

# Institutional and wholesale digital assets: latest developments

24 May 2023



# 2023

## Seminar Programme schedule

### Institutional and wholesale digital assets: latest developments

Damian Carolan – Partner, Financial Services Regulatory  
Nick Bradbury – Partner, Financial Services Regulatory  
Tom Roberts – Partner, ICM

Wednesday 24 May

9.00am-10.00am

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### Restructuring real estate – brick by brick

Joel Ferguson – Partner, Banking  
Mark Manson-Bahr – Partner, Banking  
Ali Khaki – Senior Managing Director, FTI Consulting

Tuesday 6 June

12.00pm-1.00pm

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### Financial stability and the role of deposit protection

Kate Sumpter – Partner, Financial Services Regulatory  
John Budd – Senior Associate, Financial Services Regulatory

Wednesday 21 June

9.00am-10.00am

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### The dawn of the smarter regulatory framework

Bob Penn – Partner, Financial Services Regulatory  
Kirsty Taylor – PSL Counsel, Financial Services Regulatory

Tuesday 27 June

9.00am-10.00am

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### Finance Litigation Themes and Trends

Andrew Denny – Partner, Litigation & Investigations  
Michael Godden – Partner, Litigation & Investigations  
Mahmood Lone – Partner, Litigation & Investigations  
Juliet de Pencier – Senior Associate, Litigation & Investigations

Wednesday 28 June

9.00am-10.00am

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# Summary

## Institutional and wholesale digital assets: latest developments

This session will focus on the latest law and regulation of institutional/wholesale digital assets products and services; considering amongst others, prime and custody services, derivatives and digital securities. The first quarter of 2023 has seen a flurry of new developments which are going to form the fundamental legal and regulatory building blocks in relation to this fast-growing sector. These include, for example, proposed new regulated activities regimes; new disclosure/whitepaper rules; new market abuse regimes; reforms to underlying property law; reforms to insolvency law; and proposed new industry standard derivatives documentation. In this session our digital assets experts will discuss the key issues from these proposals, and the areas where market participants will want to input into the design of these new regimes.



# Biographies



**Damian Carolan**

Partner - London

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Damian is head of A&O's UK Financial Services regulatory practice. He advises financial institutions on national and international regulations, with a particular focus on derivatives and securities regulation and the development of new markets and clearing settlement systems.

He regularly advises banks on regulatory reform, including changes to custody requirements, payment systems and the authorisation processes to open new branches and subsidiaries. Damian has assisted industry associations with developing standard form documentation and submitting responses to consultations with regulators. He is also a leading legal and regulatory expert in financial market infrastructure and has been involved in a variety of innovative bank and infrastructure projects as digital assets and distributed ledger technology become an ever more important part of the financial landscape.



**Nick Bradbury**

Partner - London

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Nick is a partner in our Financial Services Regulatory practice. He regularly advises some of the world's leading banks, broker-dealers, asset managers and other financial institutions on regulatory issues. Nick has advised on the full range of regulatory change the financial industry is facing, including recovery and resolution planning, bank structural reform, derivatives trading and clearing, MiFID II, the Senior Managers Regime and Brexit.

An area of particular focus for Nick is on the regulation of the wholesale financial markets and financial market infrastructure (securities and derivatives trading venues, custodians, payment systems and clearing houses). He also has extensive experience of advising on the regulatory aspects of corporate transactions and restructuring in the financial institutions sector.



# Biographies



## **Tom Roberts**

Partner - London

Tel +44 20 3088 3518

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Tom is one of the founding partners of Allen & Overly's Market Innovations Group. Tom specialises in delivering technology and resourcing solutions for large-scale legal and regulatory challenges. Tom is currently leading delivery of global IBOR transition projects and legal and compliance digitalisation initiatives, including use of ContractMatrix (a proprietary AI and document automation tool).

Tom was at the forefront of the development and delivery of MarginMatrix (a regulatory compliance and repapering tool, and related joint venture with Deloitte to help several global banks with the negotiation of thousands of contracts) and BrexitMatrix (a workflow, document automation and outreach tool for migration of trading documentation to EU entities).

Tom's background is in OTC derivatives and he has experience across all major asset classes as well as a focus on non-core asset and business transfers.

Tom also leads MIG's work on digital assets and distributed ledger technology, advising on new products, platforms and infrastructure across traditional capital markets, CeFi and DeFi.



# Institutional and wholesale digital assets: latest developments

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## Institutional and wholesale digital assets: latest developments

24 May 2023



## Notes



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## Agenda

- 1 Market overview and HMT crypto regime proposals
- 2 Property law treatment of digital assets
- 3 Custody; lending and borrowing; market abuse regime
- 4 Tokenised securities
- 5 Digital asset derivatives

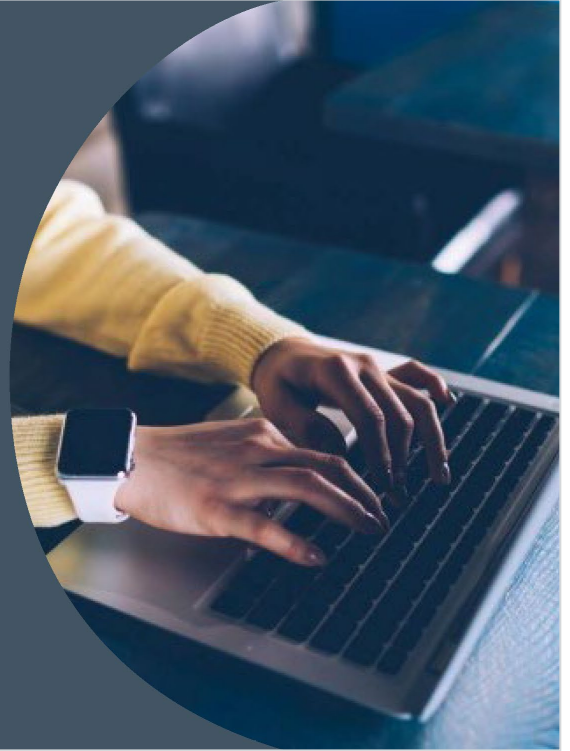
## Notes





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## Market overview



## Notes



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## UK & EU crypto-asset regulatory heat-map

