers (as the affected firm may absorb the losses)

131. We have assumed our proposed regime will avoid 60% of custody failures relative to what we have observed in the market in previous years. This estimate is based on our assessment of the causes of custody failures, while recognising that some failures, particularly hacks may continue. We consider 60% a reasonable estimate of the potential avoided losses due to our safeguarding rules. In addition, we assume 100% compliance with our proposals and that consumers can only access UK regulated custodians.

132. Our estimated benefits to consumers are £45m per year in avoided losses, with a PV of £395m over the course of our appraisal period. These avoided losses are the market value of cryptoassets UK consumers would have lost access to, in the absence of our safeguarding regime. There will be additional benefits we have not quantified, including improved mental wellbeing for UK consumers, in addition to higher levels of trust and confidence in UK cryptoasset market.

Increased opportunity to use UK qualifying stablecoins

133. The draft Treasury legislation will require any firm established in the UK issuing a qualifying stablecoin to be authorised by the FCA and subject to our rules.

134. As outlined in our description of the market, qualifying stablecoins may be able to provide efficiencies above existing financial products, particularly for payments and cross-border transactions. Using DLT, qualifying stablecoins can reduce reliance on intermediaries and lower fees which are passed on to consumers. A barrier to unlocking these benefits is the current lack of regulation, which means fiat-referenced stablecoins represent a risk for people who want to use them (and currently have effectively non-existent acceptance rates amongst merchants in the UK).

135. Our consumer data suggests there is some demand for a UK issued qualifying stablecoins or regulation of stablecoin products. 4% of UK consumers who own cryptoassets but not a stablecoin say they would consider purchasing a stablecoin if it were regulated by the FCA- this is equivalent to 205,000 individuals. Furthermore, 5% of current UK holders of overseas stablecoins say are unhappy that the market is currently unregulated (75,000 adults).

136. If, because of our intervention, fiat-referenced stablecoin issuers establish in the UK, then these consumers may benefit from increased opportunity to purchase a qualifying stablecoin which has regulatory protections. This could affect consumers who don't own fiat-referenced stablecoins but would do so if it were regulated, and consumers who own overseas fiat-referenced stablecoins but are unhappy that the market is unregulated. Using our survey data, we estimate this to affect up to 280,000 adults.

137. Furthermore, UK consumers may benefit from increased opportunities for sending money, at potentially lower cost. A common application suggested for stablecoins is the use of remittances. Remittances are transfers, often cross-border, that typically involve consumers sending small amounts overseas on a regular basis. The market for such cross-border transactions is dominated by two firms and fees are considered high[14].

138. There is some evidence that cryptoassets can be used as an alternative by consumers in such cross-border transactions. Data from the Reserve Bank of El Salvador, which receives large inflows in remittances and has implemented a cryptoasset regime aimed at encouraging usage, reported an average of 1.3% of remittances made using cryptoassets between 2022-2024. In addition, evidence from Chainalysis suggests that in Latin America more than half of cryptoasset retail transactions (including remittances) are made using stablecoins.

139. The UK is one of the top-20 remittances sending countries in the world based on the total money sent. World Bank Bilateral suggests that 2018 outflows from the UK £23.6 billion with inflows of £3.4bn. Transactions fees have declined in recent years and were estimated at an average of 7.12% in 2019. This suggests approximately £1.8bn in fees paid for remittances sent into or from the UK.

140. To illustrate the potential impact of qualifying stablecoins for cross-border payments, we estimate the potential reduction in fees paid by UK consumers for remittances. For our analysis, we assume the World Bank data is representative of the current market, adjusted for inflation. We assume that by the end of our appraisal period, 1.3% of UK remittances (both originating and receiving) are sent through qualifying stablecoins, based on the share observed within the El Salvador market, affecting both remittance inflows and outflows.

141. Adoption rates of qualifying stablecoins for remittances are scaled in line with our assumed qualifying stablecoin firm population. Our consumer research suggests 28% of cryptoasset users would be unwilling or uncertain to use an overseas fiat-referenced stablecoin for payments. We assume this represents the share of cryptoasset remittances attributable to qualifying stablecoins (i.e. 28% of the 1.3% share of remittances market). We assume that those who receive qualifying stablecoins for cross-border payments redeem them immediately and pay the required redemption fee. We further assume any reduced fees are split equally between individual sending and person receiving.

142. Analysing market data, estimated fees when using qualifying stablecoins for remittances are 3%. We assume this is net of exchange rates. This results in an estimated fee reduction of £5.1m, and assuming the benefit is split equally between those receiving and sending, **£2.5m** in reduced fees to UK consumers. Assume this benefit of reduced fees occurs each year, scaled by our population of firms, this results in a **PV benefit**

14 One UNSDG aims for remittance fees to be below 3% by 2030 (compared to 7% average now)

of £11.2m in reduced fees paid for cross-border transactions due to use of qualifying stablecoins.

Stablecoins used for retail payments

143. In Discussion Paper 23/4, we highlighted several potential benefits associated with the use of stablecoins for payments, including higher speed, more privacy, increased accuracy and reduced cost. By reducing reliance on intermediaries, stablecoins may be able to provide alternative payment services at lower cost, which may subsequently increase competition with existing payment providers such as card schemes. The Treasury's recent National Payment Vision publication[15] noted this potential use case for stablecoins, while highlighting the need for innovation and competition in the payments sector. We expect any benefits of stablecoins used for retail payments to be initially accrued by merchants in the form of reduced costs, who may subsequently pass on savings to consumers through lower prices.

144. There may also be wider costs associated with increased use of stablecoins for payments. For example, reduced reliance on intermediaries could make it easier for malicious actors to deploy applications on the blockchain that harm consumers or steal their funds. Similarly greater privacy of transactions could increase risks from money laundering or fraud.

145. Most requirements currently applicable to payments do not sit within the FCA Handbook and are instead contained within the Payment Services Regulations 2017 (PSRs) and the Electronic Money Regulations 2011 (EMRs). Our review of the UK market indicates stablecoins currently have negligible acceptance rates across UK merchants, which may partly be due to the lack of applicable regulation creating uncertainty for firms and merchants in the payments sector (the PSRs do not capture transfers of value through other assets, including stablecoins). While our proposed intervention will create use cases for qualifying stablecoins, it will not change the PSR/EMRs, meaning some regulatory uncertainty on the use of stablecoins for payments will remain.

146. As a result, while noting the strong potential benefits stablecoins could create when used for retail payments, we anticipate the marginal benefit impact of the rules proposed in this Consultation Paper on the UK payments sector to be limited over the course of our appraisal period.

Benefits to firms

147. We anticipate firms to benefit from reduced regulatory uncertainty, through clear rules and expectations for custodians and qualifying stablecoin issuers operating within the cryptoasset sector. By setting regulatory standards, firms may further benefit from reduced risk aversion when engaging with traditional financial services (ie cryptoasset firms may find it easier to engage with banking services, which we noted as a challenge for some firms in our report on payment accounts access and closures[16]).

15 https://assets.publishing.service.gov.uk/media/6736385fb613efc3f182317a/National_Payments_Vision..pdf
16 https://www.fca.org.uk/publication/corporate/uk-payment-accounts-access-and-closures.pdf

148. In addition, firms may also benefit from increased demand for cryptoassets because of our regulatory intervention. Our consumer data suggested that approximately 5% of UK consumers who currently do not own cryptoassets would be likely to purchase if we introduced some regulatory protections, while those who already own cryptoassets would buy more. Increased demand would likely result in increased revenue to firms, which may in turn increase profits.

Stablecoins used for wholesale settlement

149. Firms may further benefit from the **use of stablecoins for wholesale settlement.** This could form the basis of a wholesale use case that would enable an alternative way to operate settlement systems in the post-trade cycle, by replacing traditional Delivery vs. Payment (DvP) settlement with more efficient arrangements. Stablecoins could be an alternative to tokenised deposits, bringing the 'payment leg' of the settlement system 'on-chain'.

150. This could create a number of benefits for firms and the wider market, including allowing for "atomic settlement", ie delivery-versus- payment, where a payment and the transfer of ownership for happen at the same time. The use of qualifying stablecoins in this way could also help reduce counterparty risk and enhance efficiency and liquidity for firms.

151. While we do not quantify this benefit, our assessment is that it represents a potential future use case for qualifying stablecoins, which may result in significant improvements to liquidity or efficiency gains for firms using stablecoins in this way.

Costs

152. In this section, we consider the costs of our proposals to both cryptoasset custodians and qualifying stablecoin issuers. We also consider the impact of our prudential requirements for firms providing these activities and the potential impact on business models which will may lead to changes in behaviour acting as the key driver of benefits..

Costs to Custodians

153. Costs will be both one-off (associated with implementation of our requirements) and ongoing (which firms will incur in order to be compliant with our rules). As noted previously, the cost estimates below are subject to reporting inaccuracies and small sample size bias of our survey data.

Familiarisation with new rules

154. We expect firms affected by our intervention will read relevant proposals in this consultation paper and familiarise themselves with the detailed requirements of the proposed rules and guidance. We assume this will involve firms conducting a gap analysis and detailed legal review in order to identify how our proposed regime will impact their business model.

155. We have estimated the costs of this to firms based on assumptions on the time required to read 200 pages of CP and 100 pages of legal text that are relevant to custody of client assets. We assume that there are 300 words per page and reading speed is 100 words per minute. This means that the document would take 3.5 hours to read. We convert this into a monetary value by applying an estimate of the cost of time to firms, resulting in an average cost of £11k one-off costs per firm. Based on our estimated firm population, total familiarisation costs across our custody proposals are estimated at £550k.

Estimated total familiiarisation costs for custody rules

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (across 10 year appraisal period)
Familiarisation with new rules	£11k	£550k	£0	£0	£550k

Segregation of Assets

156. Custodians will be required to segregate clients' cryptoassets from their own through the introduction of a trust structure, recording of ownership and wallet labelling. This will help to ensure that beneficial ownership of clients' cryptoassets is protected at all times while held in custody, and minimise the risk of consumer harm.

157. Custodians will need to ensure that there are robust controls around off-chain data, including adequate and timely reconciliations between on and off chain records to ensure that custodians are holding the right value, in the right asset class, on behalf of the right consumers.

158. One-off implementation costs will primarily arise due to the need for firms to identify client assets and segregate them from the firms' own holdings of cryptoassets. These transition costs are estimated at **£405k** per firm and **£20.1m** across our firm population.

159. Ongoing costs primarily relate to monitoring costs to firms to ensure client assets remain segregated. There may also be significant opportunity costs to firms as a result of the requirement to segregate client assets. These ongoing costs are estimated at an average annual cost of **£235k** per firm. This results in a total annual population cost across our firms of **£11.8m**.

Total estimated costs for segregating client assets

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Segregation of Client Assets	£405k	£20.1m	£235k	£11.8m	£95.2m

One-off implementation costs for providing client statements are estimated at £11k per firm. Aggregate estimated population costs are £540k.

Ongoing costs will arise due to the requirement for firms to provide client statements and maintain their systems to ensure they are accurate and up-to-date. These annual ongoing costs are estimated at £12k, resulting in an population cost of £560k.

Ongoing costs will arise due to the requirement to pay for audit fees on an annual basis. These are estimated at £36k per firm, aggregating to £1.5m across our firm population.

Recordkeeping and Organisational Requirements

160. Firms will need to keep records as necessary to enable it, at any time and without delay to distinguish cryptoassets held for one client from cryptoassets held for any other client, and from the firm's own cryptoassets. They will also be required to maintain records in a way that ensures their accuracy and that they may be used as an audit trail.

161. Organisational arrangements relate to how a firm organises its operations, systems and controls. Inadequate organisational arrangements by cryptoasset service providers, including poor record-keeping practices, and weak systems and controls, have led to hacks and thefts of clients' cryptoassets and resulted in significant consumer harm.

162. Our rules will require cryptoasset custodians to have adequate organisational arrangements to minimise risk of loss or diminution of clients' cryptoassets due to misuse, poor administration, or negligence. We will require custodians to regularly review their policies, including on the skills and expertise of their employees and comply with our principles on the security of key management and security.

163. One off implementation costs for complying with our organisational requirements are estimated at **£64k** per firm. This results in a total population cost of **£3.2m**.

164. Ongoing costs will incur as firms review and amend their policies and procedures relate to their organisation, and ensure their systems and controls remain adequate. These are estimated at **£180k** per firm, equivalent to **£8.9m** across our firm population.

Total estimated costs to firms for complying with our organisational arrangement rules

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Organisational Arrangements	£64k	£3.2m	£180k	£8.9m	£57.4m

Prudential Requirements for Custodians

165. Custodians will need to comply with our prudential requirements as set out in our CRYPTOPRU and COREPRU sourcebooks. We recognise that in a competitive market, some firms may fail but our prudential requirements are designed to reduce the risk of failure and the impact of harms when firms do fail. Our prudential requirements for custodians consider relevant requirements in overseas jurisdictions and draw upon similar activities under traditional finance.al finance.

166. We identify three broad cost categories our prudential requirements will place upon cryptoasset custodians:

- Familiarisation and Legal Costs
- Own Funds requirements
- Liquidity requirements

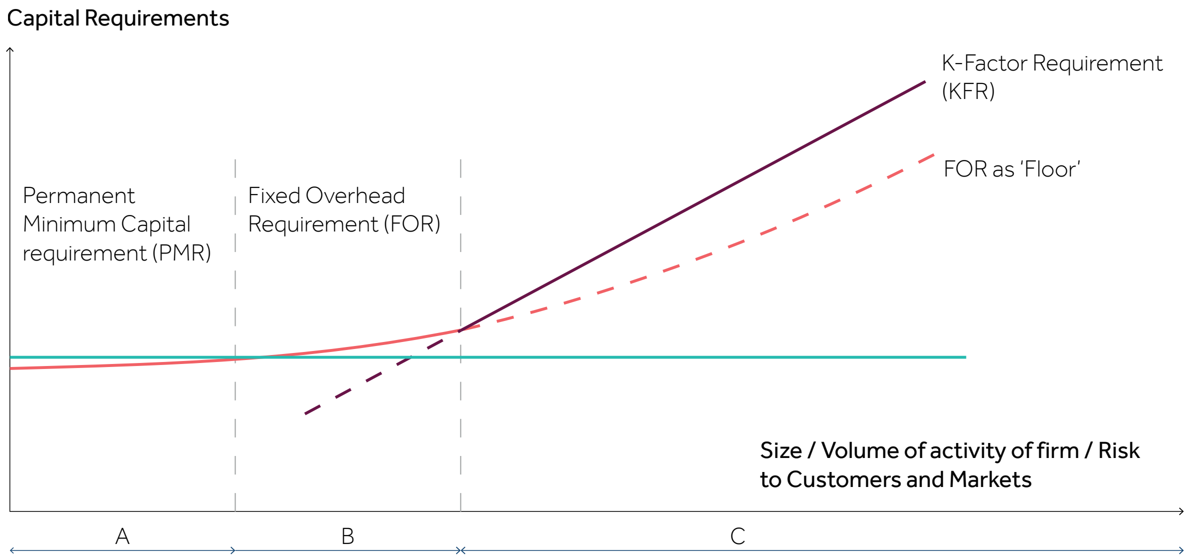
167. To familiarise themselves with our proposals, we expect that all firms will read the Prudential consultation paper (CP25/15) which is being published alongside this consultation paper. We assume firms will be required to read 40 pages of this prudential CP. In addition, we also anticipate firms to conduct a gap analysis of the amount of own funds and liquid assets required, among other things, and compare it against their current business model. We anticipate this to involve 100 pages of legal text from our CRYPTOPRU and COREPRU sourcebooks. We estimate total cost of familiarisation and gap analysis to be £3k per firm with a total cost of £150k across the population of firms.

168. Firms will need to adopt an Own Funds requirements that is the higher of the below three components:

- Permanent Minimum Requirement (PMR) of £150k
- Fixed Overhead Requirement (FOR) equivalent to 3 months fixed expenditure
- K-factor Requirement (KFR) estimated at 0.04% of the average value of the cryptoassets the firm has under custody.

169. The prudential requirements will scale with the size of the firm and we anticipate that the PMR, as the minimum requirement firms will face, will apply to smaller firms and the FOR or K-Factor requirement will apply to medium and large firms, as set out below.

Figure 17: Scaled prudential requirements



170. Responses to our custodian survey were not suitable as a basis for estimating the current own funds firms hold. As such, we have assumed that firms currently hold no funds in reserve, and all prudential requirements will be incremental costs. If firms do in fact hold some own funds, then costs estimated below will be higher than the costs firms will actually incur. Own funds are treated as a cost to firms as they represent an opportunity cost of capital, due to needing to hold the funds in reserve.

171. As noted above, we anticipate 50 firms to be within scope of our custody proposals. In order for a firm not to be subject to the PMR requirement, it must have annual fixed expenditure in excess of £600k or custody assets in excess of £390m. Our analysis of market data suggests only the largest firms operating within the UK market will meet the K-Factor requirement.

172. For the purpose of our analysis, we assume that all medium firms will custody less than £390m and so incur the FOR cost. For larger firms, we assume they face the k-factor requirement on the assumption they custody £900m in assets on average- these estimates are informed from our consumer surveys. This results in an average cost of £800k for medium-sized firms and £1.7m for larger firms.

173. Estimating the ongoing cost of the proposed prudential requirements requires an evaluation of the opportunity cost of capital to meet their estimated core capital resources requirement. We used the Capital Asset Pricing Model (CAPM), where we consider the return that investors would require from an equity investment, conditional on that equity's sensitivity to overall market risk, the equity market risk, and the risk-free rate.

174. The use of the CAPM for estimating cost of capital, allows us to produce a reasonable proxy estimate under the assumptions outlined. Our estimate for the cost of capital cryptoasset custodians is 8.3%. The average ongoing costs per firm will therefore be £77k average per firm[17].

175. Firms will also face a basic liquidity requirement of liquid assets equivalent to one month's worth of a firm's relevant annual expenditure (after allowable deductions). This is intended to allow a firm to fund the start of a wind-down or market exit at a time when income/cash-flow can be stressed and provide breathing space to realise other business assets. Based on our survey responses, we estimate the BLAR requirement at £285k average to firms.

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Familiarisation with prudential requirements rules	£8k	£370k	£0	£0	£370k
Minimum Own Funds Requirement	£840k	£41.9m	£77k	£3.8m	£64.4m
Basic Liquidity requirement	£450k	£22.3m	£0	£0	£22.3m
Total Prudential costs to Custodians	£1.3m	£64.2m	£77k	£3.8m	£87.1m

Total custody costs

In the below table, we aggregate the estimated costs of all our custody-specific requirements for cryptoasset custodians.

176.

17 This can be described by the following equation: $r_e = r_f + Brm$

Where re is the required return on equity, rf is the risk-free rate, B is the sensitivity of the investment to overall market risk, and rm the market risk premium. We estimate the risk-free rate by adjusting long-term UK government bond yields for inflation, which is approximately equal to 1%. We also set the equity market risk premium to be equal to 6.3% and the corresponding equal to 1.2, which we have estimated based on review of academic literature (Cryptocurrency returns under empirical asset pricing)

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population))	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Familiarisation with new rules	£11k	£550k	£0	£0	£0.55m
Segregation of Client Assets	£405k	£20.1m	£235k	£11.8m	£95.2m
Organisational Arrangements	£64k	£3.2m	£180k	£8.9m	£57.4m
Prudential Requirements	£1.3m	£64.2m	£77k	£3.8m	£87.1m
Total Costs	£1.8m	£89m	£0.5m	£24.5m	£240m

177. Average costs for firms are estimated at **£1.8m** implementation costs to become compliant with our rules, of which, the majority is anticipated to be one-off prudential costs. We anticipate firms will then occur average ongoing annual costs of **£0.5m**. Across our 10-year appraisal period and estimated firm population, this results in a total cost with a net present value of **£240m** for our custody proposals.

178. These cost estimates primarily relate to **compliance costs** that will be incurred by firms. There will likely be additional costs to firms associated with changes in business models which we have not captured above. New requirements could force companies to exit the market if they cannot meet the costs of our requirements, which may involve wind-up costs or stranded assets.

179. In addition, there may be indirect Research and Development costs if firms need to innovate to meet requirements and/or implement changes. For example, firms could spend less on research in order to pay for compliance costs, reducing innovation in the sector. This could impact smaller custodians, who may be impacted by smaller profit margins more significantly because of our regulation. As such the true total costs to firms may be greater than the above estimates.

180. Our safeguarding intervention will impose direct costs on firms providing custody of cryptoassets to UK consumers, with the primary benefit being avoided losses to consumers. However, these avoided losses are conditional on cryptoassets having market value, with recent years demonstrating that prices can be highly volatile. Other than prudential requirements, our proposed custody regime will not scale with the value of the cryptoasset market and so there is a risk that if market prices declined significantly, the costs of our custody rules would outweigh the value of assets being safeguarded.

181. Alternatively, if the value of cryptoassets were to increase, then the value of avoided losses would also increase, resulting in increased net benefit of our proposals. Custodians would face increase costs due to our prudential requirements, which may be offset by increased demand from consumers.

Cost to Issuers of qualifying stablecoins

182. Qualifying stablecoin issuers will need to comply with the specific requirements of our regime and will incur both one-off and ongoing costs as a result. As noted, there are currently no fiat-referenced stablecoin issuers located in the UK, and so all costs below are elective and assume that due to our intervention reducing regulatory uncertainty, stablecoin issuers establish within the UK.

Familiarisation costs

183. Fiat-referenced stablecoin issuers who enter the UK market will need to become familiar with our requirements, which we anticipate will incur costs. We expect these firms will read and familiarise themselves with detailed requirements of the proposed rules and guidance.

184. We have estimated the costs of this to firms based on assumptions on the time required to read 200 pages of CP and 100 pages of legal text that are relevant to fiat-referenced stablecoin issuers. Given the nature of our requirements, we assume firms conduct a gap analysis to ensure their business model is appropriate for our qualifying stablecoin regime. While we assume all qualifying stablecoins in our regime will be "small", we assume they incur familiarisation costs at a similar rate to "medium" sized firms, given the novelty of the regime. This results in an average cost of **£11k** one-off costs per firm. Based on our estimated firm population, total familiarisation costs across our issuance proposals are estimated at **£110k**.

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (across 10 year appraisal period)
Familiarisation with new rules	£11k	£110k	£0	£0	£80k

Costs associated with backing asset pool

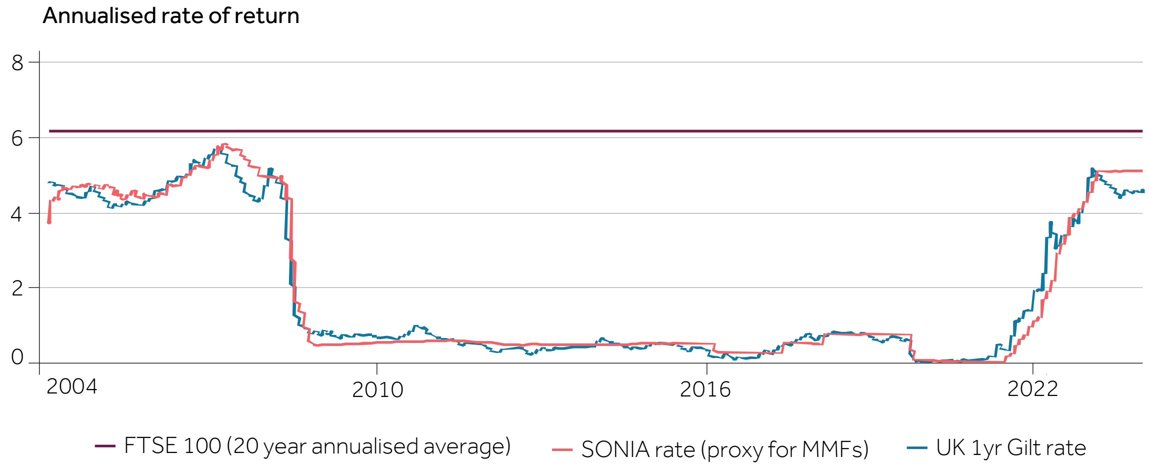
185. As part of our proposed regime, firms will be required to limit their backing asset pool to the following assets:

- short-term cash deposits
- UK government debt with short-dated maturities
- UK government debt with long-dated maturities
- reverse repos
- public debt MMFs.

186. In addition to the composition of the backing asset pool, firms will be required to manage it in a manner which is consistent with our regime. This includes conducting daily reconciliations to ensure the pool is at parity with the number of issued qualifying stablecoins, in addition to facing additional prudential requirements conditional on the assets the firm chooses to include within the pool.

187. The primary costs associated with this will be the opportunity costs associated with the business model this will impose on firms. If we did not impose this requirement, firms could choose to hold a portion of their backing asset pool in assets which provide a higher return than MMFs and UK GILTS. The comparison below illustrates the potential opportunity cost to firms from using GILTS and MMFs (we use the Sterling Overnight rate (SONIA) as an estimate of MMF rates):

Figure 18: Comparison of rates of return across UK asset classes



188. As there are currently no UK fiat-referenced stablecoin issuers, any firms that do choose to establish within our regime will be aware of these restrictions on the backing asset pool, and this has been reflected within our estimated population of firms. As such, we do not believe there to be any incremental cost of our proposed backing asset pool composition, other than limiting the potential population of firms that will be regulated in the UK.

189. Firms will face costs associated with managing the backing asset pool, including daily monitoring of value and conducting reconciliations to ensure that the balance of the backing asset is always equal to the value of outstanding qualifying stablecoins. Firms will also be required to use a custodian unconnected to their group to safeguard the backing asset pool.

190. In addition, firms will be required to make disclosures when offering a qualifying stablecoin by outlining the composition of the backing asset pool and redemption policy. Firms will also need to regularly disclose updates on any changes to the backing asset pool (and other substantive changes such as the number of stablecoins) and make regular independent reviews on the composition. We estimate this will require a small one-off change project within firms, with firms incurring smaller ongoing costs associated with disclosing changes and regular independent reviews.

191. Firms will also face an on-demand deposit requirement (ODDR) and hold a certain amount of assets as cash reserves. This is to avoid an issuer placing over-reliance upon immediate access to the markets (including where looking to sell short-term government debt). The ODDR is set at 5% and will apply to all stablecoin issuers. To estimate the ongoing cost of the ODDR, we assume 5% of a stablecoin issuers asset pool provides them negligible returns. The cost to firms is the opportunity cost to firms of the ODDR (we assume firms would otherwise hold these backing assets as UK gilts). We estimate this ongoing cost of the ODDR at £13k annually per firm.

192. Using our survey data and standardised cost model, we estimate costs associated with ensuring the backing asset pool remains compliant at £10k annual ongoing costs per firm. This assumes staff at issuers undergo training in to effectively manage the backing asset pool and comply with our rules. We assume for the average stablecoin issuer, this will result in, on average one trading and asset management staff member attending 20 hours of training per year. Total per firm and population costs are outlined in the table below:

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Backing Asset Pool costs	£10k	£100k	£23k	£230k	£0.6m

Costs associated with redemption policies

193. A key component of our proposed regime will require firms to fulfil redemption requests to holders of their stablecoin by the next business day, once AML/CTF checks have been completed. As part of this requirement, firms will be permitted to charge cost-representative fees to consumers for redemptions.

