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UK: the evolving cryptoasset regulatory landscape

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Current UK cryptoasset landscape

Current UK cryptoasset regulatory landscape

- 1 FCA sandbox – support for DLT-based services (launched in 2016)
- 2 HMT, FCA & BoE Cryptoassets Taskforce: Final Report (October 2018)
- 3 FCA's Guidance on Cryptoassets – PS 19/3 (July 2019)
- 4 UK implementation of EU Fifth Anti-Money Laundering Directive – bringing custodian wallets providers and cryptoasset exchange providers into AML & CTF regulation (came in force on 19 January 2020)
- 5 FCA's ban on sale, marketing and distribution of derivatives and exchange traded notes referencing certain cryptoassets to retail consumers (new rules took effect on 6 January 2021)
- 6 Bank of England's communications regarding minimum policy expectations for stablecoins (various dates)

Overview of cryptoasset types & current UK perimeter

UK FCA's definition: "*cryptographically secured digital representation of value or contractual rights that is powered by forms of DLT and can be stored, transferred or traded electronically.*"

Source: FCA's Guidance on Cryptoassets – CP 19/3 (July 2019)

FCA's 'Guidance on cryptoassets' sets out 3 categories of token:

E-money tokens

- Digital payment instruments that:
 - store value
 - redeemable anytime, at par
 - offer holders direct claim on issuer
- Meet electronic money definition in Electronic Money Regulations 2011.

Security tokens

- Tokens with rights & obligations akin to 'specified investments' like shares or debt instruments.
- Meet relevant definitions in the UK Regulated Activities Order 2001.

Unregulated Tokens

- These include:
- utility tokens: tokens used to buy service, or access DLT platform e.g., access to online cloud storage; and
 - exchange tokens: tokens primarily used as means of exchange, e.g. Bitcoin
- Fall outside the UK regulatory perimeter.

HMT – UK regulatory approach to
cryptoassets and stablecoins:
Consultation and Call for evidence
(‘HMT Stable token consultation’)

HMT Stable token Consultation Summary

- 1 On 6 January 2021, HMT published consultation on proposed approach to UK regulation of cryptoassets, including:
 - proposals to **extend regulated perimeter** to unregulated cryptoassets
 - initially, a **regulatory framework for "stable tokens used as a means of payment"**
 - a **call for evidence** including on:
 - future regulation of unregulated cryptoassets such as bitcoin
 - appropriateness of current regulation (e.g., clearing and settlement) with respect to security tokens
- 2 Consultation sets out **high-level proposals, without draft legislative text**
 - Cf. European Commission's approach in draft Markets in Cryptoassets Regulation (**MiCA**) and DLT pilot (**MiDLT**)
- 3 Detailed rules to implement proposed regime to be consulted on by UK supervisory authorities.
- 4 The **deadline** for responding to the consultation is **21 March 2021**.

Scope of cryptoassets in new regime

- HMT Stable token consultation proposes creating, for now, a new category of regulated token, namely “stable tokens”

Stable token features:

Function	Form	Subsets
<p><i>“stabilise their value by referencing one or more assets, such as fiat currency or a commodity... and could for that reason more reliably be used as a means of exchange or store of value.”</i></p>	<p><i>“whilst cryptoassets are typically underpinned by [distributed ledger technology i.e. DLT], stable tokens could be designed using other types of technology. This classification is therefore agnostic on the technology underpinning its use.”</i></p>	<p>(i) “single fiat-linked tokens”, whose <u>value is pegged to a single fiat currency</u></p> <p>(ii) “asset-linked tokens”, whose <u>value is associated with that of one or more physical or financial assets or cryptoassets</u></p> <ul style="list-style-type: none">- Similar to distinction between “asset-referenced tokens” and “electronic money tokens” under MiCA- Proposal to bring single fiat-linked tokens in scope of UK e-money regime

