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By email to cryptoasset.consultation@hmtreasury.gov.uk

05 May 2023

Dear Laura,

**Re: Consultation on the future financial services regulatory regime for cryptoassets**

We welcome the opportunity to provide input on HMT's consultation regarding the proposed regulatory regime for cryptoassets in the UK. The EMA represents payments, crypto asset and FinTech firms, engaging in the provision of innovative payment services, including the issuance of e-money, e-money tokens, open banking payment services, and cryptoasset related services including stable coins. A full list of our members is provided in the appendix to this document.

The EMA was established some 20 years ago and has a wealth of experience in regulatory policy relating to payments, electronic money, and more recently crypto assets.

We would be grateful for your consideration of our comments, which are set out below.

Yours sincerely,

Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

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## General statement

The EMA, and its members, are supportive of an aligned, appropriate and fit-for-purpose regulatory framework for cryptoassets. This can promote the development of the cryptoassets sector in the UK and help to achieve the government's vision of making the UK a global hub for cryptoassets.

The key principles of any envisioned regime for cryptoassets should be suitability and proportionality. As an emerging sector, it presents a great deal of potential benefit for the UK as a whole, but in order to realise those benefits, the proposed regime will have to account for the specific characteristics and nuances of cryptoassets. It will need to be proportionate and forward looking, providing sufficient leeway to allow an appropriate supervisory response, and taking into account the dynamics and innovative potential of the sector.

The government has adopted the principle of "same risk, same regulatory outcome" when designing this regime. While it is important to remain technology agnostic, the risks the regime is designed to address should be actual risks, and not simply perceived risks. The negative perception of cryptoassets in recent years has adversely affected the sector, and it is crucial that any proposed regime introduces a higher regulatory standard for cryptoassets where there is evidence of heightened risk. It is important to maintain regulatory agility, allowing not only for timely responses to evolving risks, but also for developing a deep understanding of those risks.

Additionally, and in line with that same principle, cryptoasset markets and market participants should not be held to a higher standard than those that exist within traditional financial markets. For example, in traditional financial markets regulated markets and operators of multilateral trading facilities do not assume the roles, responsibilities and liability of issuing parties and as such neither should cryptoasset trading venues.

In particular, we would like to highlight certain elements of the proposed regime that are of particular concern. These include its extraterritorial nature, where it is proposed to apply to firms outside the UK, subjecting them to a high regulatory standard, including the need to seek authorisation with the FCA. This would require significant financial and business resource and may instead result in firms exiting the UK altogether.

The responsibilities that are proposed to apply to cryptoasset trading venues are extremely onerous and place a large administrative burden on venues. These include the requirement to produce an internal policy and detailed requirements for issuance and disclosure documents for each cryptoasset traded on the platform, and to conduct appropriate due diligence to validate the accuracy of such information on an on-going basis. These requirements appear to be disproportionate to the risk(s) associated with the activities of a CTV and can be addressed in a more reasonable manner.

The proposed prudential, conduct, operational resilience and reporting requirements are also unclear, as no thresholds or standards have been proposed. The EMA would welcome a greater level of detail regarding the expectation in these areas, and care should be taken that the requirements are not so significant as to present a barrier to entry. Some of the proposals are so high level that they can only be commented on in principle, and further clarity and guidance is needed.

Likewise in relation to proposed liability requirements and potential application of the FSCS scheme to cryptoasset custody, it is challenging for our members to opine as to whether they agree with such principles without indications of, for example, how an FSCS scheme would be funded, which would provide the necessary context within which the proposals are being made.

We provide below a response to select questions from the consultation and remain committed to working closely with both the government and the FCA to ensure a future regulatory framework for cryptoassets that is suitable, and which reinforces the UK's position as a hub for innovation, investment, and regulatory development. Recognising the deep challenges in regulating for a new and growing industry, we also encourage and would be pleased to coordinate direct engagement with ourselves and our members at any stage during the policy-making process.

## Definition and legislative approach

### 1 Do you agree with HM Treasury's proposal to expand the list of "specified investments" to include cryptoassets? If not, then please specify why.

The EMA, generally speaking, supports the Treasury's proposals to bring cryptoasset activities within the regulatory perimeter. We support the Treasury's endeavors to make the UK the crypto hub for crypto businesses in the region; to differentiate itself from other jurisdictions with a view to facilitating business and, ultimately, progress.

We equally support an activity-based approach to regulation. In that regard, HM Treasury and the FCA should provide clarity on the regulatory treatment of different activities when carried on in relation to different types of cryptoassets. Such a clarification could be, for example, an explanation that Non-Fungible Tokens ("NFTs") when used for non-financial services activity would be excluded from financial services regulation.

### 2 Do you agree with HM Treasury's proposal to leave cryptoassets outside of the definition of a "financial instrument"? If not, then please specify why.

Whilst the EMA is, generally speaking, supportive of the Treasury's initiatives in this area and supportive of the UK being the regional hub for cryptoasset business, we consider the definition of "cryptoasset" under the new proposed regime to be too broad. Such a broad definition could result in activities that are not currently within scope of the legislative intent could fall within the regulatory perimeter.

