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An Assessment of U.S. and European Crypto Asset Regulations

November 7, 2023

Discussion Points

- General structure of the new European regulation, MiCA
  - The types of assets, services, and entities that are subject to the regulation
  - Impact on the securities and financial markets
- What is the overall approach of the UK government to crypto regulation?
  - Big debate on the English law's treatment of cryptoassets
- How is regulation in Switzerland different from MiCA?
- What is the approach to regulation of digital assets in the US?
- How are the offer and sale of digital asset securities being regulated in the US, the UK, the EU, and Switzerland?
  - Market access rules
- Comparative approach to regulation of stablecoins
- Laws and regulations relating to the staking of tokens
- Discuss unique regulations in Switzerland on surrender of digital assets from the bankruptcy estate of the service (custody wallet) provider
- Future trends in regulation of digital assets
  - Is comprehensive regulation of digital assets such as MiCA feasible in other jurisdictions? Which jurisdiction is ahead?

Regulation in the United States: FinCEN

- Virtual currencies are not created or overseen by a central bank in the manner of traditional currencies.
- The fact that virtual currencies are not subject to traditional regulatory oversight has drawn the attention of federal regulators including the Treasury (through FinCEN), the SEC, and the CFTC.
- FinCEN is delegated authority under U.S. Department of Treasury Order 180-01 to administer the BSA and to thereby regulate money transmission to detect and prevent money laundering, fraud, and other illegal practices.
- FinCEN regulates money services businesses (MSBs) and money transmitters.
- The BSA and FinCEN regulations consider each of the following to be MSBs: currency exchangers; issuers, redeemers, or cashiers of travelers' checks, checks, money orders, or similar instruments; the United States Postal Service; a person who engages as a business in the transmission of funds; and any business or agency which engages in any activity determined by regulation to be an activity similar to, related to, or a substitute for these activities.

Money Transmission

- The term “money transmitter” includes a person that engages in the acceptance of currency, funds, or other value that substitute for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.
- It is important to note that the definition of a money transmitter does not differentiate between real currencies and instruments deemed convertible virtual currencies (CVCs).
- A person accepting or transmitting anything of value that substitutes for currency (such as Bitcoin or other digital asset) will be viewed as a money transmitter.
- Any entity or person, including certain foreign-located persons that engage in money transmission in any amount is subject to the BSA rules.
- Persons operating money transmitting businesses must register as such with FinCEN. The failure to register a money transmitting business is a federal offense punishable by civil and criminal penalty.
- The jurisdiction of FinCEN is proscribed under the BSA.

Money Transmission

- Since 2011, FinCEN has regulated money services business models involving money transmission denominated in virtual currencies through a series of administrative rulings and guidance.
- In 2019, FinCEN issued guidance that consolidated its regulations and related administrative rulings and guidance applicable to MSBs utilizing models that involve convertible virtual currencies.
- "Money transmission" includes the "acceptance…of…other value that substitutes for currency."
- The term "other value that substitutes for currency" encompasses transmission activities that do not involve currency, but instead involves something that the parties to the transaction recognize has value that is equivalent to or can substitute for currency, which may include virtual currencies.
- FinCEN defines "virtual currency" as a "medium of exchange that can operate like a currency but does not have all the attributes of 'real' currency, including legal tender status."
- The guidance further clarifies that convertible virtual currencies ("**CVCs**") are a type of currency that either has an equivalent value as currency, or acts as a substitute for currency, and is therefore a type of "value that substitutes for currency."
- Accordingly, the definition of money transmitter does not differentiate between real currencies and CVCs.

Money Transmission

- Accepting anything of value that substitutes for currency, such as a digital asset like Bitcoin, therefore makes that person a money transmitter.
- Virtual currencies can be divided into two primary categories: (1) convertible virtual currencies and (2) nonconvertible virtual currencies.
- Nonconvertible virtual currencies are essentially credits that can only be redeemed for products or other services.
- Non-convertible virtual currencies, like Facebook credits, generally cannot be converted into state-issued or government backed currency.
- Convertible currencies, on the other hand, may act as a substitute for real currency and have an equivalent value in real currency.
- These virtual currencies are frequently converted into and exchanged for real currency. Bitcoin is a convertible virtual currency.

Money Transmission

- FinCEN regulation is less about the type of currency involved in a transmission or transaction and more about the process by which the currency is transmitted, the purpose of the transmission and the participants involved in the transmission.

- FinCEN has stated that "[w]hat is material to the conclusion that a person is not an MSB is not the mechanism by which a person obtains the convertible virtual currency, *but what the person uses the convertible virtual currency for, and for whose benefit*".

