Consultation Response

FCA's Consultation Paper 25/14: Stablecoin issuance and Cryptoasset Custody

July 2025

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **CP25/14: Stablecoin issuance and Cryptoasset Custody**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

AFME is highly supportive of the FCA's Consultation Paper CP25/14: stablecoin issuance and cryptoasset custody. Our response focuses on following key aspects of the proposed regime to help position the UK as a global leader in transparent, efficient, and fair cryptoasset markets. In particular, we note the importance of:

- **Clearly defining "qualifying cryptoassets":** with reference to the draft Statutory Instrument to implement the UK's cryptoassets framework, we reiterate the importance of avoiding an expansive definition of "qualifying cryptoassets" and clearly delineating between tokenised traditional assets and cryptoassets. Otherwise, the new regulatory regime would risk creating uncertainty for - and undermine - the growth of DLT-based capital markets in the UK.
- **Supporting participation by existing financial institutions:** we generally view that the FCA's proposals are drafted for new entrants rather than existing credit institutions, and that they should adequately reflect the role of the latter in this ecosystem as provided for by similar international regimes. Banks' existing capital, liquidity, and risk management expertise makes them suitable as stablecoin issuers and cryptoasset custodians. In line with international regimes (such as the EU's MiCA), existing credit institutions should be permitted to issue stablecoins and custody cryptoassets without additional authorisation. Such institutions should also be allowed to custody backing assets for stablecoin issues within the same regulated banking group.
- **Promoting consistency between traditional and digital asset custody regimes:** as a matter of priority for market functioning, the rules need to consider how existing global custodian, prime brokerage and related intermediated custody models, which are common in wholesale capital markets, might be leveraged for the custody of qualifying cryptoassets. In order to allow for indirect custody, we therefore encourage the FCA to closely align its cryptoasset custody proposals with the existing regime. Without such changes, the rules would restrict the ability of custodians to appoint third-party custodians, discourage participation by established custodians and financial institutions, and ultimately undermine market development.
- **Encouraging coordination and interoperability with international stablecoin regimes and upcoming systemic stablecoin regulation from the Bank of England (Bank):** the proposals do not thoroughly consider the cross-border fungibility of UK stablecoins and the possibility for foreign

Association for Financial Markets in Europe
London Office: Level 10, 20 Churchill Place, London E14 5HJ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540
Frankfurt Office: c/o SPACES - Regus First Floor Reception Große Gallusstraße 16-18 60312 Frankfurt am Main, Germany T:+ 49 (0)69 710 456 660
www.afme.eu

issuance. To maximise the potential of developing global markets, we view that the rules should at a minimum ensure interoperability between key jurisdictions with robust regimes seeking to deliver the same outcome (e.g. US GENIUS Act, EU MiCAR). In addition, given that the industry awaits the Bank's proposals on systemic stablecoins, we urge the FCA to retain flexibility and ensure stakeholders can evaluate the regime holistically once the full regulatory picture is available.

- **Addressing other technical features of the regime:** on the requirements for stablecoin issuance, we recommend clarifying requirements around disclosures, shortfall notifications, and reconciliation timelines to ensure they are proportionate and practically achievable. On cryptoasset custody, the requirements on the use of trust structures and asset segregation should reflect operational realities and market practices and provide sufficient flexibility.

AFME remain committed to supporting a coherent and competitive UK regulatory framework for stablecoins and cryptoassets and stand ready to continue engaging with the FCA to refine these proposals and ensure their effective implementation.

Questions

Stablecoins

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?

Yes, we support the introduction of additional requirements for qualifying stablecoin issuers. This is essential to ensure that stablecoins are fully backed and appropriately regulated, given the fast moving and technical nature of the product. As the banking industry, we believe robust conduct, redemption, and safeguarding standards will reinforce monetary stability and foster public trust. Given their experience in capital, liquidity, and risk management, authorised credit institutions are well placed to act as stablecoins issuers. In line with frameworks in other jurisdictions (including the EU's MiCA regime), we view that authorised credit institutions should not have to obtain additional authorisation to issue stablecoins.

However, we note that in the absence of the Bank's proposals for the treatment of systemic stablecoins, it is difficult to fully assess the appropriateness of the FCA's current proposals. The industry will need the ability to opine on the framework holistically once the Bank's proposals are published, and how the FCA's and Bank's proposals would interact with each other. The prudential regime also needs to be sufficiently accommodating of authorised credit institutions pursuing stablecoins issuance.

In addition, we also note that a key gap in the current proposals is provisions surrounding Anti-Money Laundering (AML). While this may be covered in the FCA's planned upcoming consultation, we would like to emphasise the importance of a strong, clear AML framework for all market participants. For example, the FCA should clarify its expectations with regards to credit institutions' AML obligations with respect to holding backing assets in bare trust by issuers for unidentified beneficiaries. Holding funds in bare trust without identifying beneficiaries at all times may make it difficult for issuers to hold backing assets in form of deposits with credit institutions outside the UK.