	Current – UK regulation	Proposed UK cryptoasset regime	Proposed UK cryptoasset promotions regime	Current – EU regulation	Proposed EU MiCA Regulation
<b>Security Tokens</b> (securities i.e., transferable securities (C1), collective investment undertakings (C3) and derivatives (under C4-C10) in Annex 1 to MIFID or Part 1 of Schedule 2 to RAO)	✔ Meets RAO definition of specified investments; hence subject to UK regulation under Financial Services and Markets Act	✘	✘	✔ Meets definition of certain MIFID financial instruments; hence subject to current EU securities regime e.g. MIFID II, Prospectus Directive, CSRR	✔ New MCA regime only applies to any security token not already subject to existing EU securities regime
<b>Other Utility Tokens</b> (i.e., not MIFID financial instruments/ RAO specified investments or e-money)	✘	✔ Phase 2	✔ Brought within scope of current UK Financial Promotions regime (provided they fall within the new definition of qualifying cryptoasset)	✘	✔ Outside the existing EU regulatory perimeter; subject to new MCA regime
<b>Exchange Tokens</b>	✘	✔ Phase 2	✔ Brought within scope of current UK Financial Promotions regime (provided they fall within the new definition of qualifying cryptoasset)	✘	✔ Outside the existing EU regulatory perimeter; subject to new MCA regime
<b>Stablecoins</b>	✘	✔ Phase 1 - fiat-backed stablecoins used for payment	✔ Brought within scope of current UK Financial Promotions regime (provided they fall within the new definition of qualifying cryptoasset)	✘	✔ Newly defined asset-referenced token; subject to new MCA regime
<b>E-money tokens</b>	✔ Meets UK definition of 'e-money' in Regulation 2, Electronic Money Regulations; hence subject to current UK e-money regime	✔ Phase 2	✘	✔ Meets definition of e-money in Art 2(2), Second Electronic Money Directive; hence subject to current EU e-money regime	✔ Newly defined e-money token - token that is not e-money in the traditional sense, but has similar hallmarks; subject to new MCA regime
<b>CBDCs</b>	✘	✘	✘	✘	✘

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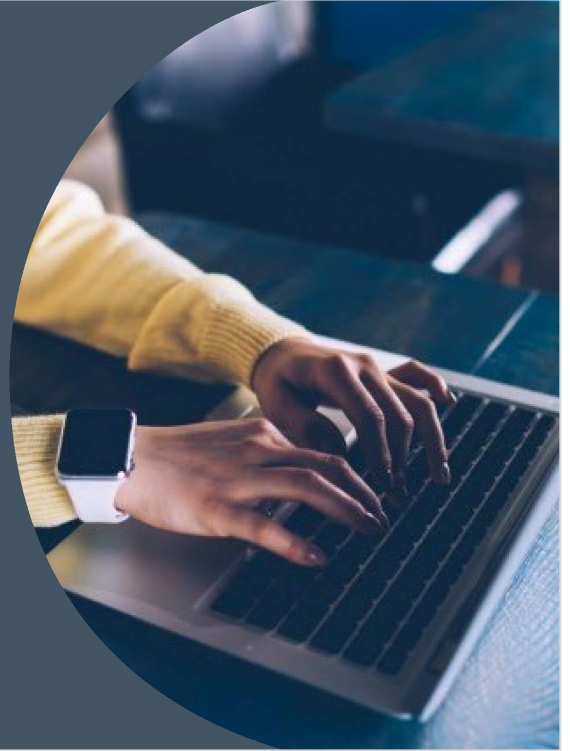
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## Notes



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## HMT Crypto Regime Proposals



Notes



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## Legislative approach – future financial services regulatory regime for cryptoassets

- HM Treasury (HMT) February 2023 consultation paper and call for evidence on a future financial services regulatory regime for cryptoassets
- UK intends to add financial services regulation of cryptoasset activities to the Financial Services and Markets Act 2000 (FSMA) as updated by the Financial Services and Markets Bill 2022-23 (FSM Bill)
- The consultation does not propose making cryptoassets "financial instruments". Instead, HMT will specify new regulated activities in relation to cryptoassets and any person carrying out certain activities involving cryptoassets "by way of business" within the regime's territorial scope would be performing regulated activities and will require authorisation, unless an exemption applies.

*"HMT's objective is to establish a proportionate, clear regulatory framework which enables firms to innovate at pace, while maintaining financial stability and clear regulatory standards"*

Same risk, same regulatory outcome

Proportionate and focused

Agile and flexible



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## Notes



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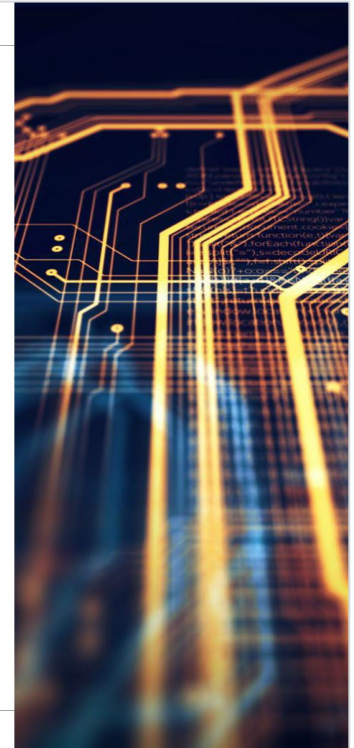
## Definition of “cryptoasset”

