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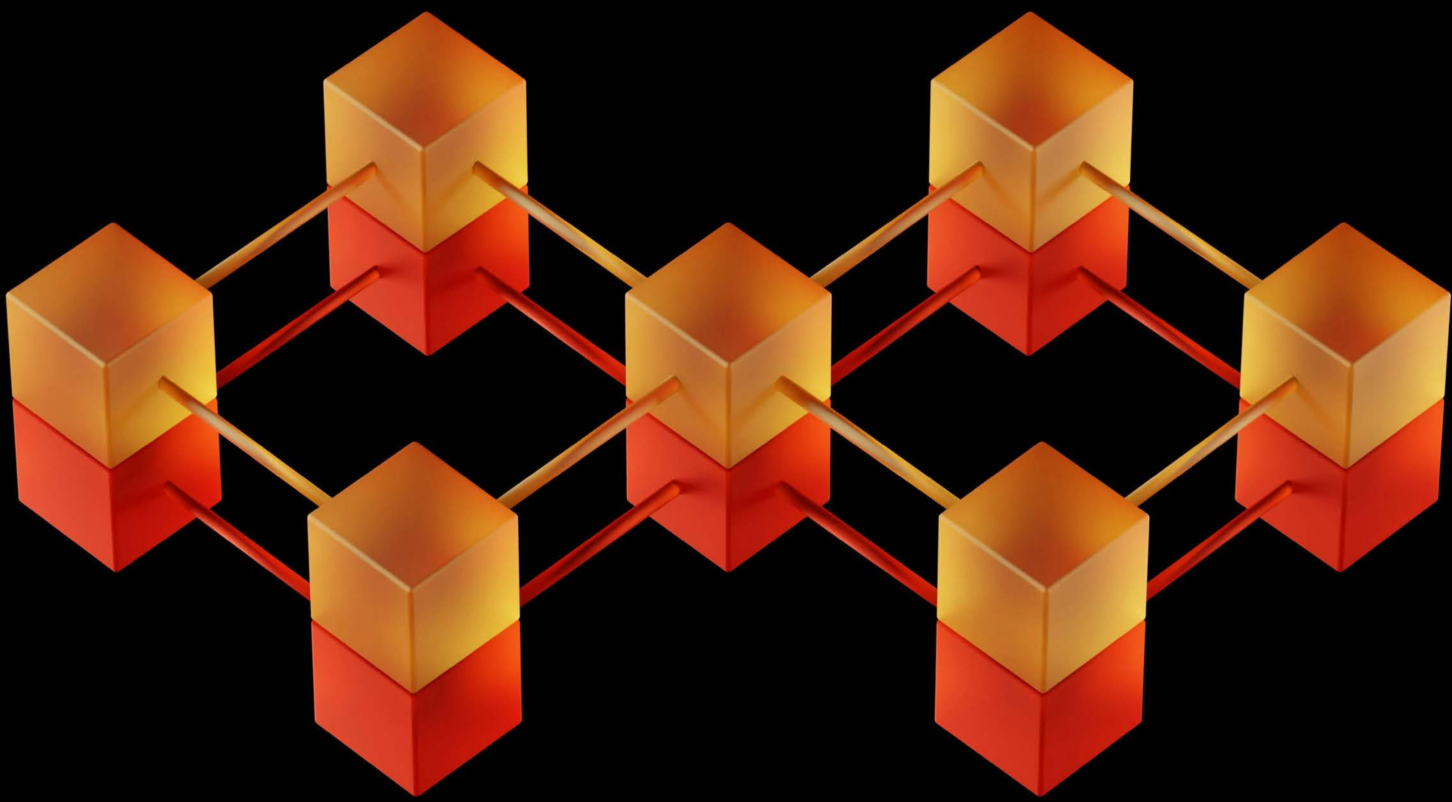

Stablecoin: The UK Opportunity

How the UK can be the leading global market and innovator for stablecoin.

By Andrew Whitworth for Digital Pound Foundation, Innovate Finance

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Executive Summary

The United Kingdom needs to put in place a competitive and robust regulatory regime for stablecoins as soon as possible. Other large financial centres already have operational stablecoin regimes (e.g. the EU) or are poised to legislate one quickly (e.g. the US). The lack of a regulatory regime for stablecoins is undermining UK competitiveness and driving business away.

The UK is lagging far behind but there is still the opportunity to put in place a stablecoin regime that will be internationally competitive. By providing a clear and consistent environment for business growth, this regime will encourage innovation in UK financial services, boost UK financial markets, and directly contribute to economic, jobs and skills growth in the UK.

The growth and competitiveness potential includes:

- **Payments:** Stablecoins offer significant benefits to financial systems, enabling faster, cheaper, and more efficient payments - both domestically and internationally. For retail users, they can reduce transaction costs, improve access to financial services, and support greater financial inclusion, particularly for underserved populations.
- **Artificial Intelligence (AI):** Stablecoins will play a crucial role in realising the ambitions of the UK's AI Action plan by providing a stable and reliable medium for transactions, enabling AI agents to handle payments, manage financial assets and complete smart contracts and automated transactions efficiently and safely.[1]
- **Tokenised securities and funds:** Stablecoins are also essential for a functioning digital securities and tokenisation markets, where there needs to be a digital settlement asset. The total market for tokenised assets is predicted to be 10% of global GDP by 2030.[2] A UK-compliant and potentially GBP-backed stablecoin as the digital settlement asset will keep value and flow in the UK and support local market participants.
- **Priority sectors in the Government's Financial Services Competitiveness and Growth Strategy:** Insurers and asset managers are utilising stablecoins for transactions and settlement and this will increasingly be a competitive edge for all key UK strategic financial

services sectors, especially any with cross-border transactions: sustainable finance, insurance and reinsurance markets, capital markets and asset management as well as FinTech.

- **Gilts:** HM Treasury's "DIGIT" project to issue a digital gilt instrument using distributed ledger technology (DLT) will only take off if stablecoins can be used for settlement. Equally, UK issued stablecoins can strengthen the UK economy and public finances, with stablecoin issuers becoming significant buyers of UK debt (e.g. Tether is now the 7th largest buyer of US government debt).
- **Eurodollar 2.0:** The UK could become the 'Eurodollar market' for stablecoins. With global stablecoin markets already valued at $200bn[3] and growing rapidly, and with GBP the 4th most traded currency in the world and London taking 40% of foreign exchange (FX) turnover, it does not seem unreasonable for the UK to host 10-20% of the future global stablecoin market, i.e. $20-40bn and growing.

The economic opportunity therefore spans productivity, public finances, competitiveness of UK financial services and a share of the global stablecoin market. At a time of global volatility this is also about building resilience in payments and maintaining the global presence of GBP.

In order to secure these benefits for the UK, we need a clear and compelling UK stablecoin strategy to guide the regulators on rapid implementation. It is critical that the legal basis for the UK regulatory regime does not rule out and can enable the development of these. This regime should have three objectives to turn the UK into the most competitive location for stablecoin activity:

- **Support the development of UK-issued GBP-backed stablecoins**
  - **Stablecoins should always be backed 1:1 with suitable assets, but the regime should avoid being overly prescriptive about the nature of the backing assets and the proportion of bank deposits within them; an effective audit and disclosure regime should ensure backing assets provide 1:1 backing.** Develop the world-class regulatory treatment of backing assets, disclosure and redemption rights with requirements that are proportionate to the risks and do not unduly target innovative features of the technology. An ideal backing regime for stablecoins in the UK should seek to achieve

a proportional degree of safety, transparency, and international competitiveness while reducing risks that stablecoins do not maintain their peg.

- To achieve this, stablecoins should be required to maintain a 1:1 backing in high-quality liquid assets (HQLA) at all times. HQLA should include (but not be prescriptively limited to) short-term gilts, money market funds (MMFs), a proportion in deposits at regulated banks and Bank of England Reserves, and reverse repos with counterparties meeting stringent creditworthiness criteria. While issuers are developing and remain small, they should be permitted to hold a portion of their backing assets as assets with similar profiles to traditional HQLA, including tokenized versions of HQLA.
- Direct redemption between end users and the issuer is not the key price stability mechanism that it is sometimes assumed to be. Instead of direct redemption for all users, stablecoin issuers typically provide redemption and issuance rights to a subset of onboarded clients who actively participate in the secondary market. Secondary market sale and purchase arrangements then provide proven and increasingly available mechanisms for reliable on- and off-ramping.
- The regulatory regime should recognise that, provided issuers are free to agree terms and commercial incentives with secondary market participants, there are reliable ways that stablecoin users can access 1:1 conversion without themselves having a direct line to redemption with the issuer. Ensuring that redemption is sufficiently accessible to enable liquidity in the secondary markets should be the regulatory objective, rather than forcing issuers to offer a costly, risky, and unnecessary redemption right to all holders.

- **Foster international openness**
  - **The UK regime should allow the trading and usage of overseas-issued and overseas-denominated stablecoins.** The UK should run a regime of Unilateral Equivalence, and allow international-currency backed, and internationally-issued, stablecoins to be issued and used freely in the UK. The UK should avoid local issuance requirements that risk reintroducing frictions in cross-border payments, undermining the international fungibility of stablecoins and reducing their benefits.

    - More generally, the UK should ensure compatibility with other jurisdictions' regulations, so that stablecoins that are regulated in those jurisdictions can also be used in the UK.
    - This will strengthen our tech and financial services bridge with the US and with Asia-Pacific and enable London to be the centre for stablecoin Eurodollar 2.0.

- **Incentivise business models**
    - Issuers should be permitted to offer interest or yield to customers who establish a direct commercial relationship with them, such as through a separate account or wallet linked to the stablecoin. In this arrangement, the issuer, which would itself be allowed to invest the reserves in HQLA such as short-term gilts or reverse repos, would be able to share a portion of the returns with customers as an incentive for holding and using the stablecoin.
    - Being able to provide these incentives to clients is crucial to allow the liquidity mechanisms that ensure secondary market price stability. It will also provide the UK with a competitive advantage over other jurisdictions that do not allow yield-sharing models.

