THE BANK OF ENGLAND'S APPROACH TO STABLECOINS: A COMMENT

KING'S College LONDON | KING'S BUSINESS SCHOOL | QATAR CENTRE FOR GLOBAL BANKING & FINANCE

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INTRODUCTION

All statements in this note should be regarded as reflecting my own views and not necessarily the views of any institution with which I am affiliated or for which I work or consult.[1]

For some time, I have been concerned by the Bank of England's approach to digital money. The concern spans their CBDC strategy and their attitudes towards privately issued moneys. Encouraging responsible innovation should be a priority for anyone concerned with British economic prospects in the long term, and I worry the Bank's approach is not consistent with that.

The overarching theme to my comments will be that the Bank is too dogmatic and extreme in its views on money – and on stablecoins in particular. There is evidence of this in Andrew Bailey's speeches, but I think the issue reaches deeper within the institution.

To begin with, let us make a general assertion: unless a regulator can point to egregious financial stability risks, or dramatic inefficiencies, or clear unfairness, then they should not be intervening. We live in a free society and if a financial product can be offered, then the default position should be that it is allowed to be offered. Households and businesses can then decide whether or not they wish to use it. This should not be controversial.

It could be that the Bank dislikes a product or thinks it is inferior to other products, but it is not their place to ban that product or undermine it to the extent that it becomes infeasible to offer. They should not invent a criterion that a product may or may not perform well upon, and then decide to ban a product on the basis of that criterion, which households and businesses are themselves willing to overlook – or at least trade off against other strengths and weaknesses of the product. The bank has elevated an extreme definition of "singleness of money" to become such a criterion and it is leading them to make increasingly misguided statements and pursue increasingly questionable policies in relation to stablecoins.

SINGLENESS AND KEY PROPERTIES OF MONEY

Singleness of money has recently emerged as a talking point in various debates over digital money. It is less a property of money, than of a set of moneys. It is commonly (and regrettably) defined in the most literal of ways – that every asset being used as money in an economy should trade at a 1:1 exchange rate with each other, or "at par". The unit of account in a country can reasonably be taken to be the unit of central bank issued money, so this is typically a question of how private moneys trade in relation to the face value of cash and central bank reserves.

[1] I was lucky enough to work on *Single Minded? Stablecoins and the singleness of money* with a host of industry experts on stablecoins. The note covers many topics similar to those in this piece. This single-authored note articulates my own personal views.

Whether a money trades at par in this way is *not* a fundamental property of money even if it is a widespread property of the money we use for much of the time – that is, commercial bank deposits. An asset can be a money even if it does not satisfy singleness always and everywhere. *Whether it is a good money is another matter!* All else equal, trading as close as possible to par is a desirable property – welfare losses arise from exchange rate volatility. But all else may *not* be equal and there are many other characteristics that determine the quality and effectiveness of a money.

Traditionally, money is defined as an asset that plays three roles: a unit of account, a store of value and a medium of exchange. There can be variation in how effective an asset is in any one of these dimensions. Of course, if it fails dramatically to satisfy any of these properties then perhaps it is unnatural to think of the asset as money. Small deviations from par surely do not disqualify an asset from being regarded as money, particularly if it is clearly being used as such at scale. The Bank has developed a bad habit of dismissing assets that are clearly moneys simply because they do not satisfy a very literal definition of singleness. This is most obvious in their treatment of stablecoins. They seem to take the extraordinarily extreme stance that a necessary condition for an asset to be regarded as money is that it must always and everywhere be at par – something stablecoins in secondary markets will likely never strictly achieve, even if they reduce deviations to *de minimis* levels.

THE BANK'S APPROACH

The Bank adopted a rather extreme position in their proposals relating to "systemic stablecoins" issued in 2023. These proposals seemed to reject the model of HQLA-backed stablecoins in favour of reserve backed stablecoins. For large value settlement/RTGS-type systems, this is perhaps reasonable – at least until custody of reserve assets and auditing of stablecoins improves and they have a track record of battle-tested reliability (both of which processes are underway). Until HQLA backed stablecoins show substantial improvements in governance and regulation, and the liquidity of their on-chain markets improves, they should likely not underpin such enormously systemic markets.

