

United Kingdom: A review of HMT's proposed cryptoassets regime – and how it compares to MiCA

In brief

On 7 January 2021 HM Treasury (HMT) published a [consultation](#) and call for evidence on the regulatory approach to cryptoassets and stablecoins. The consultation represents the first stage in HMT's consultative process on the broader regulatory approach to cryptoassets and stablecoins. The consultation closes on 21 March 2021.

In this briefing we explore the policy background underlying the consultation, set out the key points of HMT's proposals, and provide a comparison to corresponding provisions in the European Commission's recent proposal on a regulatory framework for cryptoassets.

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Policy background

Regulators continue to grapple with finding balance between fostering innovation and competition, and seeking to ensure customer and market protection against the risks of increased use of technology. Against this backdrop, the cryptoasset market continues to grow, accompanied by ever greater levels of regulatory scrutiny, and both the UK and the EU are set to expand their regulatory perimeters in the next few years to include cryptoassets.

The European Commission's Digital Finance Strategy, launched in September 2020, proposes the introduction of strict and harmonised rules on digital operational resilience and a new regulatory framework for cryptoassets, whilst also promoting open finance data sharing and enabling EU-wide interoperable digital identities in finance. The Digital Finance Strategy proposals promise to ensure "same activity, same risks, same rules" by applying the same supervision to traditional market actors, such as banks, insurance and investment firms, as well as FinTechs and BigTechs who are increasingly entering the financial services sector through their product offerings. The new regulatory framework for cryptoassets, set out in the Commission's proposed [Regulation on Markets in Cryptoassets \(MiCA\)](#), would establish the first EU regulatory regime for cryptoasset providers and hold them to a similar regulatory standard as that imposed on investment firms. Negotiations are set to continue in 2021 on the package of measures.

At the international level, in October 2020 the Financial Stability Board (FSB) published a set of high-level **recommendations** for the regulation, supervision and oversight of global stablecoin arrangements. The FSB's recommendations, which aim to address financial stability risks and promote effective cross-border oversight, call for proportionality and the need to apply supervisory and oversight capabilities and practices under the "same business, same risk, same rules" principle with a technology-neutral approach.

In the UK, following work undertaken by the Cryptoassets Task Force and its October 2018 **report** on the UK's approach to cryptoassets and distributed ledger technology (DLT) in financial services, in 2019 the Financial Conduct Authority (FCA) published its **guidance on cryptoassets** setting out details on where different types of cryptoassets might fall in the UK regulatory perimeter. The FCA's ban on retail sales of crypto derivatives took effect on 6 January 2021, and in Q1 2021 HMT is expected to issue a response to its July 2020 **consultation** on expanding the financial promotions regime to cryptoassets.

Against the backdrop of these developments both in the UK and globally, HMT's consultation on the regulatory approach to cryptoassets and stablecoins aims to establish a regulatory regime for cryptoassets guided by the objectives of protecting financial stability, delivering consumer protections, and promoting competition and UK competitiveness. To achieve these objectives, HMT's proposed framework is underpinned by the following principles:

- Maintaining the current division of UK regulator responsibilities as far as possible and applying the principle of "same risk, same regulatory outcome", echoing MiCA and the FSB's recommendations and, in keeping with MiCA and the FSB's recommendations, aims to remain technology-agnostic.
- Ensuring the approach is proportionate, focused on where risks and opportunities are most urgent or acute. HMT is proposing to take an incremental approach to the new regulatory regime for cryptoassets, starting with stablecoins and exploring expansion in due course.
- Ensuring the approach is agile, able to reflect international discussions and aligned to the future government approach to financial services and payments regulation. HMT's goal is to seek a regulatory approach that fits with the outcomes of the Future Regulatory Framework Review and Payments Landscape Review, which are focused on ensuring that the financial services regulatory framework is forward-looking and appropriate in the context of the UK's withdrawal from the EU.

In keeping with the Future Regulatory Framework Review, HMT's consultation sets out high level principles and a framework of requirements, leaving the detailed package of regulation to the regulators.

The proposed regime

Tokens within scope and key participants

The FCA's guidance on cryptoassets sets out three broad categories of token in relation to how they fit within existing FCA regulation:

- security tokens, which provide rights and obligations akin to specified investments and fall within the regulatory perimeter;
- e-money tokens, which fall within scope of e-money and are subject to the E-Money Regulations; and
- unregulated tokens, which are any other tokens that are not security or e-money tokens, including utility tokens and exchange tokens.