The fundamental principle behind this regulatory regime is that stablecoins are effectively safe from a financial stability and consumer usage point of view so long as they are 1:1 backed at all times with HQLA, convertible and redeemable at par as necessary, and with frequent audit and disclosure to the market and regulators. The aim of the regulatory design explained in this paper is to ensure these conditions.

A consistent regime across regulators

The approach we expand on below needs to be consistent across regulators. Whilst the Bank of England may well require closer supervision of any organisations in their remit, they should apply the same principles and ensure a consistent approach that avoids any requirement to fundamentally change business models or create a cliff edge for any organisation moving between one regulator and another. The UK should have a single regime for stablecoin, not multiple approaches. Investment in the UK will not be forthcoming without a single consistent approach.

Though financial stability risk mitigation is rightly important, the Bank of England has itself articulated that it does not see any stablecoin close to the thresholds for recognition under its supervision. Nonetheless, the most recent Bank of England proposals (autumn 2023) proposed a regime that prohibited activities—most tangibly the prohibition of interest—that would be permitted by the Financial Conduct Authority (FCA). This creates an existential ceiling to the sector's growth. It also stands to put the UK significantly out of kilter compared to other regimes. The Bank of England should publicly walk back from these proposals and commit to consult on a systemic regime on a longer-term basis.

In doing so, the government should extend the central bank's secondary innovation objective—of which HM Treasury has publicly committed to do so in future primary legislation—to its remit over digital settlement assets for the purposes of guiding its final proposals on systemic stablecoins' supervision. The Bank of England should be given an innovation objective in payments policy to encourage new technologies and innovation in the payments space, and ensure there is not a bias towards incumbents and legacy systems. Stablecoins should also be allowed entry into the Digital Securities Sandbox or another regulatory sandbox, enabled by legislation, to support the Bank of England working with firms to understand clearly the future systemic risk potential stablecoins' pose.

Ensure a level playing field

UK regulators need to deliver a level playing field for stablecoins to compete with other forms of digital money (based on the principle of "same risk, same regulatory outcome"), that requirements are proportionate to the risks and do not unduly target innovative features of the technology.

The approach of the Bank of England in particular has tended to view stablecoins as a risk to stability and has proposed to use holding limits to constrain the use of stablecoins in a wholesale context.[4] There should be no holding limits; the introduction of such limits would be out of kilter with other regimes and kill any opportunity for the UK to be a leading market for stablecoin trading and for corporate and wholesale services and transactions; it would in effect prevent all the growth opportunities.

The Bank of England must embrace stablecoins for on-chain settlement in a wholesale context for the UK to lead the way in the tokenisation of financial markets and to put the City of London on a strong competitive footing in the next wave of growth and innovation in global capital markets.

Avoid treating stablecoins as investments

Any regulatory treatment of stablecoins should reflect their own features, uses and risks, rather than extraneous instruments they may supposedly be similar to. For example, stablecoins are not investment products - they are not designed as such, they are not used as such, they do not present risks as such - so they should not have tax (capital gains) and financial promotions (restricted mass-market investments) treatment as if they were.

An agile regulatory approach

Similarly, at the current stage of regulatory development in the UK, regulators should focus on putting in place the core regulatory building blocks of a stablecoin regime, rather than spend time trying to regulate the entire future payments and market environment that a stablecoin may be involved in. Start with the basics, quickly, and then expand over time if necessary. The second part of this paper explains in detail the optimal regulatory regime for stablecoin backing assets, disclosures, yield-sharing models and international openness. We include as an Annex to this paper details of specific legislative changes required through Statutory instruments to implement this model. The rest of the regime as explained in Part 2 of this paper should come via regulators' rules - or by regulators agreeing not to make rules in the area.

With these elements in place, the UK will create an environment that is notably more interesting and welcoming for stablecoins than other equivalent jurisdictions. The stablecoin market is not just a driver of growth in itself, but it is also a key enabler of other digital markets and particularly for tokenisation. The UK Government has expressed a desire to foster these digital markets, but without a robust stablecoin environment this will be difficult. And the UK government should want any digital settlement asset or stablecoin being used in the UK to be GBP-denominated and issued in the UK. Currently this is impossible.

A core regulatory principle of the regime is that regulators should not attempt to second-guess and prescribe business models in a developing market, but should focus on creating regulation that will mitigate potential risks to the regulatory authorities' public objectives. That is the proper activity of regulation.

This paper provides a blueprint for a UK stablecoin regime that may be enabled at-pace and in line with regulators' objectives. There is no more time to waste.

Part 1: Introduction

The United Kingdom has no time to lose in putting in place a competitive and robust regulatory regime for stablecoins. The Kalifa Review of UK FinTech in February 2021 called for the UK to act quickly to introduce a regulatory framework for stablecoin and cryptoassets and HM Treasury set out plans to establish a stablecoin regime as the first phase of cryptoasset regulation. Subsequent regulatory delay and ensuing market dynamics have eroded any potential advantage we may have had in this rapidly evolving sector. Other jurisdictions have not stood still while the UK has delayed. The European Union's Markets in Crypto-Assets (MiCA) regulation is already in force, providing issuers with a clear and stable regulatory environment for cryptoassets including stablecoins. While MiCA is a significant landmark for global stablecoin markets, its design choices leave room for other jurisdictions to out-compete it. This presents an opportunity for the UK to craft a more competitive regime that can draw market participants seeking greater commercial opportunities than MiCA allows, while still maintaining consumer protection and financial stability. But this window of opportunity is narrowing rapidly.

Meanwhile the United States, long hostile to digital assets and stablecoins, is now actively seeking to assert leadership in the space. Adoption of currently proposed legislation would position the US as a dominant player in the stablecoin market. Nonetheless, recent market speculation[5], suggest that the final US regulatory framework may impose restrictive measures on non-US issuers, offering the UK an opportunity to develop a more competitive regime.

Other jurisdictions are already capitalising on this new market by creating clear regimes for stablecoins. The United Arab Emirates (UAE), Singapore, Japan, and soon Hong Kong have established clear and supportive regulatory regimes for stablecoins, particularly for international use. These jurisdictions are rapidly attracting serious market participants and are positioning themselves as regional, and perhaps soon global, hubs for the sector.[6] Importantly, these are not extreme jurisdictions; they are home to serious regulators who are thoughtfully considering the outcomes and consequences of their policies. Their progress demonstrates that the UK is not only competing against time but also against well-considered and ambitious regulatory frameworks.

The UK's delay so far is regulatory. The government is already taking the necessary legislative steps to equip regulators with the powers needed to oversee this space effectively.[7] Moreover, over the past five years, successive governments — regardless of leadership, political philosophy, or party — have consistently articulated a clear political vision for the UK to become a global leader in the digital assets sector.[8] This rare cross-party consensus underscores the strategic importance of digital assets to the UK's future economic growth and innovation. However, this political ambition has not been matched by corresponding regulatory action. The failure to implement, or even propose, a timely and coherent regulatory framework has left the UK trailing behind more proactive jurisdictions. Whereas once the UK was genuinely world-leading in its early thought leadership in 2021-2022, delays to the enabling legislation required to finalise a regime for authorising firms has stymied the UK's position to benefit from their growth. Whilst the FCA's Cryptoasset Roadmap published last year sets out a sequence of consultations, we lack a clear UK stablecoin strategy from the Government to guide the regulators on rapid implementation.

This gap between political intent and regulatory execution represents a significant missed opportunity, one that must be urgently addressed to align the UK's regulatory environment with its long-standing aspirations for leadership in the digital economy.

Fortunately, there are sensible and simple options available to the UK regulators. This paper is designed to offer the UK government and regulators clear arguments as to why it is in the UK's best interest to quickly put in place a clear, robust and welcoming regime for stablecoins to boost UK global competitiveness. And to offer industry's view of the key design decisions for an ideal regime to fulfil this promise while mitigating risks to regulators' mandates. With the benefit of seeing what works and does not work in other regulatory regimes, and with insights on what industry needs, **this paper provides a blueprint for the UK stablecoin regime that may be enabled at pace and in line with regulators' objectives.**

1.1 The opportunity: strengthening UK competitiveness and growth

Stablecoins offer significant benefits to financial systems, enabling faster, cheaper, and more efficient payments—both domestically and internationally. For retail users, they can reduce transaction costs, improve access to financial services, and support greater financial inclusion, particularly for underserved populations. Studies, such as those by the World Economic Forum[9] and the Bank for International Settlements[10], highlight their potential to unlock billions in economic value by streamlining payments and reducing friction in financial markets.

The UK should also want to see GBP stablecoins developed. The strongest, and most protectionist, measures in MiCA and the US proposals are designed precisely to see their national/regional currency strengthen in its use-cases and international role through digitalisation. For an open country with a strong financial sector and a world-class currency, it would be perverse for the UK to deliberately stymie the development of a well-regulated, internationally open GBP-stablecoin that would strengthen the usefulness and acceptability of GBP as a whole in a digital future. For such a stablecoin – or rather, for multiple, competing GBP-stablecoins – to exist, there needs to be a clear, robust and welcoming regime for stablecoins. And soon, before UK market participants get used to using non-GBP stablecoins for transactions they would normally do via traditional GBP-denominated money. The development of a significant GBP-stablecoin market would also support UK government finances by soaking up government debt and helping it then circulate as money. For example, Tether is now the 7th largest buyer of US government debt.[11]

The UK can recharge and boost its role in Eurodollar markets by becoming the 'Eurodollar market' for stablecoins. That means allowing international-currency backed, and also internationally issued, stablecoins to be issued and used freely in the UK. This is a precise analogy to a Eurodollar market, which is the holding of foreign currencies – outside of the issuing country's regulatory remit – in a given financial centre to support financial transactions in that currency. For example, a USD stablecoin issued and circulating in London between financial entities of any jurisdiction is precisely the same activity, but digitised. The UK created, and primarily benefited from, the first Eurodollar market. With the right regulatory regime, there is no reason it should not do the same with the second 'Eurodollar market' that is the international stablecoin market.