The current version of the Financial Services and Markets Bill 2022-2033, which sets out the legislative basis for the Treasury's proposals defines "cryptoasset" as follows:

""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)."

This definition is considerably broad as there is no reference to DLT. The Treasury may, instead, wish to utilise the existing definition of “cryptoasset” as set out in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (“**UK MLR**”).

The UK MLR defines “Cryptoasset” as follows:

“"Cryptoasset" means a cryptographically secured digital representation of value or contractual rights that **uses a form of distributed ledger technology** and can be transferred, stored or traded electronically.”

The UK MLR definition gives stakeholders more certainty as to what types of products and services would fall within scope of that definition; whereas the proposed definition under the Financial Services and Markets Bill 2022-2033 is broad (encompassing products and services that do not leverage distributed ledger technology) and may therefore include products and services that are beyond the government’s legislative intent.

We would therefore propose utilising the existing definition of “cryptoasset” from the UK MLR in the future regime. There is clearly a precedent for utilising this definition; it appears in the UK MLR and is thus the foundation of the current registration obligation and attendant AML obligations levied on firms. We therefore consider there is a strong basis to proceed with this existing definition of “cryptoasset” as set out in the UK MLR.

In addition, we would like to highlight that the scope of proposed regulation should not apply to loyalty or reward programmes. Loyalty or reward programmes typically are contracted mechanism that offer rewards to members/customers for their participation in the programme. This means the use of redeemable points or credits that are primarily obtained through participation in such programmes. The holder of such points/credits would not be able to transfer them to others without the issuer/offeror’s permission; such points/credits are non-fractionable and do not have investment purposes as they are primarily used for the purchase of goods or services or other benefits in connection with a loyalty or reward programme. It is important that such loyalty or reward programmes are clearly excluded from any proposed legislation.

**3 Do you see any potential challenges or issues with HM Treasury's intention to use the DAR to legislate for certain cryptoasset activities?**

The EMA is, generally speaking, supportive of the Treasury's initiatives to establish the UK as the regional hub for cryptoasset business. We have no specific comments with respect to the Treasury's utilising of the new DAR regime to establish the regulatory framework for cryptoassets in the UK, permitting this incoming regulatory framework is proportionate, fair, does not result in unsubstantiated regulatory burden and ultimately facilitates business and progress in the UK.

**<u>Overview of the current regulatory landscape for cryptoassets</u>**

**4 How can the administrative burdens of FSMA authorisation be mitigated for firms which are already MLR-registered and seeking to undertake regulated activities? Where is further clarity required, and what support should be available from UK authorities?**

The information a firm must provide in the context of registering under the UK MLR is already quite extensive and should therefore be taken into account when a firm subsequently undertakes Part 4A authorisation in order to provide cryptoasset services under the new FSMA regime.

For example, when registering for AML under the UK MLR, firms must provide information in relation to senior managers, beneficial owners, and close links. Firms must further provide, for example, information as to their key IT systems, submit AML policies and procedures, AML risk assessments, AML compliance framework and so on.

For firms already registered under the UK MLR, the documents these firms previously provided to the FCA during the course of registration need not be duplicated in the context of a subsequent authorisation.

In terms of timelines, the firms who are registered under the UK MLR should therefore be prioritised when applying for their Part 4A permission as they have already provided a wealth of information, are compliant with the UK AML regime and are otherwise known to the FCA. Therefore, the relevant regulator's timelines to review and provide a decision with respect to authorisation should be no more than three months.

In terms of fees, it should be taken into consideration that crypto firms registered under the UK MLR have already paid fees for such registration (currently set at GBP 10 000 pounds, cf. FEES Appendix 4R); accordingly, any subsequent fee levied for Part 4A authorisation should be reduced by the amount already part for registration.

Firms already registered under the UK MLR should be supported by the Treasury and

the FCA during the course of their transition. They should be afforded adequate time in order to prepare their application for authorisation supported by legislative transitional provisions. We would suggest a transition period of 18 months. The Treasury may wish to consider allowing existing crypto asset firms who are registered under the UK MLR to avail from grandfathering provisions in that they need not obtain a Part 4A permission at a later stage. The length of a grandfathering period should take into account both an appropriate amount of time for cryptoasset firms to gather the documentation and information needed to submit a robust application as well as an appropriate amount of time for the FCA to become operationally ready to manage such applications, in order to minimise the administrative burden for both parties.

Finally, EMA members have reported that when undergoing UK MLR registration, it was not clear exactly what information firms should provide to the FCA in order to register. This caused delays and utilised unnecessary resource on both sides. We therefore request that any documentation that is required to be tendered for a Part 4A cryptoasset authorisation is clearly articulated and set out objectively prior to any firms undertaking such authorisation; this will allow firms to prepare to their application packs to the best of their ability and not expend resource or sustain delay later on with requests for documentation that were not foreshadowed at the outset.

**5 Is the delineation and interaction between the regime for fiatbacked stablecoins (phase 1) and the broader cryptoassets regime (phase 2) clear? If not, then please explain why.**

The delineation and interaction between these phases could indeed be made clearer.