Regrettably, within the Bank's definition of systemic stablecoins, they also include the sort of coins that would be substitutes for low to medium value payments currently implemented using bank deposits. It is far from obvious that these situations call for such backing. Provided that stablecoins improve their custody/audit, it is very unclear that a coin backed by short maturity gilts, say, is riskier – at least from a solvency position – than a bank deposit, even if the bank is subject to traditional banking regulation and oversight. It is well known that banking regulation is riddled with loopholes and that bank balance sheets are often too opaque for regulators fully to assess their risks (see SVB and the not-too-distant experience of the GFC). Personally, I would be more confident in the liabilities issued by a narrow bank holding short maturity gilts than I would deposits with a regulated bank –

provided I am assured that they do in fact have those gilts and that they are held by a regulated custodian.

But what about deposit insurance? Deposit insurance and various other services governments/central banks provide to bank depositors probably should be offered in some form to stablecoin holders – deposit insurance surely plays an important role in financial stability. But deposit insurance is perhaps less vital in the context of a "narrow banking" model which stablecoins often pursue (backing themselves with short maturity HQLA and cash-like assets), rather than "fractional banking" pursued by a typical commercial bank with an elaborate loan book and other opaque and risky assets.

It should also be noted that there are significant concerns with the effectiveness of traditional deposit insurance for fractionally backed banks, where corporate deposits (again see SVB) are now, it seems, quite flighty and are in many cases well above any insurance threshold. As such, it is not at all clear that a large fraction of deposits at banks are as safe as people traditionally depict them as being, even in the presence of deposit insurance.

This raises the awkward point of why the Bank (and other central banks/governments) feels it is appropriate to support existing moneys with lines, lending facilities, deposit insurance – but are reluctant to provide a level playing field for other money creators. It is doubly awkward when in recent times many facilities have been created at fairly short notice to support financial institutions with far less compelling collateral than the sort of short term HQLA that many stablecoins hold. It is notable that the non-bank contingent lending facility that the Bank has recently announced is precisely the sort of facility they could offer to stablecoins if they truly wished to enhance stablecoins' ability to offer singleness of money. Arguably a standing facility (with haircuts and penalty rates) could be made available at all times, to simplify stablecoin redemption and enhance singleness. There are a wide variety of liquidity schemes in use around the world (see this recent survey) and it is an interesting question what might be an optimal liquidity support framework for stablecoin issuers.

At the moment, the Bank can reasonably argue that the governance, audit and asset custody practices of stablecoins, and the absence of regulatory oversight are such that the Bank might be exposed to unacceptable credit risk in providing such facilities. But that is the job of the Bank to fix – or for the Bank to advise the government on how to fix.

IN THEORY, STABLECOINS SHOULD BE VERY SAFE

Regulating a money issuer whose assets comprise a list of gilts, Treasuries and a few bank accounts should not be difficult – or at least it should be far less difficult and require far less resource intensive oversight than for a commercial bank. Central banks endlessly repeat the mantra of "same risks, same regulation" but in this case (subject to improved custody and audit) it is fairly obvious that stablecoins can be made much less risky. By the corollary of

that mantra, they should receive (eventually) "less regulation", reflecting "less risk". If a commercial bank with an opaque and complicated balance sheet, full of all sorts of loans and obscure assets were suddenly to convert all their asset holdings to gilts, that bank would be regarded as super safe and a breeze to regulate. That is essentially what an HQLA backed stablecoin is (though there is the remaining functional difference that their liabilities are bearer assets, rather than deposit accounts).

The Bank should provide clearer analysis on how oversight of HQLA backed stablecoins could be implemented and what support they could offer. If the Bank provides lines secured with short maturity gilts that are well audited, and maybe even prepositioned, then it is very hard to see why the classic Bagehot dictums do not justify secured lending to stablecoins suffering heavy redemptions, or buying the HQLA to support their prices. These actions would promote a high degree of value stability in stablecoins. Does the Bank want singleness or not?

It is very hard to run on a narrow bank holding short maturity gilts – and it is even harder to see that run starting, let alone being systemically damaging, if it is known that the central bank stands ready to buy, or lend against, gilts. If the Bank is frightened to lend against gilts, then we really have bigger problems than liquidity pressure on stablecoin issuers!