It is difficult to put a monetary value on the total potential market in the UK. But with global stablecoin markets already valued at $200bn[12] and growing rapidly, with GBP the 4th most traded currency in the world, and London as one of the two major global financial centres with nearly 40% of FX turnover, it does not seem unreasonable for the UK to host 10-20% of the future global stablecoin market, i.e. $20-40bn and growing – or around 1% of UK GDP.

On top of the contribution of the stablecoin sector itself, stablecoins are also essential for functioning digital securities and tokenisation markets: there needs to be a digital settlement asset.[13] Stablecoins are necessary for digital markets to be used safely. This is particularly the case with markets in the tokenisation of Real World Assets (RWAs) which are likely to transform capital markets in general, and specifically for digital securities markets, which the UK is hoping to develop via its Digital Securities Sandbox[14] and with the introduction of a pilot for Digital Gilts[15].

Any digital market requires a digital settlement asset, something which has been legislated for in the UK in the Financial Services and Markets Act 2023[16]. That could be a UK Central Bank Digital Currency (CBDC), if one ever exists in the UK, but in the meantime it must, by definition, be a stablecoin. If introduced, any UK CBDC will not be available until the end of the decade according to the Bank of England[17]. This is too long to wait for the UK to boost its competitiveness. Tokenised deposits may exist sooner, but due to their nature as closed loop, non-bearer instruments means they are not yet fit for purpose for digital asset settlement usage.

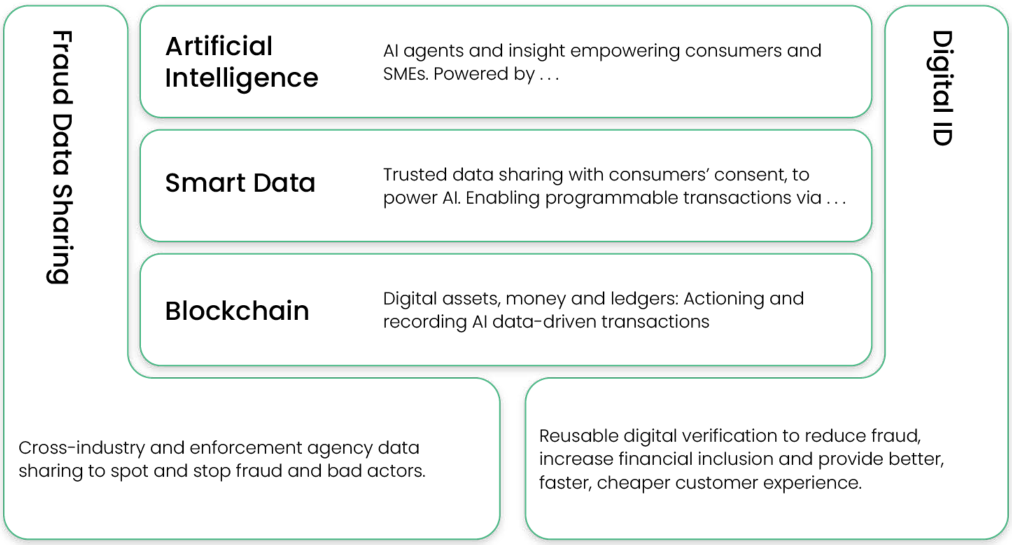
As an example, when Santander issued the UK's first GBP-denominated tokenised bond in 2019[18], there was a significant barrier in the absence of an on-chain GBP settlement asset. This barrier still exists today – holding back the development of the UK's regulated digital finance ecosystem and, as each year passes, diminishing the UK's standing as a centre for financial services innovation and strategic development. The Investment Association's industry working group on UK Fund Tokenisation has also identified on-chain digital money as a requirement for settling transactions.[19] Arguably, the success of the UK Government's ambition for digital gilts will also require on-chain digital money.

Having a UK-compliant and potentially GBP-backed stablecoin as the digital settlement asset will be beneficial to keeping value and flow in the UK and supporting local market participants. The total market for tokenised assets is predicted to be *10% of global GDP by 2030*. This is a large market - regardless of whether the UK can only manage to support tokenised markets at 10% of its own GDP, or manages to also claim a share of the tokenisation of international assets. Either way, it is a market that will be unlocked by having robust, UK stablecoins.

1.2 A core component of UK Financial Services and Growth Strategy

Just as innovation over the last 10 years came from cloud, mobile and social technology - so future growth will come from three core technologies and two enabling systems: AI, smart data, and Blockchain, supported by fraud data sharing and digital ID. These five components can build a world beating UK Tech stack - a sling shot not only for financial services but also productivity and growth across the UK economy. All five layers of the Tech Stack are needed to maximise the opportunity of AI in financial services and across the UK economy.

Proposed UK Financial Tech stack:



This should be the ambition at heart of the UK Financial Services Growth and Competitiveness Strategy being developed by HM Treasury. It is critical to the future competitiveness of all the priority sectors of the strategy: sustainable finance, insurance and reinsurance markets, capital markets and asset management as well as FinTech.

A competitive stablecoin regime is a core component of the Blockchain stack. This is also fundamental to UK AI ambitions: AI agents need digital assets and payments methods for transactions.

1.3 Principles for a competitive UK stablecoin market

Stablecoins need to be seen as an enabling innovation that supports future AI-based activities, on top of tokenisation, as well as being a worthwhile innovation in themselves. The stablecoin market, and the wider cryptoasset ecosystem, is very much still in its infancy compared to the traditional financial markets with which it will compete. It is not possible to predict its future development. The UK regulatory regime for stablecoins will need to take this into account to ensure it does not block off the future development of stablecoins for innovative purposes through proscriptive requirements.

Taken as a whole, the FCA should alter its current Crypto Roadmap to streamline approaches to stablecoin supervision, so that a regime may go-live sooner than the current target date of end of 2026. In place of waiting on multiple rounds of consultation — including on matters relating to unbacked cryptoassets and not stablecoins — the FCA could finalise a more streamlined regime of critical regulatory requirements for stablecoins this year. Crucially, this should include an articulation by the FCA as to how firms will be expected to be authorised, and a clearly articulated means for engaging case officers to do so. This is in keeping with HM Treasury's "New approach to ensure regulators and regulation support growth" and the FCA pledges in this on pre-application support for crypto firms and dedicated supervisory support for high growth firms[20]. This would likely be achieved through top-ups to existing authorisations already held by most of the sector's participants (E-Money Institutions and Fifth Money Laundering Directive, for example). Working with firms thereafter on the wider design of non-critical supervisory functions as the sector develops would be more practical for policymakers, better support this nascent but quickly maturing sector's growth, and would not detriment consumers. This needs both regulator buy-in but also crucially political will to achieve as HM Treasury's enabling legislation is passed before summer recess.

The way to achieve the aims and benefits of a developed stablecoin market set out above is through the core design decisions of the UK stablecoin regime. The specific elements that will let the UK capture these benefits are laid out in detail in Part 2 of this paper. Below are the guiding principles.

1. **Support the development of UK-issued GBP-backed stablecoins:** Unlocking business propositions in the UK to build a GBP-backed stablecoin is key for UK competitiveness. In the context of a stablecoin market globally that is growing at a blistering pace, the fact that there is no widely used or recognised GBP stablecoin in the UK speaks for itself in relation to the restrictiveness of the UK regulatory environment. The propositions are there, but they are waiting for regulatory clarity. They will not wait forever. GBP is the 4th most traded currency and yet there is no domestically-issued GBP-stablecoin that can strengthen GBP's role in digital markets. This will erode the relevance of GBP, weakening monetary sovereignty and undermining fiscal strength. Righting this situation is entirely in regulators' powers and it is now that they must put in place a clear and competitive regime. An important part of competitiveness – as the UK has long known in traditional financial markets – is having clear regulation.

2. **Foster international openness:** Alongside supporting the growth of GBP-stablecoins, the UK must allow non-GBP currency stablecoins to be issued from the UK. This will make the UK an attractive hub for international digital business and securities markets, in contrast to some jurisdictions (such as the EU) that have created fragmentary and globally inefficient localisation requirements, and recreating its role in traditional financial markets for digital ones. Attracting this business supports economic and jobs growth, brings capital and investment into the UK, and encourages further innovation and technological development.

   The UK should allow non-UK issued stablecoins of other currencies to circulate and be used in the UK to encourage international adoption and equivalence. Unilateral equivalence on its own attracts business, but also fosters the development of bi-lateral equivalence decisions, which should also be a key objective of the UK. The UK has precedent of allowing in overseas players in traditional finance with the Overseas Persons Exclusion (OPE), which many people consider to have directly contributed to the UK's post-war development as a financial hub. In a sense, the future regime could be considered an 'OPE for stablecoins'. While retail payments in a foreign currency may not be desirable (for reasons of unintended FX risk in daily transactions and tax reporting complications), it is unclear that they need to be banned through regulation.

3. **Incentivise business models and market confidence:** Permit the testing and incentivisation of different business models and use cases, including allowing different yield-sharing models as is the case in traditional finance. The UK would be the only major jurisdiction to allow this, which on its own would attract a lot of business and it would incentivise domestic firms and entrepreneurs. It is crucial to separate out here yield being given on the stablecoin itself (i.e. the bearer payment instrument) rather than provided directly by the issuer to the subset of users who are the issuer's onboarded customers. Thus, we can, for example, have a freely circulating bearer-instrument at par with its fiat reference, but still allow the issuer to share its yield with customers. There are no doubt other ways of structuring this. The key point is that yield-sharing should not be banned directly.