HMT's proposed regime maintains the FCA's broad approach to classification as far as possible. However, to reflect its policy objectives, HMT is proposing a new category of regulated tokens – "stable tokens". The regulated category of stable tokens would refer to tokens which stabilise their value by referencing one or more assets, such as fiat currency or a commodity (i.e. stablecoins), and therefore could be reliably used for retail or wholesale transactions. These would include:

- stable tokens linked to a single fiat currency; and
- stable tokens linked to an asset other than a single fiat currency (including commodities and multi-currencies)

The category would also include other forms of tokenised payment and settlement assets, as well as tokenised forms of central bank money, and is technology-agnostic. By contrast, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs) applies only to cryptoassets using DLT, defining "cryptoasset" in regulation 14A(3)(a) as a cryptographically secured digital representation of value or contractual rights that uses a form of DLT and can be transferred, stored or traded electronically.

Stable tokens would not include:

- security tokens;

Comparison to MiCA

While HMT's proposed regime is drawn from existing payments regulation, by contrast MiCA's regulatory regime is derived from MiFID and other EU legislative measures for financial services. For example, the services to be regulated under MiCA map to a certain extent those in MiFID (e.g., "the reception and transmission of orders" for cryptoassets on behalf of third parties), and the regime for offers and placings is inspired by existing capital markets and transparency measures. That being said, as a practical matter the services to be regulated under MiCA largely correspond to those falling within scope of HMT's proposed regime. In addition, MiCA will also regulate the provision of advice on cryptoassets.

- e-money tokens;
- unregulated exchange or utility tokens; and
- algorithmic stablecoins (which maintain a stable value through the use of algorithms to control supply, and which HMT considers to more closely resemble exchange tokens)

HMT is considering an approach in which the use of currently unregulated tokens and associated activities primarily used for speculative investment purposes, such as Bitcoin, could initially remain outside the perimeter for conduct and prudential purposes. At the same time, these would be subject to more stringent regulation in relation to consumer communications via the financial promotions regime (if adopted) and AML/CTF regulation. Utility tokens - those used to access a service - would also remain outside the authorisation perimeter.

HMT therefore proposes to first introduce a regulatory regime for stable tokens used as a means of payment. This would cover firms issuing stable tokens and firms providing services in relation to them, either directly or indirectly to consumers. Key participants are likely to include token issuers or systems operators, cryptoasset exchanges and wallets.

In the longer term, HMT will consider bringing a broader set of cryptoasset market actors or tokens into an authorisation regime. HMT's incremental and cautious approach to introducing wide-scale regulation clearly demonstrates the competing policy aims of protecting consumers and markets whilst avoiding unnecessarily stifling innovation and competition.

Activities to be regulated

HMT proposes that the FCA authorisation regime for stable tokens would draw on existing rules as far as possible, and has taken relevant aspects from the UK's current approach to e-money and payments regulation (governed by the Electronic Money Regulations 2011 and Payments Services Regulations 2017) as well as broader elements of financial services regulation (e.g. the protection of client assets), in setting out high level requirements. The proposed regime would apply to firms undertaking the following functions or activities, either in terms of establishing the rules governing the activities or operating the infrastructure in relation to these activities:

- **issuing, creating or destroying asset-linked or single fiat-linked tokens:** the activity of the token issuer in minting and burning tokens, likely to be conducted by token issuers;
- **providing custody and administration of a stable token for a third party:** the activity of managing tokens on behalf of owners, including the storage of private key, likely to be conducted by wallets or certain exchanges;
- **executing transactions in stable tokens – making payments:** the activity of conducting transactions on behalf of another, likely to be conducted by token issuers, wallets and exchanges; and
- **exchanging tokens for fiat money and vice versa:** the activity of purchasing/exchanging a stable token with fiat money, likely to be conducted by token issuers, wallets and exchanges.

The following activities would not require authorisation, but may be regulated as payment systems by the Payment Systems Regulator (PSR) or BoE in certain circumstances (as explained further below):

- **value stabilisation and reserve management:** the activity of managing the reserve assets that are backing the value of a stable token and providing custody/trust services for those assets to ensure stabilisation of the stable token, likely to be conducted by token issuers or payment system operators;
- **validation of transactions:** the activity of authorising or verifying the validity of transactions and records, which may be conducted by token issuers;
- **access:** the activity of providing services or support to facilitate access of participants to the network or underlying infrastructure, likely to be conducted by providers facilitating network or technology access; and
- **transmission of funds:** the activity of ensuring the correct and final settlement of transactions while limiting counterparty and default risk, likely to be conducted by designated dealers, payment system operators and wallets.