- FinCEN has stated activities that do not constitute accepting and transmitting currency, funds or the value of funds do not fit within the definition of "money transmission services" and are not subject to FinCEN's registration, reporting, and recordkeeping regulations for MSBs (United States.

- However, a CVC user that wants to purchase goods or services with CVCs it has earned, that pays CVC to a third party at the direction of a seller or creditor, may be engaged in money transmission.

Money Transmission

- FinCEN's guidance defines CVC wallets as "interfaces for storing and transferring CVCs."
- There are different wallet types that vary according to the technology employed, where and how the value is stored, and who controls the value.
- Wallets where user funds are controlled by third parties are called "hosted wallets," whereas wallets where users control the funds are called "unhosted wallets."
- FinCEN states that the regulatory obligations of persons that act as intermediaries between the owner of value and the value itself (i.e., a money transmitter) is technology agnostic.
- Determining the regulatory treatment of a digital wallet depends on four criteria: (i) who owns the value; (ii) where the value is stored; (iii) whether the owner interacts directly with the payment system where the CVC runs; and (iv) whether the person acting as intermediary has total independent control over the value.

Money Transmission

- FinCEN refers to the participants in generic virtual currency arrangements, using the terms “user, ” “exchanger,” and “administrator”.
- A user is a person that obtains virtual currency to purchase goods or services. How a person engages in “obtaining” a virtual currency may be described using any number of other terms, such as “earning,” “harvesting,” “mining,” “creating,” “auto-generating,” “manufacturing,” or “purchasing,” depending on the details of the specific virtual currency model involved. For purposes of the guidance,
- FinCEN has noted the label applied to a particular process of obtaining a virtual currency is not material to the legal characterization under the BSA of the process or of the person engaging in the process.
- An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency.
- An administrator is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.

Money Transmission

- The proliferation of decentralized applications (DApps) facilitating transactions in CVC, including its transmission, has raised concerns among regulators.

- FinCEN defines DApps as software programs that operate on a peer-to-peer network of computers running a blockchain platform and designed such that the DApp is not controlled by a single person or entity.

- Although FinCEN acknowledges that DApps typically lack an identifiable administrator, the DApp itself remains subject to the same regulatory interpretation as mechanical money transmitters (such as a CVC kiosk).

- To that end, when a DApp engages in money transmission activities, the definition of money transmitter as described above will apply to the DApp, the owner/operators (to the extent identifiable), or both.

Digital Asset Securities

- The definitions of "security" under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 are nearly identical and each is broad enough to include the various types of instruments that are used in commercial marketplaces that one might suspect to fall within the ordinary concepts of a security.

- This would include common instruments like stocks, bonds, and notes, as well as the various collective investment pools and common enterprises devised by persons seeking to generate profits from the efforts and investments of others (i.e. investment contracts and instruments commonly known as securities).

- Section 2(a)(1) of the Securities Act defines a "security" as:

> [A]any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, . . . transferable share, ***investment contract***, . . . any put, call, straddle, option, or privilege on any security, certificate of deposit, . . . or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Digital Asset Securities

- Although the term “note” is specifically enumerated in the Securities Acts' definitions of “security,” courts have not found all notes to be securities because notes are used in a variety of contexts.

- A note may function as both a commercial vehicle, which is not a security, as well as an investment vehicle, which courts have deemed to be a security.

- In Marine Bank v. Weaver, 455 U.S. 551 (1982), the U.S. Supreme Court addressed whether the sale of a $50,000 certificate of deposit, with a 6-year maturity that featured a 7.5% interest rate was a security.

- The note also provided that, if the bank permitted early withdrawal, the depositor would earn interest at the bank's current savings passbook rate on the amount withdrawn, except that no interest would be paid for the three months prior to withdrawal.

- The Court noted that while the definition of “security” in the Securities Exchange Act of 1934 (the “1934 Act”) is quite broad, Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud.

Digital Asset Securities

- The Court cautioned, however, "[t]he definition of 'security' in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires."
- The Court also noted that a certificate of deposit is not the functional equivalent of the withdrawable capital shares of a savings and loan association held to be securities, nor is it similar to any other long-term debt obligation commonly found to be a security.
- The purchaser of a certificate of deposit is virtually guaranteed payment in full, whereas the holder of an ordinary long-term debt obligation assumes the risk of the borrower's insolvency.
- The Court held neither the certificate of deposit nor the agreement in question was a security within the meaning of § 10(b) of the Securities Act.