- Cryptoassets/ activities being considered for future phase of regulation:
 - Unregulated tokens (e.g., algorithmic tokens, utility tokens, Bitcoin and Ether)
 - Specific Decentralised Finance (**DeFi**) activities (e.g., using smart contracts for P2P lending on blockchain) and related tokens

Issuers, Services and Licensing regime (I)

	Activity
1	Issuing, creating (i.e. minting) or destroying (i.e. burning) tokens
2	Providing token custody and administration services (such as providing wallets for storage of private keys)
3	Exchanging tokens for fiat money (such as fiat-crypto exchanges)
4	Executing transactions in tokens (conducting transactions on behalf of another)
5	Value stabilisation and reserve management (such as custody or management of reserve assets backing the value of tokens)
6	Facilitating access to network/infrastructure
7	Validation of transactions and transmission of funds (such as by operating a node on a blockchain)

Issuers

Central entity responsible for issuing or burning tokens

Cryptoasset exchanges

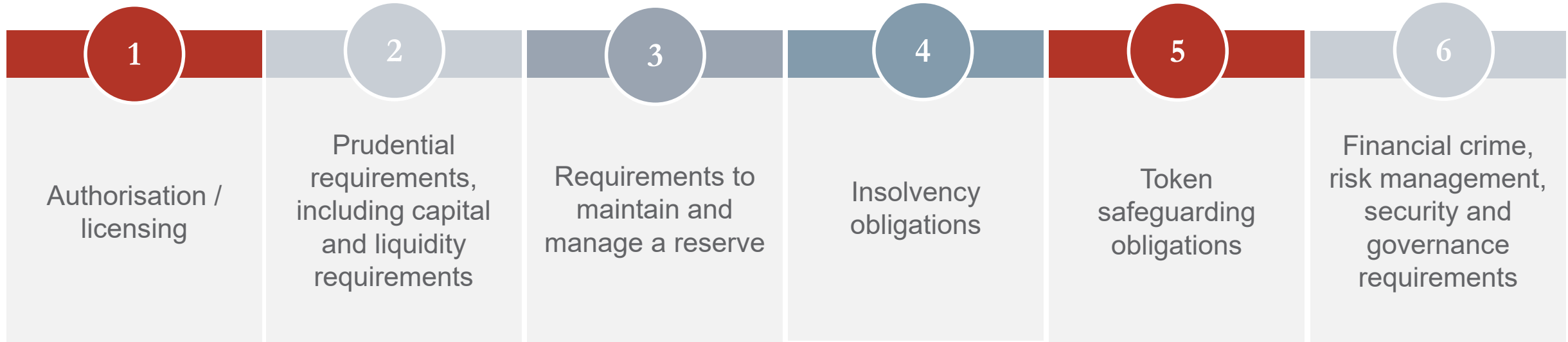
Enabling consumers to exchange tokens for fiat money or other tokens

Wallets

These may provide custody of tokens and/or manage private keys




Issuers, Services and Licensing regime (II)

Depending on activities carried out, HMT proposes firms be subject to range of requirements, including:



Territorial considerations for stable tokens

HMT set out three proposals in consultation:

-  require UK presence and UK authorisation for stable token issuers, system operators and service providers when marketed to consumers in the UK;
-  defining activity conducted in the UK and determining whether UK authorisation is required as a result; or
-  no location requirements.

Regulation of stable token payment systems

Government proposes to bring stable token payment systems (and related service providers) within scope of existing UK payment systems regulation:

Within supervision of Payment Systems Regulator under the Financial Services (Banking Reform) Act 2013

If disruption to its operation would have serious consequences for those who use its services.

Within supervision of Bank of England under the Banking Act 2009

If the stable token payment system is of systemic importance (i.e. when potential disruption could lead to financial stability risks).

