

**HM Treasury – Future Financial Services Regulatory Regime for Cryptoassets
Consultation and Call for Evidence**

Response (April 2023)

This response is provided by a working group of the Centre for Commercial Law at the University of Aberdeen (Scotland, UK). The working group consists of Dr Chike Emedosi, Dr Alisdair MacPherson, Professor Donna McKenzie Skene, Dr Burcu Yüksel Ripley and Mr Le Xuan Tung.

General

We welcome the opportunity to respond to the Consultation and Call for Evidence. We agree with the government’s intention to regulate cryptoasset activities and support its proposals, subject to the points made below.

Given that we are academics and not in practice, our response is confined to the questions in chapters 2 to 10 of the Consultation and does not extend to the questions in chapters 11-13 which relate to the Call for Evidence.

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.

We agree with the proposal.

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.

Yes, we agree with the proposal and consider the reasons provided sensible.

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

We consider that the use of the DAR regime to legislate for certain cryptosset activities may make monitoring and enforcement challenging. Unlike the RAO regime, where the authorisation and licensing system could be used to facilitate monitoring and enforcement, it is not clear how unauthorised activity providers would be effectively supervised under the DAR regime, especially in instances where they are located outside of the UK. This would more likely be the case given the cross-border nature of the cryptoassets and their global reach. These challenges may make the case for subsidiarisation and/or physical location of the firms in the UK stronger for the DAR regime.

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?

We think that it may be helpful to create a streamlined process so that firms that are already MLR-registered would not have to provide all the information that has already been provided for the MLR or repeat processes that have been completed. We think that this might be practicable given that both regimes would be supervised by the same authority (i.e. the FCA).

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

The delineation and interaction between both regimes seem clear to us. Since the regime for fiat-backed stablecoins will only apply to stablecoins that are backed by specified fiat currencies, we consider that much will depend on the extent to which the relevant fiat currencies are clearly defined.

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

Not being in practice, we are not aware of any challenges. We do wonder whether the approach would potentially cause some systems transition issues, as participants may initially need to operate parallel systems for their activities and then have to integrate the systems when the second phase is implemented.

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, in principle, agree with the proposal, especially given that the territorial scope would protect the integrity of UK markets while the extra-territorial scope would prevent regulatory arbitrage. However, we recognise that there may be difficulties in supervising participants outside the UK (see our response to question 20 below for more on this point).

We also think that the proposed exceptions are reasonable and agree that it is essential that they are defined in a way that avoids regulatory arbitrage. Particularly, we consider that the requirements for invoking the reverse solicitation exemption should be narrowed to prevent misuse.

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

Yes, we agree.

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

Yes, we agree.

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 with the assessment and consider it to be reasonably comprehensive.

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

We cannot think of any commodity-linked token that is not already caught by existing regulatory frameworks.

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

We agree with this proposal.

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

We think that the treatment is clear and sensible.

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?

Yes, we agree.

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?

We agree with this proposal. We do wonder if there will be conflict issues (regarding e.g. the performance of due diligence) if the trading venue is, at the same time, the issuer. We consider that there might be some merit in including measures in the proposed FCA's principles that could address such situations.

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

We agree with the options and consider that adopting a liability standard based on the existing regime is reasonable.

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

Yes, we agree.

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?

The intended reform of the prospectus regime seems adequate to accommodate public offers of cryptoassets. We also consider the option of using the DAR regime to capture public offers of cryptoassets that do not meet the definition of a security token offering a reasonable approach that would prevent possible regulatory arbitrage.

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?

We agree with the approach and consider that it is consistent with the government's aim of achieving a similar regulatory outcome between both regimes as far as possible.

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

We broadly agree with the proposed design features for the cryptoassets trading regime. We think that it is appropriate to have a special administration regime for cryptoassets trading firms and would suggest that the government adopts this approach as soon as practicably possible and, ideally, as part of the Phase 2 framework. As special administration regimes already apply to entities operating in comparable fields (e.g. investment banks and payment and electronic money institutions), we consider that applying a similar approach to cryptoassets would be reasonable. We do recognise that the regime for cryptoassets may differ in certain respects to account for their unique attributes.

Regarding the location requirements, we recognise potential monitoring and enforcement issues that might arise in supervising firms located outside the UK and see some merit in requiring some form of UK presence (e.g. through subsidiarisation) as part of the authorisation process. This is even more so considering the critical nature of the trading venues' role in the value chain.

In relation to the data reporting requirement, we think that it would be helpful to clarify what kind of information would be available to cryptoasset trading venues for off-chain transactions, especially given that off-chain transactions are processed outside the blockchain.

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?

Yes, we agree with the approach.

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

We broadly agree with the proposed design features for the market intermediation regime. We think that adopting a bespoke administration regime for relevant cryptoassets intermediaries

would be logical for reasons we stated in our response to question 20 above. We also consider the points made in response to question 20 above in relation to location requirements relevant to the intermediation regime.

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?

Yes, we agree.

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

We broadly agree with the proposed design feature for the custody regime. We think that adopting a bespoke special administration regime for cryptoassets custodians would be logical for reasons we stated in our response to question 20 above. We also consider the points made in response to question 20 above in relation to location requirements relevant to the custody regime.

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

We broadly agree with the assessment of the challenges of applying a market abuse regime to cryptoassets. However, we consider that attention should be given to issues relating to enforcement. The cross-border nature of cryptoassets and the fact that they are easily accessible online globally irrespective of location would make market abuse control particularly challenging for cryptoassets. We think that there might be some merit in committing some specialist resources to enhance enforcement of the market abuse regime. Greater international cooperation and information sharing among authorities would also be essential in this respect. In addition, it is worthwhile to consider the pseudonymous feature of cryptoasset transactions and the challenges that may pose as regards enforcement.

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)?

Yes, we agree.

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?

We agree that the prohibitions should be similar to those in MAR. We cannot think of any abusive practices unique to cryptoassets that would not be captured by the offences in MAR.

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

Yes, we consider the approach to be reasonable.

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

Not being in practice, we do not have any suggestions to make here.

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

Yes, we agree.

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?

Yes, we agree. We cannot think of any additional challenges that should be considered.

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?

We consider that prudential requirements (particularly liquidity requirements) and consumer protection and governance requirements would have been most effective in preventing the failure of Celsius and other cryptoasset lending platforms earlier this year. While we agree that broader issues contributed to the collapse of these lending platforms, we think that the lending platforms failed mainly due to the significant liquidity risks they had taken on and the lack of internal controls that led to the misuse of customers' funds.

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?

We agree with the approach of drawing on requirements from different traditional lending regimes, given that both regimes are generally subject to similar financial risks.

Regarding the most appropriate regimes, we broadly agree with the requirements proposed in the design features in Table 10.A. In addition, we think it is appropriate to have a special administration regime for cryptoasset lending and borrowing firms and would suggest that the government adopts this approach as soon as practicably possible and, ideally, as part of the Phase 2 framework. As special administration regimes already apply to entities undertaking comparable activities (including banks), we consider that applying a similar approach to entities engaged in cryptoasset lending would be reasonable.

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

Yes, we agree.

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)?

We are not in a position to comment on this question in detail. However, in principle, we are of the view that if the activities are functionally equivalent, the regulatory treatment should be the same (albeit that there may be some distinctions in relation to wider matters such as the property and insolvency consequences of the differing transactions).