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November 21, 2025

Mr. David Burrows and Mr. Joshua Castle
Funds and Asset Management Policy
Wholesale Buy Side
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Dear Mr. Burrows and Mr. Castle:

The International Swaps and Derivatives Association, Inc. ("**ISDA**") appreciates the opportunity to submit a response to the Financial Conduct Authority's Progressing Fund Tokenisation Consultation Paper CP25/28. Previously, ISDA responded to Consultation Paper CP23/28: Updating the regime for Money Market Funds ("**MMFs**").

As a global trade association representing participants in the derivatives markets, ISDA's mission is to foster safe and efficient derivatives markets that support economic growth and resilience. This includes the development of legal and regulatory standards for both traditional and emerging product structures, including those within the digital asset ecosystem.

Our response is primarily concerned with the derivatives markets, including financial market infrastructure processes and procedures that participants use. Our comments will be focused on the use of tokenised funds as both cleared and uncleared derivatives collateral. Tokenisation presents a significant opportunity in the derivatives market, improving risk management through the accelerated movement of collateral and is critical to facilitating 24/7 trading with sound risk management practices. However, to realise these benefits, it is fundamental to ensure that the risk management, legal enforceability, and deep liquidity foundations that underpin collateral movements in traditional markets are maintained when transitioning to distributed ledger technology ("**DLT**") and using tokenised assets as collateral. As new forms of tokenisation are contemplated and regulatory developments unfold, industry analysis should be focused on both the benefits and risks. The industry should conduct a comprehensive re-examination of eligible collateral, including tokenised assets, and market participants may or may not choose to use them, depending on their risk management and investment guidelines. To that end, we are focused on risk management and liquidity management, as well as vendor, custodian and documentation readiness, and our response represents the balance necessary to support current processes and workflows while integrating new technology and innovation.

Balancing Benefits and Risks of Tokenised Collateral

Below we take the opportunity to make some general principles-based observations on the use of tokenised assets as collateral in the wholesale derivatives markets.

It is critical that new technology and infrastructure functions safely and efficiently. It is in this broader context that we comment on the opportunities and challenges of tokenisation in wholesale derivatives markets, and with respect to this response, collateral management and mobility.

As a statement of core principle, any tokenisation or other use of new technology in financial markets:

- should not adversely affect legal and regulatory certainty or systemic stability, including settlement finality; and
- should facilitate the safe and efficient management of risks, including liquidity, market and credit risks.

As a general matter, any tokenisation structure will require analysis to understand the token mechanics and the rights/interests the token conveys together with the context of the relevant jurisdictional legal environments, to determine there is no adverse impact on legal certainty.

The opportunities and challenges presented by asset tokenisation can vary depending on the particular use case and implementation. For example:

Improving liquidity and collateral management and reducing risks via near-instantaneous and atomic settlement.

Tokenisation can facilitate almost instantaneous settlement, rather than the usual T+1/T+2 or longer timeframe.[1] This capacity offers opportunities to substantially reduce counterparty, settlement, and market risk, as well as allowing better management of liquidity, including intra-day liquidity. For instance, instantaneous posting of tokenised collateral could replace the current process of posting cash and then replacing with a money market fund ("MMF") unit or a security, if collateral had to be moved quickly. Tokenisation enables simultaneous ("atomic") exchanges of collateral, eliminating "give before get" risks in collateral substitutions.[2]

Enhancing non-cash assets for use as collateral management

Market stress events in recent years like the March 2020 dash for cash and the September 2022 UK gilt crisis have underscored the important efforts by ISDA and industry participants to bring more efficiency and data standardisation to collateral management processes. The exchange of collateral[3] is one of the central planks of regulatory efforts to mitigate counterparty credit risk and maintain the resilience of the financial system. Greater automation and data standardisation will help drive efficiency and reduce risk in collateral management, as well as help reduce funding costs for market participants.

As some of our members experienced in recent market volatility events, for example, the process of converting non-cash assets such as MMFs into cash balances to satisfy margin demands only for the transferee to reinvest cash back into non-cash assets – sometimes the same MMF that was liquidated to cash – results in a scenario where "this process pro-cyclically exacerbates and propagates volatility, as margin calls may be correlated with asset price declines that deepen due to fire sales of non-cash assets to generate cash collateral".[4] In ISDA's recent margin survey[5], non-cash non-cleared variation margin

[1] ISDA response to FCA CP23/28: Updating the regime for Money Market Funds (8 March 2024) https://www.isda.org/a/7usgE/ISDA-Response-to-FCA-MMF-consultation-030824.pdf

[2] The Impact of Distributed Ledger Technology in Capital Markets, page 160

[3] While many comments are also relevant for cleared exposures, most of the comments on collateral management are aimed at collateral for uncleared exposures.