194. Our assessment is that the primary cost to firms in permitting next day redemptions is associated with the backing assets. Firms must have sufficiently liquid backing assets so that they can adequately meet a large volume of redemption requests if required at short notice. Responses to our survey also indicated that all firms were permitting next day redemptions, with some proposing shorter timelines (ie 2 hours). As such, we do not believe there will be incremental costs of firms of requiring next business day redemption (as opposed to not mandating a redemption timeline) given that firms will already be required to hold sufficiently liquid backing assets.

195. Firms will face some costs, including conducting AML/ CTF checks for those who are requesting redemptions. Firms will also require to develop a way of allowing consumers to submit redemption requests directly to the issuer, which we assume will involve development of a mobile application or website interface.

196. We assume developing this interface will involve a small IT project to firms, where users can demonstrate their qualifying stablecoin holders and submit any AML documents required. Further costs to firms will be in conducting these AML checks, as well as setting up internal systems to allow redemptions for all holders. We assume on average, it will take 30 mins for a staff member at the qualifying stablecoin issuer to complete a redemption request, including AML checks, for a customer. Using market data, we assume an average of 10,000 redemption requests per firm per year over the course of our appraisal period. Combined, this results in £67k one-off to develop the relevant IT infrastructure, and £14k ongoing to firms to conduct AML checks.

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (across 10 year appraisal period)
Costs associated with Redemption rules	£67k	£670k	£14k	£135k	£1.2m

Prudential Requirements for qualifying stablecoin issuers

197. As with cryptoasset custodians, stablecoin issuers will also need to comply with our CRYPTOPRU and COREPRU prudential requirements, which will include:

- familiarisation and legal costs
- own funds requirements
- basic liquidity requirements
- issuer liquid asset requirements.

198. To familiarise themselves with our proposals, we expect firms will read the Prudential consultation paper ("A prudential regime for cryptoasset firms") published alongside this consultation paper. We assume firms will be required to read 405 pages of a prudential CP, some of which will not be relevant to all firms. In addition, we expect firms to conduct a gap analysis of the amount of own funds and liquid assets required and compare it against their current business model. We anticipate this to involve 100 pages of legal text from our CRYPTOPRU and COREPRU sourcebooks. We estimate the total cost of familiarisation to be around £10k per firms for the rules consulted on in this CP.

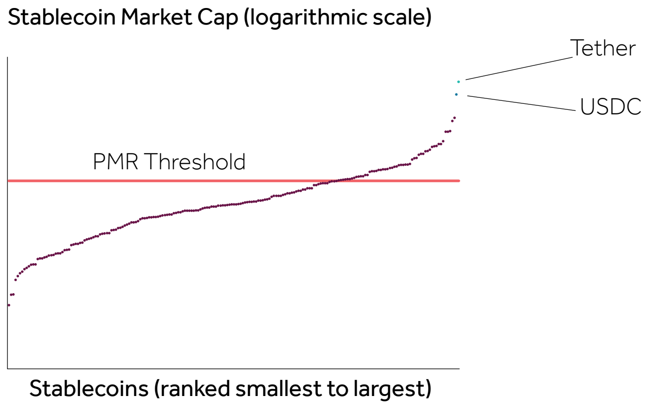
199. Firms will be required to adopt an Own Funds requirement that is the higher of the below three components:

- Permanent Minimum Requirement (PMR) of £350k
- Fixed Overhead Requirement (FOR) equivalent to 3 months fixed expenditure
- K-factor Requirement (KFR) estimated at 2% of average stablecoins issued.

200. We have assumed that firms currently hold no funds in reserve, and all prudential requirements will be incremental costs. If firms do in fact hold some own funds, then costs estimated below will be higher than the costs firms will actually incur. Own funds are treated as a cost to firms as they represent an opportunity cost of capital, due to needing to hold the funds in reserve.

201. Analysis of market data identified over 200 stablecoins being actively traded on the market, broken down by size as outlined below. In order to face the K-factor requirement, qualifying stablecoins will be required to have over £17.5m of qualifying stablecoins issued. Based on our analysis of the market, we identified 55 Stablecoins currently above this threshold.

Figure 19: Most Stablecoins would fall below the PM requirement



202. For issuers, the size of their prudential requirement will vary significantly based on the market demand, which is unknown (as demand will not be limited to UK customers). Using the current stablecoin market as an indication of the potential size is challenging, as most stablecoins in issuance would not be compliant with our rules. To estimate the size of the average qualifying stablecoin issuer, we limit our market data to remove any very small fiat-referenced stablecoins, which we categorise as having below a market capitalisation of £3m. This provides us with a subset of 90 stablecoins. As noted, the stablecoin market is highly skewed towards the two largest firms (Tether and USDC) who together comprise 89% of the total market capitalisation. To prevent this from biasing our results, we use the median value of our subset of issuers. This results in a median value of £25.7m, which we use as an estimate of the typical K-factor requirement faced by qualifying stablecoin issuers within our regime. This will result in a prudential requirement of £514k to these firms. This will increase as firms expand and the market evolves over the time of our appraisal period.

203. To estimating the ongoing cost of the proposed prudential requirements, we again used the Capital Asset Pricing Model (CAPM). Our estimate for the cost of capital for qualifying stablecoin issuers 8.3%. The average ongoing costs per firm will therefore be £36k average per firm.

204. Firms will also face a basic liquidity requirement of liquid assets equivalent to one month's worth of a firm's relevant annual expenditure. Based on our survey responses, we estimate this to be £83k average to firms

205. In addition to the above, firms will face further prudential requirement if they choose to utilise the expanded backing asset pool. This will include an issuer liquid asset requirement, which is calculated on the basis of the backing assets held by an issuer and their residual maturity and coupon. We assume this requirement will primarily impact the potential firm population through affecting business models. We assume that firms will only choose to hold assets which will result in a higher ILAR if in doing so is net beneficial to them to do so (i.e. the return from holding an asset class exceeds the cost to firms from an increased ILAR). Firms will need to be aware of the impact of the backing asset on their ILAR, which we have accounted for within our familiarisation costs.

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (across 10 year appraisal period)
Familiarisation with prudential requirements rules[1]	£10k	£100k	£0	£0	£100k
Minimum Own Funds Requirement	£514k	£5.1m	£45k	£450k	£6.2m
Basic Liquidity requirement	£83k	£830k	£0	£0	£830k
Total Prudential costs to Issuers	**£610k**	**£6.1m**	**£45k**	**£450k**	**£7.1m**

Total costs to qualifying stablecoin issuers

206. In the below table, we aggregate the estimated costs of all our qualifying stablecoin issuance requirements for firms that will establish in the UK once we introduce our proposed regime.

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Familiarisation with new rules	£10k	£100k	£0	£0	**£0.1m**
Managing of the Backing asset pool	£10k	£100k	£23k	£230k	**£0.6m**

Regulatory Requirement	Transition Costs (per firm)	Transition Costs (population)	Ongoing Costs (per firm)	Ongoing Costs (population)	Total population cost (PV across 10 year appraisal period)
Providing redemptions by next business day	£67k	£670k	£14k	£135k	**£1.2m**
Prudential Requirements	£610k	£6.1m	£45k	£450k	**£7.1m**
Total Costs	£690k	£6.9m	£81k	£800k	**£9m**

207. Average costs for firms are estimated at **£690k** implementation to become compliant with our rules, of which, the majority are one-off prudential costs. If firms are smaller than our estimate average (£25.7m) then the actual prudential costs they experience will be lower. We anticipate firms will then occur average ongoing annual costs of **£81k**, which are primarily indirect costs associated prudential requirements. Across our 10 -year appraisal period and estimated firm population, this results in a total cost with a present value of **£9m** for our proposed rules for qualifying stablecoin issuers within the UK.

208. As noted, there are currently no fiat-referenced stablecoin issuers based in the UK, and so the above costs will be elective for any firms that decide to establish within our proposed regime. We anticipate the most substantial component of our proposed requirements for qualifying stablecoin issuers will be the opportunity costs associated with our backing asset pool limitations, which will restrict business models and reduce the number and size of potential qualifying stablecoin issuers within the UK. Our assessment is that these restrictions on the backing asset pool are necessary to prevent the consumer harm outlined above from materialising.

209. In addition, our rules will allow firms to outsource certain aspects of our requirements, including the redemption process and AML/KYC checks. This may result in reduced costs relative to what we have assessed above.

Costs to consumers

210. Firm may pass on their additional costs to consumers through higher prices. This may be exacerbated if our intervention raises barriers to entry and reduces competition in the market. If firms cannot pass through costs, it may lead to them cutting operating costs by reducing the quality of their offering, which would also impact consumers.

211. There is also a risk that because of the increased consumer protection under the new regime, consumers will assume that they have protection in areas they do not. This "halo effect" of regulation could result in consumers purchasing products which they would not do otherwise. Based on our consumer research and responses to our Discussion Paper, we see a number of areas where this halo effect could create costs to consumers:

- Consumers assuming they have greater levels of regulatory protection than they actually do.
- Consumers believing that regulation will protect price levels of cryptoassets or reduce market volatility, treating cryptoassets as lower risk than they currently consider them to be.
- Consumers believing stablecoin protections apply to overseas stablecoins which will be accessible through UK regulated TPs if they comply with our proposals for a future admissions and disclosure regime.

212. We will take measures to address and minimise the above costs to consumers. We will ensure our communication is clear, to help consumers understand the regulatory protection our regime provides. However, costs may still materialise to consumers and while we do not consider it reasonably practicable to estimate these costs, we recognise they may be significant for some consumers.

Other Costs

213. As noted above, we anticipate that our regulatory intervention will result in increased ownership of cryptoasset across UK consumers. This assumption is supported by our Consumer Research series, with our most recent publication (Wave 5, November 2024) indicating 26% of UK adults who currently down own cryptoassets would consider purchasing cryptoassets if it were regulated.

214. Increased demand for cryptoassets by UK adults as a result of our regulatory intervention will necessitate reduced consumption elsewhere, increased debt or reduced savings. Our consumer research indicates that 21% of current UK cryptoasset consumers purchased cryptoassets as an alternative to traditional financial products such as shares or investments. Furthermore, 32% used long-term savings or investments to purchase cryptoassets, while 17% used a credit card or overdraft to finance their purchase.

215. If new consumers who enter the UK cryptoasset market following our regulation exhibit similar preferences to existing consumers, then increased demand following regulation may result in wider economic impacts. For example, new consumers may choose to reduce their savings rate or increase their debt relative to the counterfactual in order to purchase cryptoassets, which could create longer-term economic costs. Similarly, if consumers increasingly substitute spending on traditional financial products to purchase cryptoassets, this reduced demand from retail consumers could adversely impact UK financial sector liquidity.

Costs to the FCA

216. We will incur costs for authorising firms in the new regime. Authorisation colleagues estimate that the average numbers of hours that a case officer spends on one firm is around 40 hours, although that number can vary significantly depending on the size of the firm. We will recover these costs from firms through charging authorisation fees. Firms may pass the cost of these on to consumers in the form of higher prices.

217. Costs associated with supervision, include additional firms and familiarisation with new and emerging business models. There will also be costs associated with communication and publication of new rules. The FCA may incur additional costs to review the firms' monthly safeguarding returns, auditors' safeguarding reports, and other regulatory returns.

Risks and Uncertainty

218. We recognise that establishing potential costs and benefits before the intervention takes effect is inherently subject to uncertainties. If our assumptions do not hold or if we have not accounted for all market dynamics, the costs and benefits discussed in this CBA may be over or understated. in addition, data challenges and limitations in our methodologies could lead to inaccuracies in our estimates.

219. There may be unintended consequences of our intervention. As our custody regulation does not extend to decentralised finance or self-custody wallets, firms may pivot their business model to avoid being within scope while continuing to offer services to UK consumers. Given limitations and risks with self-custody, we anticipate the likelihood of this occurring to be low. We will continue to monitor the cryptoasset market for signs of any unintended consequences as described in further detail below.

220. We consider the assumptions listed above as comprising our "central scenario". That is, they represent our best estimate of the likely costs and benefits we expect to materialise from our proposals and are based on our analysis and understanding of UK cryptoasset markets. We recognise the currently unregulated nature of cryptoassets creates limitations for the accuracy of this central scenario, and our estimates and analysis above should be considered as subject to significant uncertainty.

221. To better account for this intrinsic uncertainty we have undertaken sensitivity analysis across several key assumptions, including:

- the growth of the UK cryptoasset markets (as measured by share of UK consumers owning cryptoassets)
- the costs of our regulatory intervention
- the benefits of reduced consumer harm through avoiding losses from improved safeguarding
- firms response to increased regulation is to raise prices.

Growth of UK Cryptoasset market

222. We have assumed that UK consumers demand for cryptoassets will increase following our regulation, which is informed through findings of our consumer research. We have assumed that demand reaches a maximum of 20% of UK adults in a central case, relative to 16% in our counterfactual. The primary impact of the level of demand is the benefits associated with avoided losses through our safeguarding rules.

223. To account for the uncertainty of our intervention, we conduct sensitivity analysis across the following scenarios:

- **Demand does not change relative to the counterfactual.** We assume consumers who indicated they would enter the cryptoasset market if it were regulated do not, and therefore our regulation has no impact on demand, which reaches 16% of adults.
- **Demand declines relative to current levels.** Alternatively, demand for cryptoassets may reduce over the course of our appraisal period, if UK consumers exit the market. This may be a result of exogenous factors which leads to reduced consumer interest in cryptoassets. We assume demand declines to 10% in our intervention, relative to 6% in our counterfactual. We assume firm population also declines proportionally.
- **Demand increases significantly following regulation.** Improved regulatory protections could increase demand beyond what we have assumed within our central scenario. We assume demand rises to 25% in our intervention, relative to 16% in the counterfactual. We assume firm population remains unchanged.

224. The results are presented in the table below:

	PV Benefits	PV Costs	NPV
Central Estimate	£406m	£250m	+£157m
No change relative to counterfactual	£469m	£250m	+£219m
Demand decline	£222m	£160m	+£62m
Demand increase	£298m	£250m	+£48m

225. In the scenario where there is no increase in demand relative to our counterfactual, the net present value of our intervention increases. This is as in our central scenario, we assume new UK cryptoasset consumers will still incur some losses due to safeguarding failures, which they would not have experienced in the absence of our regulation (as they would not have entered the market), which we net from our estimated benefit. Where there is no increase in consumer demand, our regulation will simply avoid losses being incurred by existing cryptoasset consumers.

226. Where we assume a decline in consumer demand, we observe a significant reduction in our PV benefits. This is primarily driven by the assumed ownership rate in our counterfactual, where a lower number of UK cryptoasset consumers results in a reduced volume of avoided losses. However, as we assume firm population declines proportionally (due to lower consumer demand) this scenario results in a smaller but still positive NPV of £62m.

Similarly, in a scenario where UK demand for cryptoassets increases beyond our central scenario, the net benefit of our proposals is reduced to £48m. This is primarily due by the counterfactual remaining unchanged, while new UK consumers of cryptoassets experience some losses, which reduces the estimated benefit of avoided losses. This highlights an important balance between regulation which reduces the likelihood of consumer harm from safeguarding failures and the extent to which new consumers will enter the UK cryptoasset market once regulation has been introduced.

Costs of our regulatory intervention

227. Our cost estimates are based on a combination of survey responses, previous CBAs and our Standardised Cost Model. However, costs incurred per firm may be higher, particularly if currently unregulated firms need more time to adjust their business models to our proposed rules. Given this uncertainty, we apply an uplift of 25% and 50% to our central estimates.

	PV Benefits	PV Costs	NPV
Central Estimate	£406m	£249m	+£157m
25% higher costs	£406m	£315m	+£91m
50% higher costs	£406m	£375m	+£31m

228. As demonstrated above, even at substantially higher costs to firms, our intervention remains net beneficial through reducing harm to consumers. The breakeven point is 62% (ie if we have underestimated costs to firms from our proposed rules by 63%, our intervention provides a negative NPV in terms of quantified costs and benefits).

Share of losses avoided through improved safeguarding

229. We have assumed that in the absence of regulation, cryptoasset losses would continue at a same rate as historically observed in the global market. We have also assumed our safeguarding rules will reduce client losses by 60% relative to what would have been otherwise occurred.

230. This 60% estimate is an assumption based on our understanding of our proposed custody requirements, and our review of previous cryptoasset safeguarding failures, where we observed[18]:

- 75% involved hacks of custodians or trading platforms, with some being conducted by sophisticated state actors. Many of these hacks involve private keys to hot wallets being compromised, allowing the hackers to access client funds. We anticipate our proposed safeguarding rules will reduce a significant portion of custody hacks but recognise that some hacks and client losses will likely continue.
- 30% of failures involved client assets not being appropriately segregated from the firms, resulting in client losses during bankruptcy proceedings. We anticipate that if firms are fully compliant with our rules, these losses will no longer occur.
- 40% involved some form of employee or firm mismanagement, including loss of private keys or inadequate internal systems. We expect most of these would not have occurred under our proposed regime if firms were authorised and compliant with our rules.

18 Most client losses due to inadequate safeguarding involve multiple failures, and as such the percentages above sum to greater than 100%

231. Our estimate of 60% reduced losses is subject to significant uncertainty, and to account for this, we conducted sensitivity analysis across a rate of 50% and 40%. While our proposals remain net positive with a 50% reduction assumption, our proposals breakeven at a rate of 43%, below which the costs to firms exceed the reduction in consumer harm.

	PV Benefits	PV Costs	NPV
Central Estimate	£406m	£249m	+£157m
50% reduced losses	£314m	£249m	+£65m
40% reduced losses	£223m	£249m	-£26m

Firms raise prices for consumers.

232. Following our regulation, firms may choose to raise prices for UK consumers in order to recover reduced profits due to higher compliance costs. This would in effect be a partial or complete transfer of our costs from firms to consumers. We anticipate the quantified benefits of our proposed rules to primarily impact consumers, and so our intervention will remain net beneficial even if firms do fully pass on costs to consumers.

Competition Assessment

233. In this section, we consider the potential impacts on competition for qualifying stablecoins and custody of qualifying cryptoassets as a result of our proposed regulatory interventions.

234. As the market currently functions, we believe there are intrinsic features such as network effects and economies of scale that mean the sector is predisposed to high concentration. We have ensured our rules are proportionate to reduce the extent to which our regime contributes to barriers to entry or further concentration (and therefore reduced competition).

235. In the longer term, we anticipate clearer rules and standards will lead to enhanced trust and engagement in the market, meaning the impact of our rules on competition will be positive. Greater market stability leading to enhanced investor confidence and firm entry may also contribute to beneficial impacts on competition. Depending on uptake by consumers and merchants, our regime may enable stablecoins to be used as an option for payments, remittances and wholesale settlement in the longer term.

Impacts on barriers to entry:

236. As discussed above, there are widespread harms associated with custody of cryptoassets and fiat-referenced stablecoins, resulting in a market that is not trusted nor stable, meaning effective competition cannot take place. Our aim with a new regulatory regime is to ensure we can tackle these harms, while avoiding a situation

in which our regime acts as an undue barrier to entry. This enhances the scope for effective competition to take place.

237. Conditional on the impacts on firms' costs, as estimated above, and their resulting profits and revenue, new regulatory requirements (both consumer protection and prudential rules) may act as a barrier to entry, meaning fewer firms may enter the UK market. Firms currently operating within the UK cryptoasset may choose to exit if the marginal impact of our regulation limits their business model profitability.

238. The balance between consumer protection, market integrity and effective competition is relevant throughout our regime and comes into particular focus in the context of barriers to entry in the below areas:

- **Prudential requirements to ensure firms can absorb unexpected losses in their business:** These requirements address market integrity issues, and to ensure firms can absorb unexpected losses and avoid disruptive exit. The PMR (permanent minimum requirement), will set minimum levels of capital that qualifying stablecoin issuers and qualifying cryptoasset custodians are required to hold in reserve to conduct these activities and enter the market. While this may act as a barrier to entry, these rules are scaled to firm size to mitigate negative impacts on firm entry. As noted below, having this requirement may increase investor confidence and may also be beneficial to competition.
- **Restrictions on the qualifying stablecoin issuers backing asset pool:** This is required so issuers do not investment in assets that could impact the stability or liquidity of qualifying stablecoins. This is necessary given the widespread harm that has been reported as a result of investment in volatile assets. While this restriction, in permitted backing asset investments, could impact entry (given this is issuers' primary income source), we have been as expansive as possible on the range of assets held provided they are highly liquid and offer stability.

Impact on market concentration

239. Our analysis of the market suggests fiat-referenced stablecoins and custody of cryptoassets are predisposed to high concentration including at the issuer and trading platform level (with vertical integration common) with a small number of firms capturing most of the global market. This is partly driven by network effects and first mover advantage. Reduced firm entry and increased firm exit as a result of our interventions could contribute to an increase in concentration in the sector. Our interventions could also have adverse impacts on smaller firms more than larger firms as larger firms can better spread the cost of compliance over their revenue base. The proportionality of our rules should help reduce the extent to which our rules contribute to increased concentration in the sector and limit the negative impact of regulatory compliance on smaller firms.

240. Concentration may reduce competitive pressures faced by firms, which could result in lower quality of products and/or higher prices. Our substitution analysis of cryptoasset users suggest consumers would most likely replace cryptoassets products with other forms of speculative finance or high-risk investments as a result.

Impact on consumer demand, market integrity and products

241. We anticipate our rules will result in enhanced trust and engagement from improved consumer protection. We expect this will in turn result in increased consumer demand and firm entry. Using insights from our consumer research, our assessment is enhanced consumer protection (eg, transparency and disclosure rules) will be welcomed by most existing consumers, leading to high levels of consumer trust and engagement, while also attracting new consumers into the market. Clearer standards and rules will also reduce risks to firms considering entering the market. As such, we anticipate our intervention to result in an increase in competition in the UK cryptoasset market over time.

242. We also expect increased confidence in the market from our rules. For example, while prudential rules may act as a barrier to entry, they may also enhance market stability in the market. Our new rules on capital requirements ensure firms are financially viable to provide services through an economic cycle; put right any harm they cause; and enable an orderly wind-down without causing economic harm to consumers or UK financial system integrity. This in turn reduces risk of contagion and may enhance investor confidence, promoting firm entry, and thereby having beneficial effects for competition in the market.

243. In the longer term, depending on the uptake by consumers and the extent to which merchants accept stablecoins as a form of payment, this may provide for increased options for consumers in their payment methods or cross-border transactions. Firms may also look to use stablecoins for settlement in wholesale markets, which may result in increased competition here.

244. We will monitor the impact of our intervention on the degree of competition for custody of qualifying cryptoassets and issuing qualifying stablecoins. We anticipate the aggregate on competition over our appraisal period to be positive, with the initial increase to barriers to entry being offset by increased firm entry and consumer demand.

Wider economic impacts, including on secondary objective.

245. Our proposals will help to support competitiveness and growth in the UK through influencing four of our seven drivers of growth:

- **Innovation:** Our regulation may create opportunities for firms to leverage DLT more widely, such as internal systems for custodians or using stablecoins to develop new products and services in the payments sector. Our approach will also allow firms to explore use cases for wholesale settlement with stablecoins, which may create significant efficiencies in financial markets.
- **Proportionate regulation:** Through relying on regulation that focuses on outcomes, our intervention looks to reduce harm while providing flexibility to firms to innovate and without being overly costly to firms. This will allow firms located within the UK to compete with international firms and improve the UK's competitiveness as a financial hub. In addition, our prudential regulation, which scales with the size of the firm, will ensure firms face proportionate regulation which allows them to grow.

- **Market stability:** By introducing prudential requirements for cryptoasset firm, we reduce the likelihood of disorderly firm failure and system contagion. Protecting consumers and firms in this way builds confidence in UK institutions and provides a foundation for increasing investment in the UK, supporting productivity and market growth.
- **International markets:** Our rules have been designed to be consistent with international peers (IOSCO, FSB), to ensure the UK is an attractiveness place for cryptoasset firms to invest and for businesses to establish or raise capital. Our rules have also been designed to be competitive with other jurisdictions in certain areas, which may support UK competitiveness and growth.

246. We anticipate the standards we introduce will support UK competitiveness through clear standards and robust regulation. For qualifying stablecoin issuers, our comprehensive regime will mean that global customers will have confidence when using a qualifying stablecoin, which we anticipate will encourage adoption.

247. For custody, we believe that our outcomes-based approach using design principles from our CASS rules for traditional assets will mean firms will have confidence in applying our rules to their business models, which will reduce transition costs relative to other potential regimes.

248. As outlined previously, we recognise an interaction between developing a cryptoassets regime that protects consumers and supports market integrity, and the resulting impact on competition, and growth. Consumer protection and market integrity build trust and participation, which increase effective competition, and growth. However, disproportionate requirements could make competition less effective, and potentially inhibit growth.

249. From our review of the relevant literature, we did not identify evidence to suggest economic growth materialising from consumers purchasing cryptoassets. Any benefits would instead be due to consumers increasing their consumption from converting gains in cryptoasset holdings to increased income, which we anticipate as being limited.

250. Growth may also materialise due to increased exports (ie if UK based cryptoasset firms attract business from overseas customers). However, as this will be conditional on international jurisdictions' regimes, we consider the impact uncertain and have not assessed it below.

251. We see the impact of our intervention on economic growth as dependent on the cryptoasset sector interlinking with, and creating benefits in, the real economy. We identify 3 key ways in which cryptoassets could benefit the UK's growth objective:

- **Labour market impacts:** Cryptoasset firms employ high-skilled workers and our intervention could attract cryptoasset firms to establish in the UK. This would result in direct jobs (and supporting supply chain jobs) and potentially higher wages for those in the industry.
  Our proposed intervention may impact the UK labour market if it results in cryptoasset firms establishing a branch within the UK. We assess the potential impact on growth to be small, due to low jobs numbers, meaning any new jobs would have small impact on growth.

- **Capital Inflows and Liquidity:** Similarly, more cryptoasset firms located in the UK could result in capital inflows. Higher liquidity could in turn increase efficiencies in the UK's financial sector which could impact growth. However, the extent of any future growth is conditional on the relative size of the UK cryptoasset sector. If a qualifying stablecoin gains significant market share, then this could result in significant inflows. Any backing asset pool would need to comply with our requirements, and so products such as MMFs may see an increase in demand. The extent of potential growth is uncertain as cryptoasset sector still remains small relative to the wider financial flows.
- **Innovation:** Increased use of cryptoassets and DLT due to more consumer confidence and trust may result in new products and services, benefiting consumers across the economy. Innovation is a core driver of economic growth, but the impact on growth is contingent on how the rest of economy uses cryptoasset technology (directly or indirectly).
  There is potential for our intervention to increase innovation in the UK financial sector, particularly through the use of qualifying stablecoins. By relying on DLT, qualifying stablecoins have the potential to create efficiencies for payments and cross-border transactions. This may increase competition in these sectors, which would improve outcomes for consumers and lead to higher economic growth through increased efficiency. In addition, qualifying stablecoins may provide further efficiencies if used for wholesale settlement as outlined above.