Exchanges

- Section 3(a)(1) of the Exchange Act defines an "exchange" as "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange."

- Exchange Act Rule 3b-16(a) interprets the definition to mean any organization, association, or group of persons that: (1) ***brings together the orders of multiple buyers and sellers*** and (2) uses established, nondiscretionary methods (***whether by providing a trading facility*** or by setting rules) ***under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade***.

- Absent an exemption, an exchange must register as a national securities exchange pursuant to section 6 and section 19(a) of the Exchange Act.

- If a blockchain technology platform brings together multiple buyers and sellers of digital assets that are deemed securities, the platform could be required to register as a securities exchange unless it falls within an exclusion from registration.

Alternative Trading Systems

- In 1998, the SEC adopted Regulation ATS, which allows an ATS to choose whether to register as a national securities exchange or to register as a broker-dealer and comply with additional requirements of Regulation ATS.

- An "alternative trading system" means any organization, association, person, group of persons, or system: (1) that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of Rule 3b-16 under the Exchange Act, and (2) that does not set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such organization, association, person, group of persons, or system; or discipline subscribers other than by exclusion from trading.

- A blockchain technology platform may be required by the SEC to register as an ATS if it maintains a marketplace or facilities for bringing together purchasers and sellers of digital assets that are deemed securities, and it does not set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such platform.

- If the platform is not required to register as an ATS, the operator of the platform may be required to register as a broker-dealer.

Broker-dealers

- Section 15 of the Exchange Act requires registration with the SEC of all broker-dealers using interstate commerce or the facilities of any national securities exchange to effect transactions in securities (other than exempted securities and certain short-term debt instruments).
- Section 3(a)(4)(A) of the Exchange Act defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others."
- The Exchange Act and the rules thereunder do not define these terms.
- The courts and the SEC have taken an expansive view of the scope of these terms.
- The SEC and the courts apply a "facts and circumstances" analysis in evaluating whether a person has acted as a broker, with no single element being dispositive.
- Depending on the circumstances, the operator of a blockchain technology platform may be deemed a broker-dealer if the operator of the platform is deemed to be engaged in the business of effecting transactions in securities for the account of others.

SEC v. Ripple Labs Inc.

- On July 13, 2023, Judge Analisa Torres of the U.S. District Court for the Southern District of New York issued a decision in the SEC's case against Ripple Labs. *SEC v. Ripple Labs Inc*., 2023 WL 4507900 (S.D.N.Y. July 13, 2023)

- This case concerns the sale and distribution of XRP tokens: between 2013 and 2020, Ripple Labs sold approximately $730 million of XRP tokens directly to third parties in private sales, including institutions and hedge funds ("Institutional Sales"); roughly $750 million of XRP tokens were sold by Ripple on digital asset exchanges using trading algorithms ("Programmatic Sales"); and roughly $610 million of XRP were distributed as a form of payment for services ("Other Distributions"). Ripple's founders sold some or all their XRP tokens in their individual capacities (e.g., one founder sold $450 million of XRP tokens).

- Judge Torres ruled Ripple's Institutional Sales of XRP to sophisticated individuals and entities pursuant to written contracts amounted to unregistered offers and sales of investment contracts in violation of Section 5 of the Securities Act.

- Judge Torres found that Ripple's Programmatic Sales, which were sales of XRP by Ripple to public buyers on digital asset exchanges, did not constitute offers and sales of investment contracts because the sales were blind bid/ask transactions and the buyers would not have known if their payments were going to Ripple or another seller of XRP.

- Judge Torres concluded that Ripple's distribution of XRP to employees and as compensation to third parties did not amount to investment contracts because those transfers of XRP were not done pursuant to an "investment of money", as required under *Howey*.

SEC v. Terraform Labs Pte. Ltd.

