CRYPTO ASSETS

OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK IN THE EU AND UK

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LARA KAPLAN BACKGROUND

- Financial Services Regulatory Lawyer qualified in England & Wales
- FinTech and Payments Group, Paul Hastings in Washington DC*
- Finance & Innovation Global Group, World Bank Consultant
- Previously a Lawyer at the Financial Conduct Authority in London
- Experience in the UK Parliament and European Parliament

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TERMINOLOGY?

CRYPTO ASSET

DIGITAL CURRENCY

DIGITAL ASSET

VIRTUAL CURRENCY

VIRTUAL ASSET

CRYPTOCURRENCY

TOKEN

BITCOIN

Source: Global Cryptoasset Regulatory Landscape Study, Cambridge Centre for Alternative Finance, University of Cambridge
EU – WHAT IS A CRYPTO ASSET?

Crypto asset means an asset that:

a) depends primarily on cryptography and distributed ledger technology (DLT) or similar technology as part of its perceived or inherent value;

b) is neither issued nor guaranteed by a central bank or public authority, and

c) can be used as a means of exchange and/or for investment purposes and/or to access a good or service.

EU APPROACH TO CRYPTO ASSETS

“a significant share of existing crypto-assets are likely to fall outside the rules, as things stand…[but] Importantly, we believe that a more elaborate bespoke regime for those crypto-assets that do not qualify as financial instruments is premature. The phenomenon is still novel and business models continue to evolve.”

Chair of European Securities and Markets Authority (ESMA), Steven Maijoor

“for crypto-assets that are covered by EU rules, we will review our legislation to make sure that it is fit for purpose and can effectively be applied to this type of assets. For crypto-assets that are not covered, we have launched a feasibility study on a possible common regulatory approach at EU level.”

Vice President of the European Commission, Valdis Dombrovskis
UK REGULATORY LANDSCAPE FOR FINTECH FIRMS

UK Cryptoasset TaskForce is comprised of:
- HM Treasury
- Bank of England
- Financial Conduct Authority

*Agencies indicated through the dotted line are included in the UK Cryptoasset TaskForce
The FCA ‘regulatory perimeter’ is the boundary that separates regulated and unregulated financial services activities.

**Regulated activities** =
- Specified investment +
- Specified activity +
- by way of business in the UK

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The Financial Services and Markets Act 2000 (FSMA)
Second Markets in Financial Instruments Directive (MiFID II)
Electronic Money Regulations 2011 (EMRs)
Money Laundering Regulations 2017 (MLRs)
Financial Services and Markets Act 2001 (Regulated Activities) Order (RAO)
Payment Services Regulations 2017 (PSRs)
UK - WHAT IS A CRYPTO ASSET?

Cryptoasset TaskForce – October 2018

- **Type of cryptoasset**
  - A. Exchange token
  - B. Security token
  - C. Utility token

- **Common uses of each cryptoasset**
  1a. As a means of exchange
  1b. To facilitate regulated payment services
  2a. For direct investment
  2b. For indirect investment
  3. As a capital raising tool

FCA Guidance – July 2019

- **Regulated Tokens**
- **Unregulated Tokens**
- **Stablecoins?**

Source: CryptoAsset Taskforce final report October 2018
REGULATED CRYPTO ASSET: SECURITY TOKENS

What is a security token?
- “tokens with specific characteristics that mean they provide rights and obligations akin to specified investments, like a share or a debt.”
  - Specified investments in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO)
  - Not e-money
  - Regulated by the FCA

Is it a transferable security?
- ‘those classes of securities which are negotiable on the capital market, with the exception of instruments of payment’
  - Additional applicable rules may apply, e.g. prospectus regime

Is it a non readily realizable security?
- Crowdfunding rules

Is it an investment product such as derivative contracts that reference cryptoassets?
- Proposed ban to retail consumers
Electronic money defined as “electronically (including magnetically) stored monetary value as represented by a claim on the electronic money issuer which—

(a) is issued on receipt of funds for the purpose of making payment transactions;
(b) is accepted by a person other than the electronic money issuer; and
(c) is not excluded by regulation 3

Electronic Money Regulations 2011

- Not money, not tokens, not a security
- Payment Services Regulations
- Electronic Money Regulations
UNREGULATED CRYPTOASSETS: EXCHANGE AND UTILITY TOKENS

EXCHANGE

“[N]ot issued or backed by any central authority and are intended and designed to be used as a means of exchange. They tend to be a decentralized tool for buying and selling goods and services without traditional intermediaries. These tokens are usually outside the perimeter” – FCA Guidance

- Not specified investment
- *e.g.* Cryptocurrencies
- PSR implications

UTILITY

“[T]okens grant holders access to a current or prospective product or service but do not grant holders rights that are the same as those granted by specified investments. Although utility tokens are not specified investments, they might meet the definition of e-money in some circumstances (as could other tokens). In this case, activities involving them may be regulated” - FCA Guidance

- Initial coin offerings

Applicable laws outside of the FCA perimeter are those rules that may apply to unregulated activities.
A stablecoin is a type of crypto asset for which mechanisms are established to minimize price fluctuations and ‘stabilize’ its value.
RISKS WITH CRYPTO ASSETS

Consumer related risks
- FCA research studies
- Ban on crypto derivatives

Market manipulation
- Dear CEO letters
- Market monitoring

Financial Crime
- Financial Action TaskForce Recommendation 15
- EU's Fifth Money Laundering Directive (5MLD), Money Laundering Regulations 2019
BENEFITS OF CRYPTO ASSETS

- Reduced cost of transactions
- Privacy of transactions
- Immutable record of transactions on the ledger
- ICO funding / access to credit
- Speed of settlement of transactions
- Global scale and reach