A TREND TOWARDS MORE EXTREME POSITIONS

The Bank's systemic stablecoin consultation was at the time thought very risk averse and was already an outlier relative to other jurisdictions' approaches to stablecoins in apparently only countenancing reserve-backed stablecoins. Such coins seem essentially credit risk free but in the absence of perfect arbitrage could also deviate from par in secondary markets. Perhaps this latter possibility has led the Bank to what now appears to be an even more extreme position, apparently captured in the "Outcome 1" of their recent Digital Pound update:

> The design, operation and supervision of retail payment systems must support confidence in the one-for-one exchange between central bank money and private money – whether commercial bank money or stablecoins. Put another way, all different forms of money must be exchangeable with each other at par value and at all times.
>
> Any new retail payment systems, whether using commercial bank money or stablecoins, must be interoperable with Real-Time Gross Settlement (RTGS) as the UK's core payments and settlement infrastructure, so that settlement can ultimately take place in central bank money and so support the singleness of money.

I feel there is much that is misguided in this statement or – at best – that is damagingly ambiguous. As such, we will gradually unpack it in steps...

First, there is the implicit assertion that it is the Bank's place to stop people from deciding whether or not a settlement asset that, say, trades at a random price between 0.999 and

1.001 but which settles almost immediately and at a low fee, is suitable for their purposes. Well informed corporate treasurers and financial market participants – and indeed the citizenry – could likely make this decision themselves. Might they not take out insurance for the tiny exchange rate volatility well-functioning stablecoins might imply?

Second, the most problematic assertion is the idea that to be money, or a product that people should be allowed to use as money, a stablecoin must at all times be exchangeable with other moneys at par – what I refer to as the "always and everywhere at par" approach. Presumably this means in secondary markets, but this will never (literally) happen – even if the deviations ultimately become minute.[2] The Bank appears to be adopting an extreme position without any nuance, whereas other jurisdictions provide scope for flexibility. Are MAS regulated stablecoins with a "high degree of value stability" not money?

It may not sound like a huge difference – contrasting the Bank's singleness stance with the MAS' stance of aiming for "a high degree of value stability" but it is an enormous difference. Seeking an unattainable limiting case means that the Bank cannot allow any sort of trade-off with the other advantages of stablecoins and the weaknesses of existing digital moneys, notably bank deposits. The overly literal singleness approach allows no room for experimentation or debate.

The idea that there is no scope for any "approximate singleness" (an awkward phrase featured in this Garratt and Shin note) also is somewhat in tension with how MMFs are treated. In that case, depending on whether they have floating or fixed NAV, a certain number of decimal points of deviation from a "buck" is permitted, for the fund still to be reported as being at par and treated as cash equivalent.[3]

Third, the assertion that ultimate settlement must always occur in central bank money is again far too extreme – assuming again that the Bank includes secondary market activity to fall under their requirements. Even the IOSCO PFMI's only say it is desirable to settle in central bank money, and leaves open the option to settle in an asset with excellent liquidity

[2] In other documentation the bank speaks in a way that suggests they don't only mean singleness in primary (issuance and redemption) markets: "*all different forms of money – whether we hold them in bank accounts, notes, or coins etc – must be exchangeable with each other at par value*". If the bank is referring to purely to primary market in defining "exchangeable", their position would be much more reasonable as reliable redemption at par is a much more solid concept to be defending. But I do not think this is their stance. At best, their position is ambiguous and needs to be clarified in this important respect. It occurs to me they might even be thinking of a EURO1 or Fnality type model with essentially a reserve backed stablecoin operating *within* an overarching account in the reserves system. It is very unclear.

[3] The excessive citing of the US free banking era (see Gorton's wildcat stablecoin paper – and Nic Carter's thoughtful response) also needs to stop. Bank balance sheets in that period were awful, arbitrage was enforced by riding a horse (or perhaps?) sending a telegram or mail between NYC and Philly. It is difficult to see the practical relevance to the stablecoins of today, though the Gorton paper makes other interesting points about shortages of risk bearing assets and the similarity of stables to MMF. Interestingly, in a more recent paper on stables being staked to earn a yield, to offset risks for their holders, Gorton indirectly makes a case for the simpler and more transparent model of allowing yield-bearing stables (again, see Nic Carter on this topic). Is an inflation protected stable beyond the pale? Index linked stables seem to be implicitly banned by banning interest on stables.

and low/no credit risk – and those principles relate to very high value payments, not the sort of transactions that the vast majority of household and non-financial business users make every day with bank deposits.

