CUMMINGS PEPPERDINE

CUMMINGS PEPPERDINE ON UK REGULATORY DEVELOPMENTS IN CRYPTOASSETS

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INTRODUCTION

The FCA, HM Treasury, the Bank of England (BoE) (collectively the Cryptoassets Taskforce) and the Payment Systems Regulator (PSR) are working together to develop a regime for cryptoassets (including stablecoins) that supports innovation and competition while protecting consumers, market integrity and financial stability.

In the absence of an internationally agreed definition of cryptoasset, the Cryptoassets Taskforce has defined cryptoassets as:

"Cryptographically secured digital representations of value or contractual rights that use [that is, are built on] some type of distributed ledger technology and can be transferred, stored or traded electronically."

To assist both market participants and consumers, the FCA has published non-Handbook perimeter guidance in a July 2020 policy statement (PS19/22) that further explains what cryptoassets are and categorises them into regulated and unregulated tokens.

The Cryptoassets Taskforce is now focussing on identifying those areas where the current regulatory framework could be amended to address the perceived risks of cryptoassets.

UK CRYPTOASSET REFORM

As existing UK legislative framework was not developed with the regulation of cryptoassets in mind, the FCA has to apply existing legislation which is a closer fit to "older" financial products to cryptoassets and this has not always worked.

To improve this situation, the FCA is considering two areas of change:

- Introducing a new regulatory regime for a new class of cryptoassets token (stable tokens) that are used as a means of payment; and
- Extending the financial promotion regime to cover the promotion of certain types of unregulated cryptoassets.

HM Treasury plans for any adjustments to the regulation of cryptoassets to be incremental and phased and proportionate to regulation that is sensitive to risks posed and responsive to new market developments.

REGULATION OF STABLECOINS

Background

Stablecoins are a form of cryptoassets which aims to minimise volatility in value. Depending on their specific characteristics, stablecoins can fall into any of the categories of cryptoassets, though are currently more likely to be unregulated exchange tokens or e-money tokens.

In January 2021, HM Treasury published a setting out proposals to bring so-called "stable tokens" within the FCA's regulatory perimeter. This makes it clear that HM Treasury wants to establish a sound regulatory environment for stablecoins as it is where risks and opportunities cryptoassets most urgently need addressing. To support this, they cite increasing value in transactions using stablecoins (compared, for example, to exchange tokens such as Bitcoin) and the fact that stablecoins are the most likely to be used as a means of payment rather than investment.

There is also the benefit that if appropriate standards and regulation can be met, certain stablecoins have the potential to play a key role in retail and cross-border payments and settlement.

HM Treasury's proposals include the introduction of stable tokens as a new regulated category of token (which will need its own regulatory regime. They define stable tokens as tokens that stabilise their value by referencing one or more assets, such as fiat currency or a commodity (so really a stablecoin) and could therefore more reliably be used as a means of exchange or store of value. This definition therefore captures both tokens whose value is linked to a single fiat currency and those tokens whose value is linked to another form of asset. It also includes forms of tokenised payment and settlement assets and tokenised forms of central bank money.

The proposed new regulatory regime for stable tokens which are used as a means of payment would cover bring both the tokens themselves and activities undertaken in relation to them. It would therefore cover firms issuing stable tokens and firms providing services relating to them, such as systems operators, cryptoasset exchanges and wallet providers.

The proposals were drawn on the current approach to e-money and payments, potentially with a lighter-touch regime being put in place for firms below a certain turnover, while anti-money laundering requirements would apply will apply to all cryptoasset wallets and exchanges (who may already be required to register with the FCA for their activities in relation to all types of cryptoassets).

The market participants who would be caught by the proposed regime are likely to include issuers or systems operators, responsible for managing the rulebook of a system, the infrastructure, burning and minting coins, cryptoassets exchanges, enabling consumers to exchange tokens for fiat money or other tokens and wallets providers who provide custody of tokens and manage private keys.

Certain types of cryptoasset however would not be caught in the initial stages of new regulation being introduced. These include security tokens that meet the definition of specified investment under the RAO and are already regulated, unregulated utility tokens used to access a current or future service and unregulated algorithmic stablecoins which that seek to maintain a stable value using algorithms. E-money tokens that already fall within the existing e-money authorisation regime are also outside the scope of this proposed regime, and existing requirements will continue to apply.

THE FINANCIAL PROMOTION OF CRYPTOASSETS

The second area of proposed regulation is government is the expansion of the financial promotion regime include certain types of unregulated cryptoassets.

The government is concerned that too many authorised firms are failing to satisfy its requirements when approving the financial promotions of unauthorised persons, including approving financial promotions that relate to cryptoassets that are beyond their sphere of expertise.

One potential course of action would be for new rules to be put in place which would allow the FCA to assess the suitability of a firm before it is permitted to approve the financial promotions of unauthorised person.

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Cummings Pepperdine LLP - December 2021