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David Bailey

Executive Director,
UK Deposit Takers

Nathanaël Benjamin

Executive Director,
Authorisations, Regulatory Technology,
and International Supervision

Vicky Saporta

Executive Director,
Prudential Policy

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[Dear Chief Executive Officer]

Innovations in the use by deposit-takers of deposits, e-money and regulated stablecoins

The landscape for money and payments is evolving quickly and significantly. The Prudential Regulation Authority (PRA) continues to see innovations in the forms of digital money and money-like instruments¹ available to retail customers.²

¹ In this letter, 'digital money' refers to claims on deposit-takers or other financial institutions, which exist only in electronic form and whose value is preserved through a combination of strict regulation and issuers' access to central bank deposits. 'Digital money-like instruments' refers to other assets that exist only in electronic form and are used for payments. Some of these are regulated to support a stable value, but their issuers do not have access to central bank deposits and are subject to lighter regulation. Definitions of the specific forms of digital money and money-like instruments discussed in this letter are set out in Annex 1.

² In this letter, 'retail customers' refers to natural persons; and micro, small and medium-sized enterprises.



The PRA welcomes the benefits that could come from innovation and competition by deposit-takers in this area, such as the potential to improve efficiency and functionality in payments and settlement, but is also aware of potential risks to safety and soundness posed by them.

We are writing to provide clarity on the ways in which we expect deposit-takers to address these risks while supporting innovation and competition; and, in particular, risks that may arise in relation to the availability in parallel of deposits, e-money and regulated stablecoins³ – which are all forms of digital money or money-like instruments with different protections⁴ – to retail customers.

This letter is part of a publication package from UK authorities [the PRA, the Bank of England ('the Bank') and the Financial Conduct Authority (FCA)], which focuses on how innovative technologies can be safely deployed in relation to digital money and money-like instruments. Deposit-takers should read this letter in conjunction with:

- The PRA, the Bank, and the FCA's 'Cross-authority roadmap on innovation in payments', which explains how UK authorities' current and proposed regimes for issuers of different forms of digital money or money-like instruments will interact;
- The FCA's discussion paper (DP) on the FCA's proposed regime for stablecoin issuers, custodians and 'payment arrangers'; and
- The Bank's DP on its proposed regime for systemic payment systems using stablecoins and related service providers.

Deposit-takers should also read this letter in conjunction with HM Treasury's (HMT) update on the Government's plans to legislate to bring certain activities relating to stablecoins within the UK's financial services regulatory perimeter.⁵

Currently deposits form the vast majority of the digital money held and used by people and businesses in the UK. In addition to traditional deposits, some deposit-takers have been exploring the use of new technologies in accepting deposits, for example the

³ The UK Government intends to bring the regulation of certain activities relating to 'fiat-backed' stablecoins within the UK's financial services regulatory perimeter. In this letter, 'regulated stablecoins' refers to 'fiat-backed stablecoins' within the meaning of HMT's update on plans for the regulation of fiat-backed stablecoins (October 2023): www.gov.uk/government/publications/update-on-plans-for-the-regulation-of-fiat-backed-stablecoins.

⁴ In this letter, 'protections' refers to arrangements and provisions that aim to protect customers in the event of the failure, or potential failure of a firm, eg the Financial Services Compensation Scheme (FSCS) for depositors; the ranking of claims in the creditor hierarchy; regulatory requirements such as those for capital, liquidity, or backing assets; and supervision.

⁵ October 2023: www.gov.uk/government/publications/update-on-plans-for-the-regulation-of-fiat-backed-stablecoins.

'tokenisation' of deposits. The protections available to retail depositors in particular reflect the importance for financial stability of ensuring confidence in deposits.

Alongside deposits, non-deposit forms of digital money or money-like instruments are increasing in availability. For example, e-money has been in existence for over a decade and issuing e-money is already a regulated activity. HMT, the FCA and the Bank are working to bring certain activities relating to stablecoins – an innovation that could become widely used for payments in the future – into the regulatory perimeter, including through a new issuance activity. Protections for retail holders of e-money and regulated stablecoins differ from those for retail depositors, as set out in Annex 2.