[4] GMAC, "Recommendations to Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology" (21 November 2024) https://www.cftc.gov/media/11581/GMAC_DAM_UseofDLTasDerivativesCollateral_112124/download, pages 5-6

[5] ISDA Margin Survey: https://www.isda.org/a/EyfgE/ISDA-Margin-Survey-Year-end-2024.pdf Chart 10, page 9: From 20.1% in 2020 to 31.6% in 2024.

("**VM**") received has increased from 20.1% in 2020 to 31.6% in 2024, and ISDA members, especially insurance companies and pension funds, have stated that while posting non-cash assets for non-cleared VM has its liquidity management benefits, there are operational challenges, such as managing collateral post-settlement corporate actions, dividends, and substitutions, that prevent counterparties from posting non-cash collateral as non-cleared VM.

MMFs are a compelling use-case for tokenisation because (i) the fund unit is already de-materialised and (ii) tokenisation of fund units could replace the traditional subscription and redemption workflow, making the process faster and more efficient.

<u>Lower transaction costs.</u>
Tokenisation could lead to lower transaction costs[6] by reducing the need for intermediaries and enhancing the capital efficiency of the asset. As an example, with tokenised MMF units, if all the parties (pledgor, secured party, custodian, transfer agent) are part of the golden record, there is no need to use the current operationally-intensive process to liquidate the MMF, post cash and then transform into a MMF for collateral purposes. Additionally for tokenised MMFs and other types of assets, through tokenisation, many resource-intensive manual processes in traditional financial markets could be automated through the use of smart contracts, thereby reducing costs and improving efficiencies.[7]

Legal and regulatory certainty of tokenised collateral

It is important that tokenised version of eligible collateral is treated as eligible collateral under existing regulatory framework, with equivalent legal or beneficial rights and interest to those of the 'conventional' instrument. As such we welcome the clarification in paragraph 4.15 – which provides the FCA response to CP 23/28 on Tokenised Money Markets Funds - that "*the UK EMIR does not distinguish between tokenised and conventional financial instruments when determining eligibility of particular instruments for collateral regulation purposes. There are also no restrictions on use of MMFs where firms provide collateral for uncleared derivatives outside of the scope of UK EMIR.*"

However, we believe further clarity is needed regarding the treatment of tokenised assets under the Financial Collateral Arrangements (No.2) Regulations 2003. While the Regulation provides a clear framework for traditional collateral, there is insufficient clarity regarding the specific application of its provisions to certain types of tokenised assets used as financial collateral. This lack of clarity creates uncertainty for market participants and may affect adoption of DLT-based collateral solutions. We encourage the UK authorities to undertake a detailed review of the Financial Collateral Arrangements Regulation and consider targeted amendments to support the use of DLT-based collateral (or to develop separate legislation addressing the eligibility of DLT-based collateral, as appropriate).

Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology

ISDA supports the CFTC's Global Markets Advisory Committee's (**"GMAC"**) Digital Asset Markets Subcommittee recommendation[8] which asserts that the "[u]se of DLT for holding and transferring non-cash collateral has significant potential to address key challenges posed by existing market and

[6] This will depend on the costs associated with the tokenised version of the asset, which would be dependent on the blockchain and its fee structure (e.g., gas fees) that would be imposed, as well as any cost associated with the tokenisation process itself.
[7] The Impact of Distributed Ledger Technology in Capital Markets, page 160
[8] CFTC Press Release, "CFTC's Global Markets Advisory Committee Advances Recommendation on Tokenized Non-Cash Collateral" (21 November 2024) https://www.cftc.gov/PressRoom/PressReleases/9009-24; GMAC, "Recommendations to Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology" (21 November 2024) https://www.cftc.gov/media/11581/GMAC_DAM_UseofDLTasDerivativesCollateral_112124/download.

technology infrastructure."[9] The Digital Asset Markets Subcommittee identified that the use of DLT in particular ways "can facilitate real-time, 24/7/365 transfers of the asset without costly or complex linkages across multiple intermediaries" which "has the potential to both increase the velocity of transfer of assets currently utilized as collateral, … expand the pool of assets available for use [and] permit peer-to-peer transfers". The Subcommittee also noted that the use of DLT could also "help address the challenges to non-cash collateral … by enabling the direct pledge or transfer of eligible assets without the need to convert those assets into cash" which "can facilitate asset transfers to meet margin calls during times of market stress without fire sales to generate cash collateral."[10] This takes into account that "existing transfer mechanics for many non-cash assets inhibit firms owning or holding such assets from posting them to satisfy applicable margin requirements."[11]

Smart Contracts and Data Standards

We previously responded to the FCA CP23/28: Updating the regime for money market funds consultation in March of 2024, including some of the same liquidity and operational benefits mentioned above.