252. Our assessment shows there is potential for our intervention to improve international competitiveness and growth in the medium-to-long term through the above factors. However, this subject to a significant uncertainty and dependent the extent to which cryptoasset firms establish in the UK. Growth is also dependent on several exogenous variables, in particular, the ability of DLT to create efficiencies at scale and compete with legacy financial infrastructure. However, based on the size of UK cryptoasset market currently (which has few UK-based firms), we think at a minimum, our intervention will not adversely impact UK economic growth, while creating opportunities for growth in the future.

Monitoring and evaluation

253. As outlined in our causal chain, we anticipate our intervention will result in reduced harm to consumers who choose to engage with cryptoassets. We also expect our outcomes-based regulation will reduce uncertainty to firms, and increase competition and the UK's competitiveness in the cryptoasset sector.

254. For qualifying stablecoins, we expect that by providing clear regulatory parameters to firms, our regulation will result in a number of fiat-referenced stablecoin issuers based in the UK. We anticipate that this may increase financial innovation through the use of stablecoins for payments and cross-border transactions.

255. We intend to measure the effectiveness of our interventions through:

- regulatory returns and information submitted to the FCA from qualifying stablecoin issuers and cryptoasset custodians.

- survey data, including our Consumer Research series and Financial Lives surveys, which will allow us to monitor changes in behaviours, attitudes and usage of cryptoassets (including stablecoins)
- monitoring firm failures (if any) following our intervention to determine whether client cryptoassets/ the backing asset pool are adequately safeguarded and returned promptly.
- monitoring competition with UK cryptoasset markets.

Consumer Outcomes

256. We expect that our rules will result in increased consumer understanding of the cryptoassets they are purchasing and the risks they are exposed to. We will monitor this through our ongoing consumer research series, which enable us to track consumer attitudes towards cryptoassets, including:

- understanding of products (as of August 2024, 25% of UK consumers who own stablecoins could not identify the correct definition of a stablecoin)
- awareness of regulation (many consumers incorrectly believe they have more regulatory protections in place than they actually have)
- how consumers use their cryptoassets, and the share who say have had negative experiences when engaging in the market
- consumer attitudes towards cryptoasset custody, and the firms they use for safeguarding their cryptoassets
- consumers who own stablecoins and use them for cross-border transactions or payments, and higher uptake of qualifying stablecoins in the UK.

257. Through our intervention, we envisage consumers misunderstanding of products will decline, and consumers will have the correct information to determine if a particular cryptoasset is an appropriate product for their portfolio.

258. Furthermore, we anticipate our regulation to increase the share of fiat-referenced stablecoin owners who use qualifying stablecoins for cross-border transactions, payments or sending money to friends/ family, relative to the current baseline.

Firm Outcomes

259. We anticipate that our regulation will result in reduced regulatory uncertainty to firms and potential increases in demand for products, as more consumers may choose to enter the market due to the regulatory standards we put in place (as indicated by our consumer survey data). Furthermore, our proposed intervention has taken into account feedback from our Discussion Paper 23/4, to ensure our regulation is proportionate and not overly restrictive on firm business models.

260. To understand how our rules are affecting firms, we will continue to monitor the market and engage with firms to identify any challenges to implementation and ensure our regulation is proportionate and appropriate. This will help us to understand how our regulation is impacting the market and where we can consider further refinement.

Consultation with the FCA Cost Benefit Analysis Panel

261. We have consulted the CBA Panel in the preparation of this CBA in line with the requirements of s138IA(2)(a) FSMA. A summary of the main group of recommendations provided by the CBA Panel and the measures we took in response to Panel advice is provided in the table below. In addition, we have undertaken further changes based on wider feedback from the CBA Panel on specific points of the CBA. The CBA Panel publishes a summary of their feedback on their website, which can be accessed here.

CBA Panel Main Recommendations	Our Response
Treatment of uncertainty. The proposed rules will provide for regulated markets for both activities within the jurisdiction of the UK. This injects a high degree of intrinsic uncertainty into the CBA, since it requires making predictions as to how both regulated, UK markets that do not currently exist, and competitor non-UK markets that do, will develop over time. Given this unavoidable uncertainty, the analysis would benefit significantly from including explicit sensitivity analysis under suitably broad ranges of assumptions for both: • The growth of the markets accessed by UK consumers under the proposed and counterfactual (no regulation) scenarios; and • The costs and benefits of particular regulatory options themselves.	We have conducted sensitivity analysis considering: • Different scenarios of growth of UK cryptoasset markets, and • Costs and benefits associated with our proposed rules. • Firm behaviour and response to our regulation
Assessment of costs and benefits. The analysis would benefit from a more comprehensive assessment of the costs and benefits generated by the proposals. Examples include potential benefits of increased competition for payment services that regulated UK stablecoin issuance might promote; and potential second-order costs associated with wider cryptoasset ownership that a regulated UK custody regime might bring.	We have included additional descriptive text on the role stablecoins could play in the UK payments sector, noting that our proposals will not change UK Payments Regulation and so the direct marginal impact of our intervention may be limited. We have also highlighted a potential indirect cost from our proposal being encouraging substitution away from traditional financial assets and towards cryptoassets products.
Options analysis. The CBA would benefit from an explicit quantitative evaluation of the costs and benefits of introducing alternative sets of rules, in addition to the useful qualitative assessment of different regulatory approaches currently included.	We have provided further qualitative description of the anticipated costs and benefits associated with the alternative options.

Question 28: **Do you agree with our assumptions and findings as set out in this CBA on the relative costs and benefits of the proposals contained in this consultation paper? Please give your reasons.**

Question 29: **Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?**

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules (a) is compatible with its general duty, under section 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, (b) so far as reasonably possible, advances the secondary international competitiveness and growth objective, under section 1B(4A) FSMA, and (c) complies with its general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA. The FCA is also required by s 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation are primarily intended to advance the FCA's operational objectives of:

- Delivering consumer protection – securing an appropriate degree of protection for consumers
- Enhancing market integrity – protecting and enhancing the integrity of the UK financial system
- Building competitive markets – promoting effective competition in the interests of consumers.

8. We set out how we consider our proposals comply with the FCA's operational objectives in more detail in paragraphs 2.1 to 2.13 of this consultation.

9. We consider that, so far as possible, these proposals advance the FCA's secondary international competitiveness and growth objective by improving confidence in the UK as a place where cryptoasset custody and stablecoin issuance can be carried out in a trusted market with clear and proportionate requirements. Our proposed requirements on the management of the value of qualifying stablecoins, the prompt redemption of stablecoins in return for par value, and the robust safeguarding of stablecoin backing assets held on behalf of holders, and client cryptoassets, are intended to help ensure the UK remains a stable environment for doing business. We have also had regard to relevant international standards set by bodies including the Financial Stability Board and IOSCO, both of which the FCA played a leading role in developing.

10. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s 3B FSMA.

The need to use our resources in the most efficient and economic way

11. These proposals will help us to improve our supervisory oversight of cryptoasset businesses. Requirements around information that must be reported to the FCA for qualifying stablecoin issuers and qualifying cryptoasset custodians will facilitate oversight and assurance of a firm's management of customer assets, the maintenance of the value of qualifying stablecoins, and the upkeep of proper books and records. By ensuring that firms can meet our standards before receiving authorisation, our proposals are intended to reduce the need for supervisory interventions.

The principle that a burden or restriction should be proportionate to the benefits

12. We have carefully considered the proportionality of our proposals, including through consultation with internal and external stakeholders throughout the development of our proposals.

13. The proposals may require firms to make changes, with associated costs, as to how they conduct their business. However, we consider that our proposals are proportionate and the benefits outweigh the costs. The CBA in Annex 2 sets out the costs and benefits of our proposals.

The need to contribute towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target) and section 5 of the Environment Act 2021 (environmental targets)

14. On balance, we do not think there is any contribution the proposals outlined in this consultation can make to these targets. However, we will be considering the ESG implications of our broader proposals in more detail in our 'Conduct and Firm Standards' CP later this year, at which point we will welcome feedback on this. We will continue to keep this under review when considering any final rules.

The general principle that consumers should take responsibility for their decisions

15. Our proposals will provide greater protection for consumers. They do not inhibit consumers' ability to access a range of products, nor do they seek to remove from consumers the need to take responsibility for their own decisions in relation to their use of regulated and unregulated products and services.

The responsibilities of senior management

16. Our approach to SMCR for qualifying stablecoin issuers and qualifying cryptoasset custodians was introduced in DP23/4 and we will consult on our proposals before our final rules are set out.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

17. Our proposals recognise that firms conducting different cryptoasset activities require a different approach. Our proposals include requirements that are specific to the activities a firm carries out, including some requirements that will only apply to qualifying stablecoin issuers, and others that will only apply to qualifying cryptoasset custodians.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

18. We have had regard to this principle and believe our proposals are compatible with it, including through our proposed rules on the information qualifying stablecoin issuers should disclose. We may publish data on aggregate trends in the cryptoasset market.

The principle that we should exercise of our functions as transparently as possible

19. By explaining the rationale for our proposals and the anticipated outcomes, we have had regard to this principle.

In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s 1B(5)(b) FSMA).

20. Our proposals are intended to support firms to act as a strong line of defence against financial crime. For instance, we have recognised that our requirements may interact with requirements under financial crime legislation in our rules around the timing of qualifying stablecoin redemption. We intend to consult on our approach to financial crime in later consultations on our Crypto Roadmap.

Expected effect on mutual societies

21. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies. Our proposals will apply equally to any regulated firm, regardless of whether it is a mutual society.

Compatibility with the duty to promote effective competition in the interests of consumers

22. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers. This is set out in more detail in paragraphs 2.8 to 2.10 of the Consultation Paper.

Equality and diversity

23. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

24. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraphs 2.40 to 2.44 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

25. We have had regard to the principles in the LRRA and Regulators' Code (together the 'Principles') for the parts of the proposals that consist of general policies, principles or guidance. We consider that these parts of our proposals are compliant with the five LRRA principles – that regulatory activities should be carried out in a way which is transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

Transparent – We are consulting on our proposed changes with industry to articulate our proposals. Through consultation and pro-active engagement both before and during consultation, we are being transparent and providing a simple and straightforward way to engage with the regulated community.

Accountable – We are consulting on these changes and will publish final rules after considering all feedback received. We are acting within our statutory powers, rules and processes.

Proportionate – We recognise that firms may be required to make changes to how they carry out their business and have provided for an implementation period to give them time to do so. The CBA sets out further detail on the costs and benefits of our proposals.

Consistent – Our approach would apply in a consistent manner across firms carrying out the issuance of qualifying stablecoins or the safeguarding of qualifying cryptoassets.

Targeted – Our proposals will enhance our ability to provide targeted firm engagement and consider how to best deploy our resources.

Regulators' Code – Our proposals are carried out in a way that supports firms to comply and grow through our consideration of their feedback via the CP and refining our proposals where necessary. Our CP, CBA, draft instrument, accompanying annexes, public communications and communications with firms are provided in a simple, straightforward, transparent and clear way to help firms meet their responsibilities.

Annex 4

Abbreviations in this document

Abbreviation	Description
AML	Anti-Money Laundering
BACR	Backing assets composition ratio
Bank	Bank of England
CASS	Client Assets Sourcebook
CBA	Cost Benefit Analysis
CBAR	Core Backing Asset Requirement
CDD	Customer Due Diligence
CFP	Contingency Funding Plan
CP	Consultation Paper
CMAR	Client Money and Assets Return
CPF	Counter-Proliferation Financing
CRA	Consumer Rights Act 2015
CRYPTO	Cryptoassets Sourcebook
CSD	Central Securities Depository
CTF	Counter-Terrorist Financing
DISP	Dispute Resolution Sourcebook
DLT	Distributed Ledger Technology
DP	Discussion Paper
DRA	Daily Redemption Amount
EDD	Enhanced Customer Due Diligence

Abbreviation	Description
FAQs	Frequently Asked Questions
FATF	Financial Action Task Force
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act 2023
GBP	Pound sterling
HSM	Hardware Security Modules
IOSCO	International Organisation of Securities Commissions
LRRA	Legislative and Regulatory Reform Act 2006
MLRs	Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
MPC	Multi Party Computation
ODDR	On-demand Deposit Requirement
PASS	Pre-application Support Service
PDCNAV MMF	Public Debt Constant Net Asset Value Money Market Fund
PERG	Perimeter Guidance Manual
PoR	Proof of Reserves
PRA	Prudential Regulation Authority
PSR	Payment Systems Regulator
RAO	Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
SICGO	Secondary International Competitiveness and Growth
SMCR	Senior Managers and Certification Regime
SOC	Service Organisation Control
SUP	Supervision Sourcebook
SYSC	Senior Management Arrangements, Systems and Controls
Ts&Cs	Terms and Conditions

Appendix 1

Draft Handbook text

STABLECOINS AND CRYPTOASSET SAFEGUARDING INSTRUMENT 202X

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"), including as applied by articles 98 and 99 of the Financial Services and Markets Act (Regulated Activities) Order 2000 (as amended by the Financial Services and Markets Act 2000 (Regulated Activities and Miscellaneous Provisions) (Cryptoassets) Order 2025):

(a) section 137A (the FCA's general rules);
(b) section 137B (FCA general rules: clients' money, right to rescind etc.)
(c) section 137T (General supplementary powers);

(d) section 139A (Power of the FCA to give guidance); and
(e) section 340 (Appointment); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the FCA's Handbook.

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Client Assets sourcebook is amended in accordance with Annex B to this instrument.

Making the Cryptoasset sourcebook

F. The FCA makes the rules and gives the guidance in accordance with Annex C to this instrument.

G. The Cryptoasset sourcebook (CRYPTO) is added to the Specialist sourcebooks block within the Handbook, immediately before the Critical Third Parties sourcebook (CTPS).

Notes

H. In the Annexes to this instrument, the notes (indicated by "*Editor's note*:") are included for the convenience of readers but do not form part of the legislative text.

Citation

I. This instrument may be cited as the Stablecoins and Cryptoasset Safeguarding Instrument 202X.

J. The sourcebook in Annex C to this instrument may be cited as the Cryptoasset sourcebook (CRYPTO).

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

arranging qualifying cryptoasset safeguarding	the *regulated activity* specified in article 9O(1)(b) (Safeguarding of qualifying cryptoassets and relevant specified investment cryptoassets) of the *Regulated Activities Order*, but only in relation to *qualifying cryptoassets*.
backing asset composition ratio	a proportion of a *firm's backing asset pool*, expressed as a percentage, calculated using the methodology in *CASS* 16.2.28R.
backing asset pool	a pool of *money* and/or *assets* held by a *firm* in connection with a *qualifying stablecoin* with a view to: (a) maintaining the stability or value of that *qualifying stablecoin*; or (b) meeting an undertaking to *redeem* that *qualifying stablecoin*.
backing asset pool acknowledgement letter	a letter in the form set out in *CASS* 16 Annex 1R.
backing assets account	an account which is provided by a *third party custodian* to hold and keep safe *asset*s that a *qualifying stablecoin issuer* holds as part or all of the *backing asset pool*, which meets or should meet the conditions set out in *CASS* 16.2.5R.
backing funds account	an account which is provided by a third party to hold and keep safe *money* that a *qualifying stablecoin issuer* holds as part or all of the *backing asset pool*, to which the conditions set out in *CASS* 16.2.4R apply.
burning	the process by which a cryptoasset is permanently removed from circulation on a blockchain.
calculation date	the date on which a *firm* should carry out a calculation for the purposes of *CASS* 16.2, as described in *CASS* 16.2.27R.
client-specific qualifying cryptoasset record	a *firm's* internal record, identifying each particular *qualifying cryptoasset* in respect of which the *firm* is *safeguarding qualifying cryptoassets* on behalf of each particular *client*, which sets out the detail required in *CASS* 17.5.4R.

core backing assets	(a) *on demand deposits*; and (b) *short-term government debt instruments*.

[*Editor's note*: The definition of 'expanded backing assets' takes into account the proposals and legislative changes suggested in the consultation paper 'Updating the regime for Money Market Funds' (CP23/28) as if they were made final.]

expanded backing assets	in relation to a *backing asset pool*, the following *asset*s: (a) *long-term government debt instruments*; (b) units in a *public debt CNAV MMF* or an *EU MMF* which is a *public debt constant NAV MMF* within the meaning of Article 2(11) of the *EU MMF Regulation* and which meets the following conditions: (i) all *asset*s held within the *MMF* are denominated in the *reference currency* of the *qualifying stablecoin*; and (ii) *asset*s which are a debt security represent a claim on the *UK* government or the central government of a *Zone A country*; (c) *asset*s, rights or *money* held as a counterparty to a *repurchase transaction*: (i) that has a maximum maturity up to and including 7 *days*; (ii) that concerns *long-term government debt instruments* or *short-term government debt instruments*; and (iii) in relation to which the other counterparty is limited to 1 of the following: (A) a *UK credit institution*; (B) a *MIFIDPRU investment firm*; (C) a *designated investment firm*; (D) a 'UK Solvency II firm' as defined in chapter II of the PRA Rulebook: Solvency II Firms Insurance General Application; or (E) a *third country person* with a main business comparable to any of the entities referred to in (A) to (D).
holder	the *person* who has the right to *redeem* a *qualifying stablecoin*.

issuing qualifying stablecoin	the activity defined in article 9M (Issuing qualifying stablecoin in the United Kingdom) of the *Regulated Activities Order*.
long-term government debt instrument	a debt security representing a claim on the *UK* government or the central government of a *Zone A* country with a residual maturity of more than 365 *days*.
minting	the process of putting a cryptoasset on a blockchain or network using distributed ledger technology or similar technology in a transferrable form.
on demand deposit	a *deposit* the terms of which require that the sum of *money* paid will be repaid, with or without interest or a premium, on demand.
pre-issued stablecoin	a stablecoin which meets the definition of *qualifying stablecoin* and which forms part of a *qualifying stablecoin product* but which first entered circulation prior to [*Editor's note*: insert date on which this instrument comes into force].
qualifying cryptoasset	the *investment* specified in article 88F of the *Regulated Activities Order* (Qualifying cryptoassets).
qualifying cryptoasset reconciliation	the process set out at *CASS* 17.5.11R.
qualifying cryptoasset safeguarding rules	*CASS* 17.
qualifying stablecoin	the specified *investmen*t defined in article 88G (Qualifying stablecoin) of the *Regulated Activities Order*, but only including those specified investments which involve a stablecoin referencing a single fiat currency.
qualifying stablecoin funds	(a) *money* received by a *qualifying stablecoin issuer* in payment for a *qualifying stablecoin* in the course of carrying out the activity of *issuing qualifying stablecoin*; and (b) *money* that is equivalent in value to the consideration accepted by a *qualifying stablecoin issuer* when it accepts something other than *money* in payment for a *qualifying stablecoin* in the course of carrying out the activity of *issuing qualifying stablecoin*.
qualifying stablecoin issuer	an *authorised person* with permission to carry on the regulated activity defined in article 9M (Issuing qualifying stablecoin in the United Kingdom) of the *Regulated Activities Order*.

qualifying stablecoin product	a category of *qualifying stablecoins* identifiable on the basis that each *qualifying stablecoin* within that category is fungible with each other *qualifying stablecoin* within that category and together all the coins in that category represent a single product.
redemption day	(a) any *day* in the past which was (i) a *business day*; or (ii) any other *day* of the year on which a *qualifying stablecoin issuer* proposed to complete *redemptions* as set out in its liquidity risk management policy under *CASS* 16.2.18R and completed *redemptions*. (b) any *day* in the future which is: (i) a *business day*; or (ii) any other *day* of the year on which a *qualifying stablecoin issuer* proposes to complete *redemptions* as set out in its liquidity risk management policy under *CASS* 16.2.18R and has made preparations to complete those *redemptions*.
redemption fee	the fee contractually agreed between a *qualifying stablecoin issuer* and the *holder* of a *qualifying stablecoin* which a *qualifying stablecoin issuer* is entitled to charge for carrying out *redemption*.
redemption sum	the *reference value* of the *qualifying stablecoin* in respect of which a *redemption* request is received, less: (a) any *redemption fee*; and (b) any currency exchange fees which may be incurred by the *qualifying stablecoin issuer* in meeting the *redemption* request in a currency chosen by the *holder* where that currency is different to the *reference currency*.
reference currency	the fiat currency to which a *qualifying stablecoin* is referenced.
reference value	the face value of a *qualifying stablecoin*, with reference to a unit of the fiat currency to which that *qualifying stablecoin* is referenced.
relevant data	in relation to the same calendar *day* which is in the past: (a) data showing the number of *qualifying stablecoin* a *firm* estimated prior to that *day* it would be asked to *redeem* in the course of that *day* (the 'estimated daily redemption amount'); and

	(b)	data showing the number of *qualifying stablecoin* it was in fact asked to *redeem* in the course of that *day* (the 'actual daily redemption amount').
safeguarding qualifying cryptoassets	the *regulated activity* specified in article 9O(1)(a) (Safeguarding of qualifying cryptoassets and relevant specified investment cryptoassets) of the *Regulated Activities Order*, but only in relation to *qualifying cryptoassets*.	
short-term government debt instruments	a debt security representing a claim on the *UK* government or the central government of a *Zone A* country with a residual maturity of 365 *days* or fewer.	
stablecoin backing assets	*asset*s received or held by *firm* in its capacity as trustee under *CASS* 16.5.2R for the benefit of the *holders* of a *qualifying stablecoin* in respect of which that *firm* is the *qualifying stablecoin issuer*.	
stablecoin backing funds	*money* received or held by a *firm* in its capacity as trustee under *CASS* 16.5.2R for the benefit of the *holders* of a *qualifying stablecoin* in respect of which that *firm* is the *qualifying stablecoin issuer*.	
stablecoin disclosures	the information that a *qualifying stablecoin issuer* must ensure is published online in compliance with *CRYPTO* 2.5.4R.	
stablecoin pool	a number ('X') of *qualifying stablecoins* calculated in accordance with *CASS* 16.2.9R.	
third party custodian	(a)	a *person* who is authorised and supervised in the *UK* or in a *third country* for the activity of safeguarding for the account of another *person* of assets including *core backing assets* (excluding *on demand deposits*) and *expanded backing assets*.
	(b)	any *person* appointed to safeguard *core backing assets* (excluding *on demand deposits*) or *expanded backing assets* in circumstances described in *CASS* 16.6.6R(2).
unallocated backing funds	*money* received or held in connection with the purchase of a *qualifying stablecoin* which is held by a *firm* in a segregated manner and is not co-mingled with a *firm's* own funds, pending the *firm* carrying out internal and external safeguarding reconciliations under *CASS* 16.4.9R and *CASS* 16.4.12R.	
unallocated backing funds account	an account to which the conditions set out in *CASS* 16.3.6R and *CASS* 16.3.7R apply and through which *money* should pass for a maximum of 24 hours until it is either removed into a *backing funds account* or into an account holding the *firm's* own *money*.	
unallocated backing funds acknowledgement letter	a letter in the form of the template in *CASS* 16 Annex 2R.	

Amend the following as shown.

acknowledgement letter	(1)	(in *CASS* 7) a *client bank account acknowledgement letter* (a letter in the form of the template in *CASS* 7 Annex 2R), a *client transaction account acknowledgement letter* (a letter in the form of the template in *CASS* 7 Annex 3R) or an *authorised central counterparty acknowledgment letter* (a letter in the form of the template in *CASS* 7 Annex 4R).
	(2)	(in *CASS* 16) a *backing asset pool acknowledgement letter* (a letter in the form of the template in *CASS* 16 Annex 1R) or an *unallocated backing funds acknowledgement letter* (a letter in the form of the template in *CASS* 16 Annex 2R).
acknowledgement letter fixed text	…	
	(3)	…
	(4)	(in *CASS* 16) the text in the template *acknowledgement letters* in *CASS* 16 Annex 1R and *CASS* 16 Annex 2R that is not in square brackets.
acknowledgement letter variable text	…	
	(3)	…
	(4)	(in *CASS* 16) the text in the template *acknowledgement letters* in *CASS 16* Annex 1R and *CASS* 16 Annex 2R that is in square brackets.
approved bank	(1)	(except in *COLL* and *CASS* 16) (in relation to a *bank* account opened by a firm): …
	(2)	(in *COLL*) any person falling within (a–c) above and a *credit institution* established in an *EEA State* and duly authorised by the relevant *Home State regulator*.
	(3)	(in *CASS* 16) (in relation to a *bank* account opened by a *firm*): (a) the *central bank* of a state that is a member of the *OECD* ('an *OECD* state'); (b) a *credit institution* that is supervised by the *central bank* or other banking regulator of an *OECD* state; and (c) any *credit institution* that:

(i) is subject to regulation by the banking regulator of a state that is not an *OECD* state;

(ii) is required by the law of the country or territory in which it is established to provide audited accounts;

(iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time);

(iv) has a surplus of revenue over expenditure for the past 2 financial years; and

(v) has an annual report which is not materially qualified.

asset …

(2) …

(3) (in *CRYPTO* and *CASS* 16) any property, right, entitlement or interest, excluding *money*.

CRD credit institution

(1) (except in *COLL* ~~and~~, *FUND* and *CASS* 16) a *credit institution* that has its registered office (or, if it has no registered office, its head office) in the *UK*, excluding an *institution* to which the *CRD* does not apply under the *UK* provisions which implemented article 2 of the *CRD* (see also *full CRD credit institution*).

(2) (in *COLL* ~~and~~, *FUND* and *CASS* 16) a *credit institution* that:

…

redemption …

(2) …

(3) (in relation to *qualifying stablecoin*) the process by which a *qualifying stablecoin issuer* fulfils its obligation to the *holder* of a *qualifying stablecoin*, whether carried out directly or indirectly (for example, through a third party), to provide value in exchange for the *holder* returning a *qualifying stablecoin*.

shortfall …

(3) …

(4) (in relation to *qualifying cryptoassets*) any amount by which the *qualifying cryptoassets* in respect of which a *firm* is *safeguarding qualifying cryptoassets* falls short of the *firm's* obligations to its

clients to *safeguard qualifying cryptoassets* (disregarding any decision that a *firm* may make under *CASS* 17.5.14R(3)(d)).

Annex B

Amendments to the Client Assets sourcebook (CASS)

Insert the following new chapters, CASS 16 and CASS 17, after CASS 15 (Payment services and electronic money: relevant funds). All the text is new and is not underlined.

[*Editor's note*: The numbering of the new chapters in this Annex takes into account the new chapter proposed by the consultation paper 'Changes to the safeguarding regime for payments and e-money firms' (CP24/20).]