This points to the perhaps questionable nature of the Bank/FCA's adopted approach of splitting stablecoins into two categories – systemic and non-systemic stablecoins. In the systemic category they lumped together high value payment with payments that (again, with better regulation and governance) absolutely should be fair game for stables to compete over, with banks and other e-money providers.

The Bank should as a matter of urgency split their systemic category into settlement assets for large value payments and widely held retail moneys. In the former, it may (in the short run at least) be reasonable to stick with reserves or reserve backed stablecoins. One benefit of the latter would be that the Bank could learn about how to handle payments in stables, without having to worry about credit risk. They could also learn how the market might handle exchange rate risk in secondary markets (as even a reserve backed stablecoin will deviate from par, owing to imperfect arbitrage). Having a relatively safe live environment to learn in would be enormously useful. Plausibly the digital FMI sandbox they already offer should be broadened to allow for more substantive stablecoin experiments.

Finally, it is very unclear what the Bank means by "interoperability" with RTGS. Settlement is identified with exchange of a bearer asset like a stablecoin. There is no need for any auxiliary interbank settlement through RTGS on the central bank's balance sheet (via reserve accounts) when person A sends person B a stablecoin. In contrast, when person A pays person B (at another bank) with deposits there does need to be ultimate settlement between the two banks for that transaction to have completely settled.[4] If that were not assured, then we would quickly see doubts about singleness of money among deposits re-emerge, and it is possible that one of both banks would stop being willing to enable the transaction for the users, at least at par. This is why intraday credit and other support facilities are offered, in addition to heavy vetting of who can participate in reserves systems. Again, it is vital to note the significant work many central banks do in the background to support singleness in traditional systems, which should be contrasted with the absence of such work – bordering on obstructionism in some cases – in their approach to stablecoins.

It may be reasonable to plug stablecoin issuers (or whoever handles their redemptions) into the reserves system. This may enhance the speed of redemption, though this can likely also be achieved via non-bank lending facilities or by stables holding a fraction of their backing asset with banks (though hopefully not the amazingly high ratios MiCA seems to be demanding!). But a standard transaction between stablecoin users absolutely does not require any connection to RTGS. A transaction in stablecoins implies immediate settlement

[4] From a practical point, global stablecoins are often involved in cross border transactions, making it very difficult to see how a foreign citizen might be incorporated into an RTGS-based settlement model.

and this can be buttressed with explicit legal acknowledgement of this fact (ideally codified in legislation). This is the essence of exchanging bearer assets and it is distinct from bank deposit transactions.[5]

TOWARDS A MORE NUANCED APPROACH

We can contrast the Bank's approach with jurisdictions such as Singapore, and even Europe under MiCA who seem not to adopt an "always and everywhere at par" criterion for stablecoins – even as they certainly want any deviations to be minimized. As aforementioned, all else equal, less exchange rate risk is better – deviations from singleness are a "weakness" of stables. But singleness is only one property of a monetary system and there are other characteristics of money to consider. All else may not be equal.

Transacting with a stablecoin with a small amount of exchange rate risk but which perhaps settles rapidly and at a lower fee, or with enhanced programmability and technical innovation than bank deposits, may be something that it is individually optimal to do. From a system-wide perspective, we also have spent 15 years since the GFC noting the many distortions and inefficiencies arising from the size and complexity of banks (TBTF premia, inefficiently priced deposit insurance, a lack of innovation, financial exclusion, regulatory arbitrage, endless lobbying). And yet now all these issues are apparently forgotten, for a reductionist unidimensional assessment of stablecoins based on their deviations from par in secondary markets.

Are these deviations from par excessively large? Perhaps, for now. However, stablecoin demand is substantial and growing, suggesting that their use is welfare enhancing for many users (increasingly corporate users) despite this. It is growing especially rapidly abroad but, after all, the ability to transact internationally is a priority of the G20 and would benefit UK users also. It is probably fair to say, however, that stablecoins' performance, as yet, falls short of what a regulatory might look for in a money. There have been well published disasters – though arguably these have winnowed the stablecoin market participants down to the better governed protocols (algorithmic stablecoins are very much out of fashion) and have led some of the better governed coins (notably Circle after the SVB period) to re-evaluate and enhance their approach to backing assets.

