Response to the UK Government (HM Treasury) Consultation on Managing the Failure of Systemic Digital Settlement Asset Firms

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This response is provided by Dr Alisdair MacPherson, Prof Donna McKenzie Skene and Dr Burcu Yüksel Ripley of the Centre for Commercial Law at the University of Aberdeen.

We welcome this consultation and appreciate the opportunity to provide our comments. We have particular interests in the areas covered by the consultation, namely, the law and regulation of digital assets, the law of finance and insolvency and restructuring law (please see our responses to the previous consultations in these areas at https://www.abdn.ac.uk/law/research/centre-for-commercial-law/public-policy-stakeholder-engagement-1109.php). Given that the UK government (rightly) "considers it necessary to ensure appropriate, and proportionate, tools are in place to mitigate the financial stability issues that may materialise should a firm that has reached systemic scale fail" (para 1.2), we support the decision to consult on the chosen topic and generally agree with the conclusions and proposals in the consultation.

Questions

1. **Do you have any comments on the intention to appoint the FMI SAR as the primary regime for systemic DSA firms (as defined at para 1.8) which aren't banks?**

We agree that there is some justification for using a Special Administration Regime (SAR) for systemic DSA firms, given that their systemic status may mean it is not in the public interest for the general administration process to apply. The intention to use the FMI SAR as the primary regime for systemic DSA firms appears justifiable on the basis that the FMI SAR was established to deal with risks posed by the potential failure of systemic payment systems and to address public interest issues. Furthermore, we understand why the UK government considers the Bank of England to be the most appropriate lead regulator in the administration of systemic DSA firms. In any event, making legislative provision as to the relevant FMI SAR for systemic DSA firms, and identifying which of the two SARs would take precedence if both could apply, would provide clarity and greater certainty.

A further point to note in passing is that DSA firms will not necessarily operate only in the UK or in UK currency, which means there could be practical issues involving systemic DSA firms that do not exist in relation to certain other payment systems, to which the FMI SAR regime would ordinarily apply. It may be that any such issues could be overcome without too much difficulty; however, we consider it prudent to raise the matter.

2. **Do you have any comments on the intention to establish an additional objective for the FMI SAR focused on the return or transfer of customer funds, similar to that found in the PESAR, to apply solely to systemic DSA firms?**

We understand the value in having an additional objective for the FMI SAR to apply solely to systemic DSA firms, focused on the return or transfer of customer funds. The nature and role of these firms, which may effectively have dual functions, in comparison to other firms falling under

the FMI SAR would justify this bespoke element. We agree that, as noted in the consultation paper, the usual FMI SAR primary objective focused on continuity of service may not be sufficient to mitigate risks to financial stability for at least some systemic DSA firms. The introduction of such an additional objective does, however, raise questions as to its interaction with the normal order of distribution where that objective applies. Such questions could, however, be addressed in the legislation.

3. **Do you have any comments on the intention to provide the Bank of England with the power to direct administrators, and to introduce further regulations in support of the FMI SAR to ensure the additional objective can be effectively managed, or what further regulation may be required?**

We consider it to be appropriate to provide the Bank of England with the power to direct administrators as to which objective should apply or take priority in a relevant administration. This will allow for financial stability matters and the public interest to be addressed through flexibility and the ability to make a decision based upon the prevailing circumstances. It seems to us that a relevant direction would need to be made at an early stage, and provision would need to be made for appropriate time limits for this so that the administrator would be able to act appropriately from the beginning.

Given the need to potentially apply the FMI SAR to systemic DSA firms in a different way in comparison to other firms falling under the regime, further regulations would be a suitable means of dealing with this. However, care should be taken to make sure that those regulations are limited to what is necessary, rather than placing additional burdens on any relevant party without providing substantive value or effectiveness.

A broader point is that given the need to adapt the FMI SAR regime for systemic DSA firms and to have further regulations to deal with this, then an argument could be made that there should be a separate SAR for systemic DSA firms developed now, rather than using the FMI SAR with add ons (particularly if the further regulations are considerable). We appreciate that the intention is to consider further whether a bespoke legal framework is necessary while ensuring that there is an effective regime meantime, and we do not necessarily have a preference for this approach or enough detail to ascertain its comparative value, but raise it for potential further consideration.

4. **Do you have any comments on the intention to require the Bank of England to consult with the Financial Conduct Authority prior to seeking an administration order or directing administrators where regulatory overlaps may occur?**

We agree that the Bank of England should consult with the FCA prior to seeking an administration order or directing administrators where regulatory overlaps may occur. This is sensible given the potential impact on consumers and is also more broadly useful from an information-sharing and cooperative decision-making perspective. In some instances, the consultation between the Bank of England and FCA may help determine future steps to be taken by both parties (especially if relevant potential decisions are otherwise finely balanced). The approach is also consistent with the approach taken for other entities regulated by the Bank of England and FCA, which seems to work in practice. We would, however, once again refer to the need for any directions to administrators to be made at an early stage, with the consequence that there would need to be appropriate time limits for consultation to take place.