16 Stablecoin backing assets

16.1 Application and purpose

Who

16.1.1 R This chapter applies to a *firm* that is *issuing qualifying stablecoin*.

16.1.2 G The purpose of this chapter is to set out how a *firm* should manage and safeguard the *money* and *assets* it holds as the *backing asset pool* used to maintain the value and stability of a *qualifying stablecoin*.

What

16.1.3 R Other than as set out in *CASS* 16.1.5R, this chapter applies to a *firm* that is carrying out any part of the activity of *issuing qualifying stablecoin*, including activities in relation to *pre-issued stablecoin*.

16.1.4 G This chapter does not apply to a *person* that did not create the *qualifying stablecoin* or is not a *person* on whose behalf it was created, unless it is a *group* company of:

(1) a *person* who created the *qualifying stablecoin*; or

(2) a *person* on whose behalf it was created.

16.1.5 R The *rules* in *CASS* 16.2.17R to *CASS* 16.2.42R do not apply to a *firm* which only holds *core backing assets* in the *backing asset pool*.

16.1.6 G The *rules* in *CASS* 16.2.17R to *CASS* 16.2.42R are only relevant where a *firm* chooses to hold *expanded backing assets* in the *backing asset pool*.

Where

16.1.7 R This chapter applies to a *firm*, established in the *United Kingdom*, that is carrying out any part of the activity of *issuing qualifying stablecoin* by way of business in the *United Kingdom*.

16.2 Managing and safeguarding backing assets

16.2.1 R A *firm* must ensure that at all times and, separately, in relation to each *qualifying stablecoin product*:

(1) it holds in a *backing asset pool* either:

(a) *money*; or

(b) *money* and *assets*;

(2) the relevant *backing asset pool* is:

(a) held in such a way that the *money* and *assets* it contains are segregated from the *firm's* own *money* and *asset*s; and

(b) held in accounts which are *backing funds accounts* or *backing assets accounts*;

(3) the value of the relevant *backing asset pool* is equal to the *qualifying stablecoin's reference value* multiplied by the relevant *stablecoin pool*; and

(4) it meets the *on demand deposit* requirement set out in *CASS* 16.2.3R.

16.2.2 R For the purposes of *CASS* 16.2.1R a *firm* must not hold *electronic money* in the *backing asset pool*.

16.2.3 R For the purposes of *CASS* 16.2.1R the *on demand deposit* requirement is a requirement that at all times at least 5% of a *firm's backing asset pool* must be held in *on demand deposits*.

16.2.4 R For the purposes of *CASS* 16.2.1R a *backing funds account* is an account in which the *firm* can hold *on demand deposits* and meets the following conditions:

(1) it is provided by one of the following:

(a) a *central bank*;

(b) a *CRD credit institution*; or

(c) an *approved bank*.

(2) it is provided by a third party the appointment of which complied with the *rules* in *CASS* 16.6 (Appointment of third parties) and *CASS* 16.7 (Acknowledgement letters);

(3) it is expressly held in the name of the *firm*;

(4) it includes in its title an appropriate description to distinguish the *money* in the account from:

(a) the *firm's* own *money*; and

(b) *unallocated backing funds*; and

(5) it is a *deposit* account.

16.2.5 R For the purposes of *CASS* 16.2.1R a *backing assets account* is an account which is:

(1) used by a *firm* to hold *core backing assets* (excluding *on demand deposits*) and *expanded backing assets*; and

(2) provided by a *third party custodian* the appointment of which meets the conditions set out in *CASS* 16.6 (Appointment of third parties) and *CASS* 16.7 (Acknowledgement letters).

16.2.6 R For the purposes of *CASS* 16.2.1R the value of a *backing asset pool* is the aggregate value calculated in the *reference currency* of:

(1) all *money* held in a *backing funds account*; and

(2) all *assets* held in a *backing assets account*.

16.2.7 R For the purposes of calculating the value of *assets* under *CASS* 16.2.6R(2), a *firm* must ensure that:

(1) any valuation of *assets* is performed with due skill, care and diligence;

(2) to value the *assets* it uses:

(a) the *market value* of the relevant *assets*; or

(b) where a *market value* is not available for an *asset*, an alternative measure of fair value, which may include an estimated value calculated on a best efforts basis;

(3) it bases calculations on its records at the close of business on the previous *business day*; and

(4) it records the process by which it has calculated the value of *assets*, including which method of valuation has been used.

16.2.8 R For the purposes of *CASS* 16.2.7R, relevant *assets* in the context of a *repurchase transaction* are the *assets*, rights or *money* received or held as counterparty to that transaction.

16.2.9 R A *stablecoin pool* is a number (X) of *qualifying stablecoins*, calculated as follows:

$X = A - (B + C)$

where:

- A is the number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have ever been *minted*;
- B is the number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have ever been *burned*; and
- C is the number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have been *redeemed* within the 24 hours preceding the point of calculation, but which have not been *burned*.

16.2.10 G For the purposes of carrying out the calculation in *CASS* 16.2.9R, a *firm* should include stablecoins which are part of the *qualifying stablecoin product* in question which were *minted* and *burned* at any point, including before [*Editor's note*: insert the date on which this instrument comes into force]; and including those which may have been *minted* or *burned* by a *person* other than the *qualifying stablecoin issuer*.

16.2.11 R (1) A *firm* must at all times keep records of at least the following:

(a) the total number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have ever been *minted*; and

(b) the total number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have ever been *burned*.

(2) At least once in every 24-hour period a *firm* must calculate and keep records of the number of *qualifying stablecoins* in the *qualifying stablecoin product* to which the relevant *backing asset pool* relates that have been *redeemed* within the 24 hours preceding the point of calculation, but which have not been *burned*.

16.2.12 G Records kept under *CASS* 16.2.11R may include records about activities carried out by a *firm* directly as well as activities carried out by a third party on behalf of that *firm*, or by any other *person* who may be involved in the *minting*, *burning* or *redemption* of a stablecoin which forms part of a *qualifying stablecoin product*.

16.2.13 R A *firm* is not permitted to pay interest, income or any other benefit accruing from or in connection with the *backing asset pool* to the *holder* of a *qualifying stablecoin*.

16.2.14 R A *firm* may keep interest or income accruing from the *backing asset pool* for its own account, provided that doing so is consistent with its obligations under *CASS* 16.4.15R, its obligations as a trustee under *CASS* 16.5.2R and any other legal or regulatory obligations to which the *firm* is subject.

Permissible backing assets in the backing pool

16.2.15 R A *firm* must hold all *money* and *asset*s in the *backing asset pool* in the denominated *reference currency* of the *qualifying stablecoin*.

16.2.16 R Subject to *CASS* 16.2.17R, a *firm* may only hold *core backing assets* in the *backing asset pool*.

Conditions for holding expanded backing assets in the backing asset pool

16.2.17 R A *firm* may hold *expanded backing assets* in addition to *core backing assets* in the *backing asset pool* if it meets the following requirements:

(1) it must notify the *FCA* of its intention to hold *expanded backing asset*s using the form set out at *CASS* 16 Annex 4 [to follow] and the online notification system;

(2) it must comply with all of the *rules* in *CASS* 16.2.18R to *CASS* 16.2.25R;

(3) it must ensure that *money* or *asset*s held as counterparty under a *repurchase transaction* are not pledged or reused to engage in a further *repurchase transaction* or any other *investment*; and

(4) it must comply with either (a) or (b):

(a) a *firm* which holds 180 or more consecutive *redemption days* of *relevant data* directly preceding a *calculation date* must comply with:

(i) *CASS* 16.2.26R to *CASS* 16.2.34G; and

(ii) *CASS* 16.2.41R to *CASS* 16.2.42R;

(b) a *firm* which holds fewer than 180 consecutive *redemption days* of *relevant data* directly preceding a *calculation date* must comply with *CASS* 16.2.35R to *CASS* 16.2.42R.

Expanded backing asset risk management

16.2.18 R A *firm* must have in place a robust risk management framework that enables it to identify, measure and manage risks in relation to the *backing asset pool*, including at least the following:

(1) a liquidity risk management policy which:

(a) considers the nature and level of the liquidity risk to which the *money* or *asset*s in the *backing asset pool* is or might be exposed;

(b) contains a clear statement of which *days* of the year will be *redemption days* and which will not be;

(c) sets out how a *firm* will undertake liquidity stress testing, including:

(i) risk tolerance limits on liquidity positions;

(ii) the detailed methodology by which such limits shall be calibrated; and

(iii) the way in which the needs and availability of liquidity in the *backing asset pool* will be monitored;

(d) takes into account liquidity stress testing when considering potential measures which could be taken to strengthen the liquidity arrangements within the *backing asset pool*; and

(e) sets out the amount, type and profile of liquidity resource that it considers adequate to cover:

(i) the obligations at *CRYPTO* 2.4.6R and *CRYPTO* 2.4.14R to offer *redemption* to all *holders* of a *qualifying stablecoin* and to complete *redemption* requests within 1 *day* of receiving a valid request; and

(ii) the need to at all times at least meet the *backing asset composition ratio*;

(2) a liquidity contingency funding plan, which describes the tools that will be used to monitor market conditions, and which addresses how additional liquidity would be sourced:

(a) in the event that the *firm* no longer meets its *backing asset composition ratio*; and

(b) in the event of wider market stress which may impact the number of *redemptions* anticipated; and

(3) a prudent custody policy which:

(a) addresses all aspects of who will provide custody for *asset*s in the *backing asset pool*; and

(b) ensures prompt access to those *asset*s when required.

16.2.19 G Stress testing under a liquidity risk management policy which meets the requirements of *CASS* 16.2.18R(1) should never suggest a minimum liquidity requirement that is lower than the *backing asset composition ratio*.

16.2.20 G The liquidity contingency funding plan should outline strategies for addressing liquidity shortfalls and should set out which individual or individuals within the *firm* are responsible for its monitoring and execution. It should also describe the tools used to monitor market conditions to determine when exceptional circumstances might be present. The plan should include identified funding alternatives.

16.2.21 G A prudent custody policy should ensure against concentration of *asset*s or *asset* classes with a particular custodian or group of custodians and ensure appropriate diversification between custodians.

16.2.22 R All framework and policy documents in *CASS* 16.2.18R must make clear:

(1) the identity of the *person* who is responsible for their monitoring and execution within the *firm*;

(2) the way in which the *senior management* has oversight of their monitoring and execution; and

(3) the frequency with which they will be reviewed and updated.

16.2.23 R A *firm* must have in place robust processes and systems to manage the *backing asset pool* effectively and prudently, including in line with its risk management framework, ensuring that risks associated with holding *expanded backing assets* are considered and addressed.

Governing body oversight: expanded backing assets

16.2.24 R A *firm's governing body* must oversee and approve:

(1) its risk management framework required by *CASS* 16.2.18R; and

(2) its processes and systems under that risk management framework relating to the effective and prudent management of the *backing asset pool* under *CASS* 16.2.23R.

16.2.25 R A *firm* must ensure that its *governing body's* oversight and approval of the matters in *CASS* 16.2.24R is appropriately documented.

Backing asset composition ratio: proportion of different types of backing asset held

16.2.26 R Subject to *CASS* 16.2.35R, a *firm* which opts under *CASS* 16.2.17R to hold *expanded backing assets* as part of the *backing asset pool* must at all times maintain *core backing assets* in accordance with the proportions identified by its *backing asset composition ratio*.

16.2.27 R A *firm* must calculate its *backing asset composition ratio* on each calculation date, which is:

(1) the date it commences holding *expanded backing assets* in the *backing asset pool* under *CASS* 16.2.17R(1); and

(2) every 14 *redemption days* thereafter.

16.2.28 R The *backing asset composition ratio* is a proportion of a *firm's backing asset pool* which is calculated using the formula:

(A + B) / C

expressed as a percentage, where:

- A is the *firm's* peak estimated future daily redemption amount, calculated using the methodology in *CASS* 16.2.29R;
- B is the *firm's core backing asset requirement*, calculated using the methodology in *CASS* 16.2.30R; and
- C is the total value of the *backing asset pool* as determined according to *CASS* 16.2.6R.

Peak estimated daily redemption amount

16.2.29 R For the purposes of *CASS* 16, as at any given *calculation date*, a *firm's* peak estimated future daily redemption amount is the largest number of *qualifying stablecoins* a *firm* predicts it will be required to *redeem* within any 24-hour period over the following 14 *redemption days*.

Core backing asset requirement

16.2.30 R For the purposes of *CASS* 16, a *firm's core backing asset requirement* is the product of:

(1) the highest daily error calculated using the calculation in *CASS* 16.2.31R; and

(2) the error addend calculated using the methodology in *CASS* 16.2.32R.

16.2.31 R For the purposes of *CASS* 16.2.30R(1) the highest daily error is the largest positive value obtained by subtracting the estimated daily *redemption* amount from the actual daily *redemption* amount for each of the 180 *redemption days* of *relevant data* immediately preceding the current *calculation date*. The maximum error is 0 where no positive values are obtained.

16.2.32 R For the purposes of *CASS* 16.2.30R(2) the error addend is a value calculated on the basis of the number of qualifying errors as defined in *CASS* 16.2.33R that occurred in the 180 *redemption days* preceding the *calculation date*, as follows:

Number of qualifying errors over the preceding 180 redemption day period	**Error addend**
$0 \leq 12$	0.85
$> 13 \leq 25$	1.15

> 26 ≤ 38	1.45
> 39 ≤ 50	1.75
> 51 ≤ 63	2.05
> 64 ≤ 76	2.35
> 77 ≤ 89	2.65
> 90 ≤ 102	2.95
> 103 ≤ 115	3.25
> 116 ≤ 128	3.55
> 129 ≤ 140	3.85
> 141 ≤ 153	4.15
> 154 ≤ 180	4.45

16.2.33 R For the purposes of *CASS* 16.2.32R a qualifying error is an instance where the value of the actual daily *redemption* amount is at least 110% expressed as a percentage of the estimated daily *redemption* amount for the same *day*.

Interaction of backing asset composition ratio and the on-demand deposit requirement

16.2.34 G (1) Where a *firm* must under *CASS* 16.2.26R at all times maintain as a minimum the proportion of the *backing asset pool* as *core backing assets* which is indicated by its *backing asset composition ratio*, it may count the *on demand deposits* it holds both for the purposes of meeting *CASS* 16.2.26R and also for the purposes of meeting the *on demand deposit* requirement in *CASS* 16.2.1R(4).

(2) The following is an example of the interaction of the *backing asset composition ratio* and the *on demand deposit* requirement:

Assume a *qualifying stablecoin issuer* has calculated a *backing asset composition ratio* of 16%, which means that 16% of the *backing asset pool* must be held as *core backing assets*. The *qualifying stablecoin issuer* must satisfy the *on demand deposit* requirement by ensuring that at least 5% of the *backing asset pool* is held as *on demand deposits*. The *qualifying stablecoin issuer* also needs to hold an additional amount of 11% of the *backing asset pool* as *core backing assets* to ensure it meets its minimum BACR of 16%. It may do this through holding further amounts in *on demand deposits* in a *backing funds account* or by holding *short-term government debt instruments*.

Opting to hold expanded backing assets with limited data

16.2.35 R A *firm* which opts to hold *expanded backing assets* and falls into *CASS* 16.2.17R(4)(b) must:

(1) for 90 *days* following the date the notification was made to the *FCA* under *CASS* 16.2.17R(1):

(a) hold only *core backing assets* in the *backing asset pool*; and

(b) collect *relevant data* which enables a *firm* to measure qualifying errors as defined in *CASS* 16.2.33R; and

(2) for *days* 91 to 179 following that notification, comply with *CASS* 16.2.37R.

16.2.36 G Where 180 or more *redemption days* have elapsed since a *firm's* notification to the *FCA* under *CASS* 16.2.17R(1) it will fall into *CASS* 16.2.17R(4)(a) as it will have 180 or more *redemption days* of *relevant data*.

16.2.37 R The percentage of *core backing assets* held as part of a *backing asset pool* must be not less than the higher of:

(1) the *backing asset composition ratio* calculated under *CASS* 16.2.28R but using a modified error addend as set out in *CASS* 16.2.39R; and

(2) 85% by value of the *backing asset pool*, or the percentage that is determined by decreasing 85% by 1500 basis points where the first decrease takes place on the first *calculation date* after 90 *redemption days* from the date of notification.

16.2.38 G The proportion in *CASS* 16.2.37R(2) will be 85% on the first *calculation date*, decreasing by a 15% interval from the second and each subsequent *calculation date* as follows: 70%, 55%, 40%, 25%, 10%, 0%.

16.2.39 R The modified error addend is a value which is calculated on the basis of the table set out in *CASS* 16.2.32R but using a modified error count as set out in *CASS* 16.2.40R.

16.2.40 R For the purposes of *CASS* 16.2.39R, a *firm* must calculate its modified error count using the formula:

QE x (180/D)

where:

- QE is the number of qualifying errors as defined in *CASS* 16.2.33R which occurred in the *redemption days* between a *firm* notifying the *FCA* that it proposes to hold *expanded backing assets* under *CASS* 16.2.17R(1) and the current *calculation date*; and

- D is the number of *redemption days* between a *firm* notifying the *FCA* that it proposes to hold *expanded backing assets* under *CASS* 16.2.17R(1) and the current *calculation date*.

Notification of breach

16.2.41 R Subject to *CASS* 16.2.42R, a *firm* must promptly notify the *FCA* if it holds *expanded backing assets* in the relevant *backing asset pool* and ceases at any point to comply with *CASS* 16.2.17R.

16.2.42 R A *firm* does not need to notify the *FCA* if the failure to comply with *CASS* 16.2.17R arises from a need to rebalance the percentage of *core backing assets* held within the relevant *backing asset pool* following a *firm* calculating a new *backing asset composition ratio* on a given *calculation date*, and less than 1 *business day* has elapsed since that *calculation date*.

16.3 Holding backing assets

16.3.1 R *CASS* 16.3.2R is to be read as imposing requirements on a *firm* separately in relation to each *qualifying stablecoin product*.

16.3.2 R A *firm* must:

(1) maintain adequate arrangements to safeguard the rights and interests of *qualifying stablecoin holders* in a *backing asset pool*; and

(2) prevent the use of any *money* or *asset*s comprising a *backing asset pool* for its own account.

Segregation of assets for different qualifying stablecoin products

16.3.3 R A *firm* which is a *qualifying stablecoin issuer* in relation to more than 1 *qualifying stablecoin product* must ensure that the *backing asset pool* and any *unallocated backing funds* for each *qualifying stablecoin product* are:

(1) kept separate and distinct from the *backing asset pool* and any *unallocated backing funds* held for any other *qualifying stablecoin product*;

(2) held in different and distinct accounts from those accounts which hold the *money* and *asset*s in the *backing asset pool* and any *unallocated backing funds* held for any other *qualifying stablecoin product*; and

(3) managed independently from the *backing asset pool* and any *unallocated backing funds* for any other *qualifying stablecoin product*.

16.3.4 G *CASS* 16.3.3R requires separation of the *money* or *asset*s belonging to the *backing asset pool* and any *unallocated backing funds* for each *qualifying stablecoin product*. This would not prevent a *firm* engaging the services of the same *bank* or *third party custodian* to hold the *money* or *asset*s in a *backing asset pool* in connection with different *qualifying stablecoin products* provided appropriate separation could be achieved.

Unallocated backing funds

16.3.5 R *CASS* 16.3.6R to *CASS* 16.3.9R are to be read as imposing requirements on a *firm* separately in relation to each *qualifying stablecoin product*.

16.3.6 R A *firm*, on receiving payment for a *qualifying stablecoin*, must promptly place the relevant *qualifying stablecoin funds* into one or more *unallocated backing funds accounts* opened with any of the following:

(1) a *central bank*;

(2) a *CRD credit institution*; or

(3) an *approved bank*.

16.3.7 R An 'unallocated backing funds account' is an account which meets the following conditions:

(1) it is provided by a third party the appointment of which complied with the *rules* in *CASS* 6.6 (Appointing third parties) and *CASS* 6.7 (Acknowledgement letters)

(2) it is expressly held in the name of the *firm*;

(3) it includes in its title an appropriate description to distinguish the *money* in the account from:

(a) the *firm's* own *money*; and

(b) *money* or *assets* held in a *backing funds account* or *backing assets account* on trust for the benefit of the *holders* of a *qualifying stablecoin* under *CASS* 16.5;

(4) it contains *money* held on trust for the benefit of the *holders* of a *qualifying stablecoin*; and

(5) it is a *deposit* account.

16.3.8 R A *firm* must internally record that *qualifying stablecoin funds* are held as *unallocated backing funds* and be able to distinguish the accounts in which such sums are held from:

(1) accounts in which *stablecoin backing funds* are held; and

(2) accounts in which the *firm's* own *money* is held.

16.3.9 R A *firm* may only remove or otherwise use *money* from an account containing *unallocated backing funds* as follows:

(1) where it concludes, following reconciliations carried out under *CASS* 16.4.9R and *CASS* 16.4.12R, that the following conditions are met, it may transfer *money* from an account containing *unallocated backing funds* into an account containing *stablecoin backing funds*:

(a) the value of the *backing asset pool* is less than that required by *CASS* 16.2.1R(3);

(b) that adjusting the value of the *backing asset pool* is the method it proposes to use under *CASS* 16.4.15R to address the shortfall; and

(c) that using *unallocated backing funds* is the most appropriate way to adjust the value of the *backing asset pool*; and

(2) where it concludes, following reconciliations carried out under *CASS* 16.4.9R and *CASS* 16.4.12R, that either paragraph (a) or (b) is met, it may remove *money* from an account containing *unallocated backing funds* and use it for any purpose:

(a) the value of the *backing asset pool* complies with *CASS* 16.2.1R(3); or

(b) (i) the value of the *backing asset pool* is less than that required by *CASS* 16.2.1R(3); and

(ii) it concludes that using *unallocated backing funds* is not the most appropriate way to adjust the value of the *backing asset pool*.

16.4 Records and reconciliations

Policies and procedures

16.4.1 R All of the *rules* in this section are to be read as imposing requirements on a *firm* separately in relation to each *qualifying stablecoin product*.

16.4.2 R A *firm* must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the *firm* with this chapter, including in relation to any services provided through a third party. Such policies and procedures must include at least the following:

(1) the frequency and method of the reconciliations the *firm* is required to carry out under this section;

(2) the resolution of reconciliation discrepancies under this section;

(3) the approach to the valuation of an *asset* for purposes of *CASS* 16.2.7R; and

(4) the frequency with which the *firm* is required to review its arrangements in compliance with this chapter.

Records

16.4.3 R A *firm* must keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish between:

(1) the *money* and *asset*s in each *backing asset pool* held for the *holders* of a *qualifying stablecoin*;

(2) *unallocated backing funds* held in identifiable accounts as such; and

(3) its own *money* or *asset*s.

16.4.4 R A *firm* must at all times maintain its records and accounts in a way that ensures their accuracy and, in particular, ensures accurate records about each *backing asset pool* it holds, including:

(1) the value of *money* and *asset*s that should be held in each *backing asset pool* in one or more *backing funds accounts* or *backing assets accounts*;

(2) the location of *money* and *asset*s in each *backing asset pool*;

(3) the identity of the *person* or *persons* responsible for the custody of *money* and *asset*s in each *backing asset pool*; and

(4) the value of the *money* and *asset*s in each *backing asset pool*.

16.4.5 R For each internal safeguarding reconciliation and external safeguarding reconciliation, a *firm* must keep records of:

(1) the time and date it carried out the relevant process;

(2) the actions it took;

(3) the outcome of its calculations about the amount of *money* or *asset*s in each *backing asset pool* and the *reference value* of the *stablecoin pool*; and

(4) whether any discrepancies were identified and, if so, what actions were taken in respect of those discrepancies.

16.4.6 R Unless otherwise stated, a *firm* must ensure that any record made under this section is retained for a period of 5 years starting from the later of:

(1) the date it was created; or

(2) if it has been modified since the date it was created, the date it was most recently modified.

Internal safeguarding reconciliation

16.4.7 R An internal safeguarding reconciliation requires a *firm* to reconcile its internal records and accounts of the amount it safeguards in each *backing asset pool* for the *holders* of *qualifying stablecoin* with its internal records and accounts of the amount that it should safeguard in that *backing asset pool*.

16.4.8 R In carrying out an internal safeguarding reconciliation, a *firm* must use the values contained in its internal records and not records provided by third parties with whom it has placed the *money* or *asset*s in the *backing asset pool*.

16.4.9 R A *firm* must carry out an internal safeguarding reconciliation:

(1) as regularly as necessary and at least once each *business day*; and

(2) based on the most up to date records of the *firm*.

External safeguarding reconciliation

16.4.10 R An external safeguarding reconciliation is a reconciliation between a *firm's* internal records and accounts and those of:

(1) any *person* with whom a *firm* has a *backing funds account*; and

(2) any *person* with whom a *firm* has a *backing assets account*.

16.4.11 G The purpose of an external safeguarding reconciliation is to ensure the accuracy of a *firm's* internal records and accounts against those of any third parties that hold *money* or *asset*s on behalf of that *firm* for the benefit of *holders* of a *qualifying stablecoin*.

16.4.12 R A *firm* must carry out an external safeguarding reconciliation as regularly as necessary and at least once each *business day*.

16.4.13 R When carrying out an external safeguarding reconciliation, a *firm* should:

(1) compare:

(a) the balance of funds on each *backing funds account* as recorded by the *firm*, with the balance on that account as set out in the statement or other form of confirmation issued by the *person* with whom that account is held; and

(b) the balance of *asset*s, investment by investment, on each *backing assets account*, with the balance of those *asset*s as set out in the statement or other form of confirmation issued by the *person* with whom the account is held; and

(2) promptly identify and resolve any discrepancies between those balances under *CASS* 16.4.15R to *CASS* 16.4.19R

[*Editor's note*: CASS 16.4.14G takes into account the proposals and legislative changes suggested in the consultation paper 'Updating the market for Money Market Funds' (CP23/28) as if they were made final.]

16.4.14 G When carrying out the reconciliation described in *CASS* 16.4.13R in relation to *asset*s, a *firm* is required to reconcile the quantity of *asset*s it has recorded with the quantity of *asset*s a third party has recorded, in addition to the value of those *asset*s. An example would be that a *firm* should compare its records of the number of units in a particular *money market fund* with the number of units in that *money market fund* as set out in the statements provided by the custodian of the units, in addition to the value of those units.

Identifying and resolving discrepancies

16.4.15 R When an internal or external safeguarding reconciliation identifies, or for any other reason a *firm* becomes aware of, a discrepancy between the value of a *firm's backing asset pool* and the *reference value* multiplied by the relevant *stablecoin pool*, the *firm* must determine the reason for that discrepancy and ensure the discrepancy is resolved using either the method in paragraph (1) or (2) below:

(1) the *firm* must adjust the value of the *backing asset pool* by ensuring that either:

(a) any shortfall is paid into a *backing funds account*; or

(b) any excess is withdrawn from a *backing funds account*; or

(2) the *firm* must adjust the value of the *stablecoin pool* by ensuring either:

(a) any excess of *qualifying stablecoins* which have been *minted* but are not represented by *money* or *asset*s in the *backing asset pool* are *burned*; or

(b) any shortfall of *qualifying stablecoins* which has led to an excess of value in the *backing asset pool* is resolved by the *minting* of additional *qualifying stablecoins* with no corresponding adjustment to the *money* or *asset*s held as the *backing asset pool*.