The Treasury appears to be proposing that stablecoins are subject to two regulatory regimes (both the e-money/payments regimes as well as FSMA) depending on the activity being carried out with respect to the stablecoin. Issuing, payments and custody of stablecoins are intended to be legislated for in the e-money/payments regimes (as part of phase one). Exchange and trading of stablecoins are then intended to be dealt with under FSMA (as part of phase two).

It is not proportionate to require cryptoasset firms who currently offer products and services relating to stablecoins to obtain two authorisations (e.g., payment institution and Part 4A). This is not efficient and can easily be consolidated into existing permissions in order to preserve resources on both the part of the cryptoasset firm and of the regulator.

There are several options to consider, as follows:

1. All stablecoin activities, whether issuing, payments, trading, exchange, fall entirely within the stablecoin regime that will be established in the Payment Services Regulations 2017.

2. Stablecoins as a means of payment (whilst under the new regime set out in the Payment Services Regulations 2017) can be carried out by a firm with a Part 4A permission. This is in the same way that Part 4A firms can provide payment services and

issue e-money without necessarily being authorised as an electronic money institution or payment institution.

3. All stablecoin activities fall under the new stablecoin regime that will be established in the Payment Services Regulations 2017 and all of these activities are encompassed within the Part 4A permission.

**6 Does the phased approach that the UK is proposing create any potential challenges for market participants? If so, then please explain why.**

Whilst we agree with a staged approach in principle, we urge the Treasury to ensure there is sufficient time for existing cryptoasset firms to become authorised and implement the new rules within their business. Little can be gained from rushing businesses into a new regime of rules and regulations; implementation takes time and must be carried out thoroughly. This could, for example, take several years. We also urge the Treasury to ensure there is sufficient support for existing firms that are already registered for AML purposes. Please see our response to question 4.

**Cryptoasset activities**

**7 Do you agree with the proposed territorial scope of the regime? If not, then please explain why and what alternative you would suggest.**

We suggest that the new cryptoasset regime has the same territorial scope as the UK payment services regime as set out in the Payment Services Regulations 2017 and the PERG 15 chapter of the FCA Handbook; this would ensure consistency as well as allow flexibility and innovation for entrants. As indicated in the Treasury's proposals, some cryptoassets (such as stablecoins) will be within scope of both the UK payments regime and the FSMA regime. We therefore consider it would be most straightforward to apply a similar scope of perimeter to that of the UK payments regime perimeter to cryptoassets in general.

**8 Do you agree with the list of economic activities the government is proposing to bring within the regulatory perimeter?**

The EMA, generally speaking, agrees with the list of economic activities as set out in the Treasury's proposals. As previously discussed, we agree with the Treasury's proposals to create a regulatory regime for cryptoassets in the UK and establish the UK as the central hub for cryptoasset business within the regime. We agree with the Treasury's proposals in this regard; we agree that the UK should be at the forefront of this industry and not fetter progress by regulating too many cryptoasset-related activities as is the case with other jurisdictions.

However, regulatory rules should only apply to such economic activities where a real identified risk exists, where the regulatory measure is commensurate to that risk, and where such rules are applied appropriately, logically, fairly, and to the correct person(s). For example, we do not disagree that there may exist certain circumstances where issuers should be caught within the list of economic activities, however we do not agree with the application of the proposed issuer rules to persons who are not issuers, namely CTVs. We do not agree that CTVs should stand in for issuers where there is no true issuer for a cryptoasset including assuming legal liability for factors beyond their control, neither do we agree that where there is an issuer it is necessarily always the case that disclosure rules and legal protections for placing reliance on such disclosures is an area of particular concern for cryptoasset investors or where the risk truly sits.

**9 Do you agree with the prioritisation of cryptoasset activities for regulation in phase 2 and future phases?**

Please see response to Question 6.

**10 Do you agree with the assessment of the challenges and risks associated with vertically integrated business models? Should any additional challenges be considered?**

We agree that cryptoasset exchanges play a central role in the provision of cryptoasset services and acknowledge the importance of regulating on the basis of the various individual activities, several of which may be being carried on by an exchange. However, we also believe it would be disproportionate to place all of these obligations on cryptoasset trading platforms merely on the basis that the exchange platforms might act as a conduit to other cryptoasset services and/or service providers. Any risks arising from a vertically integrated business model can be mitigated through internal systems, controls, processes, and policies, including any conflicts of interest.

**11 Are there any commodity-linked tokens which you consider would not be in scope of existing regulatory frameworks?**

No comments.

**12 Do you agree that so-called algorithmic stablecoins and cryptobacked tokens should be regulated in the same way as unbacked cryptoassets?**

The EMA urges HM Treasury to make a clear distinction between payment stablecoins that are collateralised by high quality liquid assets and so-called "algorithmic stablecoins" that do not employ a similar collateralisation mechanism. Further, HM Treasury should clearly differentiate tokenised traditional assets (i.e., tokenised cash and tokenised deposits) as a category separate from tokens that use higher risk traditional assets (such as commercial debt, or other less liquid instruments) in their reserve or as a stabilisation

mechanism, and cryptoassets that are “stabilised” by any type of “algorithmic" mechanism that is endogenously collateralised.

We understand that HM Treasury recognises that it is important to distinguish between so-called algorithmic stablecoins and those backed by either central bank or commercial bank money. We agree that so-called algorithmic stablecoins should be regulated in the same way as volatile cryptoassets, and that the government ensures that the same ‘systemic’ regulation is also applied to so-called algorithmic stablecoins.