*“cryptoasset” means “any cryptographically secured digital representation of value or contractual rights that— (a) can be transferred, stored or traded electronically, and (b) that uses technology supporting the recording or storage of data (which may include distributed ledger technology)”*

- 1 → Definition contained in **Financial Services and Markets Bill (FSM Bill)** and will be introduced in **FSMA**
- 2 → Broad definition to capture all current types of cryptoasset
- 3 →
  - Similar to definition of “**cryptoasset**” used in **regulation 14A(3)(a) of MLRs**, although new definition references wider range of underlying technology
  - Similar to definition of “**cryptoasset**” in **EU MiCA**
  - Shares some features with “**virtual asset**” in the **FATF’s recommendations**

*“digital settlement asset” means “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 (which may include distributed ledger technology)”*

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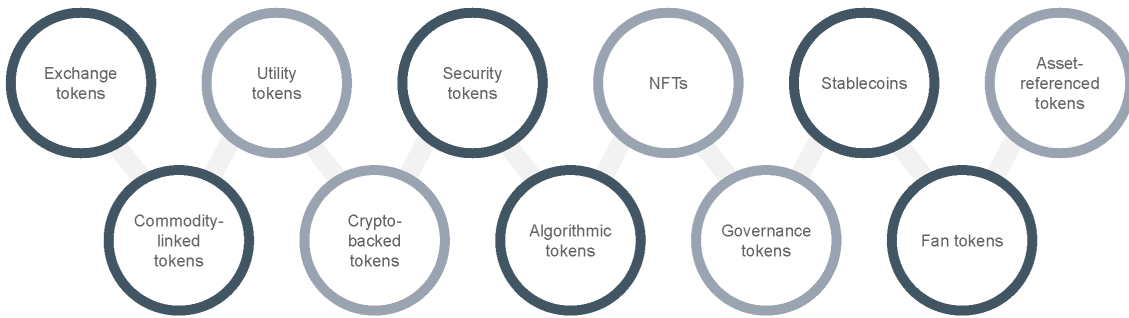
## Notes



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## Different types of “cryptoasset”

The different types of cryptoasset which could become subject to financial services regulation when they are being used for certain new regulated activities:



## Notes



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## Phased approach

HMT intends to continue to pursue a phased approach to regulating cryptoassets, which is prioritised according to the areas of greatest risk and opportunity:

### Phase 1

- Regulation of fiat-backed stablecoins which are used for payments
- Regime will address:
  - issuance activities relating to fiat-backed stablecoins
  - payment-related activities for fiat-backed stablecoins
  - **custody activities relating to fiat-backed stablecoins**

### Phase 2

- For a broader range of cryptoassets, regulation of:
  - **Safeguarding or safeguarding and administering a cryptoasset (or arranging of such)**
  - issuance activities
  - exchange activities
  - investment and risk management activities
  - lending, borrowing and leverage activities
- Not all cryptoasset activities to form part of Phase 2

### Future Phases

- Future phases include:
  - cryptoasset investment advice and portfolio management
  - post-trade activities in cryptoasset transactions (where not already covered in Phase 2)
  - crypto mining and transaction validation
  - operating a node
- DeFi
- Sustainability

## Notes



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## Territorial Scope – why no wholesale access regime?

- Proposals contain no cross-border access for wholesale business provided to UK based clients, as there is for traditional financial services – significant policy decision.
- Any role for 'overseas person exclusion', or 'reverse solicitation' and 'equivalence' assessments?
- Which activities, if any, should require UK/EU entity establishment?