16.4.16 R The resolution of a discrepancy must be carried out as soon as possible, and in any event no later than the end of the *business day* on which the reconciliation is performed or discrepancy otherwise identified.

16.4.17 G *CASS* 16.4.15R sets out some of the steps that a *firm* must carry out to ensure that it is segregating the correct amount on aggregate of *money* and *asset*s in the *backing asset pool*. Where discrepancies are identified, a *firm* is required either to make payments to remedy those discrepancies out of:

(1) *money* it has segregated as *unallocated backing funds*; or

(2) its own funds,

or it may adjust the value of the relevant *stablecoin pool* through *minting* or *burning* as appropriate.

16.4.18 G Where a discrepancy identified under *CASS* 16.4.15R has arisen as a result of a breach of the requirements of this chapter a *firm* should ensure it takes sufficient steps to avoid a recurrence of that breach.

16.4.19 R If a discrepancy is identified by an internal or external safeguarding reconciliation carried out under *CASS* 16.4.10R and *CASS* 16.4.12R, the *firm* must investigate the reason for the discrepancy without undue delay unless the discrepancy arises solely as a result of timing differences between the accounting systems of the *person* providing the statement or confirmation and that of the *firm*.

Notification requirements

16.4.20 R A *firm* must inform the *FCA* in writing without delay if:

(1) its internal records and accounts of the *backing asset pool* are materially out of date, inaccurate or invalid so that the *firm* is no longer able to comply with the requirements in *CASS* 16.4.3R or *CASS* 16.4.4R;

(2) it will be unable to, or materially fails to, conduct an internal safeguarding reconciliation in compliance with *CASS* 16.4.9R;

(3) it will be unable to, or materially fails to, adjust the value of the *backing asset pool* using the methods in *CASS* 16.4.15R(1) or adjust the value of the *stablecoin pool* using the methods in *CASS* 16.4.15R(2);

(4) it will be unable to, or materially fails to, conduct an external safeguarding reconciliation in compliance with *CASS* 16.4.10R to *CASS* 16.4.14G;

(5) it will be unable to, or materially fails to, identify and resolve any discrepancies under *CASS* 16.4.15R after becoming aware of those discrepancies through an internal or external safeguarding reconciliation or for any other reason; or

(6) it becomes aware that, at any time in the preceding 12 months, the value of the *backing asset pool* was materially different from the

reference value multiplied by the relevant *stablecoin pool* at that time.

16.5 Backing asset statutory trust

16.5.1 G (1) Section 137B(2) of the *Act* as applied by section 98 provides that *rules* may make provisions which result in a *firm* holding a sum or *asset* on trust.

(2) This section creates a fiduciary relationship between a *firm* and the *holders* of a *qualifying stablecoin*.

16.5.2 R Separately, in relation to each *qualifying stablecoin product*, a *firm* holds as trustee the following *money* and *asset*s on the terms set out in *CASS* 16.5.4R:

(1) *money* and *asset*s which comprise the *backing asset pool*; and

(2) where the value of the *backing asset pool* is less than the *reference value* multiplied by the *stablecoin pool* as required by *CASS* 16.2.1R(3), any *unallocated backing funds* to the value of that difference.

16.5.3 G For the purposes of *CASS* 16.5.2R, *money* or *asset*s includes (but is not limited to):

(1) *money* held in a *backing funds account*;

(2) *asset*s held in a *backing assets account*;

(3) *money* held in an *unallocated backing funds account*; and

(4) rights in or under and any proceeds of any *asset* which a *firm* may purchase or instruct another to purchase, or *investment* which a *firm* may make or instruct another to make, with any *money* or *asset*s owned by the *firm* or which it holds as trustee under *CASS* 16.5.2R, including but not limited to *core backing assets*, *expanded backing assets* and any right in or under or any *asset* or *money* held as a result of entering into a *repurchase transaction* in relation to any of those *asset*s.

16.5.4 R Separately, for each trust created under *CASS* 16.5.2R which corresponds to a *qualifying stablecoin product*, a *firm* holds the *money* and *asset*s specified in *CASS* 16.5.2R on the following terms:

(1) for the purposes of, and on the terms of, the *rules* in *CASS* 16;

(2) for the *holders* of the relevant *qualifying stablecoin* in respect of which the *money* or *asset*s are held or should be held in the *backing asset pool*, according to their respective interests in it; and

(3) [to follow]

[*Editor's note*: rules relating to the terms on which a *firm* holds the *money* and *assets* specified in *CASS* 16.5.2R in the event of failure of the *firm* will be consulted on via a subsequent consultation.]

16.5.5 R The trust does not permit a *firm*, in its capacity as trustee, to use trust *money* or *asset*s described in *CASS* 16.5.2R to borrow or lend *money*, except in so far as such borrowing or lending forms part of a *repurchase transaction*, or forms the act of placing *money* into a *backing funds account*.

16.6 Appointment of third parties

16.6.1 R (1) A *firm* must appoint:

(a) one or more third parties to provide it with a *backing funds account* or accounts for the purpose of safeguarding *money* in a *backing asset pool*; and

(b) where it proposes to hold *assets* in addition to *money* in a *backing asset pool*, one or more third parties to provide it with a *backing assets account* or accounts for the purpose of safeguarding *asset*s in a *backing asset pool*.

(2) A third party appointed under (1)(a) or (b) must not be in the same *group* as the *firm*.

16.6.2 R (1) A *firm* must exercise all due skill, care and diligence:

(a) in the selection, appointment, and periodic review of third parties that provide:

(i) a *backing funds account* for the purpose of safeguarding *money* in a *backing asset pool*;

(ii) a *backing assets account* for the purpose of safeguarding *asset*s in a *backing asset pool*; and

(iii) an *unallocated backing funds account* for the purpose of safeguarding *unallocated backing funds*; and

(b) in the arrangements for the holding and protection of *money* and *asset*s in the *backing asset pool*.

(2) A *firm* must consider the need for diversification as part of its due diligence under (1).

16.6.3 G A *firm* should ensure that its consideration of a third party focuses on the specific legal entity in question and not simply that *person's group* as a whole.

16.6.4 R When a *firm* selects, appoints and conducts a periodic review of a third party, it must take into account:

(1) the expertise and market reputation of the third party, with a view to ensuring the protection of *holders'* rights and interests as beneficiaries of the trust established by *CASS* 16.5; and

(2) any legal or regulatory requirements or market practices relating to the holding of *money* or *asset*s in a *backing asset pool* that could adversely affect *holders'* rights or interests as beneficiaries of the trust established by *CASS* 16.5.

16.6.5 G In discharging its obligations under *CASS* 16.6.4R, a *firm* should also consider, as appropriate, together with any other relevant matters:

(1) the third party's performance of its services to the *firm*;

(2) the arrangements that the third party has in place for safeguarding the *money* or *asset*s in a *backing funds account*, *backing assets account* or *unallocated backing funds account*, including market practices relating to the safeguarding of the *money* or *asset*s that could adversely affect the rights of the *holders* of the relevant *qualifying stablecoin*;

(3) current industry standard reports – for example, '[Assurance reports on internal controls of service organisations made available to third parties]' made in line with Technical Release AAF 01/20 of the Institute of Chartered Accountants in England and Wales or equivalent;

(4) the capital or financial resources of the third party;

(5) the amount of *core backing assets* or *expanded backing assets* placed as a proportion of the third party's capital and (where relevant) deposits;

(6) the extent to which *core backing assets* or *expanded backing assets* that the *firm* deposits or holds with any third party would be protected under a deposit protection scheme or other compensation scheme;

(7) the creditworthiness of the third party;

(8) to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the third party and affiliated companies; and

(9) the arrangements referred to in *CASS* 16.3.2R (holding backing assets)

16.6.6 R (1) Subject to (2), a *firm* must only:

(a) deposit *core backing assets* in the *backing asset pool* with a third party in a jurisdiction which specifically regulates and supervises the safeguarding of *assets*, including *core backing assets* for the account of another *person* with a third party who is subject to such regulation; and

(b) deposit *expanded backing assets* in the *backing asset pool* with a third party in a jurisdiction which specifically regulates and supervises the safeguarding of *assets*, including *expanded backing assets* for the account of another *person* with a third party who is subject to such regulation.

(2) A *firm* may deposit *core backing assets* or *expanded backing assets* with a third party in a jurisdiction which does not regulate and supervise the safeguarding of *core backing assets* or *expanded backing assets* for the account of another *person* only where the nature of the *core backing assets* or *expanded backing assets* or of the investment services connected with them requires them to be deposited with a third party in that *third country*.

(3) The requirements under paragraphs (1) and (2) also apply when the third party has delegated any of its functions concerning the safeguarding of *core backing assets* or *expanded backing assets* to another third party.

16.6.7 R (1) A *firm* must periodically review its arrangements with third parties, including whether it is appropriate to diversify (or further diversify) the third parties with which it deposits, holds or invests *money* or *asset*s in the *backing asset pool*.

(2) Where it concludes it is appropriate to do so, it must make adjustments accordingly to the third parties it uses and to the amounts of *money* or amounts or types of *asset*s in the *backing asset pool* deposited, held or invested with them.

16.6.8 G In discharging its obligations under *CASS* 16.6.7R to periodically review its arrangements with third parties, a *firm* should have regard to:

(1) whether it would be appropriate to deposit *money* in the *backing asset pool* into *backing funds accounts* opened at a number of different *banks*;

(2) whether it would be appropriate to limit the amount of *money* or *asset*s the *firm* holds with third parties that are in the same *group* as each other;

(3) whether risks arising from the *firm's* business model create any need for diversification (or further diversification);

(4) the market conditions at the time of the assessment;

(5) the outcome of any due diligence carried out in accordance with *CASS* 16.6.2R; and

(6) the arrangements referred to in *CASS* 16.3.2R (holding backing assets)

16.6.9 R (1) A *firm* must make a record of:

(a) the grounds on which it satisfies itself as to the appropriateness of its selection and appointment of a third party under *CASS* 16.6.2R;

(b) each periodic review of its selection and appointment of a third party under *CASS* 16.6.2R, its considerations and conclusions; and

(c) each periodic review that it conducts under *CASS* 16.6.7R, its considerations and conclusions.

(2) A record under (1) must be made on the date the selection is made or the review completed (as the case may be) and kept for either 5 years from that date or 5 years from the date that the *firm* ceases to use the third party, if later.

16.7 Acknowledgement letters

Purpose

16.7.1 G The main purposes of an *acknowledgement letter* are:

(1) to put third parties on notice that the *holders* of a *qualifying stablecoin* in respect of which the *firm* is the *qualifying stablecoin issuer* have an interest in the *money* or *asset*s that have been deposited with, allowed to be held by, or invested with that *person*;

(2) to ensure that a *backing funds account*, *backing assets account* or *unallocated backing funds account*:

(a) has been opened in the correct form, in accordance with and in compliance with the *rules* in *CASS* 16; and

(b) is distinguished from any account containing *money* or *asset*s that are not part of the *backing asset pool* or *unallocated backing funds*, including from any account containing *money* or *asset*s which belongs to the *firm*; and

(3) to ensure that a third party understands and agrees that it will not have any recourse or right against *money* or *asset*s standing to the credit of a *backing funds account*, *backing assets account* or *unallocated backing funds account* in respect of any liability of the *firm* to the third party (or a *person* connected to the third party).

16.7.2 R (1) For each appointed third party providing one or more *backing funds accounts*, a *firm* must complete and sign a safeguarding account *acknowledgement letter*, clearly identifying the *backing funds accounts*, and send it to the third party with which the relevant account or accounts are, or will be, opened, requesting the third party to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.

(2) For each appointed third party providing one or more *backing assets accounts*, a *firm* must complete and sign a safeguarding account *acknowledgement letter*, clearly identifying the *backing assets accounts*, and send it to the third party with which the relevant account or accounts are, or will be, opened, requesting the third party to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.

(3) For each appointed third party providing one or more *unallocated backing funds accounts*, a *firm* must complete and sign a safeguarding account *acknowledgement letter*, clearly identifying the *unallocated backing funds accounts*, and send it to the third party with which the relevant account or accounts are, or will be, opened, requesting the third party to acknowledge and agree to the terms of the letter by countersigning it and returning it to the *firm*.

(4) A *firm* must not hold any *money* or *asset*s in a *backing funds account*, *backing assets account* or *unallocated backing funds account* unless the *firm* has received a duly countersigned *acknowledgement letter* from the *person* with which the account is held that has not been inappropriately redrafted (see *CASS* 16.7.4R).

16.7.3 R In drafting an *acknowledgement letter*, a *firm* must use the template in *CASS* 16 Annex 1R or *CASS* 16 Annex 2R as relevant.

16.7.4 R When completing an *acknowledgement letter*, a *firm*:

(1) must not amend any of the *acknowledgement letter fixed text*;

(2) subject to (3), must ensure the *acknowledgement letter variable text* is removed, included or amended as appropriate; and

(3) must not amend any of the *acknowledgement letter variable text* in a way that would alter or otherwise change the meaning of the *acknowledgement letter variable text*.

16.7.5 G *CASS* 16 Annex 3G contains guidance on using the template for *acknowledgement letters*, including guidance on when and how a *firm* should amend the *acknowledgement letter variable text* that is in square brackets.

16.7.6 R (1) If, on countersigning and returning the *acknowledgement letter* to a *firm*, the third party has also made amendments to:

(a) any of the *acknowledgement letter fixed text*; or

(b) any of the *acknowledgement letter variable text* in a way that would alter or otherwise change the meaning of the *acknowledgement letter fixed text*,

the *acknowledgement letter* will have been inappropriately redrafted and no longer comply with *CASS* 16.7.4R.

(2) Amendments made to the *acknowledgement letter variable text* in the *acknowledgement letter* returned to a *firm* by a third party will not have the result that the letter has been inappropriately redrafted if those amendments:

(a) do not affect the meaning of the *acknowledgement letter fixed text*;

(b) have been specifically agreed with the *firm*; and

(c) do not cause the *acknowledgement letter* to be inaccurate.

16.7.7 R A *firm* must use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* that has been returned by a third party to the *firm* was authorised to countersign the letter on behalf of that third party.

16.7.8 R A *firm* must retain each countersigned *acknowledgement letter* it receives from the date of receipt until the expiry of a period of 5 years starting on the date on which the last account to which the *acknowledgement letter* relates is closed.

16.7.9 R A *firm* must also retain any other documentation or evidence it believes is necessary to demonstrate that it has complied with each of the applicable requirements in this section (such as any evidence it has obtained to ensure that the individual that has countersigned an *acknowledgement letter* that has been returned to the *firm* was authorised to do so).

16.7.10 R A *firm* must periodically (at least annually, and whenever it becomes aware that something referred to in an *acknowledgement letter* has changed) review each of its countersigned *acknowledgement letters* to ensure that they remain accurate.

16.7.11 R Whenever a *firm* finds a countersigned *acknowledgement letter* contains an inaccuracy, the *firm* must promptly draw up a new replacement *acknowledgement letter* and ensure that the new *acknowledgement letter* is duly countersigned and returned by the relevant third party.

16.7.12 R Under *CASS* 16.7.11R, a *firm* must obtain a replacement *acknowledgement letter* whenever:

(1) there has been a change in any of the parties' names or addresses or a change in any of the details of the relevant account(s) as set out in the letter; or

(2) it becomes aware of an error or misspelling in the letter.

16.7.13 R If a *firm's backing funds account*, *backing assets account* or *unallocated backing funds account* is transferred to another third party, the *firm* must:

(1) promptly draw up and send out a new *acknowledgement letter* under *CASS* 16.7.2R; and

(2) ensure that the new *acknowledgement letter* is duty countersigned and returned by the relevant third party.

16 Annex 1 Backing assets account and backing funds account acknowledgement letter template

16 Annex 1.1 R [*Letterhead of qualifying stablecoin issuer, including full name and address of qualifying stablecoin issuer*]

[*name and address of bank or third party custodian*]

[*date*]

Backing [asset/funds] account acknowledgement letter (pursuant to the rules of the Financial Conduct Authority)

We refer to the following account[s] which [*name of qualifying stablecoin issuer*], regulated by the Financial Conduct Authority (Firm Reference Number [FRN]), ('us', 'we' or 'our') [has opened or will open] [and/or] with [*name of bank or third party custodian*] ('you' or 'your'):

[*insert the account title[s], the account unique identifier[s] (eg, sort code and account number, deposit number or reference code) and (if applicable) any abbreviated name of the account[s] as reflected in the firm's systems*]

([collectively,] the 'backing [asset/funds] account[s]').

For [each of] the backing [asset/funds] account[s] identified above, you acknowledge that we have notified you that:

1. we are under an obligation to keep [money/assets] we hold to meet the claims of holders of [*insert name of qualifying stablecoin product*] separate from other [money/assets];
2. we have opened, or will open, the backing [asset/funds] accounts for the purpose of depositing [money/assets] with you to meet the claims of holders of [*insert name of qualifying stablecoin product*]; and
3. we hold all [money/assets] standing to the credit of the backing [assets/funds] accounts to meet the claims of holders of [*insert name of qualifying stablecoin product*] as trustee under the laws applicable to us.

For [each of] the backing [assets/funds] account[s] above, you agree that:

4. you do not have any interest in, or recourse or right against [money/assets] in the backing [assets/funds] accounts in respect of any sum owed to you, or owed to any third party, on any other accounts (including an account we use for our own [money/assets]). This means, for example, that you do not have any right to combine the backing [assets/funds] account[s] with any other account and right of set-off or counterclaim against [money/assets] in the backing [assets/funds] accounts.
5. you will title, or have titled, the backing [assets/funds] account as stated above and that this title is different to the title of any other account containing [money/assets] that belong to us or to any third party; and
6. you are required to release on demand all [money/assets] standing to the credit of the backing [assets/funds] account upon proper notice and instruction from us or a liquidator, receiver, administrator or trustee (or similar person) appointed for us in bankruptcy (or similar procedure), in any relevant jurisdiction.

We acknowledge that:

7. you are not responsible for ensuring compliance by us with our own obligations in respect of the backing [assets/funds] account[s].

You and we agree that:

8. the terms of this letter will remain binding upon the parties, their successors and assigns, and, for clarity, regardless of any change in any of the parties' names;
9. this letter supersedes and replaces any previous agreement between the parties in connection with the backing [assets/funds] account[s], to the extent that such previous agreement is inconsistent with this letter;
10. if there is any conflict between this letter and any other agreement between the parties over the backing [assets/funds] account[s], this letter will prevail;
11. no variation to the terms of this letter shall be effective unless it is in writing, signed by the parties and permitted under the rules of the Financial Conduct Authority;
12. this letter is governed by the laws of [*insert appropriate jurisdiction*] [*qualifying stablecoin issuer may optionally use this space to insert additional wording to record an intention to exclude any rules of private international law that could lead to the application of the substantive law of another jurisdiction*]; and
13. the courts of [*insert same jurisdiction as previous*] have non-exclusive jurisdiction to settle any dispute or claim from or in connection with this letter or its subject matter or formation (including non-contractual disputes or claims).

Please sign and return the enclosed copy of this letter as soon as possible.

For and on behalf of [*name of qualifying stablecoin issuer*]

x____________________________

Authorised signatory

Print name:

Title:

ACKNOWLEDGED AND AGREED:

For and on behalf of [*name of bank or third party custodian*]

x____________________________

Authorised signatory

Print name:

Title:

Contact information: [*insert signatory's phone number and email address*]

Date:

16 Annex 2 **Unallocated backing funds account acknowledgement letter template**

16 Annex 2.1 R [*Letterhead of qualifying stablecoin issuer, including full name and address of qualifying stablecoin issuer*]

[*name and address of bank*]

[*date*]

Unallocated backing funds account acknowledgement letter (pursuant to the rules of the Financial Conduct Authority)

We refer to the following account[s] which [*name of qualifying stablecoin issuer*], regulated by the Financial Conduct Authority (Firm Reference Number [FRN]), ('us', 'we' or 'our') [has opened or will open] [and/or] with [*name of bank*] ('you' or 'your'):

[*insert the account title[s], the account unique identifier[s] (eg, sort code and account number, deposit number or reference code) and (if applicable) any abbreviated name of the account[s] as reflected in the firm's systems*]

([collectively,] the 'unallocated backing funds account[s]').

For [each of] the unallocated backing funds account[s] identified above, you acknowledge that we have notified you that:

1. we are under an obligation to keep money we hold to meet the claims of holders of [*insert name of qualifying stablecoin product*] separate from other money;
2. we have opened, or will open, the unallocated backing funds account[s] for the purpose of depositing money with you to meet the

claims of holders of [*insert name of qualifying stablecoin product*]; and

3. we hold all money standing to the credit of the unallocated backing funds accounts to meet the claims of holders of [*insert name of qualifying stablecoin product*] as trustee under the laws applicable to us.

For [each of] the unallocated backing funds account[s] above, you agree that:

4. you do not have any interest in, recourse to or right against money in the unallocated backing funds accounts in respect of any sum owed to you, or owed to any third party, on any other accounts (including an account we use for our own [money/assets]. This means, for example, that you do not have any right to combine the unallocated backing funds account[s] with any other account and right of set-off or counterclaim against money in the unallocated backing funds accounts.
5. you will title, or have titled, the unallocated backing funds accounts as stated above and that this title is different to the title of any other accounts containing [money/assets] that belong to us or to any third party; and
6. you are required to release on demand all [money/assets] standing to the credit of the unallocated backing funds accounts upon proper notice and instruction from us or a liquidator, receiver, administrator or trustee (or similar person) appointed for us in bankruptcy (or similar procedure), in any relevant jurisdiction.

We acknowledge that:

7. you are not responsible for ensuring compliance by us with our own obligations in respect of the unallocated backing funds account[s].

You and we agree that:

8. the terms of this letter will remain binding upon the parties, their successors and assigns, and, for clarity, regardless of any change in any of the parties' names;
9. this letter supersedes and replaces any previous agreement between the parties in connection with the unallocated backing funds account[s], to the extent that such previous agreement is inconsistent with this letter;
10. if there is any conflict between this letter and any other agreement between the parties over the unallocated backing funds account[s], this letter will prevail;
11. no variation to the terms of this letter shall be effective unless it is in writing, signed by the parties and permitted under the rules of the Financial Conduct Authority;
12. this letter is governed by the laws of [*insert appropriate jurisdiction*] [*qualifying stablecoin issuer may optionally use this*

space to insert additional wording to record an intention to exclude any rules of private international law that could lead to the application of the substantive law of another jurisdiction]; and

13. the courts of [*insert same jurisdiction as previous*] have non-exclusive jurisdiction to settle any dispute or claim from or in connection with this letter or its subject matter or formation (including non-contractual disputes or claims).

Please sign and return the enclosed copy of this letter as soon as possible.

For and on behalf of [*name of qualifying stablecoin issuer*]

x______________________________

Authorised signatory

Print name:

Title:

ACKNOWLEDGED AND AGREED:

For and on behalf of [*name of third party*]

x______________________________

Authorised signatory

Print name:

Title:

Contact information: [*insert signatory's phone number and email address*]

Date:

16 Annex 3 **Guidance on the use of the acknowledgement letter templates**

Introduction

16 Annex 3.1 G This annex contains guidance on the use of the template *acknowledgement letters* in *CASS* 16 Annex 1R and *CASS* 16 Annex 2R.

General

16 Annex 3.2 G Under *CASS* 16.7.2R, *qualifying stablecoin issuers* are required to have in place a duly signed and countersigned:

(1) *backing funds account acknowledgement letter* for a *backing funds account*;

(2) *backing assets account acknowledgement letter* for a *backing assets account*; and

(3) *unallocated backing funds account acknowledgement letter* for an *unallocated backing funds account*.

16 Annex 3.3 G For each account, a *qualifying stablecoin issuer* is required to complete, sign and send to the *approved bank* or *third party custodian* ('the counterparty') an *acknowledgement letter* identifying that account, in the form set out in *CASS* 16 Annex 1R or *CASS* 16 Annex 2R as appropriate.

16 Annex 3.4 G When completing an *acknowledgement letter* using the appropriate template, a *qualifying stablecoin issuer* is reminded that it must not amend any of the text which is not in square brackets (*acknowledgement letter fixed text*). A *qualifying stablecoin issuer* may remove and replaced square bracketed text with the required information, as appropriate. The notes below give further guidance on this.

Clear identification of relevant accounts

16 Annex 3.5 G A *qualifying stablecoin issuer* is reminded that for each *backing funds account*, *backing assets account* or *unallocated backing funds account* it needs to have in place an *acknowledgement letter*. As a result, it is important that it is clear to which account or accounts each *acknowledgement letter* relates. As a result, the templates in *CASS* 16 Annex 1R and *CASS* 16 Annex 2R require that the *acknowledgement letter* includes the full title and at least 1 unique identifier, such as a sort code and account number, deposit number or reference code, for each account.

16 Annex 3.6 G The title and unique identifiers included in an *acknowledgement letter* for an account should be the same as those reflected in both the records of the *qualifying stablecoin issuer* and the relevant counterparty, as appropriate, for that account. Where a counterparty's systems are not able to reflect the full title of an account, that title may be abbreviated to accommodate that system, provided that:

(1) the account may continue to be appropriately identified in line with the requirements of *CASS* 16 (for example, 'account' may be shortened to 'acct' etc); and

(2) when completing an *acknowledgement letter*, such letter must include both the long and short versions of the account title.

16 Annex 3.7 G A *qualifying stablecoin issuer* should ensure that all relevant account information is contained in the space provided in the body of the *acknowledgement letter*. Nothing should be appended to an *acknowledgement letter*.

16 Annex 3.8 G In the space provided in the template letters for setting out the account title and unique identifiers for each relevant account, a *qualifying stablecoin issuer* may include the required information in the format of the following table:

Full account title	**Unique identifier**	**Title reflected in [name of counterparty] systems**
[stablecoin issuer backing funds account/backing assets account/unallocated backing funds account]	[00-00-00 12345678]	[stablecoin issuer backing funds account / backing assets account / unallocated backing funds account]

16 Annex 3.9 G Where an *acknowledgement letter* is intended to cover a range of accounts, some of which may not exist as at the date the *acknowledgement letter* is countersigned by the counterparty, a *qualifying stablecoin issuer* should set out in the space provided in the body of the *acknowledgement letter* that it is intended to apply to all present and future accounts which:

(1) are titled in a specified way; and

(2) which possess a common unique identifier or which may be clearly identified by a range of unique identifiers (eg, all accounts numbered between XXXX1111 and ZZZZ9999).

