



Crypto  
Council for  
Innovation

July 31, 2025

SUBMITTED VIA SURVEYS

To whom it may concern,

**Re: Draft Global Digital Finance and Crypto Council for Innovation response to FCA CP25/15 on a prudential regime for cryptoasset firms**

**About Global Digital Finance (GDF) and Crypto Council for Innovation**

GDF and CCI are the two leading global members' associations representing firms delivering crypto and digital assets solutions. Our members span the digital asset ecosystem and include the leading global crypto exchanges, stablecoin issuers, digital asset Financial Market Infrastructure providers, innovators, and investors operating in the global financial services sector.

Together, our members share the goal of encouraging the responsible global regulation of crypto and digital assets to unlock economic potential, improve lives, foster financial inclusion, protect security, and disrupt illicit activity.

We believe that achieving these goals requires informed, evidence-based policy decisions realised through collaborative engagement between regulators and industry. It also requires recognition of the transformative potential of crypto and digital assets, as well as new technologies, in improving and empowering the lives of global consumers.

We support and encourage a comprehensive UK digital asset regulatory approach which is robust, proportionate, and pro innovation. Appropriate regulatory guardrails are crucial to ensure the continued growth of the UK ecosystem, to further attract the predominantly global industry, and to realising the goal of making the UK a digital finance hub.

The input to this response has been curated through a series of member discussions, industry engagement, and roundtables, and both GDF and CCI are grateful to their members' input.

As always, we remain at your disposal for any further questions or clarifications you may have, and we would welcome a meeting with you to further discuss these matters in more detail with our members.

Yours faithfully,

Elise Soucie – Executive Director – GDF

Laura Navaratnam - UK Policy Lead, CCI

## Response to the Public Consultations: Executive Summary

We welcome the FCA's work to develop a tailored prudential regime for cryptoasset firms and support the objective of maintaining financial resilience while enabling innovation.

However, to achieve these aims in practice, the final regime must be internationally coherent, proportionate to actual risks, and operationally practical for a global industry. As currently framed, several aspects of the proposals risk placing the UK at a significant competitive disadvantage compared to other well-regarded jurisdictions, including the EU, Singapore, Hong Kong, and the US.

The imposition of materially higher prudential requirements than comparable jurisdictions will make it difficult for firms to justify a UK presence, and risks firms leaving the UK and/or materially limiting the scope of their UK operations. This would have negative consequences for UK economic growth, could distort competition (as UK based firms would face significantly higher costs than overseas firms accessing the UK market on a cross border basis) and would adversely affect the FCA's ability to retain proper oversight of the UK market (given regulatory levers over firms accessing the UK market on a cross border basis will be limited).

We therefore encourage the FCA to adopt a more risk-sensitive and principles-based approach across key elements of the prudential framework, including:

- **Recognition of Intangible Assets:** Allow inclusion of intangible assets in own funds where these can be independently, reliably and prudently valued, consistent with treatment in other jurisdictions.
- **Treatment of Firm-Issued Tokens:** Permit partial or full inclusion in capital where tokens demonstrate genuine market value, broad distribution, and functional utility.
- **Refinement of the Fixed Overhead Requirement:** Clarify the treatment of global shared services, inter-company technology charges, and variable costs such as on-chain fees.
- **Calibration of K-Factors:** Recalibrate the K-SII and K-QCS to reflect actual risk and avoid duplication, especially where third-party custodians are used or where stablecoin issuers maintain robust custody and redemption systems.
- **Liquid Asset Requirements:** Permit holdings in major currencies with an appropriate FX haircut to reflect real-world liquidity management practices of global firms.
- **Issuer Liquid Asset Requirement (ILAR):** Adjust the ILAR to avoid penalising the use of high-quality sovereign debt or money market funds, which are already subject to conservative risk treatments.

- **FX Risk Management:** Avoid a blunt Pillar 1-style capital charge for FX risk and instead embed robust hedging and governance expectations into the ICARA process.
- **Concentration Risk:** Provide practical guidance on how to identify “connected clients” in a pseudonymous crypto context and how to manage inherent concentrations in mandated high-quality assets.