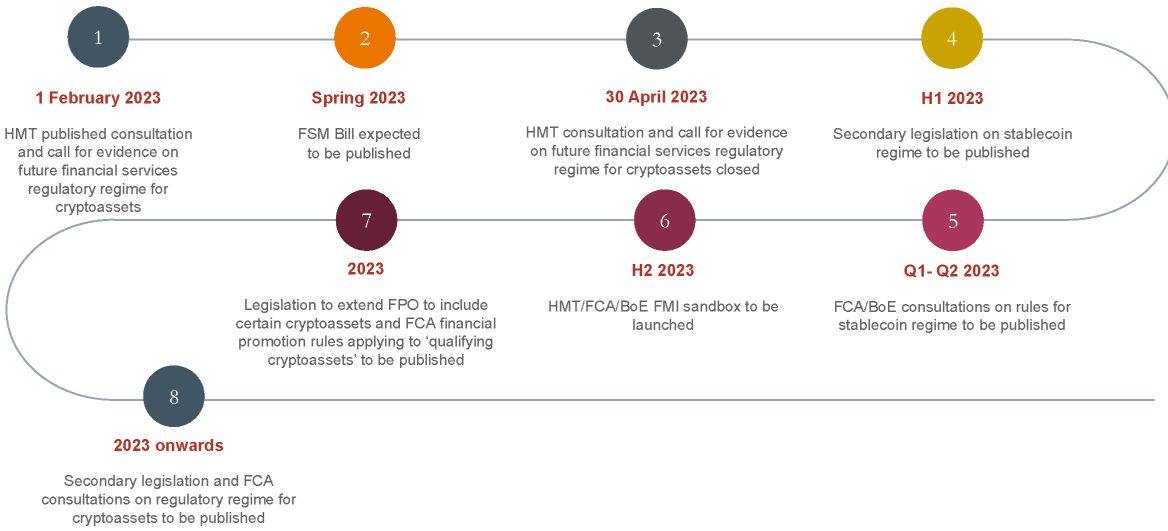
## Notes





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## Timeline

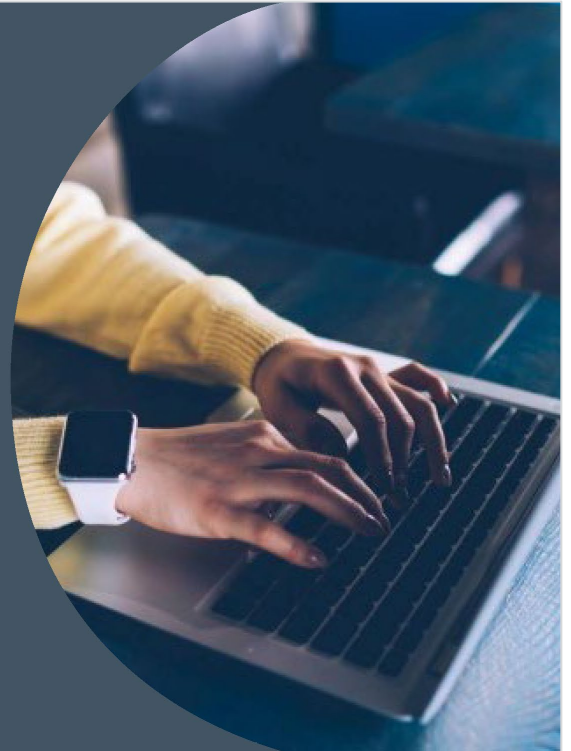


## Notes



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# Property Law Treatment of Digital Assets



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## English property law reform



### Law Commission consultation paper on digital assets (July 2022)

- English law has traditionally recognised two categories of personal property: (i) things in possession (broadly, any object which the law considers capable of possession); and (ii) things in action (any personal property that can only be claimed or enforced through legal action or proceedings).
- Digital assets are neither tangible things in the normal sense (although they do have a highly distributed tangible existence) and nor are they only claimable or enforceable by legal action or proceedings.
- Certain digital assets could fall within a **“third category” of personal property** which is neither a ‘thing in action’ nor a ‘thing in possession’ and has labelled this third category **‘data objects’**.
- It has proposed certain criteria that a thing must exhibit if it is to fall within the proposed third category of personal property.
  - Crypto-tokens satisfy the proposed criteria of data objects and are appropriate objects of property rights.
- Recognising a third category of personal property aligns with international law reform in this area, including the work being carried out by the American Law Institute and Uniform Law Commission’s Uniform Commercial Code and Emerging Technologies Committee in the US, and by the International Institute for the Unification of Private Law (UNIDROIT) Digital Assets Working Group.
  - On 10 May 2023, UNIDROIT adopted its Principles on Digital Assets and Private Law. The Principles are designed to provide clear guidance in relation to transactions in digital assets (broadly defined as being an electronic record which is capable of being subject to control).
  - The Principles cover conflict of law, the control, transfer and custody of digital assets, secured transactions, enforcement and insolvency.
  - Significantly in relation to conflict of law, the base position for precedence is first, any law expressed in the digital asset itself to be governing law; secondly, any law specified in the relevant digital system on which the digital asset is recorded; thirdly, the law of the jurisdiction in which the issuer has its statutory seat; fourthly, the law of the forum state.

## Notes



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## Law reform proposals for crypto-tokens

### Section 53(1)(c) of the Law of Property Act 1925

Dispositions of equitable interests or trust subsisting at the time of disposition must be in writing and signed by (or by a properly authorised agent of) the person making the disposition

Express exclusion from s 53(1)(c) LPA 1925 of qualifying outright transfers of equitable entitlements to crypto-tokens represented by entries recorded in electronic ledger(s), that are, or are capable of being, subject to centralised discretionary control by a direct custodian.

Dealings in equitable entitlements represented by crypto-tokens not recorded in account ledgers subject to professional, centralised discretionary control, where the underlying or linked crypto-tokens are held by a crypto-token custodian, should remain subject to s 53(1)(c).

### Allocation of shortfall losses

Arising in connection with commingled unallocated accounts or pools of crypto-tokens held on trust

Law reform clarifying and simplifying the apportionment of shortfall losses arising out of commingled crypto-token holdings held on trust by an insolvent custodian would be beneficial, taking into consider the insolvency law of England and Wales.

### Collateral arrangements in respect of crypto-tokens

Granting recourse to certain specified property or pools of property to secure or otherwise cover a payment obligation or the performance of an undertaking

Data objects should not be the subject of possessory securities, or analogous security arrangements.

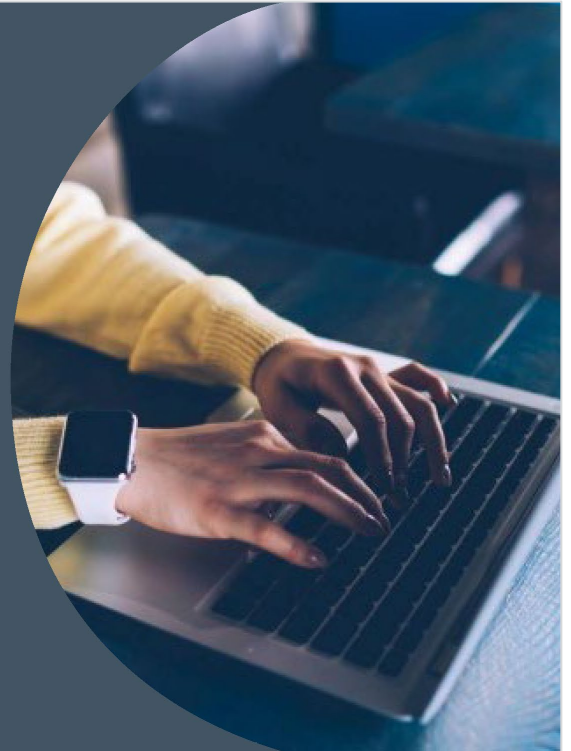
Advisable to develop bespoke statutory provisions designed specifically for collateral arrangements in respect of crypto-tokens, as an extension of the FCARs to encompass crypto-token collateral arrangements more comprehensively would not be appropriate.