Call for Evidence on investment and wholesale uses

In the call for evidence HMT is seeking views on:

- ➡ areas of existing regulation where clarification or amendments are needed to support the use of security tokens;
- ➡ the benefits and drawbacks of DLT if adopted across financial markets;
- ➡ what regulatory or legal barriers exist that currently limit the adoption of DLT in UK financial markets;
- ➡ whether there is scope for the regulatory perimeter to be extended to cover other tokens, such as those typically used by retail consumers as a form of speculative investment; and
- ➡ benefits and risks posed by the Decentralised Finance sector, and whether these developments should be brought into the regulatory perimeter in the future.

The deadline for comments is 21 March 2021.

Cryptoasset Promotions Regime

HMT Crypto FinProm Consultation Summary

- 1 On 20 July 2020, HMT issued consultation proposing to bring the promotion of **qualifying cryptoassets** within scope of financial promotions regime ('Crypto FinProm consultation').
- 2 Objectives are to enhance consumer protection, whilst fostering responsible innovation.
- 3 FCA and Cryptoassets Taskforce are concerned that advertising regarding cryptoassets targeted at retail clients is not typically fair or clear and can be misleading.
- 4 Consultation was issued on 20 July 2020 (with a deadline for responses of 25 October 2020).

Qualifying cryptoassets (to become “controlled investments”)

“

“Qualifying cryptoasset” mean any cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and which:

- (a) Is fungible;***
- (b) Is transferable;***
- (c) Is not any other controlled investment as described in this Part;***
- (d) Is not electronic money within the meaning given in the Electronic Money Regulations; and***
- (e) Is not currency issued by a central bank or other public authority.***

”




Excludes:

- Security tokens which are already specified investments under the RAO (these will already be controlled investments)
- E-money already regulated under Electronic Money Regulations 2011
- Utility tokens

Financial promotions restriction

A person must not, in the course of business, communicate an invitation or an inducement to engage in an investment activity (Article 21 Financial Services and Markets Act 2000)

The financial promotions restriction does not apply if:

-  The person is an authorised person
-  The content of the communication is approved by an authorised person
-  Certain exclusions are also available under the FSMA 2000 (Financial Promotions) Order 2005 (**FPO**)

Engaging in investment activity and application to qualifying cryptoassets

Entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity

- i. Dealing in qualifying cryptoassets
- ii. Arranging deals in qualifying cryptoassets
- iii. Managing qualifying cryptoassets
- iv. Advising on qualifying cryptoassets
- v. Agreeing to carry on any of i to iv

OR

Exercising any rights conferred by a qualifying cryptoasset to acquire, dispose of, underwrite or convert a qualifying cryptoasset

New FPO exemptions:













“The financial promotions restriction does not apply to any communication which merely states that a person is willing to accept or to offer qualifying cryptoassets in consideration for the supply of goods or services.”

Financial promotions regime – FCA conduct rules?

FCA Conduct of Business Sourcebook (COBS 4)

- 1 Fair, clear and not misleading communications
- 2 Financial promotions identifiable as such
- 3 Compensation information
- 4 Requirements relating to communications with clients
- 5 Direct offer financial promotions
- 6 Cold calls and other promotions not in writing
- 7 Record keeping
- 8 Restrictions

Asset scope: Cryptoasset promotions regime vs stable token consultation

	Cryptoasset promotions regime	Stable token consultation
Stable tokens		
Other utility tokens		
Security tokens		
E-money		
Other tokens		

(Subject to definitional limitations)

Activities: Cryptoassets promotions regime vs stable token consultation

	Cryptoasset promotions regime	Stable token consultation
Issuance	⊗	Issuing, creating or destroying tokens
Custody	⊗	Token custody and administration services
Transactions	Dealing investments Arranging deals in investments	Exchanging tokens for fiat money Executing transactions in tokens
Asset management	Managing investments	Value stabilisation and reserve management
Facilitating access	⊗	Facilitating access to a network/infrastructure
Validation	⊗	Validation of transactions and transmission of funds (node)
Advising	Advising on investments	⊗