In summary, we urge the FCA to refine the framework to ensure it is robust but not excessive, aligned with international norms, and adaptable to the rapidly evolving nature of the sector. A well-calibrated regime will attract high-quality firms to the UK, strengthen regulatory oversight, and support the government’s ambition to make the UK a global hub for digital finance.

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## Response to consultation questions

### **Question 1: Do you have any comments on our proposals for the definitions and types of, and deductions from, regulatory capital that CRYPTOPRU firms should use to calculate their funds?**

We recommend that the FCA reconsiders the proposed full deduction of intangible assets by CRYPTOPRU firms when calculating own funds. For many cryptoasset and technology firms, significant value resides in proprietary software, trading systems, and intellectual property such as audited software IP. Such intangible assets are typically treated in a more proportionate way by other regimes such as in the EU and Singapore.

We agree that assets with highly uncertain valuations or those that will not generate value in a wind-down should be deducted from own funds, we recommend that the FCA allows the inclusion of certain intangible assets that can be reliably and prudently valued by independent parties and which are essential for the firm’s ongoing operations and franchise value. The FCA’s proposed blanket deduction fails to recognise the actual economic value and resilience of modern technology-led firms.

### **Question 2: Do you have any views on our proposed requirements for deductions from CET1 capital, in particular cryptoassets held by firms which they have issued or are in control of the supply of?**

We agree that CRYPTOPRU firms should not be able to artificially inflate their balance sheet and therefore their capital position. However, we do not support the proposed blanket requirement for CRYPTOPRU firms to deduct cryptoassets that the firm or a connected party has

issued or for which they have any control over the supply. We also recommend that the FCA seeks to more closely align its proposals with international standards such as IOSCO's crypto recommendations.

A blanket deduction for all such assets fails to distinguish between assets held for speculative purposes and those that form an integral part of a functioning, valuable ecosystem. Such an approach risks significantly constraining capital adequacy, distorting balance sheet management, and limiting the utility of native tokens.

The FCA should make a distinction between tokens with little market value or utility and established, highly liquid tokens with broad utility and a distributed holder base. The latter have a verifiable market value and contribute to the firm's real economic substance and loss-absorbing capacity. We propose that, instead of a blanket deduction, the FCA should enable CRYPTOPRU firms to assess such cryptoassets based on factors including:

- market capitalisation;
- trading liquidity on independent venues;
- the degree of decentralisation; and
- the existence of robust and transparent valuation methodologies.

Where the cryptoasset has genuine, demonstrable, and resilient value, CRYPTOPRU firms should be permitted to consider part or all of the cryptoasset as own funds. CRYPTOPRU firms should also be able to reference firm-specific tokens in their ICARA.

Finally, we recommend the FCA clarify that these requirements are not intended to capture firms that merely facilitate access to or support the distribution of a cryptoasset, such as exchanges, brokers, or other intermediaries, where they do not exercise meaningful control over its issuance or supply. This will help ensure the rule remains proportionate and targeted.

**Question 3: Do you have any comments on our proposed overall approach on the Own Funds Requirement (OFR), and the detailed provisions of the specific components: (i) PMR, (ii) FOR, (iii) K-SII, and (iv) K-QCS?**

We recommend the following changes to the proposed OFR framework:

- Remove the KFR component of the OFR so it becomes the 'highest of' the PMR and FOR;
- Clarify the definition of relevant expenditure in the FOR for global shared services, inter-company technology and infrastructure charges and other overheads; and

- Ensure that prudential requirements are calibrated by reference to a firm’s regulated cryptoasset business (and not other business lines which the relevant entity may be carrying on).

We also recommend the following changes to the proposed K-Factor calculations:

- calibrate the K-SII with factors that mitigate risk, such as the quality and liquidity of reserve assets and the robustness of the issuer’s custody and redemption arrangements and the systemic importance of the entity, including through size thresholds to support proportionality; and
- revise the K-QCS to only require a firm to hold capital for assets custodied by a direct custodian rather than also requiring this for third-party custodians which may cause double counting.