## Notes



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## Custody; Lending and Borrowing; Market Abuse Regime

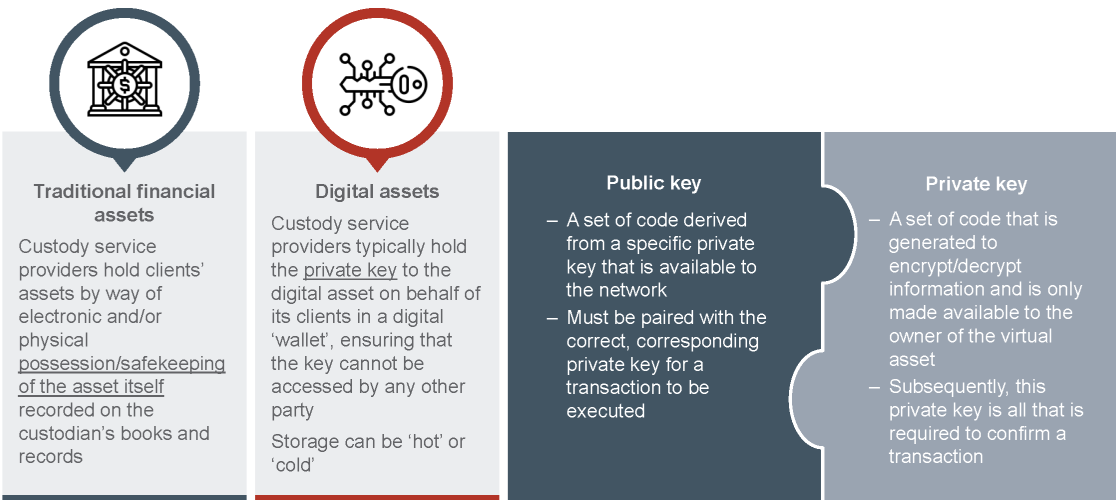


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## Custody of traditional financial assets vs. digital assets



## Notes



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## Custody arrangements in respect of crypto-tokens



- 1 Owners of crypto-tokens routinely deploy their objects of property rights — their crypto-tokens — in facilities and arrangements in which they relinquish to another party a degree of direct control over the crypto-token.
- 2 The factual concept of 'control' (as opposed to the concept of 'possession') best describes the relationship between data objects and persons. **“Positive” and “negative” control** are important developing concepts for custody of crypto assets
- 3 There are a range of crypto-token-specific holding structures under which a custody relationship could arise. These include intermediary custodians, custodial exchanges and “lock and mint” facilities such as bridges, wrapping protocols and NFT fractionalisation platforms.
- 4 Law Commission conclude against law reform amounting to a **default rule of interpretation that crypto-token direct custody arrangements take effect as trusts** in the absence of clear evidence to the contrary.

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## Notes



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## Regulated custody activities in the UK

Current article 40 of the UK FSMA 2000 (Regulated Activities) Order 2001 (**RAO**)



The activity of **both**:

- safeguarding of assets belonging to another; and
- the administration of those assets, or arranging for one or more other persons to carry on that activity



The Article 40 RAO framework for traditional custodians will be modified to accommodate cryptoassets.

Firms would need authorisation in order to **safeguard, or safeguard and administer** (or arrange the safeguarding and/or administering), of a cryptoasset or a **means of access to a crypto asset** (e.g. a wallet or cryptographic private key).



*"This activity would be broader than the closest equivalent regulated activity (Article 40 of the RAO) as it would capture firms that only safeguard (but not administer) assets (e.g. firms that solely safeguard cryptographic private keys which provide access to cryptoassets). The government considers those arrangements in the cryptoassets market to pose the same risks of harm as firms that safeguard and administer assets." (HMT)*



Similar scope to registration with FCA as "custodian wallet provider" under the Money Laundering Regulations 2017.

## Notes





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## UK Client Asset Sourcebook (CASS)

- The UK rules that apply to in-scope firms that hold financial instruments belonging to a client in the course of the firm's MiFID business and designated investment business (amongst other things) are set out in CASS.
- HMT proposals state that the existing custody provisions in CASS will be used as a basis to design bespoke custody requirements for cryptoassets.
- Core components of the new CASS provisions are expected to include the following:
  - adequate arrangements to safeguard investors' rights to their cryptoassets;
  - adequate organisational arrangements to minimise risk of loss or diminution of investors' custody assets;
  - accurate books and records of investors' custody assets holdings; and
  - adequate controls and governance over safeguarding arrangements of investors' custody assets holdings.

## Notes



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## Lending and Borrowing Platforms

- Proposed new "Phase 2" regulated activity of "operating a crypto-asset lending platform"  
This could include (i) facilitating collateralised and uncollateralised borrowing of cryptoassets (ii) borrowing of fiat currency with collateral provided in cryptoassets (margin lending) (iii) rehypothecation rights (iv) certain staking arrangements
- Proposal for SFTR-style reporting regime  
(e.g. counterparty and transactions details, collateral composition, rehypothecation, substitution of collateral at the end of the day and haircuts applied)

## Notes



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## Crypto Market Abuse Regime



Treatment of "no issuer" cryptoassets -e.g. what is "insider dealing", "inside information" or an "insider list" or a "PDMR"?



Realistic scope?: for an asset admitted to trading on a UK venue rules apply to activity wherever the person is and wherever the trading takes place



Unfair burden on exchanges/trading venues for policing market abuse and being primary enforcement mechanism as quasi-regulator?