It should be considered that so-called algorithmic stablecoins are not, in fact, stablecoins as they do not have a reserve mechanism with high quality liquid assets that would allow for a stable medium of exchange. Rather, given their reliance on other and possibly volatile assets/tokens, so-called algorithmic stablecoins should be considered and treated in the same manner as other volatile cryptoassets.

**13 Is the proposed treatment of NFTs and utility tokens clear? If not please explain where further guidance would be helpful.**

We agree that, generally speaking, NFTs represent artwork, music, or something else similarly creative, and are not used for financial services. We note that the Treasury’s legislative intent is not to bring within scope of the new regulatory regime those NFTs that are used for creative purposes. We consider that this delineation between NFTs for creative purposes (which are intended to not be within scope of the regime) and NFTs for financial services purposes (which are intended to be within scope) should be clearly delineated and expressed as such in future legislation.

We would greatly value a detailed definition of NFTs and utility tokens from HM Treasury. We believe there is an opportunity here for the UK to go further than the EU and create clearer guidance and detail on what may be considered permissible use cases of NFTs and utility tokens, potentially to the extent of creating a separate regime for NFTs and utility tokens.

## Regulatory Outcomes for Cryptoasset Issuance & Disclosure

**14 Do you agree with the proposed regulatory trigger points – admission (or seeking admission) of a cryptoasset to a UK cryptoasset trading venue or making a public offer of cryptoassets?**

The EMA is supportive of the overarching premise the trading venues should carefully select and evaluate the cryptoassets which they to list on their platform. Most venues will already have some sort of asset listing policy and do undertake due diligence before listing nay token.

However, the proposal to make the venues *responsible* for administrating and validating the accuracy of the documents the issuers need to produce, on an on-going basis, as well as any potential liability which arises, is not a feasible approach.

The trigger point for this regime is extremely broad – it essentially covers every listing of a cryptoasset on a trading venue, as well as every offer of a public cryptoasset, within the UK. It may be prudent to consider the scale of the larger trading venues here, with some listing hundreds of individual cryptoassets. Given this, there is a need to consider proportionality and the scalability of such a regime and whether it may result in pushing the larger venues away from the UK.

Similarly, the application of the regime on every public offer of a cryptoasset, including ICOs, without any other qualifying factors, may be limiting the potential of any such offers in the UK in the future and adversely affect the launch of new projects and cryptoassets which had to potential to bring innovation and other use cases.

Consideration should also be paid on the vast number of cryptoassets which have already been subject to a public offering or listing to a cryptoasset trading venue, creating an inordinate disparity for new issuances and listings.

An alternative approach here may be to build on what venues are already doing, such as the asset listing policies, and working on enhancing these and defining principles which venues should drop when choosing to list any assets. This will help ensure these is a consistent approach and a similar set of standards is being applied across the venues in the UK when conducting due diligence on cryptoassets.

**15 Do you agree with the proposal for trading venues to be responsible for defining the detailed content requirements for admission and disclosure documents, as well as performing due diligence on the entity admitting the cryptoasset? If not, then what alternative would you suggest?**

Under these proposals, trading venues would be responsible both for defining content requirements as well as vetting disclosure documents. This approach presents a major issue from the perspective of consistency and alignment across the sector. Without a centralised baseline or principles of what these requirements should be, it leaves it up to the discretion of each and every trading venue to make this decision. These will cause significant disparity in the level of information requirements and diligence.

It will also create arbitrage, with the potential for some trading venues choosing to set a lower threshold of requirements for admission and disclosure documents in an effort to streamline the process of listing cryptoassets on their platform. From a consumer and investor perspective, this has the potential to cause significant confusion as not only will they have to assess multiple sets of documents for different assets, they will also have to assess differential documentation for the *same* asset listen on different venues.

It is also our view that this is an example of a proposal where the real risk and the perceived risk do not align. It may be perceived that, as is the case in traditional financial services sectors, retail investors lose money or otherwise come to harm because a disclosure document does not exist, and that the appropriate mitigant therefore is implementing disclosure rules for cryptoasset issuers/CTVs. However, the real risk to the vast majority of retail investors of cryptoassets is that they lose their money or otherwise come to harm as a result of falling victim to a scam/fraud, as opposed to relying on false representations made by an issuer. We therefore do not agree that the imposition of burdensome disclosure rules is an appropriate mitigant that addresses the real risk to investors and the true risk profile of cryptoassets.

In addition, this approach creates a huge burden on the trading venues themselves. They will need sufficient expertise to determine the detailed content requirements for admission and disclosure, and then have to perform due diligence. There is a significant resource requirement to comply with this approach, alongside the burden of making a trading venue responsible for activities which are far removed from their normal scope of business.

These proposals also extend beyond purely the stage of listing. The trading venue would be responsible for the on-going administration and accuracy of these documents, meaning it would have to perform constant, on-going checks and validation of every single document for every single cryptoasset it lists. This approach is onerous and not practical given the huge administrative burden it presents.