#### *Own Funds Requirement (OFR)*

We do not believe the K-QCS, as described in the CP, is directly aligned to the primary purpose of the OFR which is to facilitate an orderly wind-down (facilitated by the FOR in any case). The K-QCS would not appear to provide commensurate coverage to capture the risks from safeguarding qualifying cryptoassets for clients - the stated purpose of the K-QCS. Including the K-QCS in the ‘higher of’ framework for the OFR will potentially result in a significant amount of capital being set aside for no real benefit and may place the UK at a material competitive disadvantage with other jurisdictions that do not have similar requirements, including for group structures which include a crypto custodian subject to these proposed requirements.

More broadly, looking ahead to the FCA’s second CP on prudential issues, we would urge the FCA to re-consider the application of K factors. We believe that this would put the UK at a significant competitive disadvantage relative to comparable jurisdictions (including the EU, Hong Kong, Singapore and the US). For non-retail consumer facing firms, who will be able to access the UK market on a cross border basis without a licence, the imposition of materially higher capital requirements than comparable jurisdictions will make it difficult for firms (in particular those with growth ambitions and/or large balance sheets) to justify a UK presence.

#### *Fixed Overhead Requirement (FOR)*

We recommend that the FCA provides guidance on the definition of ‘relevant expenditure’ for the treatment of costs related to shared services, inter-company charges for technology development and infrastructure, and other overheads incurred by a global parent or affiliate that benefit a CRYPTOPRU firm. For global crypto firms, a clear and consistent methodology is necessary to avoid ambiguity and ensure that the FOR accurately reflects the fixed costs of the UK operation.

In addition, we are concerned that the £2 million threshold for triggering a “material change” could be relatively easy to trigger - we consider that a projected increase of 30% or more of relevant expenditure in the current year would be a more appropriate and operationally workable threshold.

#### *K-Factor for Qualifying Stablecoin in Issuance (K-SII)*

We recommend the following changes to the proposed K-SII:

##### *Calibration at 2%*

While we understand the desire for consistency with e-money issuers, the operational risks of a fully-backed, 1-for-1 redeemable stablecoin may differ significantly. We recommend that the calibration of K-SII also consider factors that mitigate risk, such as the quality and liquidity of reserve assets (given the requirements around backing asset composition), the proposed liquidity requirements, and the robustness of the issuer’s custody and redemption arrangements. A more risk-sensitive calibration could be substantially lower than 2% for high-quality, fully backed stablecoins.

The use of distributed ledger technology (DLT) for stablecoins introduces efficiencies in monitoring and operations that lower overall risk compared to traditional e-money. Token issuance and circulation are recorded on-chain, enabling real-time regulatory and public scrutiny of supply dynamics. In addition, redemption processes are more easily automated, reducing operational delays and errors that might require higher capital buffers.

DLT infrastructure also enables low-cost, borderless scaling, with operational costs largely detached from issuance volumes. The K-SII, which scales linearly with issuance, ignores this, and may ultimately deter market entrants in the UK. The FCA could consider degressive rates reflecting diminishing marginal risks. This would better support the UK government’s aim to foster innovation and competition and discourage offshoring to regimes which emphasise flexibility and proportionality (e.g. in Singapore, and under emerging proposals such as the GENIUS Act in the US).

We also note the proposed stablecoin framework imposes stricter backing rules than for e-money, including the Backing Asset Composition Ratio to cap exposure to riskier assets, and the requirement to ring-fence in trusts, ensuring direct holder claims independent of the issuer’s solvency. With stablecoin reserves under tighter constraints, a lower threshold would suffice for operational buffers, aligning with the proportionality principle and avoiding inefficient capital lock-up.

##### *Calculation Lag*

The proposal to use a nine-month lookback period, excluding the most recent three months, could cause a firm's capital requirement to be misaligned with its current risk profile, particularly during periods of rapid growth or market volatility. We believe the ICARA process should explicitly require firms to assess and address any material discrepancy between their lagged K-SII and their current risk exposure.