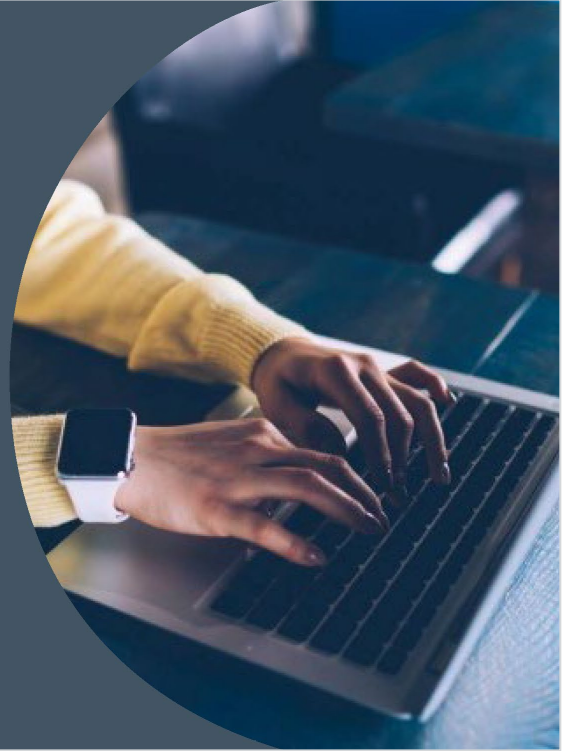
- Surveillance and STOR requirements for exchanges and firms
- Information sharing arrangements with every other venue trading same crypto asset wherever located

## Notes



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## Tokenised Securities



Notes



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## Benefits of digital bonds

### Potential long term benefits

#### Immutable shared data source

- Tamper-resistant data
- 'Golden source' of information
- It cannot be easily erased
- A consensus mechanism supports the integrity of transactions
- Costs reduced in data management, reconciliation, settlement, administration

#### Tokenization

- Efficiency improved – Speeding up processes by permitting transactions without need for one or more trusted intermediaries
- Real-time data synchronisation across participants

### Expected potential benefits

- Single source of truth
- Secure
- Auditable

- Same place for data/processing
- Can ensure consistency
- Limiting the need to rekey information such as bond static

## Notes



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## Benefits of digital bonds (cont'd)

### Potential long term benefits

#### Distribution & Decentralization

- Efficiency improved – Speeding up processes by permitting transactions without need for one or more trusted intermediaries
- Real-time data synchronisation across participants

#### Enhanced Transparency

- More transparency in regards to auditable transaction log

#### Encryption

- Cryptographic encryption provides added security

### Expected potential benefits

- Lower cost of operation
- Simplification of the parties involved (more federated approach)
- Could allow shared datasets to be maintained at a market level
- Continued operation of the system notwithstanding the failure of a individual market participants

- Creates transparency
- Reduces dispute management
- Maintained compliance with the trade limit laws
- Meet regulatory reporting requirements
- Single source of truth for regulators and other parties

- Enhanced cryptography (tamper-resistant transaction records Easily verifiable without need for checks/control)

## Notes



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## Issuance and Transfer – “On chain”

Key considerations that need to be tackled before structuring an issuance of DLT securities:

### Legal framework and regulatory characterisation

- **Governing law** of the DLT security to formally recognise the issuance and transfer
- Regulatory **characterization** of DLT securities
- Determination of the **legal ownership** of the DLT security and location of the instrument

### Settlement – Cash leg “on-chain”

A settlement token should be designed with the following points in mind

**Use cases**

- A settlement token can be used for
  - **Cash** settlement of the initial issuance of the DLT security
  - **Coupon** payments
  - **Redemption** payments
- **Technology** should enable use of the settlement token for settling secondary market transfers
- When is the performance of the **payment obligation** deemed to be complied with?

**Minor-and-biased approach? Characterisation**

- Depending on its features, the settlement token may qualify as
  - Electronic money** → Application of MIFID II or MiCAR
  - A deposit** → Application of CRD IV or MIFID II
  - A debt instrument** → Application of MIFID II
  - A stablecoin** → Application of MiCAR

### Role and liability allocation

- Responsibility allocation for **AML/KYC/sanctions** compliance
- Checking of **selling restrictions**
- Liability provisions in case of a platform failure?

## Notes



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## Public or Private DLT network?

### Public blockchain

**Decentralised** – No central authority to edit the ledger; however, it is subject to certain protocols

**Native asset** – Typically some form of user-incentivising native token to the Blockchain (i.e., Ether)

Can be permissioned or permissionless

**Anonymity** – Often no (or limited) personal data required

**Transparency** – Users have access to all information (Etherscan)

Ethereum Mainnet

### Private blockchain

**Varying decentralisation** – Members are free to negotiate levels of decentralisation. Governance does not require a consensus-based mechanism

**Non-anonymity** – Participants are known to the other participants in the network

Permissioned

**Transparency** – No requirement for public access and ensures privacy

Corda or Hyperledger

## Notes





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## UK CSDR and issues for CSD system operators

UK CSDR, as it currently stands, imposes certain requirements on CSDs which may be impractical or unnecessary when applied in the context of a DLT system on which transferable securities (which would include digital bonds) are issued, registered and transferred.

### Key issues

- Article 3 - where a transaction in securities takes place on a trading venue (e.g. as part of a secondary market) the relevant securities shall be recorded in book-entry form in a CSD
- Articles 6 and 7 – settlement discipline requirements.
- Article 9(1) –settlement internaliser reporting requirements.
- Article 18(3) – restrictions on participations.
- Article 19(1) – requirements where a service constitutes a UK CSDR 'outsourcing'.
- Article 37(1) – reconciliation requirements.
- Article 38 – segregation requirements.
- Article 39 – settlement finality requirements.
- Article 39(7) – requirements for settlement on a DVP basis.
- Article 43(2) – enforceability of rules.