For cryptoassets where an issue cannot be identified (such as bitcoin), the trading venue itself is proposed to take on the obligations and responsibilities of the issuer to admit the asset on to the venue. This raises a number of questions and concerns – would every single venue listing bitcoin, for example, have to produce distinct, standalone admission and disclosure documents? This would mean there are countless versions of these documents for the same asset. Are they all going to be the same, and how would this be achieved? Or would each and every venue have a different set of documents for bitcoin, which would only serve to cause confusion for the customer?

There is also a need to consider that if every single trading venue is issuing prospectuses and detailing all of these documents, it might lead to more consumer confusion and potentially harm. There is going to be an information overflow, and much of the information will not necessarily align with each other, making it even harder to make a qualified decision.

Another point of concern is that most cryptoasset projects are not static. They are dynamic, changing and evolving over time, benefitting from developments in technology and the blockchain infrastructure and adopting to offer an increasing number of products and services. Given this, it is not feasible for a trading venue to keep up with the development and changes in each and every type of token that it lists, and to be responsible for ensuring that all documents are constantly up to date.

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## 16 Do you agree with the options HM Treasury is considering for liability of admission disclosure documents?

The liability of the admission disclosure documents is proposed to apply to the preparer of the document, which could be the issue of the cryptoasset *or* the trading venue itself.

Where the admission disclosure documents are prepared by the issuer, this proposal may be suitable. The issuer is ultimately responsible for providing the requisite information, and where there are untrue or misleading statements within these documents, the liability should rest with the issuer. Notwithstanding this, it is our view that the liability provisions for admission disclosure documents is another example of a mitigant proposed in respect of a perceived risk rather than a real risk.

Furthermore, where the CTV is required to prepare the admission disclosure documents, including in the circumstances involving a cryptoasset where an issuer cannot be identified, such as Bitcoin, there is a significant concern. In such a scenario, the venue may be forced to adopt liability for an asset they did not issue, nor is it in their control, and they would have to provide and maintain detailed technical information on an on-going basis. We believe this stretches the principles of legal culpability beyond that which is generally recognised and accepted, as well as going beyond anything that already exists in traditional financial services regulations. In the interests of "same risk, same regulatory outcome," we do not agree that the cryptoasset industry, and specifically CTVs, should be held to a higher standard than the rest of the financial services industry including regulated markets and operators of multilateral trading facilities.

The extent of any possible liability is also not clear, and it is necessary that further information is provided concerning this. This is particularly relevant to any prudential requirements which will apply to ensure issuers or venues are able to absorb losses arising from liability through adequate financial resources, or alternatives through any professional indemnity arrangements.

## 17 Do you agree with the proposed necessary information test for cryptoasset admission disclosure documents?

The proposed necessary information test consists of the features, prospects, and risks of the cryptoassets; the rights and obligations attached to the cryptoassets (if any); an outline of the underlying technology (including protocol and consensus mechanism); and the person seeking admission to trading on a cryptoasset trading venue.

This information may vary depending on the type and design of the cryptoasset or the nature and circumstances of the person making the public offer or seeking admission to trading on a cryptoasset trading venue. The information may also vary depending on the rights and obligations attaching to a cryptoasset, which may change over time and require trading venues to constantly monitor and update disclosure documents to reflect any changing attributes.

The above is extensive, onerous, and inflexible. Elements such as the information on the underlying technology including protocol and consensus mechanism has limited value to the average consumer, is usually already publicly available and in fact may serve to create confusion and information overload. The "person seeking admission to trading" often does not exist for cryptoassets as there is usually no issuer, rather the decision to admit is often a commercial one made by the CTV itself.

Information regarding the "prospects and risks" of cryptoassets are not appropriate for CTVs to disclose as CTVs are not akin to investment advisers and want to ensure they do not stray into undertaking such activities. Moreover, traditional regulated markets and operators of multilateral trading facilities are not required to disclose such information. Likewise, the "rights and obligations" of cryptoassets tend to be inherent and therefore do not require explicit disclosure in the same manner as traditional securities; cryptoassets are more similar in nature to traditional currencies, in relation to which consumers inherently understand its value, or to spot FX, which remains unregulated today. Furthermore, the assessment and identification of risks may create a false sense of security within retail investors, who may believe that their obligation to conduct their own research, due diligence and risk management based on their own risk appetite is no longer necessary and they can depend entirely on the information contained within these documents.

The amount of information being requested creates a huge burden on the persons seeking admission to a trading venue, but equally crate an outsized burden on the trading venue itself, which will have to dedicate a large amount of resources and develop the necessary knowledge and understanding within staff in order to be able to assess and validate the necessary information. Onerous disclosure document requirements may lead to anti-competitive outcomes where smaller cryptoassets may be discriminated against because CTVs do not have the resources to prepare such documents, thus creating barriers to entry and stifling competition.

**18 Do you consider that the intended reform of the prospectus regime in the Public Offers and Admission to Trading Regime would be sufficient and capable of accommodating public offers of cryptoassets?**

## Regulatory Outcomes for Operating a Cryptoasset Trading Venue

**19 Do you agree with the proposal to use existing RAO activities covering the operation of trading venues (including the operation of an MTF) as a basis for the cryptoasset trading venue regime?**

The proposal to utilise existing RAO activities covering the operation of a trading venue, including operation of an MTF, as the basis of the cryptoasset trading venue regime may not be the most suitable approach.