Stablecoins are still in their infancy and best practice is emerging. The Bank is not being asked to give them immediate *carte blanche* to expand. The Bank is right to be hesitant – for many reasons (not least over concerns over the reliability of public blockchains).[6] But the

[5] Note that even the ostensibly "instant" FPS system is actually a deferred net settlement system, and it is only via prefunding (combined with the settlement finality directive) that makes payment irrevocable from the perspective of the user, giving the impression and effect of instant payment.

[6] Public blockchains may well become sufficiently safe and reliable to underpin systemic activities, but that is far from guaranteed. For interesting work on their oft-claimed censorship resistance see Durfee and Lee

Bank needs to give them a realistic roadmap to become the type of reliable money that they conceptually (as narrow banks with bearer liabilities) clearly are capable of being.

SVB collapsed and in very recent memory, the heavily regulated, long established traditional financial system has shown itself well capable of crises far more dramatic than anything that stablecoins have yet demonstrated. CHAPS has failed on occasion in the past decades. Only recently, Barclays faced a significant operational failure, Mastercard suffered an outage and T2/T2S experienced operational problems. These are very reliable systems that have been refined over many years. Stablecoins have a very short history, and it is inappropriate to judge them purely on their initial state. Notwithstanding this, in many dimensions they have performed amazingly well. Even in the absence of proper regulation, lending facilities, regulated audit, regulated custody – stablecoins have already delivered an impressive degree of price stability in secondary markets.

Many coins that have deviated in secondary markets – even under stress – have continued to redeem at par. Indeed, they have done so despite a very immature blockchain environment, with enormously segmented markets, limits to arbitrage (arising from among other things, gas fees, MEV attacks, limited market participation and depth), clunky banking rails (see SVB and USDC's experience), and a lack of competitive pressure. How much better could they be if regulation, audit, custody, liquidity, arbitrage, were all to improve – as they seem likely to do in the coming years?

WHAT DRIVES SINGLENESS – AND ITS DEVIATIONS?

It is useful to think of the deviations of singleness as arising from distinct components and then asking whether these components are likely to persist as stablecoins and blockchain improve their governance and efficiency and – if the regulators/legislators begin to get their act together – a more mature regulatory framework emerges. If backing assets are limited to HQLA, and in the short run, perhaps to short maturity HQLA, and if they are well custodied and audited, it seems like any credit risk component to deviations from par should be effectively eliminated.[7] That elimination of credit risk of course likely eliminates some situations of liquidity stresses, as it makes it less likely that a run would start in the first place (see Bertsch (2023), for example).

If regulators provide access to facilities like the non-bank contingent lending scheme, then liquidity pressure should also be limited, again, reducing the scope for deviations from par.

(2025), but they must be subjected to much closer scrutiny than regulators are currently capable of. Naturally, it could be that private blockchains – which have some censorship as a feature, not a bug – could become prominent if financial market participants, users and regulators collectively take that path.

[7] There are interesting proposals for how to regulate tokens, such as Liao et al's "Token Capital Adequacy Framework". In this note I take the perhaps narrow position of discussing stables that are backed essentially completely by HQLA, so that credit risk and arguably liquidity risk (though not necessarily op risk) is moot. As stablecoins emerge backed by less solid assets, they will likely need to be regulated more like traditional banks.

If blockchain scalability improves and liquidity grows (as seems likely given the growth of tokenization, which will stimulate on-chain cash demand as the cash leg asset in trading) we should see enhanced arbitrage and price discovery, again reducing deviations from singleness. Ultimately, it is plausible that the ability to redeem at par, combined with all these – very realistic and achievable – improvements, will see secondary market prices of stablecoins converge very close to par, always and everywhere. Ostensibly, this would satisfy MAS. It should satisfy the Bank.

But what about redemption? Is that as frictionless as is claimed by stablecoin fans. Apparently not – though protocols differ in how easy it is for stablecoin holders to redeem. PYUSD requires a PayPal account/balance in USD. Other stables provide various options with different amount thresholds, fees and speed of redemption. Broadly speaking, though, it is often not as simple as taking one unit of a coin to an issuer and immediately receiving one dollar of fiat (or of some other HQLA) in exchange. Is this a problem? There may be a role for policy in ensuring there is not a market failure or an egregiously exploitative practice but it is also possible that this is a legitimate dimension on which stablecoins will ultimately compete and for users to decide whether or not to accept a particular redemption policy or to go elsewhere. One could imagine that a stablecoin's liquidity pressure could be somewhat reduced by offering a slower or somehow marginally more costly redemption than another stablecoin. This could allow them to provide a better service in other dimensions, which users may value.