## Notes



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## SFRs and issues for CSD and non-CSD system operators

The SFRs set out certain protections for CSDs operating securities settlement systems, including protections in the event of insolvency.

### Scoping issues

- The definition of "system" for the SFRs turns on whether or not there are "participants".
  - It is not clear how DLT entities such as nodes would be treated for the purpose of this definition.
  - It is not clear how end-investors would be treated (i.e. whether they could be participants if accessing the DLT system through a financial institution).
- The application of the SFRs to CSDs and not non-CSDs is potentially a barrier to competition.
  - MTF system operators will be at a disadvantage as they will be unable to benefit from insolvency (and other) protections in the SFRs.
  - A new UK DLT Regime could provide that non-CSDs operating a DLT securities settlement system are also able to benefit from the relevant protections in the SFRs.

## Notes



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## Issuance and transfer of digital securities under English private law



UK Jurisdiction Taskforce of LawtechUK (UKJT) Legal Statement (February 2023)

- English law, in the main, can accommodate the issuance and transfer of digital securities via DLT-based technology systems.
- However, there are certain legal concepts and specific provisions that present some challenges which may need to be navigated.
- In terms of the legal concepts considered by the Legal Statement:
  - **Negotiability** – it is possible for a digital tokenised bond to be 'negotiable', meaning it can benefit from being capable of transfer by delivery, and the rule of *nemo dat* does not apply (so the transferee takes free of any defects in title).
  - **Stapling** – to ensure investor rights and responsibilities are not separated from the digital security upon transfer, a 'stapling' mechanism (i.e. a legal mechanism such as deed poll, application of the Third Party Rights Act, or advance consent to transfer by novation) may be required.
  - **Risks not specific to digital securities** – while digital assets and DLT-technology does involve the risks of pseudonymity, forks (multiple versions of the same digital security), and multiple intermediary use, these are not specific to digital securities and the Legal Statement considered existing methods of resolution and/or risk mitigation could be applied.
- On **negotiability**, the Legal Statement highlighted that the legal effects of negotiability could be replicated by way of drafting and structuring, if it is desirable for a digital security to be transferred in the same way (i.e. so that the issuer issues its token so that it is transferred by delivery, and no previous tokenholder can assert superior legal title against a subsequent holder).

## Notes



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## Issuance and transfer of digital securities under English private law



UK Jurisdiction Taskforce of LawtechUK (UKJT) Legal Statement (February 2023)

- There are certain specific English law requirements that present some challenges to the transfer of digital securities.
- The extent to which these apply depend on the nature of the security and any underlying asset.
- The Legal Statement cites in particular:
  - **Disposing of an equitable interest under section 53(1)(c) of the Law of Property Act (LPA)** – the LPA requires that equitable interests are disposed of in signed writing. This may be relevant where the digital security is held under a trust (for example where there is an intermediary acting as trustee, or the security is proprietary in nature and securitisation is achieved by putting the asset in a trust for the benefit of token controllers). The Legal Statement concludes that there is no reason why electronic documents and digital signatures would not be capable of fulfilling this requirement.
  - **“Proper instrument of transfer” under section 770 of the Companies Act 2006 (CA)** – the CA provides that a company may not register a transfer of shares or debentures unless a “proper instrument of transfer” has been delivered to it. The Legal Statement concludes that there are, arguably, divergent approaches depending on whether the transfer attracts stamp duty. If stamp duty applies, then the instrument must be capable of being “stamped” by HMRC. If not, then any instrument capable of recording the key details of the transfer as needed in order to effect the transfer would be sufficient.
- Blockchain and DLT-based systems used in such contexts will need to be designed and developed so that they can generate the right kind of “documentation” to meet these requirements. For the purposes of section 770 CA, the Legal Statement suggests pairing the relevant system with software which produces a document like a standard stock transfer form to minimise delays.

## Notes



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## Issuance and transfer of digital securities under English private law



UK Jurisdiction Taskforce of LawtechUK (UKJT) Legal Statement (February 2023)

- DLT-based systems may be used for the creation, storage and maintenance of token controller registers. However, where the CA applies, the Legal Statement concludes that it is unlikely to be possible for a decentralised, unpermissioned DLT to meet the relevant CA requirements.
- The Legal Statement identifies three conditions the DLT-based system would need to meet:
  - **Company records must be capable of being produced in hard copy form (section 1135(2) CA)** – in practice, the DLT-based system would need to be capable of generating hard copy, human-readable company records.
  - **Member/Debenture holder details (section 113 CA and section 734 CA)** – for both shares and debentures, the CA prescribes certain data to be held by the issuer including the names and addresses of interest holders. In practice, some of these details may be held “off-chain”.
  - **Maintenance requirements (various, including for example under section 771 CA)** – for both shares and debentures, the CA requires issuing companies to have effective and practical control over the register. The Legal Statement concludes that DLT-based systems will only be able to be used in compliance with the CA requirements where they are limited to ensure the company retains ultimate control.
- In relation to the maintenance requirements, the Legal Statement does find that a DLT-based system can meet the requirement that records are kept at the company’s registered office, even where the electronic record is kept elsewhere under the provisions allowing a “single alternative inspection location” under the Companies (Company Records) Regulations 2008.

## Notes



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## FMI Sandboxes

The FSM Bill gives the Treasury piloting powers to set up regulatory 'sandboxes' for the testing of financial marketing infrastructure (FMI) activities.

The Treasury is in the early stages of developing the parameters for the first FMI Sandbox, and is expected to consult on its proposal shortly after the FSM Bill as received Royal Assent (possibly June 2023).

The Sandbox will be created by way of a statutory instrument (the **Sandbox SI**).