Our members also believe it is important to raise concerns over the example used in CP25-15, section 4.48, where Issuer 3, described as a 'mature firm with an increased presence', is shown to hold an average SII of £40million with a corresponding K-Factor requirement of £800,000. In practice, particularly for those issuers exploring institutional issuance, the average SII is likely to be substantially higher than this assumption. As stated above, it is entirely realistic, even as a start up issuer serving institutional clients, to exceed this level by more than tenfold. Using such a low figure as a benchmark significantly underestimates the real capital requirements imposed on these types of firms and therefore misrepresents the regulatory burden new entrants would face under this proposal.

#### *Group & Subsidiary Clarifications*

We would welcome further clarification on how the proposed Own Funds Requirement (OFR), including its individual components such as the FOR, would apply in scenarios where a cryptoasset firm operates as a subsidiary within a wider regulated banking group. In particular, it is unclear whether a firm's OFR, calculated on a solo basis, could have implications at the consolidated group level either through direct prudential consolidation or indirectly through supervisory expectations. For example, would the firm's FOR, PMR or other OFR components be expected to inform or affect capital adequacy calculations at the parent entity level, particularly where the parent is subject to its own regulatory requirements under the UK's prudential regime?

While such cases may be limited to a subset of cryptoasset firms, they are material and warrant clear regulatory guidance. We recommend that the FCA explicitly clarify whether and how the OFR applies within group structures, and where necessary, delineate the boundaries of its application to avoid unintended consequences for prudential treatment at group level. This will be particularly important in ensuring consistent application of the rules and avoiding duplicative

#### *K-Factor for Qualifying Cryptoassets Safeguarded (K-QCS)*

The FCA has proposed that a firm must include the value of qualifying cryptoassets it has appointed to a third-party custodian in its own K-QCS calculation. This methodology would appear to require capital to be held against the same asset by the primary custodian (via its own K-QCS) and by the third-party custodian. This appears to create significant capital inefficiency that disincentivises the use of third-party custodians.

We recommend that the full K-QCS should apply only to the entity with primary safeguarding responsibility, to reinforce a clear distinction between custody and oversight. The firm that appoints the third party faces a different risk profile, primarily related to counterparty and operational risks from its oversight of that provider. This oversight risk should be captured by a separate, much smaller K-factor, rather than applying the full K-QCS charge. This aligns capital with risk and supports a robust and specialised custody market in the UK.

**Question 4: Do you have any views on the items to be deducted from total expenditure when calculating the FOR? Are there any others that may be relevant for cryptoasset firms, and if so, why?**

We recommend that the FCA provide greater discretion for firms to deduct variable, activity-based expenses that are not relevant to an orderly wind-down, rather than prescribing a fixed list. Given the unique and evolving cost structures of cryptoasset firms, a more principles-based approach would allow firms to justify deductions based on their specific business model and contractual arrangements. In particular, many costs in this sector, such as those linked to transactional activity, usage-based infrastructure, or customer acquisition, are not fixed overheads and would not be incurred in a wind-down scenario. Requiring these to be included in the FOR would overstate actual wind-down costs and risk setting capital requirements at disproportionate levels. Allowing for firm-level assessment, subject to appropriate documentation and supervisory review, would strike a more proportionate and accurate balance.

However, if the FCA is minded to provide guidance and/or maintain some form of list, we recommend as a minimum, expanding the list of deductible expenses to the FOR. To accurately reflect wind-down costs, deductions should be allowed for variable, activity-based expenses unique to the industry, such as the following:

- **Direct On-Chain Transaction Fees (e.g., 'Gas' Fees) which are** intrinsically linked to the volume of ongoing business activity and are not fixed overheads. In a wind-down scenario, transaction volumes would cease, and these costs would not be incurred. Including these highly variable costs would misrepresent the actual cost of an orderly wind-down.
- **Variable Technology and Data Service Costs - many of which are** priced on a usage basis or through short-term, discretionary contracts that would be terminated in a wind-down. The variable portion of these costs is not a 'fixed' overhead required for the wind-down process and should be deductible.