Stablecoins' unique selling point and core business model is to be stable and to be a reliable settlement asset.[8] If redemption frictions undermine that, it is arguably going to be a drag on demand for it.[9] This is something we might hope to leave to the market though. Indeed, if a stablecoin has, say, a large minimum threshold for redemption, then it seems plain that a business model may emerge for an institution that stands between the issuer and many small balance users, aggregates the redemption demands for users and thus reduces the implicit fixed cost to each user, when spread among them.

Ultimately, we should consider the *possibility* that competition and free markets could produce a reasonable outcome.[10] This possibility seems to be ignored by many central banks, leading to a dirigiste, patrician attitude. That is not to say that guidelines should not be issued for redemption policy – they could stop socially destructive coordination failures among the issuers. But simply pointing to frictions in redemption is not enough – and it is far

[8] Notably this distinguishes them from currency boards to which they are superficially similar. The aim of a central bank that establishes a currency board is not par *per se*, it is the ultimate goals of monetary policy (low and stable inflation, mitigated short run real volatility, and so forth). An interesting question is whether other goals could undermine stablecoins' commitment to par. But given the centrality of the stability property, it is unclear this is a risk. Definitely an interesting debate.

[9] Market responses to floating NAV MMF are indicative that there is substantial demand for reliably cash-like assets (see Allen and Winters (2020), for example).

[10] Moneys, payment networks and so forth are riddled with externalities and network effects or multiple equilibria. So regulators are right to be careful in trusting the free market completely.

from obvious that such frictions will lead to appreciable deviations in singleness in secondary markets.

If users are indeed terrified by exchange rate risk, then there is always the option of hedging or using derivatives to swap the risk of a stablecoin deviating from par, or simply not using the stable. A basic calculation (with sensible risk aversion) will show that for the sort of exchange rate volatility that well governed, well-regulated and well-arbitraged stablecoin markets will likely exhibit is extremely cheap to insure away.

CONSERVATISM NOW MAY IMPLY MORE RISKS LATER

Perhaps I am being unfair to the Bank. It is possible that they intend ultimately to approve stablecoins once they understand them better, or once stables have improved their technology, or once they see how Hong Kong, Singapore, the US and Europe manage with their legislation and regulation. The problem is that unless they provide a roadmap to a less restrictive policy, and hope for stablecoin issuers and potential innovators in these areas, a future of safe stablecoins may never materialize. This would, of course, have knock-on effects on other innovative areas such as tokenization. There is a real risk of being "left behind", with developers and human capital moving to the US or Asia leaving the UK and London as a dwindling financial centre.

Given the Bank's stance on only allowing reserve backed stablecoins (in the systemic stablecoin consultation) or the – apparently – now even more extreme and very conceptually confusing stance expressed in the D£ update that somehow the stables should be embedded in RTGS, why would anyone invest in developing new methods for custody of HQLA, or of best practice in auditing backing assets?[11] Who would fund that? Without a roadmap to success, we may never see technologies developed to a degree that could ultimately make them palatable to the Bank. The Bank should be much more positive about how they might allow HQLA stablecoins if they satisfy realistic/feasible criteria in the future.

APPROACH NEW MONEYS WITH AN OPEN MIND

The Bank does not seem to be considering these topics from first principles. They appear to be trying to force a new product into existing frameworks for which it is unsuitable. We can also see this in the complete lack of justification for banning yield or interest-bearing stablecoins. As far as I can tell, the main argument is: *"stablecoins aren't money, but if they*

[11] Again, it is unclear if they mean for easier redemption in "primary" market or – mystifyingly – for some sort of reconciliation on the exchange of a stablecoin in a secondary market. I cannot understand what the bank is trying to say in the latter case – if I swap a stable in an AMM or in a P2P transaction, are they saying that there is some role for RTGS in that, rather than just having the blockchain update balances in the stable's smart contract?

were, that would mean they shouldn't pay interest, because money doesn't pay interest". Well, bank deposits pay interest. Reserves pay interest. There is no primitive axiom of monetary theory that a money cannot pay interest.