An additional key element will be setting proportionate expectations in relation to AML on the chain of counterparties, such as how many "hops" need to be assessed. In order to provide alignment with traditional financial services, the boundary of this analysis will need to be clearly defined, and where this boundary is

drawn will be critical for the growth of cryptoassets in the UK. Furthermore, there are specific considerations for both stablecoin issuance and cryptoasset custody, which we address throughout our response.

2. Do you agree that issuers of multi-currency qualifying stablecoins should be held to similar standards as issuers of single-currency qualifying stablecoins unless there is a specific reason to deviate from this? Please explain why?

Yes, we largely believe that multi-currency qualifying stablecoins should be held to similar standards. In addition, we note that multi-currency stablecoins may entail more FX and operational risks, as well as complexity for custodial services and capital monitoring. At a minimum, equivalent regulatory treatment is necessary to prevent arbitrage and protect systemic integrity. As a solution, we suggest considering phased or conditional approvals for well-structured products.

We note that the draft Statutory Instrument limits the definition of "qualifying stablecoins" to cryptoassets that reference a single fiat currency. However, the above considerations remain relevant for the future.

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

Yes, we broadly support the backing asset requirements and also the proposal to expand eligible backing assets. In general, backing asset requirements should help preserve liquidity and minimise contagion risk. We support the proposal to limit backing assets to highly liquid, creditworthy assets to mitigate redemption risk, support stability and compliance to protect the singleness of money. Given that the list of eligible backing assets is already low-risk, secure and liquid, we believe the requirement to notify the FCA before expanding backing assets adds limited benefits and would delay the ability of issuers to respond to market conditions timely. It would be sufficiently prudent to require that issuers document their backing asset selection approach upfront to support appropriateness. Furthermore, we would also support the FCA to clarify that the eligibility for backing assets is technologically neutral, such that the assets can include tokenised forms of eligible assets, including the future Digital Gilt.

In the context of the Bank's forthcoming regime, we would also be supportive of a significant stablecoin regime under certain circumstances, for example similar to what is permitted under the e-money token (EMT) regime in EU MiCAR. Backing mechanisms should include high quality liquid assets (HQLA) and deposits in the case of financial institutions (as it is today in prudential regulation for backing balance sheet lending activity portfolios).

More broadly in an international context, we also recognise that greater regulatory alignment on use of stablecoins, backing asset requirements and redemption rights is needed between jurisdictions to allow for cross-border interoperability, issuance, and use. We would highly support the FCA to work collaboratively with the international regulatory community to align requirements.

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.

Overall, we are supportive of the proposed time horizons for managing qualifying stablecoin backing assets. Conservative parameters are appropriate to support real-time redemption and smooth liquidity management.

Banks' experience in stress testing, asset and liability management and liquidity planning makes them well suited to implement this prudently.

However, we would note that the current proposals focus on the redemptions during what may be a Business-As-Usual period. In practice, this may be extremely low if the majority of stablecoin transactions occur in the secondary market. The FCA may wish to consider the inclusion of some form of stress to ensure that stablecoin issuers are able to maintain redemption during stress periods.

In addition, regarding the remuneration of stablecoins – currently the restriction on remuneration of stablecoins set out in CASS 17 16.2.13 is limited to the issuer, and only in relation to the proceeds of the backing asset pool. To fully deliver on the policy objective, the FCA should consider broadening this restriction to include remuneration from any source, and remuneration by third parties, and close any loopholes to prohibit the granting of interest to stablecoin holders.[1]

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

We would query what a 'dynamic approach to holding backing assets' specifically entails in this context. We are generally supportive of 1) fully holding backing assets, and 2) bank-based issuers being able to draw on banking-grade risk models and compliance systems to monitor redemptions and ensure asset-liability parity.

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

We do not generally view that a qualifying stablecoin issuer should be able to hold backing assets in currencies other than the one the qualifying stablecoin is referenced to. Single-currency referencing should be matched by single-currency reserves to preserve redemption certainty and avoid FX mismatch. Multi-currency backing can introduce volatility, challenges to issuer quality and potential risks of contagion between jurisdictions in stress.

To further illustrate, the use of backing assets in different currencies to the stablecoin introduces additional FX risk in exchange for a broader range of possible assets. It is likely that the cost-benefits are not commensurate with the additional complexity in managing these FX risks, and exposure to a greater range of risks may reduce confidence in these organisations. Similarly, allowing cross-currency backing would allow the backing of e.g. GBP stablecoins with e.g. short-dated US Treasuries. This would introduce additional contagion risk between the UK and other jurisdictions.

However, we view that multi-currency backing can be explored if there are more restrictions on backing asset requirements. This can help provide greater flexibility for issuers going forward, so long as the risks are appropriately managed.

