

Cryptoassets: further reforms and regulatory scrutiny

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CRYPTOASSETS continue to attract significant attention from consumers and, as a consequence, governments and regulators worldwide. With the cryptoasset market growing rapidly an increase in regulatory scrutiny is to be expected and the recently published 2021/22 business plan from The Financial Conduct Authority (FCA) suggests that a broader regulatory approach to cryptoassets is being considered.

The FCA business plan, published last month, takes the opportunity to highlight the risks faced by consumers in the unregulated cryptocurrency market and to reference its recent consultations on extending the scope of the UK's regulatory approach to cryptoassets. Before going on to review some of the proposed regulatory changes we look at the existing regulatory regime and the different categories of regulated and unregulated cryptoassets.

FCA regulatory perimeter

In short, the FCA classifies cryptoassets into three categories: electronic (e-money), security and unregulated tokens (utility and exchange tokens). To date only security tokens and e-money tokens are regulated by the FCA. Exchange tokens (ie. Bitcoin) and utility tokens are currently unregulated tokens and fall outside the FCA's regulatory perimeter such that there is no protection for individuals who purchase them.

The FCA guidance on cryptoassets notes that if you carry on a specified activity, by way of business in the UK, involving a cryptoasset which is a specified investment (ie. a security token) FCA authorisation may be required.

If a cryptoasset business is marketing products or services relating to regulated tokens they will be required to comply with the financial promotion regime. Section 21 of the Financial Services and Markets Act 2000 contains a general restriction on the communication of financial promotions and prohibits unauthorised persons from communicating an invitation or inducement to engage in investment activity. Currently only a promotion of security tokens or e-money tokens is caught by the financial promotion regime. Other unregulated tokens are not.

While exchange tokens fall outside the FCA regulatory perimeter, cryptoasset businesses which are determined to be "relevant persons" under the Money Laundering Regulations 2017 (which came into force January 2020) are required to comply with anti-money laundering obligations. "Relevant persons" for the purposes of the Act include cryptoasset exchange providers and custodian wallet providers acting in the course of business carried on in the UK.

Ongoing consultation

HM Treasury has recently carried out consultations on bringing certain unregulated cryptoassets into the scope of financial promotions

regulations to enhance consumer protection and on the broader regulatory approach to cryptoassets, including new challenges from so called 'stablecoins'.

The government's view is that many of these unregulated cryptoassets expose consumers to unacceptable levels of risk and identified misleading advertising and a lack of suitable information as a key consumer protection issue.

The government's proposals are to introduce a new category of 'qualifying cryptoasset' which will be covered by the financial promotion regulations (with the intention that the majority of stablecoins be caught either as security tokens or under this new category) and to bring 'stablecoins' into the UK regulatory perimeter.

As noted in the most recent consultation paper (setting out proposals to bring 'stable tokens' into the FCA's regulatory perimeter) the government is considering an approach in which the use of currently unregulated tokens used for speculative investment could remain outside the perimeter for conduct and prudential purposes but subject to restrictions with respect to marketing, promotion or money laundering requirements.

As the cryptoasset market continues to grow in popularity it would seem prudent for those engaged in cryptoasset businesses to assume that a further expansion of the FCA's regulatory perimeter to other unregulated cryptoassets is likely.

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