Now, it could be that the Bank worries that paying interest could lead to a temptation to invest in risker assets. This "search for yield" concern a priori has some merit. But it is hard to see how that would happen with a strict short maturity gilts restriction on backing assets (and even long maturity gilts only have liquidity risk, and could be purchased or accepted by a central bank in Bagehot style in times of liquidity stress).

Perhaps the Bank instead is worried about disintermediation. It is beyond the scope of this note to discuss the merits of the real bills doctrine, narrow banking and so forth except to note that issues of disintermediation have arisen in the debate over CBDC (where notably the Bank seems comfortable with much higher limits for CBDC holdings that have been mooted for the dEUR – to the extent that British banks are arguably more exposed to disintermediation). But there are now several papers pointing out that in a "second best" world – i.e. a world where the existing banking system suffers from market failures – disintermediating them to some extent could be welfare improving. It is well known that there are enormous problems with banking systems stemming from inefficiently priced deposit insurance, too big to fail, a strong anti-regulatory lobby, financial exclusion, rent extraction in correspondent banking networks and a host of other problems – few of which will be solved by tokenizing deposits! This is where the Bank's fixation on an extreme "always and everywhere" interpretation of singleness is especially troubling – it gives the impression that our existing banking rails cannot be improved upon. Deviations from singleness, all else equal, are undesirable but all else is not equal. They must be set against the broader problems of the existing systems.

Of course, the Bank is very familiar with commercial banks and their apologists, many of whom feature in think tanks and industry groups lobbying the Bank of England. This gives the banks excellent opportunities to whisper in the Bank's ear about how important singleness is, or how important routing all payments directly or indirectly through reserve accounts is. It is of course purely coincidental that they dominate such systems and that they perform very well in the singleness dimension! Banks are very supportive of innovative solutions – such as the excellent Fnality/omnibus account structure the Bank has established. This impressive scheme is to be commended (no one is saying that the existing banking system should not be made as good as it can be) but it should be remembered who are the key investors in Fnality.[12] Banks know which side their bread is buttered and although there is certainly no hint whatsoever of the Bank of England helping banks

[12] "Fnality's shareholders comprise: Banco Santander, BNP Paribas, BNY Mellon, Barclays, CIBC, Commerzbank, The Depository Trust & Clearing Corporation (DTCC), Euroclear, Goldman Sachs, ING, KBC Group, Lloyds Banking Group, Mizuho Bank, MUFG Bank, Nasdaq Ventures, Nomura, Sumitomo Mitsui Banking Corporation, State Street Corporation, WisdomTree, and UBS." (Fnality website)

preserve their existing position for corrupt reasons, there is a strong whiff of subconscious regulatory capture.

On a similar note, it should be no surprise that banks are giddy to participate in the BIS' Project Agora to "modernize" correspondent banking. The scheme is very impressive and is likely to drive down costs thanks to technical advancements. However, it is unclear that simply technological improvements will fix the more fundamental problems (rent extraction, exploitation of hub status/market dominance) with correspondent banking. If I were a bank, I would be delighted that the only BIS schemes to modernize payments are focused on helping incumbents, rather than stablecoin issuers who have been the source of striking innovation in cross border payments. One could argue that the absence of KYC/AML (at least in secondary exchanges) has allowed stablecoins to provide rapid and cheap international settlement, but that appears unlikely to fully explain the vast gap in performance and speed between them and the incumbent systems. The BIS has run Project Pyxtrial on stablecoin monitoring but it should do more on custody, audit, and generalize their Project Mandala to include compliant stablecoins. The BIS should adopt a two-pronged approach of dragging stables (which are already fast and cheap) towards safety, and dragging bank rails (which are already regulated) towards rapid and cheaper settlement. At the moment they essentially only do the latter.

THE UK'S COMPETITIVE POSITION

The Bank seemingly advocates a model for stablecoins that does not exist in the wild, and which is even more extreme than that under MiCA. The Bank offers an avenue for, *at best,* reserve backed stables and, at worst, a quasi-bank account model which sees stablecoin secondary market exchange (somehow) plugged into RTGS. We have already seen that unattractive regulatory requirements can lead to stables ignoring markets altogether. Tether has left (regulated) European platforms (not necessarily a great loss) and the European DLT sandbox scheme has seen minimal engagement. The UK is a small economy with a shrinking financial sector, known (perhaps unfairly) for slow and obstructive regulation. This motivates much of Rachel Reeves' and the government's engagement with regulators at the moment.