[1] For example, we note that some loopholes around this requirement that can be envisaged include circumstances where once an issuer has retained the proceeds from the backing asset pool - this will simply be the cash reserves of the issuer and in theory could be passed on to holders of the stablecoin. Or, for instance, an issuer of multiple stablecoins could remunerate holders of one stablecoin with the proceeds from the backing assets of another stablecoin. Similarly, in other jurisdictions where restrictions on the issuer remunerating holders of stablecoins have been enacted, some issuers have explored the use of third parties to channel disbursements to get around this this restriction.

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.**

In principle, yes. However, the precise impact of any statutory trust would not be clear until the terms of that trust are known. Alignment with the statutory trust in the FCA's client money rules (e.g. CASS 7), with any necessary amendments for securities and repo, could provide a useful precedent.

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.**

Yes. Fully backing even issuer-held tokens is fundamental to maintaining systemic confidence, especially during operational disruptions. This prevents reserve dilution and aligns with prudential expectations. The backing assets should be kept in safeguarding accounts provided by regulated financial institutions or custodians to mitigate potential risks.

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?**

While we agree with the policy intention of the proposal to require the appointment of third parties to safeguard the backing asset pool, we do not agree that this requirement should apply to stablecoin issues that form part of a regulated banking group. The requirement for a stablecoin issuer to use a third-party bank/custodian unconnected with its group could potentially dissuade large banking groups from establishing a stablecoin issuer in the UK. It also does not seem to provide additional assurance to stablecoin holders.

To further illustrate, where a financial services group contains an entity providing banking or custody services, that bank/custodian will be regulated for the provision of banking and custody services and subject to requirements to protect customer's assets in the event of the insolvency of the bank/custodian. We do not consider that requiring the third-party bank/custodian to be in a separate group from the issuer necessarily will provide stablecoin holders with additional protection.

We note the FCA's existing custody rules (CASS 6) do not prohibit UK custodians from depositing client assets third parties located in the same group. Similarly, the CASS 7 client money rules permit investment firms to hold client money with members of the same group subject to a limit of 20%. In addition, EU MiCAR does not impose a general prohibition on ART issuers using group-affiliated custodians. We query why a different position would be taken for stablecoin issuers within the same regulated banking group under the FCA regime.

Furthermore, we support that the Bank will make explicit provisions for regulated banking groups to custody assets backing stablecoin issues within the same group.

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?**

Yes – to the extent the reserve backing assets are held by the stablecoin issuer on trust, a signed trust acknowledgement letter could be helpful for: (i) establishing the status and treatment of the relevant backing funds/assets account(s) maintained by the third-party bank/custodian following the failure of the stablecoin

issuer; and (ii) ensuring the stablecoin issuer and the third-party bank/custodian understand their key rights and obligations in respect of the relevant account(s).

However, the FCA should align the proposed acknowledgement letter templates in CASS 16 Annexes 1 and 2 with the existing acknowledgement letter templates in CASS 7 Annex 2R, CASS 11 Annex 1, and CASS 13 Annex 1, or clearly explain the policy rationale for any substantive difference between these templates.

For example, paragraph (f) of the existing acknowledgement letter templates (in CASS 7, 11 and 13) contemplate that the current/deposit account provider to the CASS firm (i.e. the third-party bank that accepts the relevant client money on deposit from the FCA-regulated investment firm, debt management firm or claims management firm) may obtain a contractual right to retain sums recorded to that current/deposit account until any properly incurred charges or liabilities owed to the account provider, and arising from the operation of the account, are satisfied.

By contrast, a cash/securities account provider to a qualifying stablecoin issuer (i.e. the third-party bank/custodian that has accepted on deposit/into custody the relevant cash or securities comprising the issuer's backing assets pool) would appear to be required to waive any similar contractual right of retention over the assets under paragraph 6 of the proposed acknowledgement letter templates (in CASS 16).

The policy rationale for this difference in treatment of the same third-party account provider services to an FCA-regulated firm under CASS 7, 11 and 13 versus under proposed CASS 16 is unclear. As is the position for the services banks provide CASS firms under CASS 7, 11 and 13 today, we expect that third-party banks and custodians may decline to open backing funds/asset accounts, to accept money on deposit or take securities into custody, for a qualifying stablecoin issuer if the bank/custodian is not allowed to retain an amount equivalent to any sums owed to it from operating that account at least on the failure of the issuer (as the account holder).

11. Do you agree with our proposals for record keeping and reconciliations?

Yes. Robust recordkeeping and daily reconciliation are fundamental to custody, transparency, and operational soundness — all areas where banks bring established capabilities. However, rather than requiring reconciliations to take place "within" a 24-hour window, we view that doing so on a daily basis would be preferred from an operational perspective.

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

Yes. Prompt discrepancy resolution supports trust and preserves liquidity. Burn/reback requirements provide assurance of ongoing 1:1 parity, essential for maintaining market confidence.

Clear industry guidelines for shortfall coverage and regulatory notifications if the shortfall cannot be recovered within 1 business day (e.g. to set a buffer, such as 2-3%, to deal with any unexpected shortfall) will be important.

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?