16 Annex 3.10 G For example, in the space provided in the template letter in *CASS* 16 Annex 1R and *CASS* 16 Annex 2R which allows a *qualifying stablecoin issuer* to include the account title and a unique identifier for each relevant account, a *qualifying stablecoin issuer* should include a statement to the following effect:

'Any account open at present or to be opened in the future which contains the term ['stablecoin backing funds']/['stablecoin backing assets']['unallocated backing funds'][insert appropriate abbreviation of the term 'stablecoin backing funds', 'stablecoin backing assets' or 'unallocated backing funds' as agreed and to be reflected in the third party's systems] in its title and which may be identified with [the following [insert common unique identifier]][an account number from and including [XXXX1111] to and including [ZZZZ9999]][clearly identify range of unique identifiers].'

Signatures and countersignatures

16 Annex 3.11 G A *qualifying stablecoin issuer* should ensure that each *acknowledgement letter* is signed and countersigned by all relevant parties and individuals (including where more than one signatory is required).

16 Annex 3.12 G An *acknowledgement letter* that is signed or countersigned electronically should not, for that reason alone, result in a breach of the *rules* in *CASS* 16.7. However, where electronic signatures are used, a *qualifying stablecoin issuer* should consider whether, taking into account the governing law and choice of competent jurisdiction, it needs to ensure that

the electronic signature and the certification by any person of such signature would be admissible as evidence in any legal proceedings in the relevant jurisdiction in relation to any question as to the authenticity or integrity of the signature or any associated communication.

Completing a backing funds account or backing assets account acknowledgement letter

16 Annex 3.13 G A *qualifying stablecoin issuer* should use at least the same level of care and diligence when completing an *acknowledgement letter* as it would in managing its own commercial agreements.

16 Annex 3.14 G A *qualifying stablecoin issuer* should ensure that each *acknowledgement letter* is legible (eg, any handwritten details should be easy to read), produced on the *qualifying stablecoin issuer's* own letter-headed paper and dated and addressed to the correct legal entity (eg, where the counterparty belongs to a group of companies).

16 Annex 3.15 G A *qualifying stablecoin issuer* should also ensure each *acknowledgement letter* includes all the required information (such as account names and numbers, the parties' full names, addresses and contact information, and each signatory's printed name and title).

16 Annex 3.16 G A *qualifying stablecoin issuer* should similarly ensure that no square brackets remain in the text of each *acknowledgement letter* (eg, after having removed and replaced square bracketed text as appropriate) and that each page of the letter is numbered.

16 Annex 3.17 G A *qualifying stablecoin issuer* should complete an *acknowledgement letter* so that no part of the letter can be easily altered (eg, the letter should be signed in ink rather than pencil).

16 Annex 3.18 G In respect of the *acknowledgement letter's* governing law and choice of competent jurisdiction (see paragraphs (12) and (13) of the template *acknowledgement letters*), a *qualifying stablecoin issuer* should agree with the counterparty and reflect in the letter that the laws of a particular jurisdiction will govern the *acknowledgement letter* and that the courts of that same jurisdiction will have jurisdiction to settle any disputes arising out of, or in connection with, the *acknowledgement letter*, its subject matter or formation.

16 Annex 3.19 G If a *qualifying stablecoin issuer* does not, in any *acknowledgement letter*, utilise the governing law and choice of competent jurisdiction that is the same as either or both:

(1) the laws of the jurisdiction under which either the *qualifying stablecoin issuer* or the counterparty are organised; or

(2) as is found in the underlying agreement(s) (eg, banking services agreement) with the relevant counterparty,

the *firm* should consider whether it is at risk of breaching *CASS* 16.6.2R or *CASS* 16.6.4R.

Authorised signatories

16 Annex 3.20 G A *qualifying stablecoin issuer* is required under *CASS* 16.7.7R to use reasonable endeavours to ensure that any individual that has countersigned an *acknowledgement letter* returned to the *qualifying stablecoin issuer* was authorised to countersign the letter on behalf of the relevant counterparty.

16 Annex 3.21 G If an individual that has countersigned an *acknowledgement letter* does not provide the *qualifying stablecoin issuer* with sufficient evidence of their authority to do so, the *qualifying stablecoin issuer* is expected to make appropriate enquiries to satisfy itself of that individual's authority.

16 Annex 3.22 G Evidence of an individual's authority to countersign an *acknowledgement letter* may include a copy of the counterparty's list of authorised signatories, a duly executed power of attorney, use of a company seal or bank stamp, and/or material verifying the title or position of the individual countersigning the *acknowledgement letter*.

16 Annex 3.23 G A *qualifying stablecoin issuer* should ensure it obtains at least the same level of assurance over the authority of an individual to countersign the *acknowledgement letter* as the *qualifying stablecoin issuer* would seek when managing its own commercial arrangements.

Third party administrators

16 Annex 3.24 G If a *qualifying stablecoin issuer* uses a third party administrator to carry out the administrative tasks of drafting, sending and processing an *acknowledgement letter*, the text 'Signed by [name of third party administrator] on behalf of [qualifying stablecoin issuer]' should be inserted to confirm that the *acknowledgement letter* was signed by the third party administrator on behalf of the *qualifying stablecoin issuer*.

16 Annex 3.25 G In these circumstances, the *qualifying stablecoin issuer* should first provide the third party administrator with the requisite authority (such as a power of attorney) before the third party administrator will be able to sign the *acknowledgement letter* on the *qualifying stablecoin issuer's* behalf. A *qualifying stablecoin issuer* should also ensure that the *acknowledgement letter* continues to be drafted on letter-headed paper belonging to the *qualifying stablecoin issuer*.

Naming

16 Annex 3.26 G A *qualifying stablecoin issuer* must ensure that each of its accounts uses a name which corresponds to the appropriate term in the *Glossary*. This means that all accounts should include the term 'qualifying backing funds', 'qualifying backing assets' or 'unallocated backing funds' in their title.

16 Annex 3.27	G	All references to the term ‘backing funds account’, ‘backing assets account’ or ‘unallocated backing funds account’ in an *acknowledgement letter* should also be made consistently in either the singular or plural, as appropriate.

16 Annex 4 **[to follow]**

[*Editor’s note*: the contents of the form a firm must use when it notifies the FCA of its intention to hold expanded backing assets under CASS 16.2.17R will be consulted on via a subsequent consultation.]

17 Qualifying cryptoasset safeguarding rules

17.1 Application

17.1.1 R This chapter (the *qualifying cryptoasset safeguarding rules*) applies to a *firm* in relation to *regulated activities* carried on by it from an *establishment* in the *UK*.

17.1.2 G (1) Specific sections within the *qualifying cryptoasset safeguarding rules* have a narrower application than *CASS* 17.1.1R.

(2) The application provisions within each section set out whether the provisions within it apply to a *firm* when it is:

(a) *safeguarding qualifying cryptoassets*;

(b) both *safeguarding qualifying cryptoassets* and *arranging qualifying cryptoasset safeguarding*; or

(c) merely *arranging qualifying cryptoasset safeguarding*.

17.2 General safeguarding requirements

17.2.1 R This section applies to a *firm* when it is *safeguarding qualifying cryptoassets*.

Requirement to safeguard qualifying cryptoassets

17.2.2 R A *firm* must, when *safeguarding qualifying cryptoassets*, make adequate arrangements to:

(1) safeguard the relevant *client’s* rights in relation to the *qualifying cryptoassets*, including in the event of the *firm’s* insolvency; and

(2) prevent the use of any of those *qualifying cryptoassets* on the *firm’s* own account except with the *client’s* express consent.

Requirement to have adequate organisational arrangements

17.2.3 R A *firm* must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of *qualifying cryptoassets* being safeguarded by the *firm*, or the rights in connection with those *qualifying cryptoassets*, as a result of the misuse of the *qualifying cryptoassets*, fraud, poor administration, inadequate record-keeping or negligence.

17.3 Cryptoasset safeguarding trusts

17.3.1 R This section applies to a *firm* when it is *safeguarding qualifying cryptoassets*.

Requirement to safeguard as a trustee

17.3.2 R (1) A *firm* must not *safeguard qualifying cryptoassets* other than as a trustee of the *qualifying cryptoassets*.

(2) The requirement at (1) is subject to any of the permitted exceptions set out at *CASS* 17.3.6R [to follow].

17.3.3 R Where *CASS* 17.3.2R(1) requires a *firm* to act as a trustee (taking account of any permitted exceptions), the *firm* must ensure that:

(1) from the point at which the *firm* commences the activity of *safeguarding qualifying cryptoassets* in relation to any *qualifying cryptoassets*, and for so long as it continues to do so, those *qualifying cryptoassets* are held under a trust for which the *firm* is the trustee;

(2) any such trust is settled and operated by the *firm* in accordance with applicable legal requirements for trusts in the *UK*;

(3) the terms of any such trust are clearly documented with the effect that it is clear the trust is intended and it is clear what the terms are; and

(4) the terms and operation of the trust by the *firm* deliver the objectives set out in *CASS* 17.3.4R.

17.3.4 R A *firm* must ensure that the terms and operation of any trust required under *CASS* 17.3.2R deliver the following objectives:

(1) the *firm* must act as a 'bare' trustee in relation to the *qualifying cryptoassets* held under the trust and in relation to any rights which can be exercised by virtue of the *firm safeguarding qualifying cryptoassets*, with the effect that:

(a) the *firm* must be required to respond to the lawful instructions of the relevant *client* in relation to the trust property; and

(b) save for having the necessary powers to comply with any applicable *rules* or requirements, the *firm* must not have any discretion in applying the trust property;

(2) the identity of the beneficiary or beneficiaries of the trust must be recorded in or be readily ascertainable using the *firm's client-specific qualifying cryptoasset records*;

(3) the type and quantity of any *qualifying cryptoassets* held under the trust must also be recorded in or be readily ascertainable using the *firm's client-specific qualifying cryptoasset records*;

(4) the *qualifying cryptoassets* held under the trust must be segregated from all other assets, with the effect that:

(a) the *qualifying cryptoassets* pertaining to the trust are not co-mingled with any other assets (for example, any assets for which the *firm* is not carrying on *safeguarding qualifying cryptoassets* and any assets which are held under any other separate trust that is settled to meet *CASS* 17.3.2R); and

(b) it is not possible for any creditor of the *firm* who is not a beneficiary of the trust to claim the *qualifying cryptoassets* pertaining to the trust;

(5) where there is more than one beneficiary of a particular trust, the terms of that trust must set out how any *shortfalls* which may affect the trust from time to time are to be allocated between the beneficiaries; and

(6) the terms of the trust must set out whether the trust property may be applied towards funding the distribution costs of the trust on the *failure* of the trustee and, if the terms provide for this, the basis on which that funding will be deducted from the entitlements of the beneficiaries.

17.3.5 R (1) A *firm* must retain any document required under *CASS* 17.3.3R(3) setting out the terms of a trust from the point at which the trust is settled.

(2) A *firm* must retain any document required under *CASS* 17.3.3R(3) setting out the terms of a trust until 5 years after the trust ceases to apply to any *qualifying cryptoassets* held under it.

Permitted exceptions to the requirement to safeguard as a trustee

17.3.6 R [to follow]

[*Editor's note*: the FCA is not, at this stage, consulting on permitted exceptions to the requirement at CASS 17.3.2R(1) where the firm will still be safeguarding on behalf of clients.

The FCA intends to consult on this at a later stage, when it consults on the requirements for other activities relating to qualifying cryptoassets.]

Guidance on the requirement to safeguard as a trustee

17.3.7 G (1) A *firm* should decide on an approach to settling and operating trusts under the *rules* at *CASS* 17.3.2R to *CASS* 17.3.4R which is suitable for its business model, *client* base and the types of *qualifying cryptoassets* for which it will provide services for. In particular:

(a) a *firm* may decide whether to operate separate trusts for each *client* or one or more tenants in common trusts for a particular class of *clients* (which may include all *clients*);

(b) a *firm* may decide whether to operate separate trusts for different classes of *qualifying cryptoasset*; and

(c) a *firm* may decide whether to settle separate trusts for different virtual addresses.

(2) The requirement at *CASS* 17.3.3R(1) means that a *firm* should not receive any *qualifying cryptoasset* for *safeguarding* outside of a trust environment and should not permit any such *qualifying cryptoasset* to leave the trust environment, other than in the case of the permitted exceptions at *CASS* 17.3.6R [to follow].

(3) To comply with *CASS* 17.3.3R(3) a *firm* may, for example, execute a deed or similar instrument.

(4) (a) A *firm* should consider whether the objective in relation to segregation at *CASS* 17.3.4R(4) can be achieved through the use of different virtual addresses, with regard to the operation of the relevant network.

(b) A particular network relevant to a type of *qualifying cryptoasset* may affect the choices available to a *firm* in deciding how to implement a trust which complies with the *rules* in this section.

(5) (a) In cases where a *firm* appoints a third party to carry on the activity of *safeguarding qualifying cryptoassets* in accordance with *CASS* 17.6, the effect of *CASS* 17.3.2R(1) and *CASS* 17.3.4R(1) means that the *firm's* contractual rights against that third party in relation to the relevant *qualifying cryptoassets* should be held on trust, because these are rights which can be exercised by virtue of the *firm safeguarding qualifying cryptoassets*.

(b) A *firm* in the position referred to in (5)(a) should also comply with the other requirements of *CASS* 17.6.

17.4 Means of access

17.4.1 R This section applies to a *firm* when it is *safeguarding qualifying cryptoassets*.

17.4.2 R The *rules* in this section apply where a *firm* undertakes any of the following activities in relation to the means of access to a *qualifying cryptoasset* in respect of which it is *safeguarding qualifying cryptoassets*:

(1) generating or creating the means of access, or any similar process;

(2) storing the means of access, in any form or medium of storage;

(3) exercising any form of control over the means of access;

(4) subjecting the means of access to any type of process; and

(5) destroying the means of access.

17.4.3 G References in this section to the 'means of access' to a *qualifying cryptoasset* should be read in connection with article 9O (Safeguarding of qualifying cryptoassets and relevant specified investment cryptoassets) of the *Regulated Activities Order* and include a private cryptographic key, or one or more parts of a private cryptographic key.

17.4.4 G The scope of *CASS* 17.4.2R is broad and therefore the provisions in this section will apply to a range of activities and aspects of *safeguarding qualifying cryptoassets*, for example:

(1) using 'hot' or 'cold' devices or facilities to store the means of access;

(2) making and storing written records of the means of access; and

(3) processing the means of access by sharding a private cryptographic key, and (if relevant) distributing the shards amongst the *firm's* staff or other *persons* outside of the *firm*.

17.4.5 R A *firm* must have robust security and organisational arrangements to ensure that, throughout the entire lifecycle of any means of access to a *qualifying cryptoasset*, the means of access are protected against the risks of inoperability, inaccessibility, loss and irrecoverability.

17.4.6 R A *firm* must promptly identify incidents of inoperability, inaccessibility, loss and irrecoverability to any means of access to a *qualifying cryptoasset*.

17.4.7 R A *firm* must promptly resolve any incidents of inoperability, inaccessibility, loss and irrecoverability to any means of access to a *qualifying cryptoasset*.

17.4.8 G In complying with *CASS* 17.4.5R to *CASS* 17.4.7R, a *firm* should, for example, consider whether, as relevant:

(1) its security and organisational arrangements adhere to any relevant international and industry standard practices;

(2) it is addressing any vulnerabilities to hacking and other risks of fraud and theft, including risks which originate from among the *firm's* own staff;

(3) it has a culture of detecting and acting on suspicious activity, including appropriate whistleblowing systems;

(4) it is addressing any risks of 'single point of failure' – for example, as a result of a concentration of means of access with too few members of staff or on too few devices;

(5) it has appropriate back-up and recovery systems;

(6) it has appropriate checks to ensure that means of access remain accessible and operable, which themselves do not add undue security risks; and

(7) it employs random and non-deterministic methods as part of its security arrangements to minimise the risk of irreproducibility of any important data.

17.4.9 R (1) A *firm* must keep a record of each means of access it has at any particular point in time.

(2) For each means of access, the record under (1) must set out the following information:

(a) the location (whether digital or physical) at which that means of access is being held;

(b) the relevant virtual address for that means of access;

(c) a summary of the security measures which the *firm* is using for that means of access in accordance with *CASS* 17.4.5R;

(d) the name of any natural *person*, such as a member of staff of the *firm*, who the *firm* is aware is in a position to use that means of access; and

(e) whether the means of access has been destroyed (and, if so, when).

(3) The record under (1) must not contain or reproduce the means of access itself.

17.4.10 R (1) A *firm* must promptly update any record required to be made under *CASS* 17.4.9R as often as is necessary for the details within it to remain accurate.

(2) A *firm* must review any record required to be made under *CASS* 17.4.9R at least once each *business day* in order to ascertain whether any updates that were required by (1) remain outstanding.

17.4.11 R A *firm* must ensure that any record that is required to be made under *CASS* 17.4.9R is retained for a period of 5 years starting from the later of:

(1) the date it was created; and

(2) the date it was most recently modified.

17.4.12 R (1) A *firm* must create, retain and maintain a policy document and a procedures document which, taken together, explain the *firm's* means of complying with the requirements in *CASS* 17.4.5R to *CASS* 17.4.7R and *CASS* 17.4.9R to *CASS* 17.4.11R in clear and non-technical terms.

(2) A *firm* must review the documents under (1) at least once every year, and make any necessary changes.

(3) A *firm* must retain each version of the documents required under (1) for a period of 5 years until after that version has been superseded with a new version.

17.5 Records of qualifying cryptoassets and reconciliations

17.5.1 R This section applies to a *firm* when it is *safeguarding qualifying cryptoassets*.

General requirements

17.5.2 R A *firm* must keep such records as necessary to enable it at any time and without delay to distinguish *qualifying cryptoassets* held on behalf of one *client* from *qualifying cryptoassets* held on behalf of any other *client*, and from any assets for which the *firm* is not carrying on *safeguarding qualifying cryptoassets* (whether or not *qualifying cryptoassets*).

17.5.3 R A *firm* must maintain its records in a way that ensures their accuracy at all times, and in particular their correspondence to the *qualifying cryptoassets safeguarded* on behalf of *clients*.

Requirement for a client-specific qualifying cryptoasset record

17.5.4 R For each *client* on behalf of which a *firm* is *safeguarding qualifying cryptoassets*, the *firm* must create and maintain a record (a *client-specific qualifying cryptoasset record*) which sets out the following:

(1) a list of the type of *qualifying cryptoassets* being *safeguarded* by the *firm* on behalf of that *client*;

(2) the quantity of each type of *qualifying cryptoasset* being *safeguarded* by the *firm* on behalf of that *client*; and

(3) for each *qualifying cryptoasset* being *safeguarded* by the *firm* on behalf of that *client*:

(a) the relevant virtual address for that cryptoasset;

(b) the nature of the *client's* claim against the *firm* in respect of the *qualifying cryptoasset*; and

(c) where there are any other third parties (other than the *firm* or *client*) who are involved in *safeguarding* the *qualifying cryptoasset*:

(i) the name of that third party; and

(ii) the role of that third party in the context of the *firm's safeguarding*.

17.5.5 G (1) For the purposes of *CASS* 17.5.4R(1), a *firm* should identify each type of *qualifying cryptoasset* using its name or identification code (for example, using the Digital Token Identifier system outlined in ISO standard 24165).

(2) For the purposes of *CASS* 17.5.4R(3)(b), a *firm* may (as applicable) record the *client's* claim against the *firm* as being a beneficial interest under a trust for which the *firm* is the trustee or a claim for the return of the relevant *qualifying cryptoasset*.

(3) Where a *firm* has either:

(a) appointed a third party to hold a part of a means of access (such as a shard of a private cryptographic key) that relates to the relevant *qualifying cryptoasset*; or

(b) appointed a third party under *CASS* 17.6,

the *firm* should record the name of the third party to comply with *CASS* 17.5.4R(3)(c)(i) and explain the third party's role to comply with *CASS* 17.5.4R(3)(c)(ii).

17.5.6 R A *firm* must not use any source of information to create its *client-specific qualifying cryptoasset records* which it will use for the purposes of ascertaining 'B' and 'C' (as defined in *CASS* 17.5.11R) in the course of any reconciliation required under *CASS* 17.5.10R.

17.5.7 G (1) The requirement at *CASS* 17.5.6R is to ensure that a *firm's qualifying cryptoasset reconciliations* will use an independent source of information, with the effect that the *qualifying cryptoasset* *reconciliations* will be effective in their purpose of identifying discrepancies.

(2) However, the requirement at *CASS* 17.5.6R does not prevent a *firm* from addressing any discrepancy within its *client-specific qualifying cryptoasset records* after a *qualifying cryptoasset reconciliation*.

(3) A *firm* may have a range of other sources of information which it can use to create its *client-specific qualifying cryptoasset records*. *Firms* are, however, reminded of the general requirements in *CASS* 17.5.2R and *CASS* 17.5.3R, including to ensure the *client-specific qualifying cryptoasset records* are accurate.

17.5.8 R A *firm* must ensure that any *client-specific qualifying cryptoasset record* is retained for a period of 5 years starting from the later of:

(1) the date it was created; and

(2) the date it was most recently modified.

Requirement for a qualifying cryptoasset reconciliation

17.5.9 G A *qualifying cryptoasset reconciliation* is a process to check whether the *firm's* record of the quantity of each type *qualifying cryptoassets* that it is *safeguarding* on behalf of *clients* equals the quantity of *qualifying cryptoassets* that it is *safeguarding*.

17.5.10 R A *firm* must perform a *qualifying cryptoasset reconciliation* at least once each *business day*.

17.5.11 R For each type of *qualifying cryptoasset* which the *firm* considers that it is *safeguarding*, a *firm's qualifying cryptoasset reconciliation* must ascertain whether A = B + C, where:

(1) A is the total quantity of that particular type of *qualifying cryptoasset* which is shown across all of the *firm's client-specific qualifying cryptoasset records*;

(2) B is the total quantity of that particular type of *qualifying cryptoasset* which the *firm* can access in virtual addresses on behalf of *clients*; and

(3) where a *firm* has, under *CASS* 17.6, appointed a third party to carry on the activity of *safeguarding qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard*, C is the total quantity of that particular type of *qualifying cryptoasset* for which either:

(a) the third party has confirmed to the *firm* that it has the means of access to itself; or

(b) in cases where that third party has appointed a further third party with the *firm's* consent under *CASS* 17.6.9R, the third party appointed by the *firm* has confirmed to the *firm* that the further third party has the means of access to.

17.5.12 G (1) References in this section to the ‘means of access’ to a *qualifying cryptoasset* should be read in connection with article 9O (Safeguarding of qualifying cryptoassets and relevant specified investment cryptoasset) of *Regulated Activities Order* and include a private cryptographic key, or one or more parts of a private cryptographic key.

(2) A *firm* may be able to use information contained on a blockchain or distributed ledger technology to ascertain B for the purposes of a *qualifying cryptoasset reconciliation*.

(3) Although information contained on a blockchain or distributed ledger technology may give an indication as to C, a *firm* should only use information provided from a third party appointed under *CASS* 17.6 in order to ascertain C for the purposes of the *qualifying cryptoasset reconciliation*.

17.5.13 R (1) Each time a *firm* performs a *qualifying cryptoasset reconciliation*, it must make a record, including:

(a) the date it carried out the *qualifying cryptoasset reconciliation*;

(b) the actions the *firm* took in carrying out the *qualifying cryptoasset reconciliation*;

(c) the result of the *qualifying cryptoasset reconciliation*; and

(d) a list of any discrepancies the *firm* identified, whether any of those discrepancies were as a result of, or revealed, a *shortfall*, the actions the *firm* took to resolve those discrepancies, and whether any of those discrepancies were identified in previous *qualifying cryptoasset reconciliations*.

(2) A *firm* must retain each record made under (1) for a period of 5 years.

Treatment of shortfalls

17.5.14 R (1) This *rule* applies where a *firm* identifies a discrepancy as a result of, or that reveals, a *shortfall*. This is regardless of whether the *firm* identifies the discrepancy as a result of carrying out a *qualifying cryptoasset reconciliation* or outside of its processes for *qualifying cryptoasset reconciliations*.

(2) This *rule* applies in relation to an unresolved *shortfall* which a *firm* has previously identified and for which the *firm* had taken a decision to use any of the routes at (3)(a) to (c).

(3) Immediately upon identifying that there is a *shortfall*, the *firm* must decide whether:

(a) the *firm* will resolve the *shortfall* itself, using its own resources, in time for its next *qualifying cryptoasset reconciliation*;

(b) in a situation in which the *firm* is justified in holding a third party appointed by the *firm* under *CASS* 17.6 as responsible for the *shortfall*, the *firm* will procure the third party to resolve the *shortfall* in time for the *firm's* next *qualifying cryptoasset reconciliation*;

(c) the *firm* will arrange for the *shortfall* to be resolved using a combination of (a) and (b) in time for its next *qualifying cryptoasset reconciliation*; or

(d) the *firm* is justified in concluding that neither it nor any third party appointed by the *firm* under *CASS* 17.6 is responsible for the *shortfall*.

17.5.15 G (1) A *firm* may decide to resolve a *shortfall* itself under *CASS* 17.5.14R(3)(a) even if it considers that.

(a) another *person* bears responsibility to the *firm* or to the *firm's clients* for the *shortfall*; or

(b) it would be justified in concluding that neither it nor any third party appointed by the *firm* under *CASS* 17.6 is responsible for the *shortfall*.

(2) If a *firm* cannot justify reaching the conclusion at *CASS* 17.5.14R(3)(d), the *firm* is required to resolve the *shortfall* itself under *CASS* 17.5.14R(3)(a), subject to the extent by which it is in a position to procure a third party appointed by the *firm* under *CASS* 17.6 to resolve the *shortfall* under *CASS* 17.5.14R(3)(b).

(3) A *firm's* decision to procure a third party appointed by the *firm* under *CASS* 17.6 to partially or fully resolve the *shortfall* should take account of the *firm's* rights under its agreement with that third party under *CASS* 17.6.7R. This means, for example, that if it is not contractually possible for the *firm* to procure this from the third party – for example, because of a contractual limitation of liability – the *firm* should not decide to procure this.

(4) The factors which a *firm* should have regard to when determining who bears responsibility for a *shortfall* should include:

(a) any particular reasons for the *shortfall* – for example, if the *firm* has experienced a cyber-attack or a theft of a device by an external *person*, or there is an issue in a network relevant to a particular *qualifying cryptoasset* such as a blockchain failure;

(b) the extent to which any acts or omissions by the *firm* or any third party appointed by the *firm* under *CASS* 17.6 has caused or contributed to the *shortfall* arising, including for example human errors, security breaches and weaknesses in systems and controls; and

(c) the extent to which any non-compliance by the *firm* with other *rules* has caused or contributed to the *shortfall*, including for example the *rules* at *CASS* 17.4.

(5) Because the *rule* at *CASS* 17.5.14R(3) requires decisions to be taken with reference to the *firm's* next *qualifying cryptoasset reconciliation*, the *FCA* expects that a *firm* may not be able to wait for any dispute concerning the *shortfall* to reach a conclusion. However, the *firm* should not be prevented from pursuing recoveries from any *person* who might bear responsibility as a matter of private civil law after the *firm's* next *qualifying cryptoasset reconciliation*.