There is a need to consider and account for the specific nuances and properties of cryptoassets when considering the design of any regime. This is particularly true for trading venues, who are at the forefront of a new and emerging sector based of nascent technology. To take a regime which is currently used for established practices and products within traditional finance and seek to apply it to a somewhat 'similar' activity within cryptoassets may not be appropriate, proportionate or fit for purpose.

Any elements of the existing RAO activities which are proposed to apply to trading venues need to be considered in light of the impact and applicability of them on the specific nature of the venues, and of the cryptoasset sector as a whole.

**20 Do you have views on the key elements of the proposed cryptoassets trading regime including prudential, conduct, operational resilience and reporting requirements?**

As a starting point, more detail and clarity is required on the key elements of the regime, including proposed prudential, operational resilience, and reporting requirements.

The prudential requirements for trading venues are unclear – the consultation references "Persons operating trading venues should have sufficient financial resources to conduct business in a prudent manner." It is necessary to provide further clarity on what sufficient means here, and what thresholds will apply, whether relating to minimum capital, liquidity, and other relevant prudential requirements.

When considering any prudential requirements and relevant thresholds, consideration should be given to ensure that they are not so high as to become a barrier to entry and on-going operation within the UK.

The data reporting requirements are also extensive. We agree that cryptoasset trading venues should have the capability to make accurate and complete information readily accessible for both the on-and off-chain transactions which they facilitate. However, the need to have systems in place for sharing information, such as order book data, with other trading venues that admit the same cryptoasset to trading for market abuse monitoring purposes may be difficult to achieve, as it may necessitate the procurement and implementation of specific systems in-house or outsourcing to third party providers such as specialist blockchain surveillance providers, creating a technological and financial burden.

It may also require venues to identify all other venues, negotiate with them, and sign contractual agreements, creating a significant administrative burden, as well as potential data protection considerations.

## Regulatory Outcomes for Cryptoasset Intermediation Activities

**21 Do you agree with HM Treasury's proposed approach to use the MiFID derived rules applying to existing regulated activities as the basis of a regime for cryptoasset intermediation activities?**

Please see response to question 19. While it is worth keeping the rules and principles from 'similar' activity regimes from traditional finance in mind, we do not believe the activities governed by MiFID are similar to the majority of crypto asset service provider activities and, as such, the MiFID rules are not necessarily suited as the basis upon which the cryptoasset intermediation activities regime should be built.

**22 Do you have views on the key elements of the proposed cryptoassets market intermediation regime, including prudential, conduct, operational resilience and reporting requirements?**

As indicated previously, more detail and clarity is required on the key elements of the regime, including proposed prudential, operational resilience, and reporting requirements.

One of the regulatory outcomes sought here is that persons offering cryptoasset market intermediation should have effective controls and arrangements to manage conflicts of interest. Specific guidance is necessary here on whether this would mandate segregation of entities, and whether this would prevent persons offering intermediation services to not offer any assets they themselves have any holdings in for example.

Another regulatory outcome sought here is the systems and processes to be able to detect market abuse and submit suspicious transaction and order reports. Most venues are already utilising the services of on-chain surveillance and analysis tools. To prevent the need the engage additional service providers, consideration should be paid to the capabilities of these on-chain tools and any monitoring and reporting requirements standardised to allow for the existing service providers to fulfil these requirements where possible.

## Regulatory outcomes for cryptoasset custody

**23 Do you agree with HM Treasury's proposal to apply and adapt existing frameworks for traditional finance custodians under Article 40 of the RAO for cryptoasset custody activities?**

Please see response to question 19. While it is worth keeping the rules and principles from 'similar' activity regimes from traditional finance in mind, they are not necessarily suited to be the basis upon which the cryptoasset custody regime should be built. Particularly in the context of DeFi and blockchain cryptoassets, some of the details of the

CASS regime would simply not be applicable. There are conceptual challenges as to what constitutes "custody" in the context of cryptoassets such that a simple adoption of Article 40 RAO with amendments and variations may not have the conceptual breadth to encompass all types of cryptoassets.

**24 Do you have views on the key elements of the proposed cryptoassets custody regime, including prudential, conduct and operational resilience requirements?**

The proposal to base the safeguarding principles on the existing custody provisions within the Client Assets Sourcebook (CASS) appear to be sensible. This includes adequate arrangements to safeguard investors' rights to their cryptoassets, restriction on the commingling of investors' assets and the firm's own assets, 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.

The prudential requirements here will need careful consideration, given that custodians have a very different business model then venues, and quite possible are at a lower risk of scams, hacks, and cyber-attacks.

The liability considerations are also significant. In the case of failed custodians, the availability of FSCS protection for claims is under consideration to be determined by FCA. This is a positive development and could help to provide consumers with confidence in utilised authorised cryptoasset custodians within the UK.

In addition to this, liability standards for custodians themselves are also under consideration, with the government exploring an approach which "may not impose full, uncapped liability on the custodian in the event of a malfunction or hack that was not within the custodian's control". This indicates that a failure which *is* deemed to be in the custodians control may create full, uncapped liability on the custodian. It is vital that clarity is provided around all proposed liability standards being considered, including both through the FSCS and through the cryptoasset custodians themselves.