Yes. T+1 redemptions are appropriate and consistent with expectations for money-like instruments. This supports liquidity access for all holders and limits potential destabilising withdrawal behaviour. Beyond this it is possible that in the future, on-chain mechanisms facilitate T+ 0 as an achievable standard.

However, we also note that there are certain operational burdens associated with this requirement. We therefore encourage a degree of flexibility in the application of rules to ensure that risks such as fraudulent requests can be managed effectively.[2]

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?

Yes. Redemption rights must transfer with ownership to protect end-users, especially when stablecoins circulate in secondary markets or wallets outside the issuing platform. If available in secondary markets, issuers should ensure sufficient liquidity for potential redemptions at par.

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?

Yes. Third-party agents should be used under strict contracts with issuer oversight. Accountability must stay with the issuer — a key tenet in any standalone or consortium-based issuance framework. However, we would clarify that provision of liquidity in the secondary market, e.g. through market-making agreements, should not be considered as outsourcing of the functions of the stablecoin issuers.

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?

Yes. Independent audit of backing disclosures enhances market discipline and transparency. For banks, this complements internal audit and compliance processes already in place.

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

Yes. Regular public disclosures on asset composition, policies, and issuer structure increase market trust. In particular, we note that prospective bank issuers would be well-positioned to deliver on these via existing governance and reporting systems.

However, we note that the current proposals for disclosure of the number of stablecoins and the value and breakdown of backing assets on the basis of when this data becomes inaccurate could lead to complexity. The FCA does not appear to parameterise the degree of inaccuracy or the frequency – this could lead to significant deviation and inconsistency across the market as well as a high frequency of updates being driven by immaterial changes in the value of backing assets. Therefore, we view it may be simpler to require daily disclosure of value, to align with reconciliation requirements.

[2] For example, the rules should cate for avoiding the exacerbation of run risks if competitors / malicious organisations ask for redemptions of small amounts, especially given that any user is able to request redemption. In order to address this risk from bad actors, it may be necessary to introduce a mechanism to allow stablecoin issuers to suspend redemptions for a specific counterparty or individual, or to cluster redemptions in some fashion, on a targeted basis.

Furthermore, we would suggest that the FCA set out more specific requirements for a more granular disclosure of the type of assets in the backing pool. Currently the FCA requires that this disclosure give value and % by type of asset. It is unclear exactly what granularity is meant by the asset type e.g. whether this just means "Cash" and "Short dated sovereign bonds", or if there should be a breakdown by the issuing sovereign and the remaining tenor on the bond. Including this degree of breakdown would be helpful to support trust in the stablecoin and support the singleness of money.

Custody of cryptoassets

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?

Yes, prescribing specific rules for the custody of qualifying cryptoassets is appropriate. However, given that dual-regulated credit institutions are already subject to rigorous regulatory and supervisory expectations (covering prudential, conduct, and AML requirements), we do not view that such institutions should require new authorisation to undertake activities as qualifying cryptoasset custodians. Instead, a streamlined variation of permission notification should be made available for these institutions to undertake the custody of qualifying cryptoassets, with approval provided within a limited time period. This would put the FCA's regime on par with the notification regime under EU MiCAR for existing credit institutions.

Furthermore, it is important that rules on client assets are applied consistently across cryptoassets and traditional assets, and that the FCA retain optionality and flexibility in the application of different forms of client asset rules. In this context, we note that the current proposals deviate significantly from the FCA's existing custody rules in CASS 6 in multiple areas, with no explanation as to why these deviations are necessary or appropriate. Our view is therefore that requirements for the custody of cryptoassets should be aligned with those for custody assets in CASS 6 to the greatest extent possible. We note that introducing a new CASS chapter for custody requirements for cryptoassets could significantly increase the compliance burden for firm's already subject to CASS 6, particularly given the already substantial cost associated with CASS audits.

Finally, it is important to acknowledge that "custody" can encompass a wide range of operational models, including traditional securities custody, digital asset safekeeping, and complex custody chains. Any regulatory framework should be sufficiently flexible to accommodate these diverse models while maintaining strong client asset protections.

These issues could be addressed through a number of mechanisms, with the addition of specific changes addressed in our responses to other questions. We envisage the following possible solutions:

1. Explicitly incorporate the activity of safeguarding qualifying cryptoassets into the scope of CASS 6, with specific additions for the treatment of features unique to cryptoassets (such as key management). To avoid unnecessary complexity, we recommend that the FCA consider whether enhancements can be delivered within the existing CASS 6 framework, or potentially as an extension of CASS 7, depending on the nature of the activities in scope. For firms currently subject to CASS 6 and undertaking Article 40 activities, it would be more proportionate and operationally efficient to incorporate any new requirements directly into CASS 6 (e.g. by adding and disapplying existing CASS 6 requirements, as relevant), rather than introducing a wholly separate chapter. Where established firms already offer traditional custody, the additional burden and cost should be minimised to avoid disincentivising these firms from offering cryptoasset custody.