Comparison to MiCA

Compared to HMT's proposals, the reach of MiCA is decidedly broader. MiCA will establish a regulatory regime applying to any person providing cryptoasset services or issuing cryptoassets in or into the EU. MiCA covers cryptoassets falling outside existing EU financial services legislation, as well as e-money tokens, and establishes a specific regulatory regime for the following stablecoins:

- asset-referenced tokens, which are referenced to several fiat currencies, one or several commodities or one or several cryptoassets (or a combination of those assets); and
- e-money tokens, the main purpose of which is to be used as a means of exchange and which are referenced to a single fiat currency.

Particular requirements apply in relation to e-money tokens, which are explained further below.

As with HMT's proposed regime, MiCA excludes algorithmic stablecoins from scope. In addition, MiCA is similarly agnostic on technology, defining "cryptoasset" as "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology". However, unlike HMT's proposals, MiCA includes within scope utility tokens and excludes central bank digital currencies (CBDCs).

HMT proposes that there would be exclusions to the need for authorization where the activity does not give rise to the same risks, for example services based on stable tokens used within a closed loop system or for acquiring a very limited range of goods or services (such as store payment cards).

Requirements to be imposed

The proposed regulatory regime would involve the following high-level requirements:

- **authorisation requirements with associated threshold conditions:** the requirement to be authorised prior to operating;
- **prudential requirements, including capital and liquidity requirements, accounting and audit requirements:** requirements relating to effective management of capital and liquidity, to protect consumers and financial stability;
- **requirements for the maintenance and management of a reserve of assets:** the obligation to have reserve assets underlying the token's value and requirements to ensure the quality and safekeeping on those assets;
- **orderly failure and insolvency requirements:** requirements to ensure issuers and service providers are prepared for modified resolution or administration, or insolvency;
- **safeguarding the token:** requirements principally on wallets and exchanges to ensure those entities are appropriately protecting users' tokens and the privacy and security of keys to those tokens;
- **systems, controls, risk management and governance:** requirements relating to effective overall management of an issuer or service provider;
- **notification and reporting:** requirements relating to firms' disclosures to regulators and customers;
- **record keeping:** requirements relating to firms' internal record keeping processes;
- **conduct requirements:** requirements relating to the rights that firms must provide toward customers;
- **financial crime requirements:** requirements relating to proper implementation of AML/CTF rules, among others;
- **outsourcing requirements:** requirements relating to safe outsourcing of key services to ensure continuous and adequate functioning;
- **operational resilience, service reliability and continuity requirements:** requirements to ensure business continuity in the event of physical, electronic, governance or other business failures; and
- **security requirements (including cyber and cloud):** requirements relating to safeguards against cyber security risks related to the technology and infrastructure used.

Comparison to MiCA

MiCA will impose similar requirements on cryptoasset service providers, cobbled together from other EU directives and regulations. As is to be expected, MiCA contains much more detailed proposals on those requirements than HMT's consultation, which leaves the detail to the regulators. The high level requirements applying to cryptoasset service providers under MiCA largely correspond to those under HMT's proposed regime. Interestingly, MiCA expressly imposes requirements relating to systems, procedures and arrangements to monitor and detect market abuse – it remains to be seen whether HMT or the FCA will require the same.

The regulatory requirements imposed by MiCA on issuers of asset-referenced tokens and e-money tokens are more stringent than those imposed on issuers of other cryptoassets. No asset-referenced tokens can be offered to the public in the EU or admitted to trading on a trading platform for cryptoassets if the issuer is not authorised in the EU. Issuers of asset-referenced tokens must comply with additional requirements under MiCA, including (among others) the obligation to be established and authorised in the EU, own funds requirements, robust governance obligations and orderly wind-down plans. MiCA also contains lighter-touch requirements for small offerings of cryptoassets, and for offers of cryptoassets marketed only to qualified investors.

Whereas HMT is still considering whether to do so, under MiCA e-money tokens are deemed to be electronic money for the purposes of the E-Money Directive (EMD), and to avoid regulatory arbitrage e-money token issuers must be authorised as a credit institution or as an e-money institution under the EMD.

HMT expects that financial crime, including AML, requirements will apply to all wallets and issuers and that these will also have to register under AML legislation for their activities in relation to all types of cryptoassets, not just stable tokens. As noted above, the obligations set out in the MLRs apply to a more limited scope of cryptoassets that use DLT; HMT's proposals would significantly expand on these obligations. The AML registration may not cover issuers; HMT would expect issuers to be subject to AML requirements in line with other regulated entities.

Tokens meeting the criteria for e-money will be subject to the UK's e-money regulatory regime and must be authorised by the FCA as such. HMT is also considering whether stable tokens that are linked to a single fiat currency should meet the requirements applicable to e-money, to avoid regulatory arbitrage and confusion for consumers.

HMT is considering a lighter regime for smaller firms below a certain turnover, also akin to current payments regulation.

