

Proposed regulatory regime for sterling-denominated systemic stablecoins: Positive Money response

Q1: Do you have views on our proposal to allow systemic stablecoin issuers to hold up to 60% of backing assets in short-term sterling-denominated UK sovereign debt securities alongside unremunerated deposits at the Bank, as an appropriate balance between business model viability and mitigation of financial stability risks?

It is concerning that the Bank of England appears to have watered down its regulatory approach following industry lobbying. If the benefits of stablecoins are supposed to be derived from innovation in payments, issuers should be able to construct a viable business model from payment services, rather than subsidising their business with income from maturity transformation. If stablecoin issuers want to profit from maturity transformation the Bank of England should insist that they apply for a banking licence, rather than accommodate shadow banking. We do recognise however the need for a more proportionate regulatory regime which could allow new entrants to enter the market and provide much-needed competition for incumbent banks, and would recommend that the Bank allows stablecoin issuers, and other firms wishing to provide limited services without the costs of acquiring a full banking licence, to apply for 'narrow' banking licences.

Rather than watering down regulations for systemic stablecoins, the Bank of England should mitigate risks by raising standards for non-systemic stablecoin issuers. The most effective way of avoiding a fragmented regulatory regime vulnerable to arbitrage risks would be to require that any authorised issuer (whether deemed 'systemic' or not) fully backs their stablecoins with central bank reserves, which could be (fully or partly) remunerated to enable a viable business model. This may however raise the question of what the benefits of stablecoins are over giving the public direct access to central bank money in digital form through a digital pound, which may be an uncomfortable question for the industry to answer.

The Bank of England's attempt in the consultation paper to distinguish between issuers of payment instruments and banks involved in the

transmission of monetary policy is problematic, given that bank deposits are relied on as a means of payment.

The Bank of England's data suggests that there are more than £450bn of bank deposits that are unremunerated - around a fifth of total demand deposits. These deposits appear to be insulated from the transmission of monetary policy and are presumably held for payment purposes. Yet banks are able to earn the base rate on their full holdings of central bank reserves. The Bank of England's paying of interest on reserves held by commercial banks has at times been justified as remuneration for providing services, given the reliance on bank deposits for payments in today's economy. If the Bank of England is averse to paying interest to stablecoin issuers, this raises the question of whether it should be paying its policy rate on commercial banks' full holdings of central bank reserves.

Q2: Do you have comments on the step-up regime as a way of supporting innovation while mitigating financial stability risks?

Rather than the proposed step-up regime, the most effective way of supporting innovation while mitigating financial risks would be requiring all authorised stablecoin issuers, whether deemed systemic or not, to fully back coins with reserves/deposits at the central bank, as argued in our response to Q1. These reserves could be at least partially remunerated, just as reserves held by banks are, despite around a fifth of bank deposits being unremunerated and thus used for payments.

Q8: What are the operational challenges to implementing holding limits or other tools we are exploring? How might those challenges be addressed, including for individual and business limits?

Holding limits, as proposed for both stablecoins and a publicly-issued digital pound, would restrict households and businesses' ability to benefit from new forms of money, and would pose challenges to the Bank's stated objectives of increasing competition and supporting innovation in money and payments.

Concerns over 'disintermediation', the justification for holding limits, appear to be based on questionable theoretical grounding. Following the principles of double-entry bookkeeping, banks' loss of deposit funding must be

accompanied by other balance sheet changes. Funds do not just disappear from the financial system. If deposits are exchanged for a stablecoin backed by central bank money, the stablecoin issuer would accumulate liabilities of the central bank, which could be backed by government bonds or loans to banks. If the latter, the size of bank balance sheets need not change, as deposit funding can simply be replaced by ‘pass-through’ funding from the central bank. Whether or not this has an impact on the provision of credit to the UK economy will depend on the terms on which the Bank of England would recycle funding to lenders.

We propose a more optimal alternative to holding limits in Q10.

Q9: What are your views on the usability of stablecoins in the presence of holding limits, both for individuals and businesses? What use cases do you envisage would require exemptions from the proposed limits? What uses would not be possible given the proposed limits?

Though the case for holding limits is unconvincing, it remains unclear what use cases stablecoins offer that would not be better served by a publicly-issued digital pound.

Q10: Other than holding limits, what do respondents consider are the tools best suited to mitigating the risks we have identified?

Rather than holding limits, the Bank’s objectives for maintaining financial stability while allowing increased competition and innovation in money and payments would be better satisfied by requiring banks to pre-position sufficient collateral to cover their demand deposits, as suggested by former Bank of England policymakers Lord Mervyn King and Sir Paul Tucker. With such pre-positioning in place, banks would be able to weather any scale of transition to new forms of money without risking financial stability. If there are concerns about the provision of credit to the economy under a digital currency regime, banks’ role in credit provision could be maintained by the central bank allowing lenders to draw upon ‘overdraft’ funding against suitable collateral.

Q11: Do you have views on our proposal that systemic stablecoins should access payments systems that support interoperability across

different forms of money directly rather than through a sponsoring participant?

We support the proposal that stablecoins should access payment systems directly to reduce risks such as tiering.