   As ever, a stablecoin would require 1:1 backing assets for each stablecoin, made up of HQLA. This mitigates risk of deviation from par and potential flight risk. Unlike MiCA, the UK should not mandate a certain percentage of backing assets in bank deposits, which in general is a lower quality backing asset than the stablecoin itself should be. Strong and understandable audit and disclosure requirements are needed to build market confidence without prescribing the business model. Businesses innovating in this developing market must be given room to experiment with revenue models and products. The UK has the opportunity to become the place where innovative businesses come to develop their products. Finally, the tax treatment of stablecoins needs to be clarified to make sure that it is appropriate for their use-case (that is, payments rather than investment). This will also streamline adoption.

4. **Sectoral clarity:** Many jurisdictions have tripped up by trying to force stablecoins into existing regulatory regimes. While simpler (and perhaps quicker) from a regulatory point of view, it applies conduct and business model requirements that are not compatible with

stablecoins' business model as transferable bearer instruments. Examples include the MiCA requirements for on-demand redemption for all users directly with the issuer. This is not compatible with the stablecoin business model, in which the issuer is removed from the end user and ensures secondary market liquidity through direct issuance and redemption provided to a select few primary customers, who in turn provide end users with access at a 1:1 stable price (for a fee). Hence, MiCA-compliant stablecoins typically impose such burdensome onboarding and KYC requirements that the direct redemption right is extremely inefficient and almost counterproductive.

Similarly, MiCA's treatment of stablecoins as 'funds' brings them into payment services regulation, imposing a regulatory regime that is not suitable for a peer-to-peer payment tool that operates on global blockchain networks. It also causes confusion in markets by creating the risk of multiple overlapping regulatory regimes applying to a single activity. Thus, the UK should, explicitly, make clear through a clear regulatory statement that stablecoins are not e-money, deposits or MMFs, and that they can be used for payments purposes outside the UK's payment services and e-money regulations. The current UK Government has helpfully already taken steps in this direction by announcing that stablecoins will be kept outside payments regulation.

As should be clear, none of these requirements should imply a 'light-touch' or 'loose' regime for stablecoins. As described in Part 2, there are various important requirements that need to be present in a regulatory regime for stablecoins.

A key point is that stablecoin issuers and users also want the same thing: an on-chain token that maintains stable value against a reference asset, which can be used for various digital markets and payments. Regulation, market need and individual business models are all in alignment. It is not for regulators to decide whether or not a use-case for them is valid, or desirable, or appropriate, so long as their regulatory objectives are achieved. They achieve their mandates by ensuring consumer protection, market integrity, and the stability of the financial system. Nothing in a well-designed, internationally competitive, stablecoin regime goes against those objectives – and, indeed, can support them.

1.4 The counter view

There are three broad potential arguments against the view outlined above:

Regulatory argument:

Some might argue that this regime is not safe enough for UK consumers or the financial system as a whole. But the design itself mitigates against these risks: backing, custody, audit, disclosure, governance, operational requirements. The UK has been internationally open in traditional financial markets for decades, and regulators have made themselves comfortable with this. As the ecosystem develops, stablecoins should not pose anything like the same risks as global banking, through their very nature. They do not operate a fractional reserve and maturity transformation business model in the same ways as banks. It is not clear why digitisation should drive a different approach. The clearest answer would be the potential speed of flows 'out' of the UK in a stress. But it is unclear what 'out' means in the context of, for example, a non-GBP stablecoin, or a stablecoin already issued in a foreign jurisdiction. Relying on slow and outdated technology in order to limit risks – while at the same time fundamentally hobbling competitiveness and growth – is the 'stability of the graveyard'.

Some regulators may argue that stablecoins are not needed because there will be a CBDC, and argue (plausibly) that public money outcompetes private money where they are equally available. As noted, the UK will not have a CBDC for a long time – if ever – and if stablecoins are outcompeted in the market, then that is a risk entrepreneurs knowingly take on. Stablecoins may have some compensating advantages in terms of functionality or speed for example, depending on how any CBDC is designed. For some transactions, safety of the settlement asset is paramount. For many others there is a trade off. Again, it is not for regulators to prejudge this through regulatory design. In any case, it is possible, even likely, they will coexist.

Regulators should recognise that regulation itself, particularly regulation that dictates product design and business model (rather than, say, requiring disclosure), risks proscribing the existence of a business or service that could be useful and productive and could provide economic growth and employment. The regulators' job is not to prevent risk at all costs or decide which markets or products should exist. Regulatory interventions must be proportionate and, in a highly innovative, rapidly-growing market, the risk of losing future economic and welfare gains is particularly acute.

Commercial arguments:

Commercial banks have been known to push back against stablecoins (and indeed CBDCs) because of a risk of bank disintermediation. This pushback takes two forms: firstly, the 'debanking' of stablecoin companies and users (that is, not letting them have or use their bank accounts for these activities) in order to impede their existence. This is anti-competitive behaviour that has been criticised by the government[21] and is purely designed to protect against innovative business models. Secondly, by highlighting risks to financial stability by disintermediation. This has been hugely successful, to the point that central banks are proposing even to limit their own CBDCs to limit outflows from banks. But it is unclear why the movement from an inherently risky asset (a bank deposit, based on fractional reserve banking in which only a fraction of bank deposits are required to be available for withdrawal) to an extremely safe asset (a stablecoin backed 1:1 by HQLA) would increase financial instability. Rather, it will decrease it, if we only accept that (systemic) financial stability is not the same as 'banking stability'. There could be chaotic effects if there was a sudden and massive flow but that is extremely unlikely to happen in modern circumstances or from the development of the regime described here[22]. There may be effects on credit creation (rather than systemic stability) from a decrease in bank deposits being turned into credit, but we should expect alternative credit providers to step in (and the Bank of England's own analysis showed the effect to be relatively minor[23]). In either case, it is not the role of regulators to defend banks' business models through regulation designed to hobble their competitors.

Some commercial banks also say that markets 'do not need' stablecoins because they are working on tokenised bank deposits, which they argue are the same. They are not the same, as stablecoins are bearer instruments while tokenised bank deposits are closed-loop non-bearer instruments. As with CBDCs, we should let the market decide which form of private digital money it wants to use. Competition and innovation through new technology is an important mitigant to the emergence of "too big to fail" oligopolistic financial services incumbents. It is not the regulator's job to prejudge through regulatory design.

Political arguments:

Some might contend that the UK actually does not want a large international stablecoin market because it would, in effect, dollarise the economy. But the UK's wholesale markets already are largely dollarised[24]. The change here is in digitising those already existing markets. The risk of a *de facto* dollarisation of retail payments seems unlikely. The regime proposed in this paper will incentivise GBP-stablecoins just as much as attract international stablecoins. In fact, a relatively open regulatory regime is the only way the UK can have its own GBP-based market, rather than see business shift to offshore service providers. If UK-based businesses are not able to compete, it will not be long before all GBP stablecoins are issued by businesses offshore, where the UK regulators have even less control. It is also unclear under what circumstances any retail user would want to pay in a foreign currency for a product in their home country. Why would you go from your salary in GBP to a USD stablecoin to buy a coffee denominated in GBP inside the UK? If you are buying goods or services abroad or online, you already have to switch currency (even if sometimes seamlessly) – and usually pay a fee for it. Again, it is not clear why making that same transaction via a stablecoin should be penalised compared to doing it via a bank account, debit or credit card, particularly when it can be cheaper, quicker, and safer (given more end-to-end traceability).

Supporting the development of a stablecoin regime that both enables the growth of GBP-stablecoins and welcomes international stablecoins will strengthen UK monetary sovereignty by enhancing the role and use of GBP in digital markets. This will, obviously, become more important as time goes on. This is also why other jurisdictions are moving ahead too on their own ground.

The main point is that different payment and money instruments can, do and should coexist. This is true in traditional markets and will be true in digital/onchain markets. There will be a mix of public, private, physical and digital (on-chain) forms of money. It is not necessary for the government or regulators to pick winners, or to try to design the acceptable business model before businesses have had a chance to test them commercially.

Stablecoins are not, on their own, a silver bullet. They are a necessary, but certainly not sufficient, element for maintaining London's attractiveness as a global financial centre, to boost digital securities markets, maintain a growing, innovative tech and fintech ecosystem and boost jobs and tax revenue. Regulation - or its lack - should not get in the way of the growth of this sector.

Part 2. Design choices for the ideal regime

There are various elements necessary to get right in terms of regulatory design of the stablecoin regime to achieve the outcomes set out above. Below we explain these particularly insofar as they diverge from existing proposals by UK regulators. For the sake of completeness we also discuss other areas towards the end of the section where we consider existing treatments to be sufficient.

The fundamental principle behind this regulatory regime is that stablecoins are effectively safe from a financial stability and consumer usage point of view so long as they are 1:1 backed at all times with HQLA, convertible and redeemable at par as necessary, and with frequent audit and disclosure to the market and regulators. The aim of the regulatory design below is to ensure these conditions.

2.1 Backing assets

An ideal backing regime for stablecoins in the UK should seek to achieve a proportional degree of safety, transparency and international competitiveness while reducing risks that stablecoins do not maintain their peg. To achieve this, stablecoins should be required to maintain a 1:1 backing in HQLA at all times. HQLA should include (but not be prescriptively limited to) short-term gilts, MMFs, a proportion in deposits at regulated banks and Bank of England Reserves, and reverse repurchase agreements (reverse repos) with counterparties meeting stringent creditworthiness criteria. This is explicitly different to jurisdictions such as the EU with MiCA which, for example, restrictively require certain proportions of backing assets (at least 30%) for E-Money Tokens (EMTs) to be held in bank deposits. The audit and disclosure requirements (see below) provide the safeguards for assessing that these assets are HQLA.