With the emergence of multiple forms of digital money and money-like instruments, there is a risk of confusion among customers, especially retail customers, if deposit-taking entities were to offer e-money or regulated stablecoins under the same branding as their deposits. Retail holders of e-money or regulated stablecoins might mistakenly assume that they have exactly the same protections as retail depositors. This risks contagion, even for stablecoins used in systemic payment systems (for which the Bank's proposed regime aims to ensure an equivalent overall level of protection to that for depositors, but with different types of protection). In particular, following any event that draws retail customers' attention to different types of protections, or prompts them to lose confidence in e-money or regulated stablecoins, retail customers may lose confidence in deposits – especially if deposit-takers were to offer multiple forms of digital money or money-like instruments.

We therefore expect deposit-takers to mitigate the risk of contagion in the following ways. Deposit-takers that experience any difficulty or hesitation in mitigating the risk of contagion in these ways should contact their supervisors.

First, deposit-takers should ensure that deposit-taking entities only provide innovations in digital money to retail customers in the form of deposits. If deposit-takers or their groups want to issue e-money or regulated stablecoins to retail customers, then this should be done from separate non-deposit-taking and insolvency-remote entities, ensuring that: (i) they have distinct branding to the deposit-taker; and (ii) their failure would not have adverse impacts on the rest of the deposit-taking group and the continuity of its deposit-taking services. We recognise that a small number of deposit-takers have already issued e-money to retail customers from a deposit-taking entity. These deposit-takers should engage with the PRA on how they intend to mitigate the risk of contagion and restructure their activities as soon as practicable. The PRA recognises such deposit-takers may need time to adjust and will adopt a proportionate approach to implementation.

Second, where a firm without a deposit-taking permission has issued e-money or regulated stablecoins to retail customers and seeks a deposit-taking permission, we

expect them to transition their UK customers to deposits at the new deposit-taking entity as soon as practicable; and to engage with the PRA on their plans to do so.

Third, where a deposit-taker intends to innovate in the way that it takes deposits from retail customers (eg by taking ‘tokenised’ deposits), we expect this to be done in a way that meets the PRA’s rules for eligibility for depositor protection under the FSCS.⁶ Deposit-takers must also ensure they meet the single customer view and exclusions view requirements in respect of such deposits.⁷ Deposit-takers considering such innovations – especially innovations such as transferable ‘tokenised’ deposit claims,⁸ where they may find it more challenging to meet these rules – should inform their supervisor of their intentions. The PRA will continue to monitor potential risks and risk-mitigants for such innovations as more applications and use cases emerge, and may apply additional expectations for them in due course.

For international deposit-takers with UK branches, or for those seeking to open them, this letter should be read in conjunction with the PRA’s expectations for international deposit-takers that engage in retail activities.⁹ But it should be noted that the risk of contagion described above exists independently of the scale of any particular operations, and we expect international deposit-takers operating in the UK to follow the same approach as domestic deposit-takers for their UK operations.

The PRA’s broader expectations for deposit-takers in the context of either retail or wholesale innovations in the use of digital money or money-like instruments are set out in Annex 3. We highlight that all such innovations may pose novel challenges. For example, there is a risk that the product or customer characteristics associated with these innovations may expose deposit-takers to a higher liquidity risk than that usually assumed for traditional retail liabilities. And where they could lead to reliance on new

⁶ The Depositor Protection Part of the PRA Rulebook. These requirements include that: the customer’s claim is not a debt security, or an obligation whose existence can only be proven by a financial instrument; principal is repayable at par; and the holder and any beneficial owner of the deposit have been identified in accordance with money laundering regulations.