- **Specific User Acquisition and Business Development Costs which** are directly related to business growth, not its ongoing maintenance or orderly wind-down, and would be the first expenditures to be halted in a distressed situation. Specific, verifiable expenses aimed purely at growth are not fixed and should be deductible.

**Question 5: Do you agree with our proposal that the value of qualifying cryptoassets appointed by or to a third-party custodian for safeguarding must be included in the measurement of QCS? If not, how else would you suggest that the risk of potential harm from the use of third parties is mitigated?**

We do not agree with the FCA's proposals to require a firm to hold capital against the full value of assets safeguarded by a third-party custodian. We don't believe this reflects the actual risk - which is one of oversight, not direct custody - and discourages the use of specialist custodians. We propose several alternatives, including a smaller capital charge that reflects only the oversight risk.

We support the FCA's aim to reduce the risk of potential harm from the use of third parties but applying the full K-QCS capital charge:

- misaligns capital with risk;
- creates disincentives to the prudent use of specialist third-party custodians;
- fails to distinguish between the direct operational risk of custody and the distinct oversight risk associated with managing a third-party provider.

We recommend the following alternative approaches:

- **Bifurcated K-Factors:** a differentiated K-factor could be applied for assets held with a third-party custodian. A significantly lower percentage than that proposed for directly custodied assets would recognise the residual risks (e.g. counterparty risk, operational risk of inadequate oversight) at a more proportionate level.
- **Risk-Based Approach Based on Third-Party Custodian Standards:** The capital requirement could be contingent on the regulatory status and standards of the third-party custodian. If a firm uses a custodian that is itself a regulated entity subject to robust prudential requirements (in the UK or an equivalent jurisdiction), the K-QCS applied to the appointing firm should be substantially reduced or set to zero. This would incentivise the use of highly regulated and secure custodians.
- **Focus on Robust Due Diligence and Oversight Requirements:** Instead of a direct capital charge, the FCA should develop a framework based on robust and auditable

requirements for the selection, appointment, and ongoing monitoring of third-party custodians. This would include stringent due diligence, clear contractual obligations, and requirements for regular reporting and independent audits, directly addressing the harm identified in the consultation. Furthermore, such a framework could take account of third-party custodians that meet equivalent prudential standards, including mapping outsourcing and SYSC requirements to justify such differential treatment.

- **Transparent Allocation of Liability:** Regulations should permit the precise and legally enforceable allocation of liability for the loss of cryptoassets to third-party custodians, ensuring transparency and accountability. Where such liability is transferred to a regulated and well-capitalised custodian, the rationale for the appointing firm to hold significant capital against the full value of those assets is diminished.

Finally, we recommend clarifying that this proposal should not apply where a firm acting as an authorised custodian uses a third party solely for technical or ancillary services (e.g. node infrastructure or key storage support), where custody remains under the authorised firm's control. In such cases, the risk lies in operational execution rather than the delegation of custody, and the capital treatment should reflect that distinction.

#### **Question 6: Do you agree with our proposals on the basic liquid asset requirement (BLAR)?**

We support the BLAR in principle but recommend enabling firms to hold liquid assets in major currencies, such as USD or EUR, with a small haircut applied to cover foreign exchange risk to improve operational practicality for global firms.

We support a Basic Liquid Asset Requirement (BLAR) which is linked to the FOR to facilitate an orderly wind-down. We also support the proposed list of "core liquid assets", but would encourage the FCA to provide a pathway for future evolution to permit other asset types in the future, subject to stringent criteria, such as certain fully reserved, fiat-backed stablecoins that undergo robust, independent audits.

We recommend changes to the proposed requirement that non-sterling assets can be held only in the same proportion as the firm's overheads that are incurred in that currency. For global firms, this rule does not align well with modern treasury management and may force firms to:

- Fragment liquidity pools inefficiently.
- Avoid unnecessary foreign exchange transaction costs and risks by avoiding constant rebalancing of holdings.

- Potentially hold significant assets in less liquid currency pairs, contrary to prudent liquidity management.