While issuers are developing and remain small, they should be permitted to hold a portion of their backing assets as assets with similar profiles to traditional HQLA, including tokenised versions of HQLA. This ensures that stablecoin issuers hold sufficient liquidity to meet redemption demands promptly, even during periods of market stress. It also gives issuers room to identify and test business models. Stablecoins will have different use cases and target markets, which could have significant implications for the most viable backing asset models. For instance, a stablecoin used in institutional asset management as a means of exchange between tokenised fund products will need to be able to accept assets other than traditional financial products and quickly safeguard them as their backing assets. As on-chain financial market products, this will need to include safe cryptoassets such as tokenised MMFs and other stablecoins. To have fast, reliable, and operationally resilient processing of issuance and redemption transfers, issuers must have discretion to calibrate backing assets to the market and counterparties they are working with.

Additionally, the regime should allow for partial backing in currencies other than the stablecoin's peg currency, though to mitigate risks associated with FX volatility it could require such holdings to be overcollateralised within a reasonable range. In general, the regime might want to allow (but not require) overcollateralisation of backing assets to offset any potential fluctuations of value from volatility in the backing reserve. Permissible backing assets denominated in a different currency might be restricted, for example, to AAA-rated short term government bonds, and regularly reviewed against the credit risk and market risk associated with those instruments.

As a general principle, regulation should recognise that managing backing assets involves significant costs and infrastructure. Issuers should be given as wide discretion as possible to identify what is viable, within high-level regulatory parameters and subject to detailed public disclosure (discussed further below).

2.2 International openness

The UK regime should allow locally regulated issuers to issue stablecoins denominated in any currency, while also permitting overseas issued stablecoins to be used in the UK, provided they meet equivalent consumer protection and regulatory standards. In the early stages, as regulatory regimes develop, there should be a presumption of equivalence for issuer jurisdictions unless the UK regulators proactively declare otherwise. By allowing overseas stablecoins to operate in the UK under these conditions, the regime would encourage innovation, competition, and cross-border interoperability, allowing London to remain a global financial centre while providing a mechanism for the regulators to take action if necessary to improve safeguarding consumer interests and financial stability. To repeat the principle, opening up the UK market internationally does not require the regulator to take a stance on what they feel the 'correct' stablecoin or business model 'should' be, but rather allows market practice to evolve.

In essence, this regime calls for a type of 'unilateral openness' both to encourage activity and investment in the UK and to spur other jurisdictions to do the same for GBP-backed stablecoins. This unilateral openness should also spur the development of international equivalence decisions, making the global landscape more favourable for UK-based firms that may want to expand internationally.

2.3 Yield-sharing

To facilitate yield-sharing while maintaining the integrity of stablecoins as a payment instrument, the regulatory regime should clearly distinguish between the issuance and use of bearer payment stablecoins and the offering of interest or yield by issuers to customers with whom they maintain a commercial relationship.

However, issuers should be permitted to offer interest or yield to customers who establish a direct commercial relationship with them, such as through a separate account or wallet linked to the stablecoin. In this arrangement, the issuer, which would be required to invest the reserves in HQLA such as short-term gilts or reverse repos, would be able to share a portion of the returns with customers as an incentive for holding and using the stablecoin. Being able to provide these incentives to clients is crucial to allow the liquidity mechanisms that ensure secondary market price stability. To summarise these mechanisms, issuers will provide direct access to redemption and issuance for certain, typically larger institutional, secondary market participants. This subset of stablecoin users in turn provides broking and liquidity services to end users, for a fee, giving them access to liquidity at par value (1:1) without having to rely on floating exchange prices available on cryptoasset exchanges. The issuer must be in a position to implement whatever incentive arrangements are commercially necessary to ensure secondary market participants operate in this ecosystem and meet secondary market demand.

This separation between instrument and issuing company ensures that the primary function of the stablecoin as a reliable medium of exchange and store of value is preserved while allowing for innovation and customer benefits. It maintains a clear separation between the stablecoin's payment function and the yield-sharing mechanism. To ensure consumer protection, issuers must provide transparent disclosures about the risks and terms of yield-sharing, and demonstrate that such arrangements do not compromise the stability or redeemability of the underlying stablecoin.

The regulatory regime would not need to specify the mechanism for allowing yield-sharing – this should be left to the market – so long as it allows yield-sharing in principle, subject to the backing and redemption requirements on the bearer instrument itself as set out in this regime.

2.4 Redemption and convertibility

Stablecoin convertibility and redemption are two distinct mechanisms that allow stablecoin holders to exchange their tokens for other forms of money. They operate in different ways, serving different functions and therefore should be viewed as playing distinct roles in the stablecoin ecosystem.

- Convertibility involves the ability of stablecoin holders to exchange their tokens with other market participants for other forms of money, such as bank deposits, other stablecoins. Today, convertibility is generally facilitated by exchanges or intermediaries. When a stablecoin is converted to another form of money, the stablecoin continues to exist but is held by a new owner.
- Redemption involves returning stablecoins to the issuer in exchange for commercial bank money, or e-money (or, in the future, potentially CBDC), after which the stablecoins are 'burned': removed from circulation. In contrast to convertibility, when a stablecoin is redeemed, it ceases to exist outside the issuer, and the original owner holds the equivalent value in another form of money. Redemption results in a reduction in the circulating supply of the stablecoin. While convertibility will likely play a role in stablecoins' everyday functionality, redemption

may, in the long term, become a more occasional, exceptional option rather than a core, routine feature of stablecoin use.

Thus, the regulatory regime should recognise that direct redemption between end users and the issuer is not the key price stability mechanism that it is sometimes assumed to be while convertibility is a critical mechanism for exchanging value in and out of stablecoins.

Instead of direct redemption for all users, stablecoin issuers typically provide redemption and issuance rights to a subset of onboarded clients who actively participate in the secondary market. Secondary market sale and purchase arrangements then provide proven and increasingly available mechanisms for reliable on- and off-ramping. Contrary to concerns commonly expressed by regulators, this does not mean users must be at the mercy of volatile cryptoasset exchanges when they seek to convert back into fiat. There are two principal reasons.

I. Cryptoasset exchanges provide reliable liquidity, driven by secondary market participants who operate directly on the exchange, buying and selling in response to minor price deviations in order to make a return ('arbitrage') through bulk redemptions or bulk issuance at 1:1 directly with the issuer.

II. Users can put in place their own bilateral arrangements with secondary market participants such as brokers and liquidity providers by which they ensure they have reliable access to 1:1 conversion without ever using a cryptoasset exchange. Like a large-scale ATM service might operate in relation to physical cash, these bilateral arrangements enable end users to buy and sell at 1:1 (for a fee) as if they had a direct redemption access to the issuer. The liquidity provider must have direct or indirect access to redemption with the issuer to ensure it will always be able to convert the stablecoins it receives in the secondary market. However, the end user does not require this level of access to the issuer. If, for example, a large corporate chose to accept stablecoins as payment or to use stablecoin to pay suppliers, it would first put in place a direct arrangement with a liquidity provider who buys and sells direct to them for a fee. The liquidity provider would itself have a direct arrangement with the issuer, including certain volume or value related incentive arrangements, which may include yield sharing.

Rather than providing direct redemption rights to all holders, the issuer puts in place redemption and issuance arrangements with only a selection of onboarded clients. This is significantly more practical and cost effective for the issuer. It should also be a safer model than the regulatory proposals for on-demand and universal redemption rights, as it gives the issuer more scope to manage the risks around liquidity events and large-scale redemptions (akin to bank runs) by putting in place terms and conditions that allow it to halt or delay redemptions.

The regulatory regime should recognise that, provided issuers are free to agree terms and commercial incentives with secondary market participants, there are reliable ways that stablecoin users can access 1:1 conversion without themselves having a direct line to redemption with the issuer. Ensuring that redemption is sufficiently accessible to enable liquidity in the secondary markets should be the regulatory objective, rather than forcing issuers to offer a costly, risky, and unnecessary redemption right to all holders.[25]

To ensure stablecoin redemption processes are both efficient and practical, the UK regime should require issuers to process redemptions within a reasonable timeframe. But this should not be prejudged by regulators at this early stage. Issuers must be allowed flexibility to manage operational and logistical challenges. Redemption, so far as it is offered to stablecoin holders, should be at par value, ensuring that stablecoin holders receive the full value of their holdings.

Issuers should not be required to fulfill 100% of redemption requests at any given time; instead, issuers should have discretion to implement a cap of, say, 40-50% of total outstanding stablecoins within a 24-hour period to manage liquidity risk and prevent market disruptions (in reality any redemption requests at this level are likely to imply that there is a 'run' on the stablecoin and business-as-usual (BAU) requirements are not appropriate. The issuer may already be effectively in recovery and resolution).

This approach balances the perceived consumer protection benefits of prompt redemptions with the practicalities of reserve management and operational constraints. As noted previously by the FCA, the redemption period should recognise the need for issuers to conduct anti-money laundering and combating the financing of terrorism (AML/CFT) checks, but issuers should be given sufficient time to complete these checks, particularly for higher-risk holders. Additionally, redemption should be encouraged from the intermediating commercial distributor who is more likely to already have a relationship with the stablecoin holder and thus be able to redeem more efficiently.

In fact, for redemptions above £1 million, which typically rely on CHAPS ("Clearing House Automated Payment System") rather than the Faster Payments System (FPS), the current operating hours of CHAPS (6am to 6pm) may pose challenges, though the likely extensions to CHAPS hours by the Bank of England would alleviate this in the future. It would be impractical to put regulatory requirements on issuers which cannot be fulfilled due to the limitations of public infrastructure.

Similarly, stablecoins are generally intended to be capable of cross-border use, operating on global blockchains. This means that a universal redemption right would require the issuer to make payments to fiat accounts located overseas with associated costs. Alternatively, users could be required to have a UK bank account to receive redemption payments, but this would undermine the benefits of using the stablecoin for international users.