⁷ In outline, single customer view and exclusion view requirements mean deposit-takers must be able, within 24 hours of a request, to provide files with prescribed information about depositor balances and the identity and address of depositors, so that the FSCS could operationalise a rapid pay-out. See definitions of ‘single customer view’ and ‘exclusions view’ in Rule 1.4 and the Single Customer View Requirements in Chapter 12 of the Depositor Protection Part.

⁸ We are aware of market participants exploring the possibility of tokenised deposit arrangements in which the token representing the deposit claim is a transferable liability of the issuing deposit-taker and where, in payment transactions that involve a transfer of the token between individuals, the recipient becomes a customer of the issuing deposit-taker.

⁹ Supervisory statement (SS) 5/21 – International banks: The PRA’s approach to branch and subsidiary supervision: www.bankofengland.co.uk/prudential-regulation/publication/2021/july/pru-approach-to-branch-and-subsiary-supervision-ss.

and potentially untested payment rails with operational uncertainties, we expect deposit-takers to have fully understood the impact of such innovations on their operational resilience, and to have met our supervisory expectations as set out in SS1/21¹⁰ and SS2/21,¹¹ before offering them to customers in any material way.

Deposit-takers should consider such challenges at a senior level within their organisations. We expect boards and senior management teams to understand the potential safety and soundness implications of moving into such innovations before they do so. In particular, an individual approved by the PRA to perform an appropriate Senior Management Function should be actively involved in reviewing and signing off on the risk assessment framework for any planned use of new technology in the provision of important business services and critical functions.

Next steps

Fundamental Rule 7 requires deposit-takers to deal with regulators in an open and co-operative way, and to disclose appropriately anything of which we would reasonably expect notice. Accordingly, we ask you to keep your supervisor(s) updated about any material developments in your planned innovations in the use of digital money or money-like instruments, and how your plans meet the expectations set out in this letter. We will continue to monitor developments and to work with other UK authorities on the development of overall regulatory framework.

Yours sincerely,



David Bailey
Executive Director
UK Deposit Takers



Nathanaël Benjamin
Executive Director
Authorisations, Regulatory
Technology and
International
Supervision



Vicky Saporta
Executive Director
Prudential Policy

¹⁰ March 2021: www.bankofengland.co.uk/prudential-regulation/publication/2021/march/operational-resilience-impact-tolerances-for-important-business-services-ss.

¹¹ March 2021: www.bankofengland.co.uk/prudential-regulation/publication/2021/march/outsourcing-and-third-party-risk-management-ss.

Annex 1: Definitions of the forms of digital money and money-like instruments discussed in this letter

Deposit	A sum of money within the meaning of Article 5 of The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).
'Tokenised' deposit	Concepts, terms, potential forms and use cases for tokenisation are still evolving. Standard-setters and market participants have not yet settled on any definitions for 'tokenised' deposits. In this letter, tokenised deposits mean deposit claims represented on programmable ledgers that enable novel techniques such as atomic settlement and smart contracts.
E-money	Electronically stored monetary value as represented by a claim on the issuer within the meaning of the Electronic Money Regulations 2011 (SI 2011/99).
Regulated stablecoin	Stablecoins described as 'fiat-backed stablecoins' within the meaning of HMT's update on plans for the regulation of fiat-backed stablecoins (October 2023), ie a form of digital asset that purports to maintain a stable value relative to a fiat currency by holding assets (which may be of variable value) as backing.

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Annex 2: Risk of contagion arising from multiple forms of digital money or money-like instruments with different protections

Current and future non-deposit forms of digital money or money-like instruments – specifically e-money and regulated stablecoins under the FCA’s and the Bank’s proposed regimes – come with different protections for their retail holders than those for retail depositors.

If a firm that offers e-money or regulated stablecoins were to fail and be placed into insolvency, outcomes for retail holders of e-money or regulated stablecoins would differ – in terms of speed of the return of funds and their risk of absorbing some losses – from those for retail depositors. These differences are set out in the ‘e-money versus deposits’ and ‘regulated stablecoins versus deposits’ sections below.