(6) Because *CASS* 17.5.14R(2) applies to unresolved *shortfalls*, a *firm* would be expected to take a decision under *CASS* 17.5.14R(3) on any *business day* on which there is an unresolved *shortfall*, other than one for which *CASS* 17.5.14R(3)(d) applies.

(7) A *firm* should consider whether it is appropriate to notify the *FCA* of the *shortfall* under *Principle* 11 and the requirements of *SUP* 15.

17.5.16 R (1) A *firm* must make a written record of its decision under *CASS* 17.5.14R(3), which includes its reasons for reaching that decision.

(2) A *firm* must retain each record made under (1) for a period of 5 years.

Resolution of shortfalls

17.5.17 R (1) This *rule* applies where a *firm* has decided to resolve a *shortfall* in time for its next *qualifying cryptoasset reconciliation* using any of the routes at *CASS* 17.5.14R(3)(a) to (c).

(2) A *shortfall* is only considered to be resolved once the *firm* commences *safeguarding* an amount of *qualifying cryptoassets* that corresponds to the *shortfall* for the relevant affected *clients* in accordance with the *qualifying cryptoasset safeguarding rules*.

(3) To the extent that a *firm* is pursuing the route under *CASS* 17.5.14R(3)(a), it must either:

(a) recover the appropriate amount of *qualifying cryptoassets* to cover the *shortfall* and treat them in accordance with (2); or

(b) appropriate a sufficient number of its own *qualifying cryptoassets* to cover the *shortfall* and treat them in accordance with (2). Where the *firm* has an insufficient amount of *qualifying cryptoassets*, it must obtain a sufficient amount using its own resources.

(4) To the extent that a *firm* is pursuing the route under *CASS* 17.5.14R(3)(b), it must procure the third party to take the same steps as under (3) with the effect that the outcome at (2) is achieved by the *firm*.

(5) If a *firm* foresees that a *shortfall* will not be resolved in time for the *firm's* next *qualifying cryptoasset reconciliation*, or it has failed to meet that timeframe, it must immediately:

(a) notify the *FCA* in writing, setting out:

(i) the reasons for the *shortfall*;

(ii) the name of each type of *qualifying cryptoasset* for which there is a *shortfall* and the amount of the *shortfall* in the case of each such *qualifying cryptoasset*;

(iii) the number of *clients* affected by the *shortfall* and, for each affected *client*, the impact of the *shortfall* on the *client's* claim against the *firm* in respect of the *qualifying cryptoasset*, taking into account the terms of any relevant trust that is in place under *CASS* 17.3;

(iv) if applicable, the name of any third party appointed under *CASS* 17.6 which the *firm* is holding responsible for the *shortfall*, whether in whole or in part, and the basis on which the *firm* considers it justified to hold that third party responsible; and

(v) the *firm's* expected timeframe for resolution of the *shortfall*, including detail on the steps which the *firm* and any third parties intend to follow to achieve resolution; and

(b) subject to (6), notify each affected *client* setting out, in clear terms, at least the following:

(i) the fact that the *shortfall* (in so far as it is unresolved) has affected the *client*;

(ii) an explanation of the impact of *shortfall* (in so far as it is unresolved) on the *client's* claim against the *firm* in respect of the *qualifying cryptoasset*, taking into account the terms of any relevant trust that is in place under *CASS* 17.3;

(iii) an explanation of the difference in that claim before and after the *shortfall* (in so far as it is unresolved); and

(iv) the *firm's* expected timeframe for resolution of the *shortfall*.

(6) A *firm* need not make a notification to an affected *client* under (5)(b), or may only include certain but not all of the points at (5)(b)(i) to (iv) in a notification under (5)(b), if:

(a) the *firm* considers that would be in the *client's* bests interests; and

(b) the *firm* has explained its rationale for (6)(a) to the *FCA* at the time of its notification at (5)(a).

Notifications of unresolved shortfalls in other cases

17.5.18 R (1) This *rule* applies where a *firm* considers that it is justified in concluding that neither it nor any third party appointed by the *firm* under *CASS* 17.6 is responsible for a *shortfall*, in accordance with *CASS* 17.5.14R(3)(d).

(2) The *firm* must immediately:

(a) notify the *FCA* in writing, setting out:

(i) the reasons for the *shortfall*;

(ii) the basis on which the *firm* considers it justified to reach the conclusion at *CASS* 17.5.14R(3)(d);

(iii) the name of each type of *qualifying cryptoasset* for which there is a *shortfall* and the amount of the *shortfall* in the case of each such *qualifying cryptoasset*; and

(iv) the number of *clients* affected by the *shortfall* and, for each affected *client*, the impact of *shortfall* on the *client's* claim against the *firm* in respect of the *qualifying cryptoasset*, taking into account the terms of any relevant trust that is in place under *CASS* 17.3; and

(b) notify each affected *client* in writing setting out, in clear terms, at least the following:

(i) the fact that the *shortfall* has affected the *client*;

(ii) an explanation of the impact of *shortfall* on the *client's* claim against the *firm* in respect of the *qualifying cryptoasset*, taking into account the terms of any relevant trust that is in place under *CASS* 17.3;

(iii) an explanation of the difference in that claim before and after the *shortfall*; and

(iv) the rights, if any, of the *clients* to pursue recoveries or to complain to the *firm* or any other *person*.

Other notification requirements

17.5.19 R A *firm* must notify the *FCA* in writing without delay if any of the following apply:

(1) its internal records of *qualifying cryptoassets safeguarded* by the *firm* are materially out of date, or materially inaccurate or invalid, so that the *firm* is no longer able to comply with the requirements in *CASS* 17.5.2R and *CASS* 17.5.3R; and

(2) it will be unable, or materially fails, to take the steps required under *CASS* 17.5.10R to *CASS* 17.5.13R.

17.6 Appointing third parties to safeguard cryptoassets

17.6.1 R This section applies to a *firm* when it *safeguards qualifying cryptoassets* and, in the course of carrying on that activity, it *arranges qualifying cryptoasset safeguarding* in the way described at *CASS* 17.6.3R.

Purpose of this section

17.6.2 G (1) Where a *firm* carries on the activity of *safeguarding qualifying cryptoassets*, it may be necessary for the *firm* to appoint a third party to carry on the activity of *safeguarding qualifying cryptoassets* in relation to a particular *qualifying cryptoasset* or one or more particular types of *qualifying cryptoasset*.

(2) That third party appointed by the *firm* may itself be a *firm* or may, for example, be an overseas *person* who is not required to be *authorised* to carry on the activity of *safeguarding qualifying cryptoassets* in these circumstances.

(3) The *FCA* considers that there may be risks involved in the appointment which could result in harm to the *firm's client*, particularly in cases where the third party is not itself a *firm*.

(4) This section sets out the *rules* that apply to such an appointment by a *firm* of a third party to carry on that activity in order to address those potential risks.

(5) In the *FCA's* view, where a *firm* appoints a third party to carry on the activity of *safeguarding qualifying cryptoassets* in relation to any *qualifying cryptoasset* which the *firm* has undertaken to its own *client* to *safeguard*, the *firm* will be carrying on both the activity of *safeguarding qualifying cryptoassets* and *arranging qualifying cryptoasset safeguarding*.

(6) The scenario described in (5) is different to one in which a *firm*, in relation to the *qualifying cryptoassets* in question, only carries on *arranging qualifying cryptoasset safeguarding* and does not itself carry on *safeguarding qualifying cryptoassets*.

(7) This section does not apply to the scenario described in (6) in which a *firm* only carries on *arranging qualifying cryptoasset safeguarding*. The *rules* in *CASS* 17.7 apply to a *firm* that only carries on *arranging qualifying cryptoasset safeguarding*.

The conditions for appointing third parties to safeguard cryptoassets

17.6.3 R A *firm* may appoint and retain another *person* (a 'third party') to carry on the activity of *safeguarding qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard*, but only if the following conditions are met:

(1) the third party operates in a jurisdiction which specifically regulates the safeguarding of *qualifying cryptoassets* through mandatory requirements concerning financial and operational resilience, security of the means of access to *qualifying cryptoassets*, and record-keeping, and the activities of the third party pursuant to the appointment by the *firm* are supervised in that jurisdiction;

(2) in accordance with *CASS* 17.6.4R, the *firm* has concluded that the appointment of the third party is and remains necessary in order for the *firm* to fulfil its own obligations to *safeguard qualifying cryptoassets*;

(3) in accordance with *CASS* 17.6.6R, the *firm* has concluded that the appointment of the third party is and remains in the best interests of its *client* on whose behalf it is *safeguarding qualifying cryptoassets*;

(4) prior to the appointment commencing, the *firm* has entered into an agreement with the third party in the form required at *CASS* 17.6.7R; and

(5) the *firm* has met the governance requirements at *CASS* 17.6.10R.

The necessity condition

17.6.4 R In concluding that the appointment and retention of a third party to carry on the activity of *safeguarding qualifying cryptoassets* which a *firm* has undertaken to its *client* to *safeguard* is necessary for the purposes of *CASS*

17.6.3R(2), a *firm* must be satisfied that there are sufficiently compelling reasons:

(1) for which it is not possible for the *firm* to undertake the *safeguarding qualifying cryptoassets* activity entirely by itself; and

(2) for which it is not possible for the *firm* to make suitable adaptations in order to undertake the *safeguarding qualifying cryptoassets* activity entirely by itself.

The best interests condition

17.6.5 G (1) In considering whether the appointment and retention of a third party to carry on the activity of *safeguarding qualifying cryptoassets* which a *firm* has undertaken to its *client* to *safeguard* is and remains in the best interests of its *client* for the purposes of *CASS* 17.6.3R(3), the *firm* should have particular regard to the selection of that particular third party in accordance with *CASS* 17.6.6R.

(2) A *firm* should not conclude that the appointment and retention of a third party to carry on the activity of *safeguarding qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard* is and remains in the best interests of its *client* for the purposes of *CASS* 17.6.3R(3) simply because the relevant *client* has instructed the *firm* to use that third party. This is regardless of whether such an instruction was solicited by the *firm* or provided by the *client* at the *client's* own initiative.

(3) If a *firm's* terms of business with a *client* provide that the *firm* may or will appoint and retain a third party to carry on the activity of *safeguarding qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard*, the existence of that term should not, of itself, lead the *firm* to conclude that such an appointment would be in the best interests of its *client* for the purposes of *CASS* 17.6.3R(3).

17.6.6 R (1) Where a *firm* has concluded that it is necessary to appoint a third party to carry on the activity of *safeguarding qualifying cryptoassets* in relation to any cryptoasset which the *firm* has undertaken to its own *client* to *safeguard*, the *firm* must exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the *safeguarding* of the relevant *qualifying cryptoasset*, in order to conclude that the appointment is and remains in the best interests of the *firm's client*.

(2) When a *firm* makes the selection, appointment and conducts the periodic review referred to under this *rule*, it must take into account:

(a) whether the third party has the appropriate regulatory permissions to carry out the appointment;

(b) the arrangements that the third party has in place for *safeguarding qualifying cryptoassets*;

(c) the capacity and capability of the third party to provide the contracted services;

(d) the capital or financial resources of the third party;

(e) the creditworthiness of the third party;

(f) the potential impact on the contracted services of any other activities undertaken by the third party and, if relevant, any *affiliated company*;

(g) the expertise and market reputation of the third party;

(h) any legal requirements relating to the *safeguarding* of the relevant *qualifying cryptoassets* that could adversely affect the *firm's clients'* rights;

(i) market practices relating to the *safeguarding* of the *qualifying cryptoasset* that could adversely affect the *firm's clients'* rights;

(j) any relevant industry standard reports, including in relation to security; and

(k) where the third party appointed by the *firm* has appointed a further third party with the *firm's* consent under *CASS* 17.6.9R, all the factors set out above in relation to that further third party.

The agreement condition

17.6.7 R A *firm* must have entered into a written agreement with any third party that it appoints to carry on the activity of *safeguarding qualifying cryptoassets* under *CASS* 17.6.3R. This agreement must, at minimum:

(1) set out the binding terms of the arrangement between the *firm* and the third party;

(2) be in force for the duration of the appointment;

(3) clearly set out the service(s) that the third party is contracted to provide;

(4) require the third party to seek and obtain the *firm's* written consent prior to the third party being able to appoint a further, different, third party to carry on the activity of *safeguarding qualifying cryptoassets*;

(5) where the *firm* is subject to the requirement at *CASS* 17.3.2R to act as a trustee:

(a) require that any *qualifying cryptoassets* that are subject to the appointment are segregated from any assets belonging to the third party;

(b) require that any *qualifying cryptoassets* that are subject to the appointment are segregated from any assets belonging to the *firm* for which it is not carrying on *safeguarding qualifying cryptoassets*;

(c) make clear to the third party that the *qualifying cryptoassets* are held by the *firm* on trust for the *firm's clients* and that the third party is not entitled to exercise any right of set-off or counterclaim against the *qualifying cryptoassets* in respect of any debt owed to it or to any other *person*; and

(d) make clear to the *firm* that the third party acknowledges and agrees to the points referred to in (c);

(6) require the third party to notify the *firm* whenever *qualifying cryptoassets* are no longer subject to the terms of the agreement for any reason;

(7) include provisions detailing the extent of the third party's liability in the event of the loss of a *qualifying cryptoasset* caused by the fraud, wilful default or negligence of the third party or an agent appointed by them; and

(8) set out the procedures and authorities for the passing of instructions to, or by, the *firm*.

17.6.8 R A *firm* must take the necessary steps to ensure that to ensure that the *firm* and the third party adhere to the agreement referred to at *CASS* 17.6.7R at all times.

Consenting to safeguarding chains

17.6.9 R (1) This *rule* applies where, under the mandatory term described at *CASS* 17.6.7R(4), a third party appointed by the *firm* seeks the *firm's* consent to itself appoint a further, different, third party to carry on the activity of *safeguarding qualifying cryptoassets* in relation to *qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard*.

(2) The *firm* must withhold such consent unless it is satisfied that:

(a) the further appointment is necessary;

(b) the further appointment is in the best interests of the *firm's client*; and

(c) the agreement under which the further appointment will be governed (as between the third party appointed directly by the *firm* and the further third party) contains terms which provide equivalent safeguards to those set out at *CASS* 17.6.7R(1) to *CASS* 17.6.7R(8).

(3) (a) The *firm* must approach its assessment under (2)(a) by applying the same factors set out at *CASS* 17.6.4R in relation to the position of the third party appointed directly by the *firm*.

(b) The *firm* must approach its assessment under (2)(b) by evaluating the prospective further third party using the factors set out at *CASS* 17.6.6R(2)(a) to *CASS* 17.6.6R(2)(j).

The governance condition

17.6.10 R (1) Each proposed appointment by the *firm* of a third party under *CASS* 17.6.3R and each consent given by the *firm* under *CASS* 17.6.9R, together with the *firm's* considerations and conclusions to support that proposal, must be approved by the *firm's governing body* before the appointment is made or the consent is given.

(2) The outcome of each periodic review of a *firm's* selection and appointment of a third party that it conducts under *CASS* 17.6.6R, together with the *firm's* considerations and conclusions, must be approved by the *firm's governing body* within 3 *months* of the review being concluded.

Policy on appointing third parties

17.6.11 R (1) A *firm* must produce and maintain a written policy that sets out its methodology for any selections, appointments, periodic reviews and consents that are required to be carried out under *CASS* 17.6.6R and *CASS* 17.6.9R.

(2) A *firm* must retain the written policy under (1) until 5 years after it has been superseded by any new version of the written policy, or otherwise indefinitely.

Records

17.6.12 R (1) Whenever a *firm* either appoints a third party under *CASS* 17.6.3R to carry on the activity of *safeguarding qualifying cryptoassets* which the *firm* has undertaken to its *client* to *safeguard*, or provides consent to a further appointment of a third party under *CASS* 17.6.9R, the *firm* must make a record of the grounds upon which its *governing body* was satisfied of:

(a) the necessity of the appointment, making explicit reference to the factors set out in *CASS* 17.6.4R; and

(b) the appointment being in the best interests of the *firm's client*, making explicit reference to the factors set out at *CASS* 17.6.6R(2).

(2) A *firm* must make the record under (1) prior to the relevant appointment commencing.

(3) Whenever a *firm* undertakes a periodic review of its selection and appointment of a third party under *CASS* 17.6.6R, the *firm* must make a record of the conclusions of its review, making explicit reference to the factors set out at *CASS* 17.6.6R(2)(a) to *CASS* 17.6.6R(2)(j).

(4) A *firm* must make the record under (3) on the date it completes the review.

(5) A *firm* must make a record of its *governing body's* approval under *CASS* 17.6.10R(2).

(6) A *firm* must make the record under (5) on the date of the *governing body's* approval.

(7) A *firm* must retain the records under (1), (3) and (5) until 5 years after the relevant appointment ceases.

17.7 Arranging qualifying cryptoasset safeguarding

17.7.1 R This section applies to a *firm* when it *arranges qualifying cryptoasset safeguarding*.

Agreements

17.7.2 R Each time a *firm*, on behalf of a *client*, *arranges qualifying cryptoasset safeguarding* with another *person*, it must enter into an agreement with that other *person*. This agreement must, at minimum:

(1) set out the obligations between the *firm* and the other *person*, including any ongoing obligations of the *firm*;

(2) set out the basis for any payments or other consideration between the 2 parties; and

(3) include provisions detailing the extent of either party's liability in the event of the loss of a *qualifying cryptoasset*.

Records

17.7.3 R (1) When a *firm arranges qualifying cryptoasset safeguarding*, it must ensure that proper records of the arrangements are made at the time the arrangements are put in place, and at the time the arrangements are amended.

(2) A *firm* must retain the records made under (1) for a period of 5 years after they are made.

Annex C

Cryptoasset sourcebook (CRYPTO)

In this Annex all text is new and is not underlined. Insert the following new sourcebook, Cryptoasset sourcebook (CRYPTO).

1 Reference table for CRYPTO provisions

[to follow]

[*Editor's note*: The FCA will, in due course, produce a table to sit in CRYPTO 1 which assists firms carrying out those regulated activities at article 9M to 9Z7 of the Regulated Activities Order to identify the rules and guidance that are relevant to their activities.]

2 Stablecoins

2.1 Application and purpose

2.1.1 G (1) This chapter of *CRYPTO* is the specialist sourcebook for *qualifying stablecoin* activities.

(2) *CRYPTO* 2 is relevant to *qualifying stablecoin issuers*.

(3) *CRYPTO* 2 applies as described in this section unless the application provisions of a section or a *rule* make it clear that the section or *rule* in question is applied differentl*y*.

Purpose

2.1.2 G The purpose of this chapter is to set out the detailed obligations which are specific to the activity of *issuing qualifying stablecoin* and the connected activities.

2.1.3 G The detailed obligations which apply to the activity of *issuing qualifying stablecoin* aim to ensure (among other things):

(1) that the *holder* of a *qualifying stablecoin* will always have a claim for the *redemption sum* of their *qualifying stablecoin* against a *qualifying stablecoin issuer*;

(2) that there is sufficient transparency by a *qualifying stablecoin issuer* about matters which are important to:

(a) the stability of a *qualifying stablecoin*; and

(b) the ability of a potential *holder* of a *qualifying stablecoin* to make an informed decision as to the risks, benefits, rights and obligations associated with becoming a *holder* of that *asset*.

[*Editor's note*: The FCA will consult on applying other high-level obligations – for example, obligations in PRIN, GEN and SYSC – and prudential rules in the FCA Handbook to firms carrying out issuing qualifying stablecoin in a subsequent consultation.]

Who?

2.1.4 R This chapter applies to a *firm* with respect to the activity of *issuing qualifying stablecoin*.

2.1.5 G A *firm* is carrying out the regulated activity of *issuing qualifying stablecoin* where that *firm* both:

(1) creates the *qualifying stablecoin*, or is the *firm* on whose behalf the *qualifying stablecoin* is created; and

(2) carries out one or more of the activities set out in article 9M(2) of the *Regulated Activities Order* by way of business in the *UK*.

What?

2.1.6 R All the *rules* in *CRYPTO* 2 apply in relation to *issuing qualifying stablecoin*, unless otherwise stated.

2.1.7 R A *firm* which is a *qualifying stablecoin issuer* of a *pre-issued stablecoin* is required to comply with the *rules* in *CRYPTO* 2 in relation that *qualifying stablecoin*.

2.1.8 R A *firm* which carries out *issuing qualifying stablecoin* because it is carrying out only some of the activities set out in article 9M(2) of the *Regulated Activities Order* is responsible for complying with all of the *rules* in *CRYPTO* 2 to the same extent as if it were carrying out all of those activities.

2.1.9 G A *firm* which relies on a third party to carry out any part of the activity of *issuing qualifying stablecoin* must ensure that all of the activities described in article 9M of the *Regulated Activities Order* are carried out in a way that complies with the *rules* in *CRYPTO* 2.

Where?

2.1.10 R This chapter applies to a *firm*, established in the *United Kingdom*, where any part of the activity of *issuing qualifying stablecoin* is carried out by way of business in the *United Kingdom*.

2.1.11 G A stablecoin is issued in the *United Kingdom* if any of the activity described in article 9M(2) of the *Regulated Activities Order* is carried out by way of business in the *United Kingdom*, whether or not the *person* to whom a *qualifying stablecoin* is issued or who becomes the *holder* of that *qualifying stablecoin* is in the *United Kingdom*.

2.2 General requirements

Building a qualifying stablecoin

2.2.1 R A *firm* must understand and appropriately managed the risks associated with the design and build of a *qualifying stablecoin*.

2.2.2 R Subject to *CRYPTO* 2.2.3R, a process by which a *firm* can demonstrate that it understands and has appropriately managed the risks associated with the design and build of a *qualifying stablecoin* must be carried out before a *qualifying stablecoin* is offered for sale or subscription.

2.2.3 R (1) Where a *firm* is a *qualifying stablecoin issuer* in relation to a *pre-issued stablecoin*, the process in *CRYPTO* 2.2.2R must be carried out as soon as is reasonably practicable after [*Editor's note*: insert the date on which this instrument comes into force].

(2) Where a *firm* becomes a *qualifying stablecoin issuer* by assuming obligations to the *holder* of a *qualifying stablecoin* under the process in article 9M(4)(a) of the *Regulated Activities Order*, the process in *CRYPTO* 2.2.2R must be carried out as soon as is reasonably practicable after that assumption.

2.3 Appointment of third parties

Application

2.3.1 R This section applies to a *firm* that is *issuing qualifying stablecoin*.

2.3.2 R This section applies to activities which are critical for the performance of, or amount to part of, the *regulated activity* of *issuing qualifying stablecoin*, including:

(1) the making or accepting of an offer to buy or subscribe to *qualifying stablecoin*;

(2) providing an undertaking to *redeem* a *qualifying stablecoin*; and

(3) the carrying out of activities designed to maintain the value of the *qualifying stablecoin*, other than activities in respect of which a *firm* is required by *CASS* 16.6.1R to appoint an independent third party to safeguard *money* or *asset*s.

2.3.3 G In so far as a *firm* wishes to engage a third party to carry out activities not within scope of *CRYPTO* 2.3.2R, including *ancillary activities* to *issuing qualifying stablecoin*, it should consider whether *SYSC* 8 applies to that outsourcing arrangement.

2.3.4 R If a *firm* appoints a third party in circumstances in which this chapter applies, it must comply with the following conditions:

(1) the appointment of a third party must not result in the delegation by *senior personnel* of their responsibility;

(2) the relationship and obligations of the *firm* towards the *holders* of a *qualifying stablecoin* under the *regulatory system* must not be altered;

(3) the conditions with which the *firm* must comply in order to be *authorised* and to remain so must not be undermined; and

(4) none of the other conditions subject to which the *firm's authorisation* was granted must be removed or modified.

2.3.5 G Where a *firm* appoints a third party in circumstances in which this chapter applies it remains fully responsible for discharging all of its obligations under the *regulatory system*.

Purpose

2.3.6 G Where a *firm* carries on the activity of *issuing qualifying stablecoin*, it may choose to appoint a third party to carry on one or more parts of that activity. This section sets out the *rules* that apply to such an appointment by a *firm* of a third party.

2.3.7 G Where a *firm* appoints a third party to carry on part of the activity of *issuing qualifying stablecoin*, the *firm* will be carrying on and responsible for all parts of the activity of *issuing qualifying stablecoin*.

2.3.8 G Where a *firm* appoints a third party to carry on part of the activity of *issuing qualifying stablecoin*, that third party is unlikely to itself be *issuing qualifying stablecoin* unless it was also involved in the creation of the *qualifying stablecoin* (as set out in article 9M of the *Regulated Activities Order*).

Appointing a third party: general requirements

2.3.9 R A *firm* must not appoint or retain another *person* (a 'third party') to carry on the activity of *issuing qualifying stablecoin* on its behalf, or part of that activity, unless the following conditions are met:

(1) the *firm* has taken reasonable steps to ensure that the third party has sufficient experience in and is competent to carry on the activity for which it is engaged;

(2) the *firm* has assured itself that it can monitor and assess the quality of the service the third party is providing;

(3) the third party will provide a service of an appropriate standard; and

(4) any risks around the appointment of the third party are identified and adequately managed;

2.3.10 R A *firm* must review its arrangements with third parties annually, including at least the following:

(1) that the third party continues to have sufficient experience in and be competent to carry on the activity for which it is engaged;

(2) that the *firm* is effectively monitoring the quality of the service that the third party is providing;

(3) that the third party is providing a service of an appropriate standard; and

(4) that any risks around the continued appointment of each third party are identified and adequately managed.

2.3.11 R (1) A *firm* must make a record of the grounds on which it satisfies itself as to the matters in:

(a) *CRYPTO* 2.3.9R; and

(b) on each review, *CRYPTO* 2.3.10R.

(2) A record under (1) must include a record of the considerations a *firm* made and the conclusions it reached.

(3) A record under (1) must be made on the date the selection is made or the review completed (as the case may be) and must be kept for either:

(a) 5 years from that date; or

(b) 5 years from the date that the *firm's* relationship with that third party ends (if later).

2.3.12 R A *firm* must ensure that any *money* or *asset*s it receives in exchange for a *qualifying stablecoin* in the process of carrying out the activity of *issuing qualifying stablecoin* are received directly by the *firm* and not at any point received or held by a third party on the *firm's* behalf.

2.3.13 G A third party appointed by a *firm* to carry out part of the activity of *issuing qualifying stablecoin* which involves offering or selling *qualifying stablecoin* must not receive or hold *money* or *asset*s on the *firm's* behalf, and a *firm* is expected to structure its arrangements with that third party so that this is not necessary.

2.3.14 R A *firm* must ensure that any third party acting on the *firm's* behalf prominently displays on its website and any other public communication a statement that it acts on the *firm's* behalf.