Comparison: UK v EU proposals

MICA vs UK stable token proposal – key similarities and differences

- HMT describes UK approach to cryptoasset regulation ‘**staged and proportionate**’, ‘**sensitive to risks posed**’, and ‘**responsive to new market developments**’.
- UK considers risks and opportunities of stablecoins most urgent.
- HMT is not proposing regulation of any other types of cryptoasset, except in relation to financial promotions; and is seeking evidence particularly, in relation to cryptoassets used for investment purposes and use of DLT in financial services and financial market infrastructures.
- EU approach differs materially:
 - proposals include bespoke framework to regulate entire cryptoasset industry (**MiCA**) and pilot regime for digital financial market infrastructure (**MiDLT**).

Territorial scope

- MiCA: applies to issuers of cryptoassets or those providing services related to cryptoassets “**in the Union**” (Article 2(1))
- UK proposal: marketing to UK consumers v no location v another

Cryptoassets v stable tokens

- MiCA: all unregulated cryptoassets (including stablecoins)
- UK proposal: stable tokens only (for now)

E-money token approach

- MiCA: bespoke regime for all ‘e-money tokens’, similarities to E-Money Directive
- UK proposal: apply E-Money Regulations to all single-fiat stable tokens?

MICA vs UK proposal – overview comparative table (I)

	UK stable token proposals	EU MiCA
Scope	Stable tokens	All cryptoassets including previously unregulated cryptoassets e.g., stablecoins (Categories: (i) asset-referenced tokens; (ii) e-money tokens; and (iii) other cryptoassets)
Licensing requirements	<p>Issuers and service providers: marketing to UK consumers v no location v another</p> <p>Specific permissions required TBC</p>	<ul style="list-style-type: none"> • Issuer of e-money tokens: must be authorised as credit institution or electronic money institution. • Issuer of asset-referenced token: must be authorised as an asset-referenced token issuer under MiCA or as a credit institution. • Issuer of other cryptoassets (other than e-money/ asset referenced tokens): no authorisation requirements. • Cryptoasset service providers (CASP) : must be authorised by NCA as a cryptoasset service provider under MiCA or authorised as a credit institution or MiFID firm providing CASP-like activity.
Excluded assets	Existing regulated tokens and unregulated cryptoassets not falling within stable token regulation	Financial instruments, e-money unless they qualify as e-money tokens, deposits, structured deposits, securitisation

MICA vs UK proposal – overview comparative table (II)

	UK stable token proposals	EU MiCA
Activities	<ul style="list-style-type: none"> i. Issuing, creating or destroying stable tokens ii. Providing token custody and administration services iii. Executing transactions in tokens iv. Exchanging tokens for fiat money v. Value stabilisation and reserve management vi. Facilitating access to a network/infrastructure vii. Validation of transactions and transmission of funds 	<ul style="list-style-type: none"> i. Issuing crypto-assets, including ARTs and EMTs ii. Custody and administration on behalf of third parties iii. Operation of a trading platform iv. Exchange for fiat currency or other crypto-assets v. Execution of orders on behalf of third parties vi. Placement of crypto-assets vii. Reception and transmission of orders on behalf of third parties viii. Advising on crypto-assets
Equivalence	Currently unknown – awaiting further guidance	None – though contemplated in draft, when MiCA is reviewed.
Market Abuse regime	Currently unknown – awaiting further guidance	Yes
Change in Control regime	Currently unknown – awaiting further guidance	Yes
Passporting	N/A	Yes
Prospectus-style whitepaper requirements	Currently unknown – awaiting further guidance	Yes – whitepapers required for all issuers of cryptoassets unless exemption applies

Key Takeaways

- Apparent divergences between scope of cryptoassets and activities covered by the 3 regimes
- Ability of stable token / other cryptoassets to circulate between different jurisdictions?
- Firms to keep watching brief on regulatory developments
- Uncertainty of timing of introduction of UK and EU proposals
- Consideration of marketing restrictions and need to update customer facing materials
- Ability to leverage existing licenses – unlevel playing field?

Questions?

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