Retail customers may not fully appreciate these differences and might expect all forms of digital money or money-like instruments to have the same types and levels of protection as those that come with deposits. This expectation – and hence the potential for confusion – is likely to be stronger among customers of deposit-takers if they were also to offer multiple forms of digital money or money-like instruments.

The PRA is concerned that any event which draws attention to the differences in protections or otherwise prompts retail customers to lose confidence in a non-deposit instrument, such as the failure and insolvency of a firm that offers it, could also lead to a loss of confidence in deposits – especially if deposit-takers were to offer multiple forms of digital money or money-like instruments. This contagion risk could pose significant risks to safety and soundness, and could therefore have an adverse effect on the stability of the UK financial system.

E-money versus deposits

There are differences in the level and types of effective protections when deposits and e-money are compared:



- Deposit protection by the FSCS applies to eligible deposits,¹² but not to e-money.¹³ FSCS protection applies up to a limit of £85,000¹⁴ per person per deposit-taker. The FSCS aims to pay compensation within seven days of the failure of a deposit-taker, although more complex cases will take longer.
- If a deposit-taker that has issued e-money were to fail, holders of FSCS-eligible deposits would be preferred creditors in insolvency, but (if the deposit-taker is not a credit union) holders of e-money would rank as unsecured creditors.

As a result, if an e-money institution (EMI), or a deposit-taker with the preferred resolution strategy of modified insolvency¹⁵ that has issued e-money, were to fail, customers might not get their e-money funds back, and payment of any refunds to e-money customers would typically take much longer than compensation to holders of FSCS-protected deposits.¹⁶ The FCA has previously expressed concern that EMIs have not adequately disclosed these differences to their customers.¹⁷

Regulated stablecoins versus deposits

Recent legislative changes (in FSMA 2023), alongside existing powers (in FSMA 2000), have extended the regulatory framework to capture, and allowed UK authorities to regulate, certain activities relating to stablecoins.

FSMA 2023 provides the Bank with powers over payment systems that use a Digital Settlement Asset (DSA) and are recognised by HMT as systemic, and over related service providers. The definition of DSA was designed to capture regulated stablecoins, but has been drawn broadly in order to ensure the required future regulatory flexibility.

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¹² As defined in Rule 2.2 of the Depositor Protection Part.

¹³ Article 9J of the FSMA 2000 (Regulated Activities) Order 2001 excludes e-money from the scope of the FSCS.

¹⁴ The limit is increased to £1,000,000, or is unlimited or otherwise varied, in some circumstances. See Chapter 4 of the Depositor Protection Part.

¹⁵ December 2021: www.bankofengland.co.uk/paper/2021/the-boes-approach-to-setting-mrel-sop.

¹⁶ Deposit-takers whose preferred resolution strategies would apply stabilisation powers, including bail-in, would not be expected to go into insolvency. They should have sufficient MREL to enable loss absorption and recapitalisation; and have other continuity arrangements such that customers would be able to keep accessing their accounts and business services as normal through the resolution.

¹⁷ May 2021: www.fca.org.uk/publication/correspondence/dear-ceo-letter-e-money-firms.pdf.

¹⁸ The definition of a DSA is 'a digital representation of value or rights, whether or not cryptographically secured that: a) can be used for the settlement of payment obligations; b) can be transferred, stored or traded electronically; and c) uses technology supporting the recording or storage of data (including DLT)'. A DSA also includes a right to, or an interest in, a DSA. A DSA comprises only those assets that can be used for the settlement of payments.

Forthcoming legislative changes to the UK regulatory perimeter will create a new regulated activity of issuing regulated stablecoins, regulated by the FCA.¹⁹ HMT has announced that tokenised deposits will be excluded from the definition of regulated stablecoins, but the precise legal form of this exclusion has still to be settled.

Protections proposed for holders of regulated stablecoins will also differ from those given to depositors, so issuance of regulated stablecoins could give rise to the same risk of contagion as outlined for e-money above.