The Sandbox SI is expected to cover:

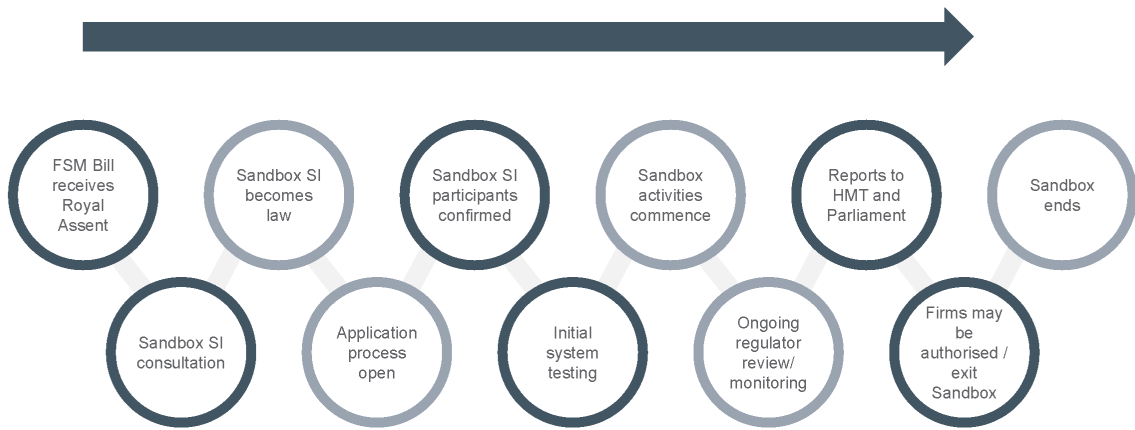
- Which entities are eligible to apply to participate
- Which asset classes will be in-scope
- Which FMI activities will be in-scope
- Which rules will be flexed/modified/disapplied
- Regulator powers to determine the application process
- Regulator authority to set any size/scale limitations
- Duration of the Sandbox
- The legislation to be flexed/modified/disapplied is expected to include:
  - CSDR
  - SFRs
  - FCARs
  - USRs
  - Companies Act 2006
  - MiFID/MiFIR

## Notes



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## FMI Sandboxes – expected process

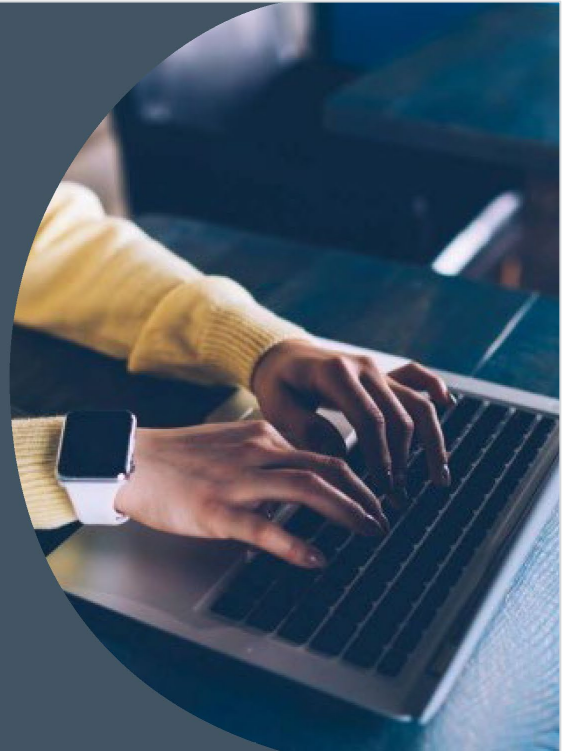


## Notes



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## Digital Asset Derivatives




### Notes





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## Market outlook

- 
- 1 Increasing institutional interest + regulatory focus/uncertainty
  - 2 Development of "institutional grade" platforms and integrations
  - 3 New product development - prime brokerage solutions, exchange traded options, vaults, on-chain OTC, ETH staking index etc.
  - 4 Regulatory compliance, risk and reputational management at the forefront

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## Notes



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## ISDA Digital Asset Definitions

### Definitions for OTC non-deliverable digital asset forwards & options referencing BTC & ETH



#### Valuation

- Selection of sources – risk of disparity is material
- Disruptions – unavailability, discontinuance, change in methodology
- Fallback selection and hierarchy



#### Disruption Events

- Familiar events – hedging disruption, increased cost of hedging
- Fork event – crypto specific technical event with a detailed methodology linked to the impact of the event
- Change in law



#### Business Days

- Crypto never sleeps – traditional business days vs 24/7



#### Conditional Logic

- The definitions are drafted using conditional statements for the purposes of translation into code and with a view to apply in DLT-based contexts (including smart contracts).

## Notes



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## A Few Hot Topics

- **Margin Rules**

Application to exchange traded derivatives. Crypto is not eligible collateral. Rules were designed for conventional OTC market, not "exchange traded OTC".

- **Reporting**

Introduction of new UK and EU reporting fields for crypto derivatives in 2024.

- **Netting**

ISDA working on updating netting opinions in relevant jurisdictions to cover digital assets. Netting arrangements relating to digital asset derivatives are likely to be enforceable in major jurisdictions (including England & NY), but enforceability in each jurisdiction will depend on counterparty's local insolvency law.

- **Crypto collateral**

Crypto assets as "non-reg" variation and initial margin. Most developed jurisdictions will likely recognise digital assets as property capable of protection under local law but precise nature & extent of rights associated with that property interest, strength of legal certainty and technical issues (i.e. methods by which digital assets may be posted as enforceable collateral) will vary by jurisdiction. Documentation needs to address features specific to crypto – for example, transfer timing and method, risk of loss/technical failure, airdrops, staking, business days and valuation methodology and dispute resolution.

- **Asset holding structures**

Analysis of insolvency and operational risk. Particularly exchanges and crypto custodians.

## Notes



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## Questions?

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## Notes



# Notes



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