Payment systems and systemic regulation

HMT is considering whether to make legislative adjustments enabling the PSR to regulate stable token arrangements which play a similar function to existing payments systems. This would empower the PSR to place requirements or take action on the participants in that stable token arrangement.

Additionally, HMT's proposed regime would extend the Bank of England's (BoE) regulatory powers over systemically important payment systems to include stable token arrangements which reach systemic scale. The BoE would consider the ability of stable token arrangements to disrupt the UK financial system and businesses based on the same criteria as payment systems, including current or likely volume and value of transactions, nature of transactions and links to other systems, and substitutability and use by the BoE in its role as monetary authority. HMT proposes to extend these criteria to stable tokens arrangements that perform a retail or wholesale payment system function, which may mean that these arrangements are captured at launch by BoE regulation depending on their characteristics. HMT is also considering whether other service providers forming part of a stable token chain, such as wallets, should be subject to systemic regulation.

Designation as a systemic stable token arrangement would bring enhanced supervision and additional requirements, including, for asset-linked tokens, additional capital and prudential requirements and other protections.

Territorial scope and location requirements

The territorial scope of the proposed regime is still under consideration. By way of comparison, while for firms carrying on payment services, the requirement to be authorised or regulated by the FCA applies in relation to activities that are carried on by way of regular occupation of business activity in the UK, the powers in relation to recognized payment systems are extra-territorial. HMT is considering whether firms actively marketing to UK consumers should be required to have a UK establishment and be authorised in the UK. This would represent a significant shift in the usual UK approach of regulating activities based on characteristic performance of the service, rather than marketing factors as is usual in the EU.

Options under consideration include:

- requiring UK presence and UK authorisation for stable token issuers, system operators and service providers when marketed in the UK;
- defining the activity conducted in the UK and determining whether UK authorization is required as a result; or
- no location requirements.

HMT is also considering location requirements for systemic stable token arrangements.

Call for evidence on other issues

Set out in chapter 4 of the consultation, HMT's call for evidence seeks views on a broader range of questions in relation to cryptoassets used for investment purposes and the use of DLT in financial services. In particular, HMT asks about:

- areas of existing regulation where clarification or amendments are needed to support the use of security tokens;
- the benefits and drawbacks of adopting DLT across wholesale markets and financial market infrastructures;
- whether there are obstacles to the adoption of DLT;
- whether to bring tokens typically used by retail consumers as a form of speculative investment (e.g., Bitcoin or Ether) within the regulatory perimeter; and

Comparison to MiCA

Assuming HMT proceeds with its proposals for systemic regulation, MiCA provides for similar requirements. Under MiCA, the European Banking Authority (EBA) is empowered to classify these tokens as significant based on satisfaction of at least three criteria, including the size of the customer base or the issuer's reserve, the value of the tokens issued or transactions, the significance of the cross-border activities of the issuer, or the interconnectedness with the financial system.

Where an asset-referenced token or e-money token is deemed to be "significant", MiCA imposes additional requirements and obligations on issuers and service providers. For example, issuers of significant asset-referenced tokens or e-money tokens must implement robust governance arrangements set out in a remuneration policy, establish a liquidity management policy, and comply with higher own funds requirements.

Comparison to MiCA

MiCA applies to the issuance or offer of cryptoassets in the EU, or to the provision of services related to cryptoassets in the EU. E-money tokens which reference an EU currency are deemed to be offered in the EU.

Under MiCA, cryptoasset service providers must be registered and authorized in the EU. As noted above, issuers of asset-referenced tokens or e-money tokens must be established, and authorized, in the EU.

MiCA provides for passporting across the EU, in line with other Single Market measures. However, there are no provisions on third country equivalence, which may cause potential duplicative regulation issues for UK service providers seeking to offer services in both the UK and the EU.

- the possible benefits and risks posed by decentralised finance (DeFi), and whether these developments should be brought into the regulatory perimeter in the future.

Next steps

As noted above, the proposed regime is the first stage in HMT's consultative process on the broader regulatory approach to cryptoassets and stablecoins. The consultation closes on 21 March 2021. Although HMT has not indicated a specific target date by which it will respond or set out legislative measures, the FSB's roadmap to enhance cross-border payments targets the completion of international standard-setting work on global stablecoins by December 2021 and the establishment of national regulatory frameworks by July 2022.

HMT also indicates that it will respond to its consultation on expanding the financial promotions regime to cryptoassets in Q1 2021. In the longer term, HMT will consider bringing a broader set of cryptoasset market actors or tokens into an authorisation regime.

In the EU, negotiations on MiCA and the other elements of the Digital Finance Strategy are set to continue during 2021.