Contagion risks will be lower for stablecoins used in systemic payment systems regulated by the Bank, than for e-money or other regulated stablecoins captured by the FCA's regime. The Bank's proposed regime for stablecoins used in systemic payment systems aims to ensure that the overall level of protection for coinholders is equivalent to that for depositors, in line with the Financial Policy Committee's (FPC) expectations for stablecoins set out in the December 2019 Financial Stability Report.²⁰ But the types of protection will still differ.

Issuers of stablecoins used in systemic payment systems regulated by the Bank will be subject to the modified Financial Market Infrastructure Special Administration Regime (FMI SAR). The modified FMI SAR is not a resolution regime, so it will not have the range of tools to facilitate continuity of service in the way that resolution regimes do for the largest deposit-takers. In addition, the timeliness of payout by issuers will be dependent on the speed with which administrators are able to make such payout. It is likely that the payment of refunds to coinholders may not be as swift as compensation to holders of FSCS-protected deposits.

Other elements of the proposed regime for stablecoins used in systemic payment systems regulated by the Bank will be stricter than for deposits, to ensure that the overall level of protection is equivalent to that for depositors. This will include strict backing requirements, capital and shortfall reserve requirements, and a trust structure, to ensure coinholders' funds are protected at all times.

¹⁹ October 2023: www.gov.uk/government/publications/update-on-plans-for-the-regulation-of-fiat-backed-stablecoins.

²⁰ December 2019: www.bankofengland.co.uk/financial-stability-report/2019/december-2019.

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Annex 3: Our broader expectations for deposit-takers for innovations in the use of digital money or money-like instruments

Money Laundering/Terrorist Financing risks

The PRA continues to consider money laundering and terrorist financing (ML/TF) concerns in our prudential assessments of deposit-takers.²¹

Where your firm decides to engage in innovations in the use of any form of digital money or money-like instrument, you should meet deposit-takers' obligations under the PRA's General Organisational Requirements to have effective processes for identifying, managing, monitoring and reporting ML/TF risks. And in line with the PRA's Fundamental Rule 1 that a deposit-taker must conduct its business with integrity, we remind you of your wider obligations, including compliance with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, and with the FCA's SYSC provisions.

Strong risk controls

In addition to mitigating the risks from customer confusion set out above, where your firm decides to engage in innovations in the use of any form of digital money or money-like instrument, you should meet deposit-takers' general responsibilities under the PRA's Fundamental Rules 3, 5 and 7 to: (i) act in a prudent manner; (ii) have effective risk strategies and risk management systems; and (iii) deal with regulators in an open and co-operative way, and disclose appropriately anything relating to your deposit-taker of which we would reasonably expect notice.

The banking prudential regulatory framework is flexible and risk-sensitive. The scope and level of requirements of the framework can adjust up and down in a proportionate way, depending on the risks of different business models and activities. However, within the existing regulatory framework, deposit-takers may need to adjust methodologies and calibrations for identifying and addressing relevant risks in some

²¹ September 2019: www.bankofengland.co.uk/prudential-regulation/letter/2019/money-laundering-terrorist-financing-risks-in-prudential-supervision.



areas if innovative digital money products are offered. We provide you with some examples of aspects that may need consideration below.

Liquidity and funding risk

Where deposit-takers offer innovative forms of digital money or money-like instruments to retail customers, there is a risk that their product or customer characteristics will expose deposit-takers to a higher liquidity risk than that usually assumed for traditional retail liabilities. When considered alongside the greater uncertainty about the nature and scale of risks when products are new, deposit-takers should be extra prudent in relation to such innovations.