Issuers should be permitted to outsource or involve third parties in the redemption process, particularly in cases where intermediaries, rather than the issuer itself, face end-users. This is especially relevant for wholesale issuers or complex market structures. Given that stablecoins are bearer instruments, there should be no requirement for holders to prove ownership or provenance at the point of redemption, simplifying the process and enhancing user experience. By implementing these measures, the UK can ensure a robust and efficient redemption framework that supports both consumer protection and market stability.

As explained, convertibility and redemption of stablecoins serve distinct purposes, and in BAU scenarios, convertibility is often more critical for operationalising the utility of a stablecoin as a medium of exchange. This is essential for ensuring that stablecoins can function effectively in everyday transactions, enabling users to leverage their holdings for payments, remittances, or trading across platforms. Unlike redemption, convertibility relies on interoperability across a network of intermediaries, exchanges, and payment processors to facilitate liquidity and usability. A robust convertibility framework is therefore key to maximising the utility and adoption of stablecoins in the broader financial ecosystem, while redemption mechanisms serve as a critical backstop to maintain confidence in the stablecoin's value. But this convertibility does not in itself require regulating at this stage, the market providing the necessary framework.

2.5 Custody arrangements

To ensure effective custody and safeguarding of backing assets for stablecoins, the regulatory framework should adopt a balanced and proportionate approach that promotes operational efficiency while safeguarding consumer rights. This approach is different to that in the Client Assets Sourcebook (CASS) and the existing custody regime for traditional finance, but should be aligned with that for other cryptoassets.

Regulated custodians should be permitted to use omnibus wallets (that allow comingling of customers' funds within one wallet, rather than requiring segregation per customer) for safeguarding cryptoassets, as this aligns with operational efficiencies and is legally effective under English law (para 5.17 of the FCA Discussion Paper DP23/4 on Regulating cryptoassets: Stablecoins and the Law Commission's Final Report on Digital Assets). Additionally, custodians should be allowed to perform other cryptoasset services, such as staking, lending, or holding cryptoassets as collateral, provided appropriate safeguards are in place to address conflicts of interest and protect client assets (as envisaged under paragraphs 5.23, 5.49-5.53 of the FCA Discussion Paper). Issuers of multiple regulated stablecoins should not be required to segregate backing assets for each stablecoin, as this would create unnecessary complexity (as noted in paragraph 3.17 of the FCA Discussion Paper). While regulated issuers should not be mandated to appoint an independent custodian, those performing their own custody should do so through a regulated custodian entity with an arm's-length agreement (paragraphs 3.35-3.38 of the FCA Discussion Paper).

A proportionate approach to custody is essential, avoiding uncapped liability for custodians in cases of hacks or losses beyond their control (paragraph 5.27 of the FCA Discussion Paper). Custodians should also be permitted to leverage third-party technology providers for infrastructure and storage, ensuring flexibility and access to specialised expertise (paragraphs 5.36-5.41 of the FCA Discussion Paper). While omnibus wallets offer cost and efficiency benefits, individual client wallets may be warranted in specific situations, though further clarity is needed on when and how CASS requirements would apply. Legal separation should be applied proportionately, considering the size and nature of firms' activities to avoid stifling innovation in this nascent sector. Finally, allowing a single legal entity to provide both exchange and custody services can enhance settlement speed, efficiency, and risk reduction, provided robust contractual arrangements are in place to mitigate conflicts of interest and protect client funds. This approach balances consumer protection with the need to foster a competitive and innovative stablecoin ecosystem in the UK.

2.6 Disclosure

Issuers should provide transparent, accurate, and timely information about the stablecoin's operations, reserve holdings, risks, audits, policies, and governance to regulators, users, and the public. This information should be provided at least monthly and should be allowed in real-time as technology enables this. This information will enable users to make considered decisions and enhance consumer protection. At the early stages of market development, disclosure requirements should be a key tool for regulators.[26]

2.7 Audit

An ideal auditing regime for stablecoin issuers should prioritise transparency, accountability, and market trust by ensuring that stablecoins are always backed 1:1 by HQLA. The regime should mandate regular, independent audits of stablecoin reserves by accredited third-party auditors. These audits should be conducted at least quarterly, with issuers required to publish detailed attestation reports that provide a clear breakdown of reserve holdings, including the types and liquidity of assets held.

2.8 Singleness of money and systemically significant stablecoins

The "singleness of money"—the idea that all forms of money should be uniform and interchangeable—does not need to be directly regulated. Instead, it naturally emerges from a well-regulated and accessible stablecoin market that enforces key principles such as 1:1 backing in HQLA and robust redemption rights. By ensuring stablecoins are fully backed and redeemable at par value, alongside clear regulatory standards for issuers and intermediaries, the market can maintain confidence in stablecoins as a reliable form of money. This approach allows the singleness of money to arise organically through market mechanisms, without the need for prescriptive regulation, while safeguarding financial stability and consumer protection.[27]

Finally, this approach needs to be consistent across regulators. Whilst the Bank of England may well require closer supervision of any organisations in their remit, this should be about applying the same principles and ensuring a consistent approach that avoids any requirement to fundamentally change business model or create a cliff edge for any organisation moving between one regulator and another. The UK should have a single regime for stablecoin, not multiple approaches.

Though financial stability risk mitigation is rightly important, the Bank of England has itself articulated that it does not see any stablecoin close to the thresholds for recognition under its supervision. Nonetheless, a proposed regime that prohibits activities—most tangibly the prohibition of interest—that will be permitted by the FCA, regardless of whether activated over certain firms in the short-term, creates an existential ceiling to the sector's growth. It also stands to put the UK significantly out of kilter compared to other regimes. Our suggestion is that the Bank of England publicly walks back from these proposals and commits to consult on a systemic regime on a longer-term basis. In doing so, the government should be motivated to extend the central bank's innovation objective—of which HM Treasury has publicly committed to do so in future primary legislation—to its remit over digital settlement assets for the purposes of guiding its final proposals on systemic stablecoins' supervision. We would also welcome stablecoins' entry into the Digital Securities Sandbox or another regulatory sandbox, enabled by legislation, to support the Bank of England working with firms to understand clearly the future systemic risk potential stablecoins' pose.

2.9 Governance and Operations

Typical governance arrangements from the Senior Managers and Certification Regime (SMCR) and operational requirements for the wider cryptoasset regime should be applied to issuers. These should be proportionate to the potential risk posed by an issuer. Similarly, any privacy arrangements should be proportionate and in line with other similar instruments.

2.10 Capital requirements

Whereas commercial banks need to be subject to specific minimum capital requirements due to their credit creation role and corresponding fractional reserves model, this should not apply to stablecoin issuers, which are required to maintain 1:1 HQLA reserves backing. Stablecoin issuers do not pose the same risks as banks and it would be inappropriate and unduly punitive to require them to set aside significant amounts of money for risks they do not pose.

The FCA's DP23/4 expressly says that the FCA based its initial thinking on prudential requirements on the Investment Firms Prudential Regime. This would have the immediate effect of requiring stablecoin issuers and custodians to conduct complex calculations, most obviously including K-factors. Should the FCA still intend to place capital requirements on stablecoin issuers, by far the most obvious and proportionate starting point would be the regime for electronic money institutions or authorised payment institutions (the safeguarding regime in the Electronic Money Regulations 2011 and the Payment Services Regulations 2017 being an obvious parallel to the backing assets requirements). Imposing prudential requirements that are both disproportionately onerous (both in absolute terms and in terms of the compliance burden) and not reflective of the risks posed by the relevant business models will inevitably discourage market entry and growth.

2.11 Tax

Stablecoins are not investment products and are not bought for investment reasons. They function more similarly as payment instruments, akin to traditional forms of money (including e-money). GBP-backed stablecoins should therefore not be subject to capital gains tax when used for transactions, which is how HM Revenue & Customs (HMRC) currently treats them. Unlike investment assets, which are subject to capital gains tax or other forms of taxation due to their speculative nature, and corresponding use for investment purposes, stablecoins are designed to maintain a stable value and function primarily as a medium of exchange. By definition, these stablecoins – like fiat currency – are not used for investment purposes but rather to facilitate payments, remittances, and other everyday financial transactions. Taxing stablecoins in the same way as investment assets would create an unnecessary and onerous burden for both users and HMRC, requiring extensive reporting and compliance efforts with little to no fiscal benefit. This would also undermine the utility of stablecoins as efficient payment tools, stifling innovation and adoption in the UK's digital economy.

Further, stablecoin price stability relies on liquid and active secondary markets driven by participants with access to the primary market of direct issuance and redemption. This activity must be encouraged, not punished by incurring tax.

Moreover, treating GBP-backed stablecoins as taxable instruments would introduce complexity and friction into the payment process, discouraging their use and hindering the UK's ability to compete globally in the rapidly evolving digital payments landscape. Just as sterling currency is not taxed when used for transactions, GBP-backed stablecoins should be afforded the same treatment to ensure consistency and fairness. By explicitly exempting such stablecoins as chargeable assets for capital gains tax purposes, the UK can foster a supportive environment for digital innovation, reduce administrative burdens, and position itself as a leader in the adoption of next-generation payment technologies. This approach aligns with the broader goal of creating a competitive and efficient financial ecosystem that benefits consumers, businesses, and the economy as a whole.

2.12 Sectoral clarity

Stablecoins should be explicitly distinguished from e-money, and it should be made clear that they do not fall under the scope of the Electronic Money Directive (EMD) or its UK equivalent. E-money is defined as a digital store of monetary value that represents a claim on the issuer and is used for making payments, with the issuer required to safeguard the corresponding fiat funds received from customers with regulated banks. Stablecoins are fundamentally different in their structure and purpose. They generally do not constitute a bilateral relationship between issuer and holder. In addition, unlike e-money issuers, stablecoin issuers do not typically provide any payment services as stablecoins are a peer-to-peer payment instrument. While used for payments, stablecoins more commonly support other use cases, including in providing a means of exchange for digital asset trading and collateral arrangements. By clarifying that stablecoins are not e-money, regulators can avoid imposing inappropriate regulatory requirements that were designed for a different type of financial instrument. This distinction is crucial for fostering innovation in the stablecoin space while ensuring that stablecoin issuers are subject to a tailored regulatory framework that addresses their unique risks and characteristics.