Appointing a third party: contractual requirements

2.3.15 R Where a *firm* appoints a third party to carry out all or part of the activity of *issuing qualifying stablecoin*, it must have in place a contract with that third party which meets all of the following conditions:

(1) it is governed by *UK* law;

(2) it enables the *firm* to request and obliges the third party to provide to the *firm* information that is sufficient to enable the *firm* to meet the *rules* to which it is subject in the *regulatory system*; and

(3) it enables the *firm* to request and obliges the third party to provide to the *firm* further information where requested for the purposes of enabling the *firm* to make an informed assessment of whether it is compliant with its obligations under the *regulatory system*.

2.3.16 R Where a *firm* appoints a third party to make or accept offers for another to buy or subscribe to *qualifying stablecoin* on its behalf, it must have in place a contract with that third party which includes provisions that set out how the *holder* of a *qualifying stablecoin* may contact the *firm*, including making clear what role (if any) the third party plays in customer service.

2.3.17 R Where a *firm* appoints a third party to act on its behalf in administering an undertaking to *redeem* a *qualifying stablecoin*, it must have in place a contract with that third party which includes:

(1) provisions setting out how the third party will handle, process, safeguard and segregate any *qualifying stablecoin* which it has received in the course of the *redemption* process;

(2) provisions requiring the third party to promptly provide to the *firm*:

(a) information on the number of *redemptions* carried out by the third party on the *firm's* behalf; and

(b) information on the monetary values of *redemptions* carried out by the third party on the *firm's* behalf;

(3) provisions requiring the third party to provide particular information on expected *redemption* timeframes to customers seeking *redemption*;

(4) provisions requiring the third party to ensure that all the *redemption rules* in *CRYPTO* 2.4.14R to which the *firm* is subject, including timeframes, are met;

(5) provisions requiring the third party to:

(a) immediately notify the *firm* in the event of exceptional circumstances which may require the suspension of *redemption*, as set out in *CRYPTO* 2.4.25R and *CRYPTO* 2.4.26G; and

(b) where it makes such a notification, immediately provide the *firm* with all information and/or documentation available to it about those exceptional circumstances;

(6) provisions prohibiting the third party from suspending its service of *redemption* unless either:

(a) it has written agreement or instruction to do so from the *firm*; or

(b) continuing with *redemption* would be contrary to a legal requirement to which the third party is subject;

(7) provisions requiring the third party to make available to the *firm* the public address or addresses to which *qualifying stablecoins* which are the subject of a *redemption* request are to be sent by the *holder*; and

(8) provisions requiring the third party to process *redemptions* in the order based on the fair and objective criteria the *firm* has determined under *CRYPTO* 2.4.22R.

2.3.18 R In the event that the *firm* receives a notification from a third party carrying out *redemption* on its behalf that there may be exceptional circumstances which require the suspension of *redemption*, it must consider whether the conditions in *CRYPTO* 2.4.25R are met.

2.3.19 R Where a *firm* appoints a third party to carry on activities designed to maintain the value of a *qualifying stablecoin* on its behalf, it must have in place a contract with that third party which must include provisions which require the third party to provide the *firm* with all information required for the *firm* to carry out valuation and reconciliation of the *backing asset pool* as set out in *CASS* 16.4.

2.4 Issuance and redemption

Application

2.4.1 R This section applies to a *firm* that is *issuing qualifying stablecoin*, including a *pre-issued stablecoin*.

2.4.2 R *CRYPTO* 2.4.5R does not apply to a *firm* that is *issuing qualifying stablecoin* where the cryptoasset in question is a *pre-issued stablecoin*.

Purpose

2.4.3 G This section sets out requirements and guidance for *firms* in relation to *issuing qualifying stablecoin*, including *redemption* of *qualifying stablecoin*.

Issuance

2.4.4 R A *firm* must not offer or arrange for another *person* to offer a *qualifying stablecoin* for sale or subscription other than in exchange for *money* or *qualifying stablecoin* in respect of which there is an *authorised person* as *qualifying stablecoin issuer*.

2.4.5 R Where a *firm* receives *money* or *qualifying stablecoin* in exchange for the purchase of a *qualifying stablecoin*, it must immediately send a *qualifying stablecoin* to the *holder's* nominated blockchain address without delay and at *reference value*.

Redemption

2.4.6 R A *firm* must ensure that the *holder* of a *qualifying stablecoin* can *redeem* that stablecoin with the *firm*:

(1) at any time;

(2) in exchange for *money* (excluding *electronic money*) which is denominated in the *reference currency*; and

(3) for the *redemption sum*.

2.4.7 R A *firm* must ensure:

(1) that there is a contract between the *qualifying stablecoin issuer* and the *qualifying stablecoin holder* which clearly and prominently states the conditions of *redemption*, including any fees in relation to *redemption*; and

(2) that any contractual obligations it owes to the *person* to whom a *qualifying stablecoin* is first provided for sale or subscription are effectively transferred in law along with the *qualifying stablecoin*, such that when the *qualifying stablecoin* transfers to a new *holder*, that new *holder* acquires rights against the *firm* in respect of that *qualifying stablecoin*.

2.4.8 R Any conditions of *redemption* agreed between a *firm* and a *qualifying stablecoin holder* must not:

(1) impose any minimum *redemption* quantity; or

(2) impose conditions which are onerous or difficult for a *holder* to meet.

2.4.9 G Examples of conditions which might be onerous or difficult to meet are:

(1) a contractual requirement to have an account with a particular *UK credit institution* before *redemption* can be carried out; or

(2) unreasonable restrictions to the payment methods made available to *holders* seeking *redemption*, such that the *holder* will incur unnecessary cost or difficulty in receiving or accessing their *redemption sum*.

2.4.10 R When a *qualifying stablecoin holder* enquires with a *firm* about *redemption*, the *firm* must provide appropriate information to that *qualifying stablecoin holder* about:

(1) the payment methods the *firm* makes available for *redemption*; and

(2) the likely timeframes within which the *qualifying stablecoin holder* will receive the *redemption sum* using those payment methods.

2.4.11 R The information in *CRYPTO* 2.4.10R must be provided before the *holder* confirms the preferred payment method by which they will receive the *redemption sum*.

2.4.12 G *CRYPTO* 2.4.10R and *CRYPTO* 2.4.11R apply to a *firm* even where that *firm* offers *redemption* through a third party. In these circumstances, one way of meeting these obligations is for a *firm* to ensure that a *qualifying stablecoin holder* receives information from a third party on the *firm's* behalf.

2.4.13 G In order to give a *holder* informed choice about which payment method to select, information about timeframes will not be appropriate unless it is based on research about past timeframes achievable by different payment methods, including recent historical data.

2.4.14 R On receipt of a full *redemption* request, a *firm* must ensure that *redemption* is completed:

(1) at the value of the *redemption sum*;

(2) unless the *holder* requests a different currency, in the *reference currency*; and

(3) as soon as practicable but no later than the end of the *business day* following the *day* on which a valid *redemption* request is received.

2.4.15 G For the purpose of calculating the *redemption sum* in *CRYPTO* 2.4.14R(1), the value of the *backing asset pool* is irrelevant.

2.4.16 R For the purposes of *CRYPTO* 2.4.14R, a full *redemption* request is received at such time as the *firm* has received both:

(1) a valid *redemption* request as defined in *CRYPTO* 2.4.17R; and

(2) (where relevant) all information necessary to comply with relevant customer due diligence requirements under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692), under any *rule* under the *regulatory system*, or under any other enactment.

2.4.17 R A *redemption* request is valid if it is made:

(1) by the *holder* of a *qualifying stablecoin*, or by an agent acting on behalf of a *holder* as a principal; and

(2) in a manner which meets any terms and conditions in the contract between the *qualifying stablecoin issuer* and *qualifying stablecoin holder*.

2.4.18 R Where the terms and conditions of the contract between the *qualifying stablecoin issuer* and the *qualifying stablecoin holder* do not meet the requirements of *CRYPTO* 2.4.7R or *CRYPTO* 2.4.8R, those terms and conditions are to be ignored when considering the validity of the *redemption* request under *CRYPTO* 2.4.16R(2).

2.4.19 R Unless *CRYPTO* 2.4.20R applies, for the purposes of *CRYPTO* 2.4.14R(3) a *redemption* is completed when a payment order instructing the transfer of the *redemption sum* from the *firm* to the *holder* has been made.

2.4.20 R Where a *firm* operates a payment account for a *holder* and credits the *redemption sum* to that account without needing to transfer the *redemption sum* to another payment service provider, *redemption* is complete at the point the *firm* credits the *redemption sum* to the *holder's* payment account.

2.4.21 R The time limit in *CRYPTO* 2.4.14R(3) does not apply in any of the following circumstances:

(1) the completion of a particular *redemption* request within that time limit would cause the *firm* to be in breach of any legal requirement or court order, including those contained in or made under the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the *Money Laundering Regulations*;

(2) all of the following are met:

(a) the *holder* of the *qualifying stablecoin* requests *redemption* in a currency other than the *reference currency*;

(b) the currency exchange required to meet that request takes more time to carry out than meeting a request in the *reference currency*; and

(c) the *firm* has made clear to the *holder*, at the point at which the *holder* enquired about *redemption*, what is the likely timeframe within which *redemption* in the currency requested will be completed; or

(3) a decision is taken to suspend *redemption* under *CRYPTO* 2.4.25R to *CRYPTO* 2.4.32G.

Order of redemptions

2.4.22 R A *firm* must complete *redemptions* in an order which is based on fair and objective criteria and does not prejudice, directly or indirectly, the interests of any particular type of *holder*.

Security of redeemed stablecoins

2.4.23 R Where a *firm* receives a *qualifying stablecoin* in the course of carrying out, or in connection with, a *redemption*, within 24 hours it must either:

(1) record that *qualifying stablecoin* as part of the relevant *stablecoin pool*; or

(2) ensure that the relevant *qualifying stablecoin* is *burned*.

2.4.24 G Where a *firm* records a *qualifying stablecoin* as part of the relevant *stablecoin pool* under *CRYPTO* 2.4.23R(1), it must ensure that it adds *money* or *asset*s to its *backing asset pool* if necessary so that it complies with *CASS* 16.2.1R at all times.

Suspension of redemption

2.4.25 R A *firm* must suspend all *redemption* where all of the following conditions are met:

(1) there is an exceptional circumstance which threatens the integrity of the relevant *qualifying stablecoin product* or the interests of the *holders* of the relevant *qualifying stablecoin product*;

(2) the *firm* has taken all reasonable steps to respond to the exceptional circumstance in such a way that does not involve suspending all *redemption*; and

(3) the *firm* concludes on a proper basis that temporarily suspending all *redemption* is necessary to protect the rights of *holders* of a *qualifying stablecoin* or the integrity of that *qualifying stablecoin*.

2.4.26 G Exceptional circumstances are likely to include:

(1) failure of the underlying distributed ledger technology or other infrastructure on which the *qualifying stablecoin product* relies;

(2) failure of a system upon which the *firm* or a third party relies to carry out *redemption*;

(3) a sudden loss of confidence in the relevant *qualifying stablecoin product* such that the *firm* or a third party who carries out *redemption* on behalf of the *firm* receives an exceptionally high number by volume or value of *redemption* requests;

(4) the insolvency of the *firm*.

2.4.27 G Exceptional circumstances are unlikely to include:

(1) the suspension of trading of the relevant *qualifying stablecoin product* on a secondary market, unless that suspension of trading is caused by

a sudden loss of confidence in that *qualifying stablecoin product* as set out in *CRYPTO* 2.4.26G(3); or

(2) the insolvency of a third party carrying out *redemption* on behalf of the *firm,* unless that insolvency threatens the integrity of the relevant *qualifying stablecoin product* or the interests of the *holders* of the relevant *qualifying stablecoin product*.

2.4.28 G (1) Where the exceptional circumstance causes or is caused by an inability of the *firm* to resolve a shortfall identified in the circumstances set out in *CASS* 16.4.9R or *CASS* 16.4.12R by either of the methods set out in *CASS* 16.4.15R(1)(a) or *CASS* 16.4.15R(2)(b), reasonable steps for the purposes of *CRYPTO* 2.4.25R(2) would include the *firm* exploring whether it can source additional resources or liquidity in order to continue to meet *redemptions*.

(2) Where a third party carrying out *redemption* on behalf of a *qualifying stablecoin issuer* becomes insolvent, reasonable steps for the purposes of *CRYPTO* 2.4.25R(2) would include the *firm* exploring whether *redemption* of the relevant *qualifying stablecoin product* can continue through other third parties or directly by the *firm.*

2.4.29 R A *firm* which suspends *redemption* must:

(1) immediately notify the *FCA* as to:

(a) the fact it has suspended *redemption*;

(b) the period of time for which it is anticipated that *redemptions* will be suspended; and

(c) the reason why it has suspended *redemption*; and

(2) immediately notify in writing all third parties who carry out *redemption* on the *firm's* behalf.

2.4.30 G All third parties who carry out *redemption* on behalf of a *firm* should be informed where a decision to suspend all *redemption* is taken.

2.4.31 R A *firm* that has suspended *redemption* must restart *redemption* as soon as possible, but no earlier than when all of the following are met:

(1) a reconciliation to confirm that the value of the *backing asset pool* is equal to the *qualifying stablecoin's reference value* multiplied by the relevant *stablecoin pool* (as required by *CASS* 16.2.1R) has been completed; and

(2) the *firm* has:

(a) formulated a plan as to how and when it will restart *redemption*;

(b) after formulating that plan, promptly submitted it to the *FCA*, ensuring a reasonable period between submission and restarting *redemption*, in any event not less than 5 *business days* unless a shorter period is agreed with the *FCA*; and

(c) assured itself that the reason notified to the *FCA* under *CRYPTO* 2.4.29R(1)(c) for the suspension of *redemption* has been remedied and is no longer likely to impact the *firm's* ability to meet *redemption* requests.

2.4.32 G The plan referred to in *CRYPTO* 2.4.31R(2) should at least cover the following:

(1) the *firm's* forecast as to anticipated numbers of *redemption* requests within the 14 *redemption days* which follow restarting *redemption*;

(2) the proportion of the *backing asset pool* that is held, and should continue to be held in *core backing assets*, and the period needed over which any adjustments to that proportion of *core backing assets* will take place;

(3) the way in which adjustments to the proportion of *core backing assets* it is proposed that the *firm* will make could impact on markets for *expanded backing assets* or *core backing assets* over the period set out in (2);

(4) consideration as to how the *firm* meets and will continue to meet wider obligations under the *regulatory system*; and

(5) an explanation as how the *firm* has assured itself of the matters at *CRYPTO* 2.4.31R(3).

Redemption fees

2.4.33 R *Redemption* may be subject to a fee only where:

(1) the fee is stated in the contract between the *qualifying stablecoin issuer* and the *holder* of the *qualifying stablecoin* in accordance with *CRYPTO* 2.4.7R(1); and

(2) the fee is proportionate and commensurate solely with the operational costs actually incurred by the *qualifying stablecoin issuer* in respect of that *redemption* and does not include costs or losses incurred through the sale of *core backing assets* or *expanded backing assets*.

2.4.34 R A *firm* must not charge a fee for *redemption* that is greater than the value of the *qualifying stablecoins* to which that *redemption* request relates.

2.5 Stablecoin disclosures

Application

2.5.1 R This section applies to a *qualifying stablecoin issuer* in relation to any *qualifying stablecoins* or *pre-issued stablecoins* for which that *firm* is the *qualifying stablecoin issuer*.

Purpose

2.5.2 G This section sets out requirements on *firms* about the information that must be published online about a *qualifying stablecoin product*, including the type of information and the frequency of when this information must be reviewed and updated.

Relevance of other obligations

2.5.3 G The obligations set out in this section about the publication of information by *firms* are in addition to any other obligations imposed on a *firm* by the *regulatory system*. A *firm* should be aware that the publication of information in accordance with this chapter may also be subject to additional and overlapping obligations.

Obligations to publish disclosures

2.5.4 R A *firm* must ensure that the following information is published online in relation to any *qualifying stablecoin product* for which that *firm* is the *qualifying stablecoin issuer*:

(1) the general information referred to in *CRYPTO* 2.5.25R;

(2) the *backing asset pool* information referred to in *CRYPTO* 2.5.27R;

(3) the *redemption* information referred to in *CRYPTO* 2.5.28R; and

(4) the review information referred to in *CRYPTO* 2.5.29R and *CRYPTO* 2.5.30R.

2.5.5 R If a *firm* is the *qualifying stablecoin issuer* of more than one *qualifying stablecoin product*, the *rules* in this section must be read as applying separately for each *qualifying stablecoin product*.

2.5.6 G The effect of *CRYPTO* 2.5.5R is that a *firm* must publish, review and update separate sets of *stablecoin disclosures* for each *qualifying stablecoin product* in relation to which that *firm* is the *qualifying stablecoin issuer*.

2.5.7 R In complying with *CRYPTO* 2.5.4R a *firm* must take all reasonable steps to ensure that it easy for prospective readers to:

(1) locate the *stablecoin disclosures*;

(2) access the *stablecoin disclosures*; and

(3) identify the date that the *stablecoin disclosures* were last updated or amended.

2.5.8 R A *firm* must ensure that the information that it publishes in compliance with *CRYPTO* 2.5.4R is clear, fair and not misleading.

2.5.9 G In complying with *CRYPTO* 2.5.8R, a *firm* should consider what is appropriate and proportionate taking into account the means of communication and the fact that a *firm* should assume that the information it publishes will be read by retail customers.

2.5.10 R When publishing information online in accordance with *CRYPTO* 2.5.4R, a *firm* should:

(1) explain or present information in a logical manner;

(2) use plain and intelligible language and, where use of jargon or technical terms is unavoidable, explain the meaning of any jargon or technical terms as simply as possible;

(3) make key information prominent and easy to identify, including by means of headings and layout, display and font attributes of text, and by use of design devices such as tables, bullet points, graphs, graphics, audio-visuals and interactive media;

(4) avoid unnecessary disclaimers; and

(5) provide an appropriate level of detail.

2.5.11 G The *rules* in this section do not require a *firm* to publish all the information listed in *CRYPTO* 2.5.4R together as a single document or webpage. A *firm* should choose the best format for publishing the *stablecoin disclosures* in line with the *rules* of the chapter.

2.5.12 G When publishing information online in accordance with *CRYPTO* 2.5.4R, a *firm* should consider whether to provide additional information to help support a reader's understanding of the *stablecoin disclosures*. In doing so, a *firm* should ensure that it does not obscure the information referred to *CRYPTO* 2.5.4R.

2.5.13 G A *firm* may consider publishing additional information alongside the *stablecoin disclosures* about risks associated with the *qualifying stablecoin product*, and any mitigating steps taken by the *firm* against such risks, including:

(1) risks associated with the technology used to support the *qualifying stablecoin*;

(2) risks to the interests of a *holder*; and

(3) risks to the ability of the *qualifying stablecoin issuer* to continue maintaining the stability or value of the *qualifying stablecoin product*.

2.5.14 R Subject to *CRYPTO* 2.5.15R, a *firm* must comply with the requirement in *CRYPTO* 2.5.4R before the corresponding *qualifying stablecoin* is offered for sale or subscription (within the meaning of article 9M of the *Regulated Activities Order*).

2.5.15 R In relation to *pre-issued stablecoins*, a *firm* must comply with the requirement in *CRYPTO* 2.5.4R on the first *day* that the *rule* comes into force.

2.5.16 R For the purposes of the *rules* in *CRYPTO* 2.5.25R and *CRYPTO* 2.5.27R, the given point in time that a *firm* selects must be:

(1) the same point in time for both of those *rules*; and

(2) be no more than 24 hours prior to the date when the *firm* intends to publish the information referred to in those *rules* which references the point in time selected.

Obligations to review and update stablecoin disclosures

2.5.17 R A *firm* must update the information referred to in *CRYPTO* 2.5.18R that it has published in its *stablecoin disclosures* at least once in every 3-*month* period, determined in accordance with the following:

(1) if the *stablecoin disclosures* are first published on the first *day* of a *month*, the first 3-*month* period begins on that *day*;

(2) if the *stablecoin disclosures* are first published on a *day* that is not the first *day* of a *month*, the first 3-*month* period begins on the first *day* of the following *month*; and

(3) no more than 4 *months* can pass between each update.

2.5.18 R The information referred to is:

(1) the information referred to in *CRYPTO* 2.5.25R(1) (total number of *qualifying stablecoins*);

(2) the information referred to in *CRYPTO* 2.5.27R(3) (value of the relevant *backing asset pool*); and

(3) the information referred to in *CRYPTO* 2.5.27R(4) (percentage breakdown of *backing asset pool*).

2.5.19 R A *firm* must update the information referred to in *CRYPTO* 2.5.20R that it has published in its *stablecoin disclosures* in accordance with the following:

(1) if, and to the extent that, any of the information becomes inaccurate; and

(2) as soon as reasonably practicable after the information becomes inaccurate.

2.5.20 R The information referred to is:

(1) the general information referred to in *CRYPTO* 2.5.25R;

(2) the *backing asset pool* information referred to in *CRYPTO* 2.5.27R; and

(3) the *redemption* information referred to in *CRYPTO* 2.5.28R,

that is not referred to in *CRYPTO* 2.5.18R.

2.5.21 R To ensure compliance with *CRYPTO* 2.5.19R, a *firm* must have systems in place to regularly review its *stablecoin disclosures* to ensure any inaccuracies in the information it has published are identified.

2.5.22 G The information caught by the 3-*month rule* in *CRYPTO* 2.5.17R is not caught by the *rule* in *CRYPTO* 2.5.19R. The *rules* in *CRYPTO* 2.5.17R and *CRYPTO* 2.5.19R apply to different sets of information because:

(1) the information referred to in *CRYPTO* 2.5.18R is likely to change rapidly, so the *rule* in *CRYPTO* 2.5.17R requires a *firm* to, at a minimum, update this information once in every 3-*month* period; and

(2) the information referred to in *CRYPTO* 2.5.20R, being the remaining general information (the technology and third parties involved in issuing), the *backing asset pool* information and the redemption information, is likely to be more static, so *CRYPTO* 2.5.19R requires a *firm* to update it whenever that information becomes inaccurate.

2.5.23 G The review information referred to in *CRYPTO* 2.5.29R and *CRYPTO* 2.5.30R is not caught by either *rule* in *CRYPTO* 2.5.17R or *CRYPTO* 2.5.19R because that information is point-in-time and will instead be periodically produced in accordance with *CRYPTO* 2.5.29R and *CRYPTO* 2.5.30R.

2.5.24 G In complying with *CRYPTO* 2.5.17R, a *firm* has discretion to align the timing with other obligations under the *regulatory system* or to accommodate other commercial or practical considerations, provided that no more than 4 *months* has passed between each update.

General information to be published

2.5.25 R The general information to be published for each *qualifying stablecoin product* is:

(1) the total number of *qualifying stablecoins*, described in terms of:

(a) the total number of *qualifying stablecoins* the *firm* has sold, or which are subject to subscription;

(b) the total number of *qualifying stablecoins* the *firm* is presently offering for sale or subscription, but which have not yet been sold or subscribed; and

(c) the total number of *qualifying stablecoins* the *firm* has had *minted* but which have not yet been offered for sale or subscription,

at a given point in time, selected in accordance with *CRYPTO* 2.5.16R.

(2) a description of the technology used to support the recording or storage of data for the relevant *qualifying stablecoin* (such as the distributed ledger technology); and

(3) the name(s) of any *person* with whom the *issuer* has made arrangements to:

(a) offer the *qualifying stablecoin* for sale or subscription;

(b) undertake on behalf of the *issuer* to redeem the *qualifying stablecoins*; and/or

(c) carry on activities on behalf of the *issuer* designed to maintain the value of the *qualifying stablecoin*.

2.5.26 R The *rule* in *CRYPTO* 2.5.25R(1) to publish the total number of *qualifying stablecoins* includes where a *firm* has arranged for another to sell or subscribe, offer for sale or subscription, or *mint* on its behalf.

Backing asset pool information to be published

2.5.27 R The *backing asset pool* information to be published for each *qualifying stablecoin product* is:

(1) the name of any third party or third parties appointed by the *firm* to provide it with a *backing funds account* or accounts for the purpose of safeguarding *money* in the *backing asset pool*;

(2) the name of any third party or third parties appointed by the *firm* to provide it with a *backing assets account* or accounts for the purpose of safeguarding *assets* in the *backing asset pool*;

(3) the value of *backing asset pool* held by the *firm* at a point in time selected in accordance with *CRYPTO* 2.5.16R, expressed in terms of the *reference currency* and described with the following detail:

(a) the total value held;

(b) the value(s) held as *core backing assets*, broken down into the type(s) of *asset*(s); and

(c) if relevant, the value(s) held as *expanded backing assets*, broken down into the type(s) of *asset*(s); and

(4) the value(s) referred to in *CRYPTO* 2.5.27R(3)(b) and (c) also expressed as a percentage of the total value of the *backing asset pool*.

Redemption information to be published

2.5.28 R The *redemption* information to be published for each *qualifying stablecoin product* is:

(1) an explanation of any *redemption fee* that may be payable by a *holder*, including how such a *fee* will be calculated;

(2) the steps that a *holder* must take in order to redeem the *qualifying stablecoin*, including a list of any information that a *holder* may be asked to provide as part of a *redemption* request;

(3) a summary of the steps that will be taken by the *issuer* or other parties involved in the *redemption* process following a request to redeem; and

(4) the payment methods the *firm* makes available for *redemption*.

Review information to be published

2.5.29 R Each time a *firm* updates the information referred to in *CRYPTO* 2.5.18R in accordance with *CRYPTO* 2.5.17R, the *firm* must also publish a statement confirming whether the *backing asset pool* for that *qualifying stablecoin product* is equal to the *qualifying stablecoin's reference value* multiplied by the relevant *stablecoin pool* in accordance with *CASS* 16.2.1R(3).

2.5.30 R As soon as practicable following the independent review referred to in *CRYPTO* 2.5.31R, the *firm* must ensure it publishes a statement prepared by the *person* conducting the independent review, confirming:

(1) the date the independent review took place;

(2) the overall outcome of the independent review; and

(3) the relevant qualifications of the *person* who conducted the independent review.

Obligation to conduct and publish an independent review

2.5.31 R At least once every 12 *months*, a *firm* must undertake an independent review of the statements it has published over the previous 12 *months* in accordance with *CRYPTO* 2.5.29R.

2.5.32 R The independent review referred to in *CRYPTO* 2.5.31R must determine whether the relevant statements published by the *qualifying stablecoin issuer* were accurate.

2.5.33 R The independent review referred to in *CRYPTO* 2.5.31R must be conducted by a *person* who, at a minimum, meets the following requirements:

(1) is neither an employee nor an agent of the *firm*;

(2) is not a member of the same *group* as the *firm*;

(3) is eligible for appointment as an auditor under Chapters 1, 2 and 6 of Part 42 of the Companies Act 2006;

(4) has otherwise been appointed as an auditor under another enactment, and the *person* meets the requirements for appointment under that enactment; or

(5) is overseas and is eligible for appointment as an auditor under any applicable equivalent laws of that country or territory in which they are established.

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