The PRA has a general expectation that deposit-takers ensure they assess and capture the liquidity risk of their liabilities. In order to ensure these risks are captured in this context, deposit-takers should:

- Actively consider the appropriate outflow rates for new types of retail liability (including innovative forms of digital money or money-like instruments) when calculating their Liquidity Coverage Ratio, based on factors such as the relationship between the deposit-taker and the customer, nature of the liability, and remuneration rate compared to that applied to similar retail liabilities;²² and
- Actively assess and capture the liquidity risk posed by their new types of retail liability (including innovative forms of digital money or money-like instruments) via internal liquidity stress testing.²³ For example, where such innovations are offered via third parties and represent a significant portion of their balance sheet, this could present a concentrated liquidity risk for those deposit-takers. In line with the 2021 Dear CEO letter on deposit aggregators from the PRA and the FCA,²⁴ deposit-takers should factor such considerations into their management of liquidity risk and funding needs.

Operational risk and resilience, including third-party risk management

Some innovations in the use of digital money or money-like instruments by deposit-takers could lead to reliance on new and potentially untested payment rails with operational uncertainties. Third parties, such as deposit aggregators and wallet providers, already play key roles in the delivery of deposit-takers' important business services; and the services they provide to deposit-takers may change and grow as innovations in the use of digital money or money-like instruments develop.

²² As set out in the Liquidity Coverage Ratio Part.

²³ As required by the Internal Liquidity Adequacy Assessment Part.

²⁴ April 2021: www.bankofengland.co.uk/prudential-regulation/letter/2021/april/deposit-aggregators.

The PRA's operational risk capital framework is flexible enough to capture operational risks arising from such innovations. However, the limited past data to model the kind of novel operational risks these innovations bring will present a particular challenge for deposit-takers. In line with the PRA's Fundamental Rule 5 to have effective risk strategies and risk management systems, deposit-takers that want to introduce such innovations should – as a priority – develop robust ways of identifying, measuring and mitigating associated operational risks.

We expect deposit-takers to have fully understood the impact of such innovations on their operational resilience, and to have met our supervisory expectations as set out in SS1/21 and SS2/21, before offering them to customers in any material way.

Wallet providers and deposit aggregators (third-party risk management)

There is an emerging class of third-party wallet and deposit aggregation products, in part enabled by open banking. As these services grow, deposit-takers should ensure they closely and prudently manage the risks arising from using services provided by external third parties through outsourcing and other arrangements as part of their wider operational-resilience framework.

Where third parties are involved in providing wallet services for deposits and act as deposit aggregators,²⁵ deposit-takers should meet their obligations to prepare for resolution – in line with the 2021 Dear CEO letter on deposit aggregators from the PRA and FCA – and meet single customer view and exclusions view requirements. They may need to plan ahead with wallet providers to ensure eligible claimant criteria are met and customer-specific information is available to ensure a swift FSCS pay-out.

One way of facilitating a swift FSCS pay-out would be for third parties to provide wallets on a pass-through basis. When pass-through wallets are used, users are direct customers of the deposit-taker (as with deposit aggregators that use the direct model as opposed to the trust model) and users' balances are recorded on the deposit-taker's ledger. Pass-through wallets would allow customers to hold and use deposits which would always be a direct liability of the deposit-taker.

²⁵ Deposit aggregators are providers of intermediary services who sit between savings account providers and retail customers. Deposit aggregators operate under two models: one where their customers become direct customers of the firm ('direct models'), or one where the deposit aggregator holds the deposit accounts on trust for their customers who thus do not become the firm's direct customers ('trust models'). Customers who place their deposits via a deposit aggregator may not fully understand how these relationships work or, in trust models, how they can differ from a direct-depositor relationship. They may not know that in the event of a failure of the deposit-taker, FSCS payments can take longer for deposits placed via a deposit aggregator under the trust model.

Senior managers' responsibilities

Innovations in the use of digital money or money-like instruments by deposit-takers could pose novel challenges that should be considered at a senior level within those deposit-takers. We expect boards and senior managers to understand the safety and soundness implications of moving into such innovations before they do so. In particular, an individual approved by the PRA to perform an appropriate Senior Management Function should be actively involved in reviewing and signing off on the risk assessment framework for any planned use of new technology in the provision of important business services and critical functions.