2. Presumed compliance for CASS6 firms with respect to CASS 17, combined with a streamlined CASS 17 authorisation process for CASS 6 firms. If the FCA retains a version of CASS 17 separate from CASS 6, we think that cryptoasset custodians who also safeguard and administer investments (e.g. under Article 40 RAO) should be able to opt-in to safeguard qualifying cryptoassets in accordance with CASS 6 (subject to any necessary modifications) (e.g., similar to the opt-in to the CASS 7 client money rules for all of a firm's activities involving client money, where that firm holds client money both in the context of insurance intermediary activities subject to CASS 5 and in the context of investment business subject to CASS 7)(see CASS 7.1.3R and 5.1.8G). The objective would be to ensure relevant firms subject to both regimes are not required to duplicate their CASS supervisory, compliance and audit arrangements twice for the same activity (e.g., protecting client assets).
3. For crypto-native firms, there may be a case for aligning custody arrangements with CASS 17, given the nature of custody in a digital asset context. However, we believe there is merit in consolidating all custody-related requirements—regardless of asset class—within a single, coherent chapter of the CASS regime. This would promote clarity, consistency, and ease of application across firms.]

With regards to the FCA's proposals, we also note the following issues requiring clarification:

- The FCA should clarify that a wallet is an "account". Similarly, we would expect the industry to treat such 'client-specific records' in a manner consistent to a traditional custodian's books and records.
- There is no clarity on how existing CASS rules would be adapted to apply to the custody of fiat cash in the context of distributed ledger technology (DLT) platforms, which we believe should be clarified. In particular, clients typically do not own interests in omnibus accounts—ownership arises in segregated arrangements. Where intermediaries are maintaining keys or digital wallets on behalf of clients, this may be done on an omnibus basis, but the underlying assets must still be maintained on a segregated basis from the firm's own assets and those of other clients.
- Further clarity is needed around how far up the custody chain CASS 6 applies. For example, the FCA should provide clarity that CASS 6 applies only to the intermediary maintaining a direct relationship with the client.

Beyond the specific proposals, we would also like to reiterate our concern that under the draft SI being finalised (to provide for the statutory framework of the FCA's rules), 'safeguarding' carries an expansive definition that needs to be narrowed and clarified to avoid capturing activities that should not be considered as such.

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?

Generally, we view that clients should be given the power to choose omnibus and fully segregated accounts, in line with existing CSDR. This principle of choice is key to client protection and aligns with broader regulatory trends across financial services.

Under English common law, trust structures (express or implied) have long been used to establish and maintain a clear link between clients and their assets. In principle, we understand the potential benefits for applying a non-statutory express trust model to qualifying cryptoassets held by custodians. However, there

are alternative legal structures to an express trust that could achieve equivalent client protection, such as through the use of nominee or orphan holding structures.

Additionally, we view that there could be unintended consequences from the FCA's proposal to mandate the use of an express trust structure, particularly without broader legal consensus. There is currently no clear guidance from law firms or insolvency practitioners supporting a mandate for the use of an express trust, and we caution that unintended consequences may arise.

We also question whether the risks associated with the custody of cryptoassets differs materially from the custody of traditional assets and whether sufficient policy justification has been presented for diverging from the existing, well-functioning framework for asset segregation. Corporate nominees and similar orphan holding structures could also provide viable options.

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?

We recommend that the FCA avoid prescribing a single trust structure. Both individual or collective/omnibus trust and account/wallet structures, as proposed, should be permitted. A flexible, outcomes-based approach would be more appropriate, allowing firms to choose the structure most suited to their business model and legal framework - provided the arrangement delivers effective segregation, clear client entitlements, and compliance with regulatory objectives.

Where relationships are not governed by English law, the regulator should allow regulated firms to determine adequate legal structures, which may or may not include a trust. In cross-border contexts, we view that requiring English law trust arrangements may be impractical or even unenforceable, and may pose challenges in terms of inter-jurisdictional liabilities.

Ultimately, what matters is not the form of the trust or alternative legal structure, but that clients retain enforceable property rights and are adequately protected, particularly in an insolvency scenario. The content of the notification letter to clients may be a more effective tool for ensuring clarity and protection than mandating a specific trust form, whether individual or omnibus.

iii. Do you foresee any challenges with firms complying with trust rules where clients' qualifying cryptoassets are held in an omnibus wallet?

As above, the FCA should clarify that use of an omnibus wallet does not negate the requirement to maintain client-level segregation on a notional or beneficial basis.

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?

Innovation in wallet structures, should be supported rather than constrained. Rigid trust requirements may inadvertently discourage or prevent the adoption of innovative custody solutions, especially those that are designed to improve transparency, control, and compliance.

The regulatory framework should remain technology-neutral and outcomes-focused, ensuring client protection without prescribing how custody must be achieved.

Trust structures may be one viable approach, but should not be the only permitted solution, particularly as the digital asset ecosystem continues to evolve.

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?**

We generally agree with the requirements, but have observed several challenges.