## General Market Abuse Requirements

**25 Do you agree with the assessment of the challenges of applying a market abuse regime to cryptoassets? Should any additional challenges be considered?**

The challenges identified to applying a market abuse regime to cryptoassets are well considered and thorough.

One of the key challenges is around the specific nuances which apply to cryptoassets and make them distinct from traditional finance and securities markets. This includes the possible lack of a traditional issuer, which may not be easily identifiable, and may be an individual rather than a corporate entity.

The fluctuations and price movements of the cryptoasset markets are often linked to supply and demand rather than the fundamental nature of the cryptoasset, and as such it may be harder to detect or identify market abuse and manipulation.

The proportionally higher number of direct retail participants within cryptoassets as compared to traditional markets is also significant. This potentially disrupts the surveillance of market abuse without the need for intermediaries who have obligations to detect and prevent market abuse, an issue exacerbated by DeFi products with no intermediary at all.

The very nature of cryptoassets themselves, being borderless and cross-jurisdictional, complicated the challenge of identifying and preventing market abuse. Cryptoasset trading venues are globally accessible by retail and institutional market participants, and there is little geographic nexus between the trading venue, the entity who issued the cryptoasset and those trading the cryptoasset.

Additional challenge to consider is the lack of disclosure requirements which are currently in place, meaning it is harder to identify individuals and entities who control significant proportions of specific cryptoassets and can therefore engage in trading tactics which cause notable price fluctuations which can be traded against.

**26 Do you agree that the scope of the market abuse regime should be cryptoassets that are requested to be admitted to trading on a cryptoasset trading venue (regardless of where the trading activity takes place)?**

The proposed scope applies when an admission of a cryptoasset to a UK cryptoasset trading venue is requested, although often the concept of "requested" to be admitted does not exist in cryptoasset markets where often there is no issuer. The proposed scope does not distinguish between the location of the actual market abuse activity itself, which could take place within the UK or overseas.

This would serve to place an additional, disproportionate burden upon venues, who are charged with identifying and disrupting market abuse. Trading venues may have to devote significant resources to identifying bad actors in other jurisdictions and then taking the appropriate action, given that they are required to investigate suspected market abuse and sanction individuals. It is unclear how this would be achievable in practice. In addition, the additional burdens placed on UK CTVs compared to CTVs in other jurisdictions could have the unintended consequence of driving CTVs outside of the UK where the costs of operation are lower, leaving UK customers with fewer protections.

**27 Do you agree that the prohibitions against market abuse should be broadly similar to those in MAR? Are there any abusive practices unique to cryptoassets that would not be captured by the offences in MAR?**

No comments.

**28 Does the proposed approach place an appropriate and proportionate level of responsibility on trading venues in addressing abusive behaviour?**

Under the proposed approach, there are significant responsibilities assigned to trading venues, including the need to establish systems and controls to prevent, detect and disrupt market abuse. Venues will further be responsible for determining the appropriate systems, controls, and methods of disruption.

This places a significant burden on venues. While we agree that venues should have the necessary internal controls and systems to prevent and detect market abuse, the obligation here goes beyond that to actually disrupting the market abuse instead of reporting it to the relevant authorities, which goes above and beyond the expectations for traditional financial institutions and is not commensurate with “same risk, same regulatory outcome”.

In addition, there is indicative guidance that venues should maintain “public blacklists” and “sanction individuals”. Given that venues are not governmental agencies and authorities, who are empowered to creates public blacklists following thorough investigations, this creates huge liability and reputational issues, and opens venues up to repercussions. The ability to “sanction individuals” is also far outside the remit of trading venues, particularly where there is potential for misidentification or similar issues. The data protection issues here are also significant and need to be considered.

Consideration should be paid to the appropriate balance of responsibility between the FCA and cryptoasset trading venues within the market abuse regime. The proposed model would place the primary responsibility on the trading venues for preventing, detecting, and disrupting market abuse, with an expectation that they establish “who” the offenders are, establish information sharing arrangements with other venues that admit the same cryptoassets, and to have an effective regime for disrupting market abuse such as the ability to publicly blacklist offenders.

These significant obligations will necessitate the development of appropriate systems and controls, the procurement of specific tools and technologies, and the development of contractual relationships with all other venues that admit the same cryptoasset to enable information sharing. All of these will requirement significant internal expertise and resources.

In short, the proposed model places a lot of responsibility on trading venues. It has always been the job of trading venues to be the first line of spotting market abuse, however in

traditional financial institutions there is a far clearer regime to follow. Here, the government rightly assert that it may be difficult to reach the same outcomes as MAR given the nuances of the cryptoasset industry, however then placing the onus on trading venues to navigate these complexities. In order to achieve this, the FCA would need to work closely with trading venues and build upon what exchanges already have in place, provide further guidance, scope, and reasonable timeframes for implementation.

**29 What steps can be taken to encourage the development of RegTech to prevent, detect and disrupt market abuse?**

Similar to steps that can be taken to prevent, detect, and disrupt illicit finance risks in cryptoassets, RegTech can be employed at the firm level to prevent, detect, and disrupt activity taken on the part of a market participant by an employee of that firm (or another person) to abuse the market or consumers who use cryptoasset products and services.