At the same time, regulators should expressly allow stablecoins to be used as a means of payment in the UK without applying the existing payment services regulation, which is not suitable for peer-to-peer payment instruments. Consideration will still need to be given to consumer protections given that stablecoins exhibit finality. This approach aligns with HM Treasury's updated stance, as announced by the then-Economic Secretary to the Treasury in November 2024, which seeks to balance innovation with consumer protection and aligns with ambitions set out in the National Payments Vision. The use of stablecoins for peer-to-peer payments and also for other purposes such as being a medium of exchange or store of value makes the payment services regulatory regime inappropriate and excessively burdensome. It also creates headaches for secondary market participants in the nascent ecosystem who would be left unclear as to whether handling stablecoins for clients is itself a regulated activity.

By permitting stablecoins to be used for payments, the UK can position itself as a global leader in digital finance, enabling businesses and consumers to benefit from faster, cheaper, and more efficient payment solutions. However, this should be accompanied by clear guidelines to ensure that stablecoin payments are secure, transparent, and compliant with AML and CFT requirements. By creating a supportive regulatory environment that distinguishes stablecoins from e-money while allowing their use in payments, the UK can foster a competitive and innovative financial ecosystem that meets the needs of a digital economy.

In both cases it is important to be clear that multiple different regulatory regimes (e-money and payment services regulation) do not apply to stablecoins, but rather just the new stablecoin regime.

2.13 Financial Promotions

At present, the financial promotions rules for cryptoassets make no distinction between the risk level of different types of products and services. When the FCA introduced the current regime, they committed to keeping it "under review and consider if changes are needed due to market events and as the wider regulatory regime for cryptoassets develops". In 2023, Innovate Finance called for financial promotions rules to be reviewed in light of the development of the authorisation regime, to ensure that lower-risk activities are not treated in the same way as high-risk activities.[28]

With the introduction of a regime for stablecoins, stablecoins should no longer be categorised as high risk investments and 'Restricted Mass Market Investments' and the associated restrictions on how they can be marketed to UK consumers should be lifted. Restrictions such as risk warnings, banning incentives to invest, positive frictions including a cooling off period, client categorisation requirements and appropriateness assessments should all be lifted. None of these is appropriate for a regulated stablecoin, which is not an investment. The continued application of these rules would strangle the development of the UK stablecoin market and adoption.

Therefore, they should be explicitly carved out from the current approach to cryptoasset financial promotions and should be treated similarly to e-money which is also used primarily as a payments instrument. As explained above, unlike investment assets, which are inherently speculative and subject to price volatility, stablecoins are specifically engineered to maintain a stable value pegged to fiat currencies or other HQLA. They function primarily as a medium of exchange, store of value, or payment tool, rather than as vehicles for generating returns or capital appreciation. Requiring stablecoin issuers or service providers to use language that implies investment characteristics would indeed itself mislead consumers and create unnecessary confusion, undermining the utility and adoption of stablecoins as efficient payment instruments.

Furthermore, since stablecoins do not involve the speculative investment of money in the traditional sense—users simply hold them for transactional purposes—imposing such language would be both inaccurate and counterproductive. It could deter users from adopting stablecoins for legitimate payments and remittances, stifling innovation in the UK's digital economy. Regulators should instead focus on ensuring that stablecoins are clearly positioned as payment tools, with appropriate consumer protections and transparency around their stability mechanisms and redemption processes. By avoiding misleading terminology and aligning regulatory language with the true nature of stablecoins, the UK can foster a clearer, more supportive environment for their use, promoting financial inclusion and innovation while maintaining consumer trust.

Stablecoins should therefore be removed from the Financial Promotions Regime: the Financial Promotion regime, governed by Section 21 of the Financial Services and Markets Act 2000 (FSMA), primarily focuses on investments and investment activities and is therefore not relevant to a regulated stablecoin. Stablecoins should be subject only to the "clear, fair, and not misleading" principle of financial promotions. The Consumer Duty and any additional admissions and disclosures rules and guidance should sufficiently cover appropriate consumer information.

Given the potential (under this proposed regime) for issuers to pass on a portion of the yield generated from the stablecoin's backing reserves to their customers, some specific financial promotions regime requirements regarding the yield-bearing nature of the stablecoins could apply to the extent it does to the backing assets in question.

2.14 AML/KYC

Existing approaches to Anti-Money Laundering/Know Your Customer (AML/KYC) are appropriate for stablecoins. AML/KYC requirements do not need to be undertaken on individual holders of stablecoins on an ongoing basis by stablecoin issuers, given that AML/KYC checks will have to happen whenever a regulated financial activity is undertaken including on onboarding with usual intermediaries like Cryptoasset Trading Platforms (CATPs) or for redemption.

The UK should continue to adhere to global Financial Action Task Force (FATF) standards for regulating stablecoins, but without introducing unnecessary additional requirements that could stifle innovation or reduce competitiveness. The FATF standards, which are widely recognised and implemented across jurisdictions, provide a robust framework for addressing AML and CFT risks associated with stablecoins. These standards strike a careful balance between mitigating financial crime risks and fostering innovation in the digital asset space. By aligning with FATF guidelines, the UK can ensure a consistent and internationally harmonised approach to stablecoin regulation, facilitating cross-border interoperability and reducing regulatory fragmentation.

Gold-plating—adding extra layers of regulation beyond what is required by FATF—would create unnecessary burdens for stablecoin issuers and service providers, potentially driving innovation and investment to more accommodating jurisdictions. This could undermine the UK's ambition to become a global hub for digital finance. Moreover, excessive regulation could disproportionately affect smaller firms and startups, limiting competition and reducing the diversity of the stablecoin ecosystem. By focusing on implementing FATF standards effectively and proportionately, the UK can maintain a strong regulatory regime that safeguards against financial crime while supporting the growth of a dynamic and competitive stablecoin market. This approach ensures that the UK remains an attractive destination for fintech innovation without compromising its commitment to financial integrity and consumer protection.

As blockchain analytics develop, the transparency and technological capabilities, including freezing and clawbacks, could lead to improvements in controlling financial crime compared to traditional financial systems. The FCA should monitor this and keep the AML regime under review.

Conclusion

The framework above describes the key points of the ideal regime for stablecoins in the UK. None of this is extreme or liable to explode the financial system. The two areas of major potential for UK competitiveness here described, and where this regime diverges from other jurisdictions' approaches, are international openness and allowing yield-sharing. Openness has always been the UK's way for international finance, while allowing yield-sharing is a design choice that will incentivise adoption by businesses and consumers. These are policy decisions that can be taken quickly by regulators.

Industry believes that this regime will give material benefits to the UK fairly quickly and at essentially no cost. It is time for regulators to get on and put this framework into regulation. That way, the UK can boost its international competitiveness, develop its digital markets with a safe digital asset, and ensure the ongoing protection of consumers and financial stability.

Annex: Secondary legislation - Legislative changes required through Statutory instruments

Due to the structure of UK law in this area, in order to implement the approach set out in this paper some legislative elements need to be updated as Secondary Legislation in Government Statutory Instruments (SIs), namely:

1. Backing assets: Under FSMA 2000, the FCA currently only has the power to make rules creating the statutory trust in CASS for "money". This should be extended to cover the handling of non-cash HQLA that, in our view, should be capable of being used to back stablecoins (e.g. gold). In addition, the regime should permit – where appropriate – backing assets to be held outside a statutory trust. For example, gold or other tangibles could be held through bailment arrangements.

2. Overseas Persons Exclusion (OPE): This exclusion is contained within the Regulated Activities Order. HM Treasury's refusal to extend it to stablecoin risks fragmenting stablecoin market activity due to restrictive location and market access policies.

   Although HM Treasury's rationale for refusing to extend the OPE was that "firms dealing directly with UK retail consumers should be required to be authorised irrespective of where they are located" (see paragraph 4.33 of HMT's response, October 2023), the OPE (as it currently exists) contains limitations which protect UK retail consumers and mitigate the risk of "direct dealing" – because, for the OPE to be applicable, the relevant transaction must be either (a) entered into "with or through" an authorised person or exempt person, or (b) the result of a "legitimate approach".

   Re-evaluating this policy is crucial. The Statutory Instrument should extend the OPE to stablecoins.

3. CATP immunity: The extent of the regulatory responsibilities (and potential liabilities) to be assumed by the operators of CryptoAsset Trading Platforms (CATPs) appear to be closer to the "regulatory

functions" currently discharged by the operators of regulated markets (as recognised bodies under FSMA). Accordingly, on the basis of the "same risk, same regulatory outcome" principle, CATPs should benefit from statutory immunity similar to the protections afforded to recognised bodies under section 291 FSMA.

4. Custodian liability: HM Treasury's Response (October 2023) and, in particular, FCA DP 23/4 suggest that the legislative approach to custodian liability will draw upon the statutory scheme for near strict liability (and the reversal of the burden of proof) in Alternative Investment Fund Managers Regulations (AIFMD) (see paragraph 5.27 of FCA DP 23/4). Instead, the regime should align with that for custody of shares – which would allow custodian liability to be determined by contract, not legislation. To do otherwise risks impeding the growth of the stablecoins market, and may well result in the additional costs associated with providing custody services being passed onto users of stablecoin custody services.