In draft CASS 17.5.4R(3)(b), the FCA proposes requiring custodians to keep client-specific qualifying cryptoasset records which specify, among other things, the nature of the client's "claim against the custodian in respect of the qualifying cryptoasset". According to draft CASS 17.5.5G(2), a firm may 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. We question whether "claim" is the appropriate terminology in the context of a trust structure, or otherwise, where the client has proprietary rights in relation to the cryptoassets held by the custodian. In such cases, the client's rights are more accurately described as beneficial entitlement. By using the word "claim", the draft rules could be interpreted as characterising the client's right as a personal one against the relevant firm. We encourage the FCA to reconsider how these rights are described in its rules in order to more accurately reflect the legal nature of the relationship and the protection that the CASS rules are intended to provide.

We would also support that the FCA consider firms to be able to fulfill their primary record requirements through the use of DLT. If the DLT-based record is considered the primary record, then we would assume that existing practice to complete reconciliations by the end of the day remains. Additionally, in draft CASS 17.5.2R, the FCA proposes that a custodian must keep such records as necessary to enable it at "any time and without delay" to distinguish assets held for one client from assets held for another and for asset held for clients from assets held for the firm. Draft CASS 17.5.3R states such records must be accurate "at all times". It is not clear what "at any time and without delay" and "at all times" mean or whether this is practically achievable. For example, a custodian would not typically be expected to update its independent internal records over the weekend, especially if such records are independent of the DLT in which the relevant assets are recorded. In the context of cryptoassets, a wallet may receive an 'air drop' where tokens are paid into a wallet without instruction from the wallet holder, which would require investigation by the custodian prior to updating its books and records.

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.

In principle, yes. Daily reconciliations and structured shortfall remediation are prudent and expected in a bank-managed custody service. These should mirror traditional asset safeguarding standards. However, we do support further clarifications with regards to the rules on addressing shortfalls as follows, and generally to ensure consistency with current notification requirements:

- *Treatment of shortfalls*: It is unclear whether proxy assets/money can be held in lieu of the shortfall. This should be explicitly included as an option per CASS 6 as it may not be possible to obtain the same asset e.g. due to liquidity. For example, proposed CASS 17.5.14(3)(a) would allow a firm to resolve a

shortfall itself by "using its own resources". We would suggest, similar to the position established in CASS 6.6.54R, that relevant cryptoasset custodians be explicitly allowed in the rules to cover a relevant shortfall by segregating their own assets and money as client assets (e.g., subject to CASS 6, or 7 or 17, as applicable) and the firm's own assets should not need to be the same type or kind of qualifying cryptoasset (which it may not be possible for the custodian to source at the time of the shortfall, e.g., due to liquidity).

- *Timeframes for resolving shortfalls*: CP 25/14 proposes requiring cryptoasset custodians to decide whether to resolve any shortfall "immediately". The equivalent rule in CASS 6 requires firms to "promptly" investigate the reason for the discrepancy and resolve it "without undue delay". The investigation and resolution may take more than one day. It is impractical for firms to make a decision to resolve a shortfall immediately without having sufficient time to investigate. This would allow firms more flexibility to investigate and resolve which may be required when dealing with complex digital asset custody arrangements that may involve multiple wallets, sub-custodians or technological challenges unique to distributed ledger technology.

- *Shortfall notifications*: In terms of the timeframes for shortfall notifications, CP25/14 proposes requiring firms to notify the FCA and clients about shortfalls "immediately". The notification must set out, among other things, the reasons for the shortfall, the number of clients affected and the timeframe for resolving the shortfall. It is impracticable for firms to make these notifications immediately. There is no corresponding timeframe for similar notifications under the existing CASS 6 regime. We think that the existing flexibility under CASS 6 should also apply to the cryptoasset shortfall regime. By comparison, the FCA's proposed operational incident reporting regime (CP24/28) would require initial incident reports to be made "as soon as is practicable" after a crystallised operational incident has breached a threshold. Adopting a similar approach to cryptoasset shortfall notifications would allow cryptoasset custodians more flexibility to respond to shortfalls appropriately, and promote consistency and clarity for market participants.

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

Yes. Strong internal controls and governance are foundational to safe cryptoasset custody. We note that regulated credit institutions already meet these organisational arrangements and can integrate them with minimal friction.

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

Although AFME members agree with the principle of ensuring adequate protection of the means of access, the proposed CASS 17.4.5R requiring 'robust security and organisational arrangements' is likely to be interpretated broadly by auditors, which could have the unintended consequence of extending the CASS audit to the entirety of a firm's IT security arrangements and control environment. This is also duplicative of CASS 17.2.3R. We suggest the scope of this rule should be more narrowly defined. Any new minimum regulatory standards regarding IT security and control arrangements, if required, should sit elsewhere in the FCA Handbook (for example under the requirements for ICT risk management).

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?

Yes, we are strongly supportive of the proposed approach.

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?