RegTech that can identify and trace wallet addresses can track market abuse and market integrity activity, such as when a firm might move customer assets on-chain. There are already solutions for these purposes in use by digital asset-native analytics firms.

**30 Do you agree with the proposal to require all regulated firms undertaking cryptoasset activities to have obligations to manage inside information?**

The government is proposing that all regulated firms undertaking cryptoasset activities would be required to disclose inside information and maintain insider lists. This presents a significant departure from MAR, under which only issuers are required to do so.

These requirements may be burdensome for firms, who often treat all employees as 'insiders', meaning the lists need to be constantly updated and subsequent disclosures made to the regulator, a burden which appears disproportionate to the risk and diverges from requirements on traditional financial institutions.

In addition, the approach would require sharing insider information with more people and transferring it through methods which may not be secure, heightening the risk of leaks or malicious acts, and increasing the potential for someone to act on the inside information. With such information, the priority should be on keeping it contained.

We therefore disagree with this proposal as it is not the appropriate tool for guarding against insider dealing.

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## Regulatory outcomes for operating a cryptoasset lending platform

**31 Do you agree with the assessment of the regulatory challenges posed by cryptoasset lending and borrowing activities? Are there any additional challenges HM Treasury should consider?**

The regulatory challenges identified include risky wholesale investment with guarantees on interest repayments to retail customers, credit risk from lending to institutional borrowers, liquidity risks and the lack of a regulatory framework.

Two specific examples of failure are also cited – Celsius and FTX. While the failure of both is significant, it may be that the risks which both represented are now more prominent and are being seen as indicative of the entire cryptoasset lending sector.

While it is important to have effective safeguards and risk mitigation, there are genuine cryptoasset lending business which do not present such risks, and this should be considered when designing the regulatory regime for lending platforms which is proportionate and fit for purpose.

**32 What types of regulatory safeguards would have been most effective in preventing the collapse of Celsius and other cryptoasset lending platforms earlier this year?**

One potential regulatory safeguard here would have been more scrutiny and diligence on "guaranteed" high interest rates for retail customers - Celsius was offering investors up to 20% interest.

With such high rates being offered, it can force a platform to pursue riskier investments to generate the necessary revenue to pay customers. In the case of Celsius, this meant they turned to high-risk DeFi yield products, which offer high returns but are at a risk of fluctuating value and liquidity risk.

In the case of FTX there was no financial reporting or auditing giving rise to scrutiny which would have served as an early warning and led to the right questions being asked.

**33 Do you agree with the idea of drawing on requirements from different traditional lending regimes for regulating cryptoasset lending? If so, then which regimes do you think would be most appropriate and, if not, then which alternative approach would you prefer to see?**

No comments.

**34 Do you agree with the option we are considering for providing more transparency on risk present in collateralised lending transactions?**

The proposed approach aims to allow authorities to monitor the build-up of risk present in collateralised lending transactions, through the means of disclosure requirements derived from those applied to Securities Financing Transactions (e.g., counterparty and transactions details, collateral composition, rehypothecation, substitution of collateral at the end of the day and haircuts applied).

While these may help improve transparency associated with the use of collateral in cryptoassets financing activities, it is necessary to ensure any such measures do not create an outsized administrative burden on lending platforms. Consideration needs to be paid in particular to the extent and frequency of reporting to ensure it is proportionate.

We also request clarification of the short-term regulatory treatment of staking before regulation is introduced. Staking should not be treated the same as a regulated activity or likened to a collective investment scheme as set out under section 235 FSMA 2000 or to cryptoasset lending activities. Conceptually, staking is very different to collective investment scheme and cryptoasset lending. CeFi lending, yield farming and liquidity farming are often mistermed as staking, and the distinction needs to be recognised.

The purpose of staking is to help facilitate consensus within a blockchain network in order to process transactions and create new blocks. Staking incentivises users with rewards to use their holding of cryptocurrencies to support a blockchain network. This is done by delegating their tokens to a validator – the users do not exchange their tokens for anything in return. The Proof-of-Stake consensus mechanism requires validators to stake the native cryptocurrency in order to validate transactions and are rewarded with a transaction fee.

**35 Should regulatory treatment differentiate between lending (where title of the asset is transferred) vs staking or supplying liquidity (where title of the asset is not transferred)?**

The regulatory treatment of staking, if any, should not be similar to regulatory treatment of lending because of the different risks presented by these activities. As HMT has noted in its question, staking does not involve the transfer of title to the crypto asset at issue and the risk of loss via slashing is significantly lower than in traditional lending. This lower risk arises in part because of the reduction in counterparty risk in staking–if a validator becomes insolvent, the individual or entity that staked their assets will not lose their principal investment. Rather, they may lose their rewards (depending on the nature of staking) and will simply need to find another validator.

Furthermore, given the importance of staking to the crypto asset ecosystem and the UK's stated intent to become a crypto hub, clarity should be provided that staking does not

amount to a collective investment scheme, as there is currently a view that staking may constitute a collective investment scheme, at least in some cases.

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