We propose that firms be permitted to hold the BLAR in core liquid assets denominated in other major, freely convertible currencies (e.g. USD, EUR), provided these assets are of the same high quality. To mitigate currency risk, a small haircut could be applied to non-sterling assets to account for potential foreign exchange (FX) volatility. This would achieve the same prudential outcome while allowing firms to manage their liquidity on a global, commercially sensible, and risk-efficient basis.

Finally, we would welcome clarification that the reference to “guarantees firms have given to clients” within the BLAR calculation is intended to capture explicit, legally enforceable guarantees, and not broader commercial arrangements or contractual obligations, which could otherwise risk unintended consequences or overstatement of liquid asset needs.

**Question 7: As part of the BLAR, can you identify any circumstances where the provision of guarantees provided to clients by firms might apply to cryptoasset custodians or qualifying stablecoin issuers?**

We recommend that liquidity charges should only be applied to distinct, contractual financial guarantees such as ancillary promises (e.g. guaranteed investment yield ) and not to the core duties of a custodian or issuer.

We agree that where a firm provides a distinct contractual guarantee, it is appropriate for this to be reflected in its liquidity requirements. The key distinction is between the standard provision of a regulated service and the creation of a separate, ancillary financial guarantee. Applying the proposed 1.6% charge is an appropriate measure to ensure firms maintain sufficient liquidity to cover these specific, additional liabilities.

*Cryptoasset Custodians*

The core duty of care for a custodian does not in itself constitute a "guarantee" for the BLAR calculation. However, a guarantee could arise in circumstances including:

- **Explicit Insurance Guarantees:** A premium service that includes an explicit guarantee to compensate clients for losses from events like hacks or theft, up to a specified limit.
- **Guarantees Against Staking Penalties (Slashing):** A guarantee to reimburse a client for losses incurred due to "slashing" penalties resulting from validator downtime or misbehaviour managed by the custodian.

- **Third-Party Service Guarantees:** A guarantee against losses from specific failures of a third-party service (e.g. a DeFi protocol) that the custodian facilitates access to.

### *Qualifying Stablecoin Issuers*

Other requirements address the core obligation to honour redemptions at par. An additional guarantee might apply in circumstances including:

- **Guaranteed Yield Programmes:** An issuer offering a programme that provides stablecoin holders with a **guaranteed** fixed or variable yield, which represents a liability beyond the core promise of redemption.
- **Guarantees to Partner Platforms:** An issuer providing a financial guarantee to a third-party platform to encourage the adoption of its stablecoin, for example, by guaranteeing to cover losses for the platform's users under specific conditions.

**Question 8: Do you agree with our proposals on the issuer liquid asset requirement (ILAR) to address price risk when government debt instruments are held in a backing pool? If not, please explain why you disagree with specific aspects and what alternative solutions you would suggest.**

While we support the FCA goal of covering price risk in a stablecoin's reserve assets, we are concerned that, as currently proposed, the ILAR does not meet its stated policy objective, places the UK at a competitive disadvantage to other jurisdictions which do not have a similar requirement, and imposes an implicit penalty on the use of sovereign debt instead of cash.

The ILAR appears to blur the boundary between capital adequacy and liquidity management policy objectives. It seems to create an additional buffer based not on a firm's liquidity risk exposure, but on the perceived volatility of high quality liquid assets (HQLA) that are already being held on a fully reserved basis. This penalises firms for using non-cash assets and is inconsistent with the regulatory consensus that high-quality sovereign debt and money market instruments are low risk and liquid. Therefore, our recommendation would be to not introduce the ILAR.

If the FCA decides to proceed with the ILAR then we recommend making the methodology more risk-sensitive in order to avoid a disproportionate approach which does not reflect actual risks posed to end users. Specifically, we believe that the proposed charges on high-quality sovereign debt and money market funds are too conservative and that charges on repo transactions should be based on the net risk after accounting for existing collateral.