No. While we support the FCA's goal of ensuring appropriate controls over third-party arrangements, we think the FCA's draft rules for appointing third parties to safeguard cryptoassets (proposed CASS 17.6) should be aligned with the FCA's existing custody standards for depositing assets with third parties (i.e. CASS 6.3).

The requirements in proposed CASS 17.6 are highly restrictive and deviate from CASS 6 in a number of key areas with no explanation as to why the deviations are required. Restricting the ability of custodians to appoint third party custodians, particularly in wholesale markets, will increase costs and decrease flexibility for firms, and is likely to disincentivise established custody firms from offering these services, negatively impacting the resilience of the sector and customer outcomes.

AFME members have raised significant concerns that proposed rules would not be suitable for global custodians and other intermediaries operating in diverse or global markets and responsible for client assets beyond only 'qualifying cryptoassets'. Additionally, AFME members are alarmed that proposed CASS 17.6 would prevent cryptoasset custodians and their clients from using the intermediation models for safekeeping client assets that are common in traditional capital markets. This would be both controversial and disruptive to wholesale capital markets and appear contrary to the FCA's objectives of fostering innovation and competition in the cryptoasset custody market.

In particular, we are concerned that the CP and requirements in proposed CASS 17.6 are focused on the use of third parties in Direct Custody models instead of Indirect (or Intermediated) Custody models for safeguarding cryptoassets (see next).

Direct vs Indirect (or Intermediated) Custody

AFME have discussed that cryptoasset custodians could deploy at least one of two general business models for safeguarding cryptoassets:

- **Direct Custody** – this is where the cryptoasset custodian (a "**Direct Custodian**") undertakes to its client to directly (either itself or on a white-labelled basis) operate, or hold the cryptographic key (or part of the key) or other technological means of access to, the wallet or other digital address in which the cryptoasset is recorded (think: Client -> Direct Custodian -> DLT); and

- **Indirect (or Intermediated) Custody** – this is where the custodian (an "**Intermediary**") undertakes to the client to open an account in its books for recording the cryptoasset and then appoints one or more other persons to act as the Direct Custodian(s) for the cryptoassets (i.e. to operate, or hold the cryptographic key (or part of the key) or other technological means of access to, the wallet or other digital address in which the cryptoasset is recorded) and the Intermediary does not undertake any Direct Custody itself i.e. Client -> Intermediary -> Direct Custodian -> DLT).

Conceptually, the Direct Custody model is akin to the primary safeguarding function of a local sub-custodian/settlement agent for securities in traditional capital markets, whereby the sub-custodian/settlement agent undertakes either the registration of title/ownership of the security with the issuer/registrar, or operates the account(s) with the relevant financial market infrastructure (FMI), such as the central securities depository (CSD) or central counterparty/clearing house (CCP), in which the security is deposited or recorded.

Similarly, the Indirect (or Intermediated) Custody model is akin to the primary safeguarding function of the various types of intermediaries in traditional securities markets (such as global custodians, depositaries, prime brokers and trustees), whereby the intermediary, acting on behalf of its client(s), will appoint and select, and open one or more segregated accounts with, the local sub-custodian/settlement agent (who then interacts directly with the relevant issuer/registrar or FMI, as relevant).

While both Direct Custody and Indirect (or Intermediated) Custody models can provide benefits for clients, Indirect (or Intermediated) Custody is common, particularly in wholesale markets, where it can: (i) reduce the financial, operational and legal burdens for an investor in holding multiple asset types and connecting with multiple providers and infrastructure; and (ii) generate economies of scale from aggregated asset flows.

Use of Third Parties in Direct vs Indirect Custody Models

We can envision that both Direct Custody and Indirect (or Intermediated) Custody models can involve a relevant cryptoasset custodian using third parties.

In the Direct Custody Model, while there would be no sub-custodian in the traditional sense, the Direct Custodian may still involve a third party in the safeguarding of the asset either directly or on a white-labelled basis. For example, through: (a) the use of specific third-party security and technology services connected to the operation of, or the holding or storing of the key or other technological means of access to, the wallet or other digital address; or (b) by appointing another Direct Custodian to hold part of the means of access (such as a shard) to the wallet or other digital address in which the cryptoasset is recorded.

In this way, while the relevant third party may or may not be performing the regulated activity of safeguarding, the core safeguarding function of the Direct Custodian(s) remains specific to its own arrangements for operating, or holding or storing the means of access to, the relevant wallet or digital address itself.

In the Indirect (or Intermediated) Custody Model, the Intermediary would appoint one or more Direct Custodians, as sub-custodians, to, among other things, operate, or physically hold or store the key or other technological means of access, to the wallet or other digital address in which the cryptoasset is recorded.

In this way, the core safeguarding function of the Intermediary is specific to its selection, appointment and periodic review of the relevant sub-custodian(s) and the sub-custodian's arrangements for safekeeping the cryptoassets, as the Intermediary generally may not undertake any of the specific technological and operational tasks necessary to safeguard the cryptoasset (including the wallet or the means of access to the wallet) itself.