Endnotes

1. World Economic Forum: *www.weforum.org/stories/2025/01/stablecoin-ai-business/*
2. *www.thecityuk.com/media/wrgfylfs/the-digitalisation-of-uk-capital-markets.pdf*
3. *www.spglobal.com/ratings/en/research/articles/250210-stablecoin-regulation-gains-global-momentum-13400761#:~:text=Stablecoins%20have%20become%20a%20significant,early%202025%20(see%20chart)*
4. *www.bankofengland.co.uk/-/media/boe/files/paper/2024/the-boes-approach-to-innovation-in-money-and-payments.pdf*
5. For example: *www.ft.com/content/c3259063-8b35-4a04-b571-0eaf78146830*
6. EG USDC's recent approvals in the UAE and Japan. *99bitcoins.com/news/usdc-booms-as-circle-gets-approval-to-operate-in-japan-and-uae/*
7. Financial Services and Markets Act 2023. *www.legislation.gov.uk/ukpga/2023/29/contents*
8. EG since Sunak as Chancellor and Prime Minister to Rachel Reeves' recent moves with Digital Gilts. *www.gov.uk/government/news/government-sets-out-plan-to-make-uk-a-global-cryptoasset-technology-hub and www.bloomberg.com/news/articles/2025-03-18/uk-chancellor-reeves-invites-fintech-firms-to-test-digital-gilts?srnd=phx-crypto*
9. *www3.weforum.org/docs/WEF_Digital_Currency_Governance_Consortium_White_Paper_Series_2021.pdf*
10. *www.bis.org/cpmi/publ/d187.pdf*
11. USDT Issuer Tether Ranks Among Top Foreign Buyers of U.S. Treasuries in 2024, Firm Says. *www.coindesk.com/business/2025/03/20/tether-ranks-among-top-foreign-buyers-of-u-s-treasuries-in-2024-firm-says*
12. *www.spglobal.com/ratings/en/research/articles/250210-stablecoin-regulation-gains-global-momentum-13400761#:~:text=Stablecoins%20have%20become%20a%20significant,early%202025%20(see%20chart)*
13. Indeed the Government's plans for a Digital Gilt would be improved by having access to a stablecoin as a digital settlement asset. Something which is currently precluded by the design of the Digital Securities Sandbox.
14. *www.fca.org.uk/firms/innovation/digital-securities-sandbox*
15. *questions-statements.parliament.uk/written-statements/detail/2024-11-18/hlws224*
16. *www.legislation.gov.uk/ukpga/2023/29/part/1/chapter/2/crossheading/digital-settlement-assets*
17. *www.bankofengland.co.uk/-/media/boe/files/paper/2023/the-digital-pound-consultation-working-paper.pdf*

18. www.santander.com/content/dam/santander-com/en/documentos/notas-de-prensa/2019/09/np-2019-09-12-santander-launches-the-first-end-to-end-blockchain-bond-en.pdf
19. www.theia.org/sites/default/files/2023-11/UK%20Fund%20Tokenisation%20-%20A%20Blueprint%20for%20Implementation.pdf
20. www.gov.uk/government/publications/a-new-approach-to-ensure-regulators-and-regulation-support-growth/new-approach-to-ensure-regulators-and-regulation-support-growth-html#annex-a-key-regulator-pledges, March 2025
21. EG from the then Economic Secretary to the Treasury.
22. It can also be mitigated by permitting delayed redemption timeframes, contrary to some risk-increasing regulatory proposals for widespread rights to rapid redemption.
23. www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money
24. As indeed increasingly is UK trade post-2016: Selling England (no longer) by the pound: currency-mismatches and the dollarisation of UK exports – Bank Underground
25. MICA imposes a requirement for universal on-demand redemption. This has proved to be somewhat of a farce, as issuers impose onboarding and KYC conditions that effectively limit redemption to larger institutions and secondary market participants anyway. Meanwhile it is not clear that it has had any notable positive effect on stablecoins' price stability or consumer protection. However, an analysis of MICA is not within scope of this paper.
26. Both Innovate Finance and the DPF responded recently to the FCA Discussion Paper on Admissions and Disclosure which covers this topic in depth: see www.innovatefinance.com/consultation/fca-discussion-paper-dp24-4-regulating-cryptoassets-admissions-disclosures-and-market-abuse-regime-for-cryptoassets/ and digitalpoundfoundation.com/response-to-dp24-4-regulating-cryptoassets-admissions-disclosures-and-market-abuse-regime-the-discussion-paper/
27. For more discussion on the Singleness of Money, please refer to this paper: www.kcl.ac.uk/news/stablecoin-regulation-and-the-singleness-of-money
28. www.innovatefinance.com/consultation/fca-guidance-consultation-gc23-1-guidance-on-cryptoasset-financial-promotions-innovate-finance-response/

About Us

About Innovate Finance

Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. Our mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators. When engaging the government and regulators, we aim to reflect the UK FinTech ecosystem and specifically the needs of start-ups, scale-ups and high growth enterprises.

The Digital Pound Foundation, Innovate Finance

The Digital Pound Foundation (DPF), an Innovate Finance programme since completing a merger in February 2025, is dedicated to advancing the UK as a leading global centre for development and adoption of new forms of digital money, including stablecoins, central bank digital currencies (CBDC) and tokenised deposits. It is a member-led forum supporting a diverse, effective and competitive ecosystem for new forms of digital money in the UK and globally and the development of a legal, regulatory and political landscape that enables the UK to embrace opportunities to become a leader in the FinTech space.

The DPF's members include Accenture, Agant, Avalanche, Chavanette Advisors, ClearBank, CMS, Enryo, Fireblocks, KodeLab, LINK, NOBO, Quant, Payment Systems Consultancy, Ripple, SETL, Tokenised GBP and Travers Smith.

Acknowledgements

Dr Andrew Whitworth

Andrew Whitworth is a researcher and advisor on digital asset policy. He is an Adjunct Professor at IE University in Madrid, a Visiting Fellow at the European University Institute, and founder of Global Policy LTD, a UK-based crypto, fintech and tech policy advisory company. Previously, he worked at the Bank of England, as EMEA Head of Policy at blockchain company Ripple, and for a UK FinTech startup. He has published *Regulating banks: the politics of instability* and *How to understand MiCA: A policy guide to the EU's cryptoasset Regulation for people in Web3, finance and the law*.

Get in touch with us

Adam Jackson

Chief Strategy Officer,
Innovate Finance

adam@innovatefinance.com

Claire Conby

Head of Digital Pound Foundation,
Innovate Finance

claire.conby@digitalpoundfoundation.com

INNOVATE FINANCE

Innovate Finance policy team:

policy@innovatefinance.com

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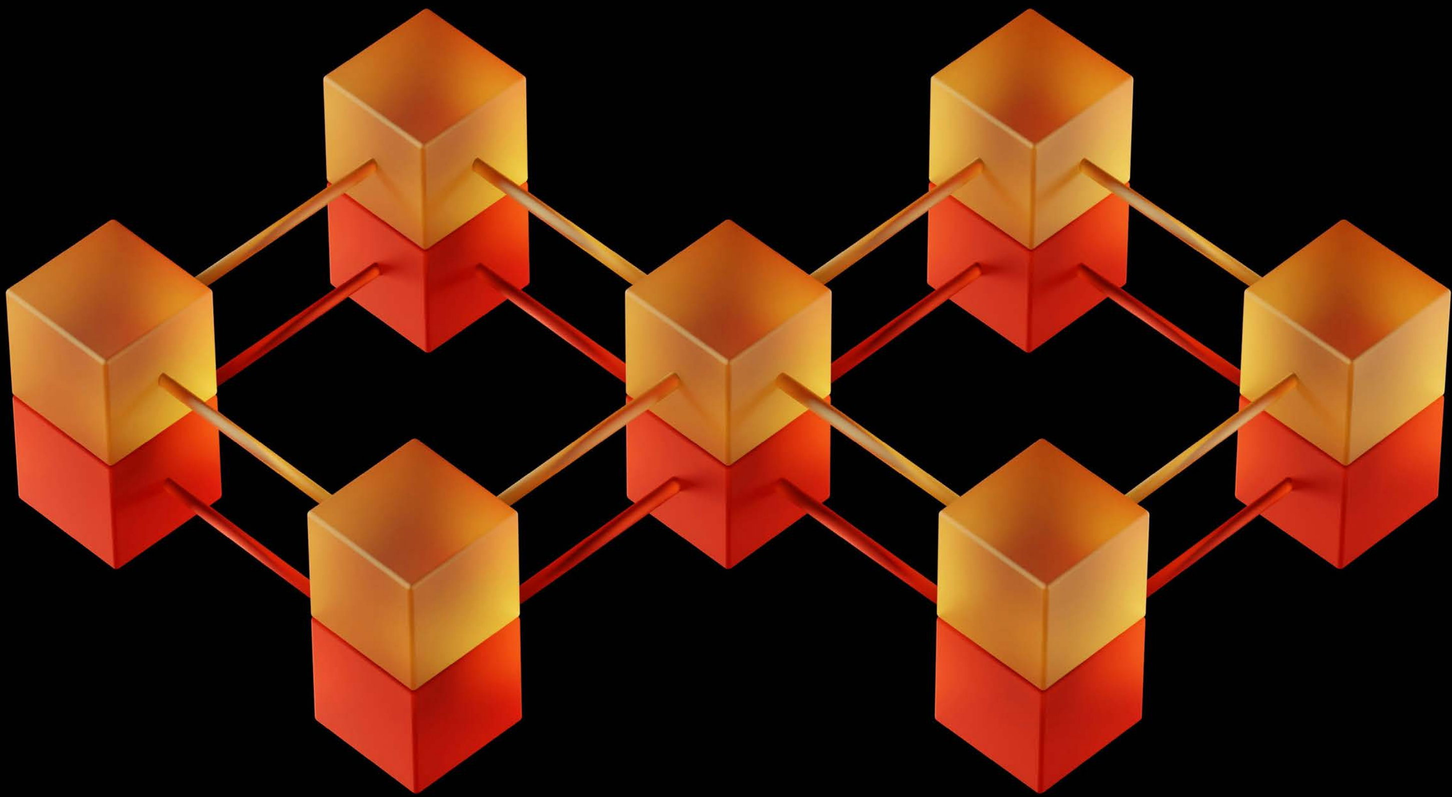

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