If/when APAC, Europe, Middle East and – soon – the US surge ahead with tokenization and stablecoins, it will be immensely embarrassing for the government and the Bank if they establish a stablecoin regime for it then to be ignored by the stablecoins that dominate the global financial markets. Looking at the sort of regime the Bank seems to favour, if I were Circle or any other globally important stable, I wouldn't touch the UK if it were to pursue the approach the Bank currently seems to be advocating. Why compromise your entire global business model for a rapidly shrinking (in influence and size) market?

The good news for the Bank is that no country has yet nailed stablecoin legislation. Even in leading countries one can point to flaws in their approach. There is scope to develop a sensible, safe, and attractive framework.

Generally, the Bank seems to have little strategy beyond an extreme definition of singleness. It is only a matter of time until they are forced to change tack. The longer it is delayed, the more difficult it will be. Their first act should be to retire their singleness language and start talking about (like MAS) a "high degree of value stability" in secondary markets. They should simultaneously focus attention on custody and audit. Another priority should be to explore models for reliable redemption at par in primary markets, though again there is a legitimate question over whether fees and delays to redemption can be left to the market to determine.

STABLECOIN RISKS

There are many problems with stablecoins. But those problems are not only – or even mainly – about singleness. I have already noted several problems above and also note that their KYC/AML features are very much in flux. At redemption and issuance, some KYC/AML is done, by some stablecoins, but it is reasonable to argue that their approach is still lacking. Of course, this can technically be fixed – indeed, much innovation in privacy enhancing technologies that allow claims to be proved and partial observability of transaction and counterparty details should soon allow stablecoins and other digital assets to be transacted with less fraud and more oversight than has traditionally been possible in the incumbent banking system. But we are not there yet. Plausibly, in early years of stablecoins being regulated, they may require old fashioned and inefficient approaches to KYC/AML to be adequate for regulated use. However, reflecting the fact that cryptography is a primitive of the digital asset paradigm, it seems plausible that far more sophisticated approaches will be adopted in the future.

Unknown unknowns still abound within crypto and the relatively short lifespan of the industry, which still has not reached anything like the scale of tradfi, means that many protocols, including stablecoins are not yet battle tested. For example, stablecoins have experienced a limit number of business cycles and rates cycles. Clearly one should not disallow stablecoins simply based on their immaturity, though of course this (reasonably) underpins many concerns that central banks have.

Perhaps the biggest – but most nebulous – risk around stablecoins is that to become sustainably profitable, they will be forced to develop business models that could lead to market failures that are not yet apparent. It cannot be that simply buying a lot of treasuries and issuing zero yielding liabilities is a sustainable route to profits. If it were, MMF and banks would already be doing it - MMFs are low margin and high scale, banks take on a lot of risk with a levered balance sheet. Naturally, if they are effective as money, stables can

benefit from relatively cheap funding due to their money services (a liquidity premium) – but it is likely that stablecoins will eventually have to charge fees, compete on returning yield to users (another reason why banning interest on stables will hinder innovation) or – perhaps – partnering with trading platforms. The latter approach opens up the risk of "walled gardens" and anticompetitive behaviour.

As and when these problems emerge – or *if* these problems emerge – there are various policies that could be brought to bear. They are orthogonal to the debate over singleness but they will feature in future regulatory discussions if stablecoins do scale up dramatically. Of course, there is the possibility that stablecoins will fizzle out and never become sustainably profitable. Time will tell. They should be given a chance to fail or succeed, and not have their success pre-judged by the Bank of England, and certainly not on such a flimsy basis as a singleness concept as simplistic as *"always and everywhere at par"*.

Disclosure: I am an (unpaid) research affiliate at the Central Bank of Ireland, an (unpaid) contractor – in unrelated areas – at the Bank of England, and a (paid) advisor to Chainlink Labs (Banking and Capital Markets). None of the views expressed in this note should be interpreted as representing those of any of these institutions. All views, and any errors and omissions should be taken as my own. I hold small balances in a few stablecoins, as part of a modest (currently – 12/03/2025 – under £2500) portfolio of a broad set of digital assets.