The Consultation Paper Lacks Analysis of Indirect (or Intermediated) Custody Models

The Consultation Paper's discussion of the use of third parties and proposed CASS 17.6 appear to focus on a cryptoasset custodian operating as Direct Custodian (under a Direct Custody model) rather than as an Intermediary (under an Indirect (or Intermediated) Custody model).

For example, Paragraph 4.6 of the Consultation Paper suggests that there "*are a number of firms in the cryptoasset market offering custody services*" in a manner distinct to traditional finance custody because: (i) cryptoasset custody "*involves taking control over a client's cryptoassets, often by holding or storing the means of access to the cryptoasset*"; and (ii) "*there are no external third parties that verify the ownership of qualifying cryptoassets in the same way*" as CSDs that register ownership of assets.

Additionally, Paragraph 4.64 of the Consultation Paper suggests the use of third parties for cryptoasset custody primarily would arise from seeking security or technology efficiencies related to infrastructure, storage, or specialist expertise, such as from third-party key sharding, multi-party computation (MPC) and hardware security module (HSM) services.

These examples appear directly relevant to the technological and operational arrangements a Direct Custodian may require to operate itself, or gain direct access to, a wallet or other digital address for a cryptoasset.

The Consultation Paper contains no discussion on the potential for a cryptoasset custodian to appoint a sub-custodian, i.e. act as an Intermediary in an Indirect Custody model for a cryptoasset, where the sub-custodian, rather than the Intermediary, would be the Direct Custodian for the cryptoasset by operating, or physically holding or storing the means of access to, the wallet, albeit on the instruction of the cryptoasset custodian.

Proposed CASS 17.6 Presents Significant Difficulties for Indirect (or Intermediated) Custody Models

If adopted in its current form, CASS 17.6 could make it practically impossible for cryptoasset custodians to adopt an Indirect (or Intermediated) Custody Model and this could in turn limit the ability of investors to use existing market intermediaries, such as the global custodians, prime brokers and trustees commonly used by institutional investors in traditional capital markets, to obtain custody services for cryptoassets.

As a result, we think proposed CASS 17.6 should be replaced, or otherwise substantively aligned, with the existing requirements of CASS 6.3

In particular, the FCA should align proposed CASS 17.6 with CASS 6 to address the following difficulties for firms:

- *Necessity* – The use of sub-custodians is largely driven by commercial considerations, operational practicalities and efficiency. Demonstrating that the use of a sub-custodian is necessary will be challenging, and it unclear why this restriction is needed for the custody of cryptoassets but not of traditional assets. This condition appears to require the custodian to have a sufficiently compelling reason for which it is not possible for the firm to undertake the activity entirely by itself. With no regard for operational or cost efficiencies, it will always be theoretically possible for custodian to undertake all relevant activities by itself, albeit potentially at a significantly increased cost and reduced efficacies for its underlying customers. Additionally, it approach fails to recognise the use of some third parties/sub-custodians can improve risk management processes, e.g. key sharding and multi-party computation methods or facilitate compliance with laws and rules in other jurisdictions.

- *Best interests* – Similar to the point above, the appointment of a sub-custodian may not strictly be in the best interests of the client, but may benefit the custodian with no detrimental effect on the customer. Again, it is unclear why this restriction is necessary, or what the justification for a deviation from traditional custody is. This condition may be unworkable and it is not clear who it aligns with the FCA's similar client best interests rule (e.g. COBS 2.1), to which most traditional custodians already will be subject.

- *Board approval* – Requiring board approval for the appointment of sub-custodians is disproportionate, especially for large international firms seeking to offer these services. While the appointment of sub-custodians should be subject to appropriate governance, firms should have the flexibility to determine their governance approach

- *Third Party Rights* - We see no reason for the FCA's position on the ability of the custodian to grant certain limited liens/rights over clients assets (e.g. for unpaid fees or where required under foreign law, e.g. for accessing central clearing and settlement services) to differ from the position contemplated by CASS 6.3.6.AR to CASS 6.3. CASS 17.3 would prevent cryptoasset sub-custodians from having any claim or right over a cryptoasset they hold to recover debt for the services they provide for the asset. This is not commercially practical for cryptoasset sub-custodians and may make it impossible for sub-custodians to obtain or support central clearing or settlement systems for qualifying cryptoassets.

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.**

No answer.

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

We view that there are two additional, related, costs that are of critical importance in weighting the costs and benefits to consumers that require more detailed consideration:

- The impact of stablecoin adoption on commercial bank deposit balances and, therefore, the availability and cost of credit for UK consumers and businesses; and
- The long-term systemic risks associated with an on-aggregate systemic amount of stablecoin issuance by non-systemic parties and sufficient details on how this risk will be managed by the Bank of England in collaboration with the FCA and the market.

AFME Contacts

Coco Chen
Associate Director, Technology and Operations
coco.chen@afme.eu

Priya Deuchande
Graduate, Technology and Operations
priya.deuchande@afme.eu