We recommend the following to ensure the methodology is proportionate and risk-sensitive:

- **Proportionality of Charges:** The charges for high-quality sovereign debt are inconsistent with regulatory norms which recognise this as a safe and liquid asset class, and risks creating capital inefficiencies for issuers by disincentivising their use in favour of cash. Instead, the FCA should adopt a more dynamic approach where charges are periodically reviewed. Furthermore, for sophisticated issuers, a provision could be made to allow the use of internal models (subject to regulatory approval) to calculate the price risk buffer.
- **Treatment of Money Market Funds (MMFs):** Applying a flat 5% charge where a look-through is not performed appears overly punitive for highly regulated, stable-value funds. Instead, we propose a more nuanced, tiered approach for MMFs based on the fund's credit rating, domicile, and adherence to specific regulatory standards.
- **Treatment of Repurchase (Repo) Transactions:** Applying the full ILAR charge to securities in repo transactions may result in an excessive liquidity requirement that does not accurately reflect the net risk, which is already mitigated by haircuts and collateralisation. Instead, the ILAR for assets in repo transactions should be calculated based on the firm's net risk exposure, taking into account the mitigants already within the transaction.

**Question 9: Do respondents consider that the foreign exchange risk for qualifying stablecoin issuers described in paragraph 5.22 needs to be addressed through minimum requirements, for example, would a specific capital charge be appropriate?**

We recommend the FCA does not introduce a specific capital charge for FX risk and instead adopts a principles-based approach where firms must demonstrate a robust FX risk management framework (including hedging and stress testing). We believe a specific, Pillar 1-style capital charge would:

- Not adequately account for the sophisticated and dynamic hedging strategies a global firm may employ and measure gross exposure rather than the actual net risk;
- Incentivise firms to hold capital against an unmanaged risk, rather than actively and efficiently managing that risk through hedging; and
- increase the cost of issuing stablecoins in the UK, particularly those pegged to non-GBP currencies, potentially making UK-authorized stablecoins less competitive.

We also note that FX risk is already addressed within the broader prudential framework, including through liquidity, own funds, and wind-down planning requirements. These provide

adequate tools for the FCA to assess and mitigate FX risk without the need for a standalone capital charge.

We recommend that the FCA adopts a more principles-based approach where FX risk is treated as a key component of a firm's overall risk management framework, assessed by the FCA as part of a future ICARA-type process. This would require an issuer to demonstrate a comprehensive framework to manage FX risk, including:

- **Identification and Measurement:** Robust systems to identify, monitor, and measure FX exposures in real-time.
- **Management and Mitigation:** A clear, documented strategy for managing FX risk using a range of tools (e.g. FX swaps, forwards).
- **Stress Testing:** Rigorous and regular stress testing of FX exposures under severe market scenarios.
- **Governance and Reporting:** Strong internal governance and regular reporting to senior management and the FCA.

This approach is more risk-sensitive, allowing firms the flexibility to manage risks efficiently while providing the regulator with the necessary oversight.

**Question 10: Do you have any comments on the proposal for monitoring and control of concentration risk? Please provide suggestions for any specific clarifications that may be helpful.**

We support the FCA's proposed principles-based approach over rigid quantitative limits but recommend clarifications to support implementation, including guidance on managing concentration in mandated high-quality assets, identifying "connected clients" in a crypto context, and the FCA's expectations for risk policies and reporting.

#### *Guidance on Inherently Concentrated Asset Pools*

The rules for qualifying stablecoin backing assets and core liquid assets can inherently lead to concentration (e.g. in UK government securities or deposits with a few systemic banks). We suggest the FCA clarifies how it expects firms to balance the requirement to hold specific high-quality assets with the general obligation to manage concentration risk within those asset pools. Firms should also have discretion to implement mitigating factors, such as the assessment of counterparty creditworthiness or earnings exposure, when evaluating concentration risk in these contexts.

#### *Practical Application of "Group of Connected Clients"*

We recommend the FCA provides guidance on the expected level of on-chain analysis to identify connections between pseudonymous parties.

*Supervisory Expectations for Policies and MI*

The FCA should provide further guidance on the expected scope and content of a firm's concentration risk policy. Additionally, examples of the type and granularity of management information (MI) the FCA would expect to see would help firms design and implement their internal reporting and control mechanisms.