Specific to smart contracts, in our 2024 letter, we stated, "Traditional financial market infrastructure can be slow and cumbersome, requiring manual reconciliation. Through tokenisation, many of these manual processes could be automated through the use of smart contracts. This may be particularly useful for managing the distributions of income from the fund and any required reinvestment." The letter also addressed disadvantages, which we stated, "The use of smart contracts within such platforms – while introducing potential efficiency benefits – could introduce risk into the system if they do not operate as expected or are compromised by a bad actor."

Although there are risks to using smart contracts, with proper governance and using industry-developed standards, such as the Common Domain Model ("**CDM**"), these risks can be mitigated and both operational and liquidity benefits may be realised. Our collaborative work with Fintech Open Source Foundation ("FINOS"), the International Securities Lending Association ("ISLA"), and the International Capital Market Association ("ICMA") has been thoughtfully coordinated with industry members to ensure that there is strong governance of the data model.

FINOS has launched two recent working groups, the CDM Tokenised Assets Working Group and the CDM Smart Contracts Taskforce; both have attracted industry involvement to develop standards that can not only structure tokenised assets for collateral purposes but for cash markets as well. And, the smart contracts working group is focusing on developing the foundation that will be needed for the industry to benefit from automated workflows with increasingly fast-paced deadlines. We encourage industry members to join these working groups and contribute to developing and implementing data standards.

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[9] GMAC, "Recommendations to Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology" (21 November 2024) https://www.cftc.gov/media/11581/GMAC_DAM_UseofDLTasDerivativesCollateral_112124/download, page 11.
[10] GMAC, "Recommendations to Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology" (21 November 2024) https://www.cftc.gov/media/11581/GMAC_DAM_UseofDLTasDerivativesCollateral_112124/download, page 7; Also see ISDA, Response to FSB Consultation report "Liquidity Preparedness for Margin and Collateral Calls" (Jun. 19, 2023) (link) at 3 (recommending consideration of how "innovation in collateral and tokenization may offer improvements in collateral mobility and reduce the need for collateral holders to liquidate collateral to realize cash").
[11] GMAC, "Recommendations to Expand Use of Non-cash Collateral Through Use of Distributed Ledger Technology" (21 November 2024) https://www.cftc.gov/media/11581/GMAC_DAM_UseofDLTasDerivativesCollateral_112124/download, page 5.

Collaborative Efforts Driving Industry Developments

Recognising that this topic does require a collaborative approach with other markets beyond derivatives, ISDA has collaborated with other trade associations to produce the Report on DLT in Capital Markets[12], an overview of current legal, regulatory and risk management frameworks for digital assets and developments in collateral management and tokenisation. We have also recently introduced Digital Asset Definitions[13] (available via ISDA's MyLibrary)[14] to provide a starting point for the documentation of digital assets derivatives. ISDA has provided Tokenized Collateral Guidance and will continue to assess where updates are needed to these referential documents to facilitate the use of tokenised assets as eligible collateral. As mentioned above, we have worked with the FINOS, ISLA, and ICMA to develop the **CDM**, an open-source, standardised model for financial products and transaction lifecycles, including collateral representation, margin call and collateral settlement processes, and smart contracts, and was built with the intention to live on-chain.

Building on ISDA's contributions to the recently published work of Global Digital Finance ("**GDF**"): Case for Collateral Mobility in Europe and the UK Using Money Market Funds[15], ISDA will co-sponsor the U.S. Tokenized Money Market Fund Working Group, providing legal and collateral management operations subject matter expertise. We look forward to working with the industry to support such initiatives and move production-level pilot programs forward, with initial limits on volume and then expand, focusing on the most liquid products first.

Closing

ISDA appreciates the opportunity to provide comments related to fund tokenisation as it would support the derivatives markets, specifically for collateral management. We are well-positioned to support collaborative efforts given our global membership and existing work with other trade associations on DLT in capital markets, and we welcome the opportunity to assist with collaborative efforts going forward.

Sincerely.

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[13] ISDA MyLibrary: https://mylibrary.isda.org
[14] Tokenized Collateral Guidance: https://www.isda.org/a/ox1gE/ISDA-Tokenized-Collateral-Guidance-Note-052124.pdf.
[15] Global Digital Finance: Case for Collateral Mobility in Europe and the UK Using Money Market Funds; https://www.gdf.io/resources/the-case-for-collateral-mobility-in-europe-the-uk-using-money-market-funds/

About ISDA
Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

ISDA has over 1,000 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.