CRYPTOASSET REGULATORY UPDATE: HM TREASURY PUBLISHES CONSULTATION PAPER ON THE FUTURE OF THE FINANCIAL SERVICES REGULATORY REGIME FOR CRYPTOASSETS

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Policy and Regulatory Alert

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INTRODUCTION

On Wednesday, 1 February 2023, HM Treasury announced its intention to regulate a variety of crypto-asset activities under the UK financial services regulatory regime. The announcement arrived in the form of a consultation paper (Future financial services regulatory regime for cryptoassets) in which the government highlighted its ambition for the United Kingdom to become one of the "most open, well-regulated, and technologically advanced capital markets in the world." The consultation paper highlights the government's belief that crypto-asset technologies will have a profound effect across the wider financial services sector and that the development of advanced crypto-asset markets will bring opportunity as well as risk to the United Kingdom. The UK government has recently acknowledged such risks, with the second reading of the Economic Crime and Corporate Transparency Bill introduced earlier last year to extend powers to seize and recover crypto-assets that are suspected of being proceeds of crime. The recent turbulence in the crypto-asset market has highlighted the need for "clear, timely regulation and proactive engagement" with the industry, and many investors are urging the UK government to catch up with other jurisdictions in the race to regulate crypto-assets. Interested parties should review the consultation paper closely and consider providing feedback to HM Treasury in order to ensure that they are aware of the proposals and what that might mean for their business.

SCOPE

The announcement signals the government's ambition to expand upon existing "Phase 1" proposed regulatory regimes, such as those for stablecoins, the details of which are expected to be published during the first half of this year. The intended regulation of broader crypto-asset activities, dubbed "Phase 2," will focus on targeting activity in areas associated with a higher degree of risk from a consumer and market perspective. The consultation paper signals that not all crypto-asset activities will form part of Phase 2 and that a key aim of changes to legislation will include crypto-assets as a form of "specified investment" within the Financial Services and Markets Act 2000 (FSMA) to be amended by the Financial Services and Markets Bill 2022 (FS&M Bill) which is currently going through the legislative process.

The consultation paper refers to the definition of "cryptoassets" to be set out in the FS&M Bill, which is:

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- [A]ny 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).

The definition is purposely broad in its nature in order to "capture all types of cryptoasset" and underpins the powers HM Treasury has to specify activities within the FSMA (Regulated Activities) Order 2001 or to designate activities as part of the Designated Activities Regime being legislated for in the FS&M Bill.

The paper also outlines the proposed "cryptoasset activities" to be brought within the regulatory perimeter, including, but not limited to, issuance of crypto-assets or making a public offer of a crypto-asset, operating a crypto-asset trading venue, and certain intermediation activities, such as dealing in crypto-assets and arranging deals in crypto-assets. As crypto-asset activities are "provided and consumed digitally and are not confined to a specific jurisdiction," HM Treasury proposes to capture crypto-asset activities provided in or to the United Kingdom so that UK firms performing the relevant activities to persons based in the United Kingdom or overseas, as well as overseas firms performing the relevant activities to UK persons, are included.

IMPACT

When the consultation closes on 30 April 2023, HM Treasury will consider feedback before the new regulations are formalized under FSMA. Currently, firms that provide certain crypto-asset-related services in the United Kingdom must be registered with the Financial Conduct Authority and comply with anti-money laundering and counterterrorist financing requirements. The proposed crypto-asset regulations will align crypto-asset activities with regulations governing traditional finance, and various new obligations will be imposed upon crypto-asset-related activities (i.e., the principle of "same risk, same regulatory outcome"). The planned regulation may be viewed by some as a long-overdue necessity rather than a proactive engagement with the industry. The recent demise of FTX (the then second-largest cryptocurrency exchange) left over 50,000 UK investors with few options to recover their investment. While the key aim of the regulations is to spur innovation and competitiveness within the United Kingdom, the regulations will likely make operating within the United Kingdom more burdensome for crypto-asset businesses. Many have highlighted that the consultation document is overdue and overly reactive without acknowledging many of the issues that businesses and individuals who are involved in the crypto-industry may face in the future. Businesses that provide crypto-asset services will need to ensure that they are prepared for legislative changes and the additional requirements that they will bring.

The firm will continue to follow the impact and changes to the United Kingdom's proposed regulation of crypto-asset activities. The firm is equipped to advise on how best to prepare for any legislative changes and any potential issues your business may face. If you have any questions regarding crypto-assets, please do not hesitate to contact any member of our investigations or crypto-asset practices.

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