- The decision in the Ripple case appears to be in contrast with the recent ruling in another case before the U.S. District Court for the Southern District of New York.
- The SEC alleged that Terraform Labs PTE Ltd ("Terraform") and Do Hyeong Kwon ("Kwon") orchestrated a multi-billion-dollar crypto asset securities fraud involving an algorithmic stablecoin and other crypto asset securities.
- According to the SEC, Terraform and Kwon raised billions of dollars from investors by offering and selling an inter-connected suite of digital asset securities: "mAssets", which the SEC claims are security-based swaps designed to pay returns by mirroring the price of stocks of U.S. companies, and Terra USD ("UST"), a digital asset security referred to as an "algorithmic stablecoin" that supposedly maintained its peg to the U.S. dollar by being interchangeable for another of the defendants' crypto asset securities, LUNA. According to the SEC, the defendants also offered and sold to investors the crypto asset security tokens MIR – or "mirror" tokens – and LUNA itself.
- The SEC's complaint alleged that Terraform and Kwon marketed crypto asset securities to investors seeking to earn a profit, repeatedly claiming that the tokens would increase in value. For example, they touted and marketed UST as a "yield-bearing" stablecoin, which they advertised as paying as much as 20 percent interest through the Anchor Protocol. The SEC's complaint also alleges that, while marketing the LUNA token, Terraform and Kwon repeatedly misled and deceived investors that a popular Korean mobile payment application used the Terra blockchain to settle transactions that would accrue value to LUNA. Meanwhile, Terraform and Kwon also allegedly misled investors about the stability of UST. In May 2022, UST depegged from the U.S. dollar, and the price of it and its sister tokens plummeted to close to zero.
- The SEC charged the defendants with violating the registration and anti-fraud provisions of the Securities Act and the Exchange Act.
- Judge Rakoff did not distinguish between the primary and secondary sales of the tokens, which shows a different approach from that of Judge Torres.
- Judge Rakoff ruled that the lawsuit will continue as planned. Both sides filed motions for summary judgment.

Other SEC Enforcement Actions

- Coinbase:
  - On June 6, 2023, the SEC charged Coinbase with operating its digital asset trading platform as an unregistered national securities exchange, broker, and clearing agency. According to the SEC's complaint, Coinbase has made billions since 2019 by unlawfully facilitating the buying and selling of crypto asset securities.
  - The complaint alleges Coinbase (i) provided a marketplace that matches multiple buyers and sellers using non-discretionary methods (i.e., using technology), (ii) facilitated securities transactions for its customers, (iii) provided securities depository services, and (iv) engaged in unregistered securities offerings through its staking-as-a-service program. *SEC v. Coinbase*, Inc., No. 23-cv-04738 (S.D.N.Y. June 6, 2023).
- Bittrex:
  - The SEC recently settled charges against digital asset trading platform Bittrex, Inc. (Bittrex) and its co-founder and former CEO William Shihara.
  - The SEC complaint, filed on April 17, 2023, alleged that Bittrex acted as an unregistered broker, exchange, and clearing agency by providing services to U.S. investors in connection with digital assets that the SEC alleged were offered and sold as securities.
  - The SEC also alleged Bittrex and Shihara directed issuers who sought to have their digital assets made available for trading on Bittrex's platform to first delete from public channels certain "problematic statements" that Shihara believed would lead a regulator, such as the SEC, to investigate whether the digital asset was offered and sold as a security.
  - As part of settlement, Bittrex and its foreign affiliate Bittrex Global GmbH agreed to pay disgorgement of $14.4 million, prejudgment interest of $4 million, and a civil penalty of $5.6 million, for a total monetary payment of $24 million. *SEC v. Bittrex, Inc., Bittrex Global GmbH, and William Shihara*, No. 23-cv-00580 (W.D.W.A. Aug. 15, 2023)

Executive Order on Digital Assets

- March 2022 - President Biden signed an Executive Order on Ensuring Responsible Development of Digital Assets
- The order instructs various agencies of the Federal Government with respect to the development of digital assets
- The Biden administration identified several policy priorities in the Order and requires the production of several reports on digital assets, blockchain technology, and CBDCs:
  - Consumer and investor protection
  - Financial stability and mitigating systemic risks
  - Addressing the potential for illicit finance and national security risks
  - U.S. leadership in the global financial system and economic competitiveness
  - Equitable access to safe and affordable financial services
  - Fostering responsible digital asset innovation
  - U.S. Central Bank digital currency
  - Fostering international cooperation and U.S. competitiveness

Federal Regulation of Stablecoins

- Currently, there is no comprehensive nationwide regulatory framework for stablecoins.

- There is uncertainty as to whether stablecoins should be regulated as securities by the SEC or as commodities by the CFTC.

  - On June 5, 2023, the SEC sued Binance for offering and selling BUSD (US dollar-backed stablecoin) as an unregistered security. The SEC alleged that Binance improperly marketed and touted BUSD as a profit-generating instrument by promising interest payments to investors who merely held BUSD on the Ethereum blockchain.
  - On October 15, 2021, the CFTC settled charges with the companies that created the stablecoin Tether for alleged misrepresentations regarding the reserves backing the stablecoin. The order against the Tether companies required them to pay a $41 million fine and cease and desist from further violations of the CEA.

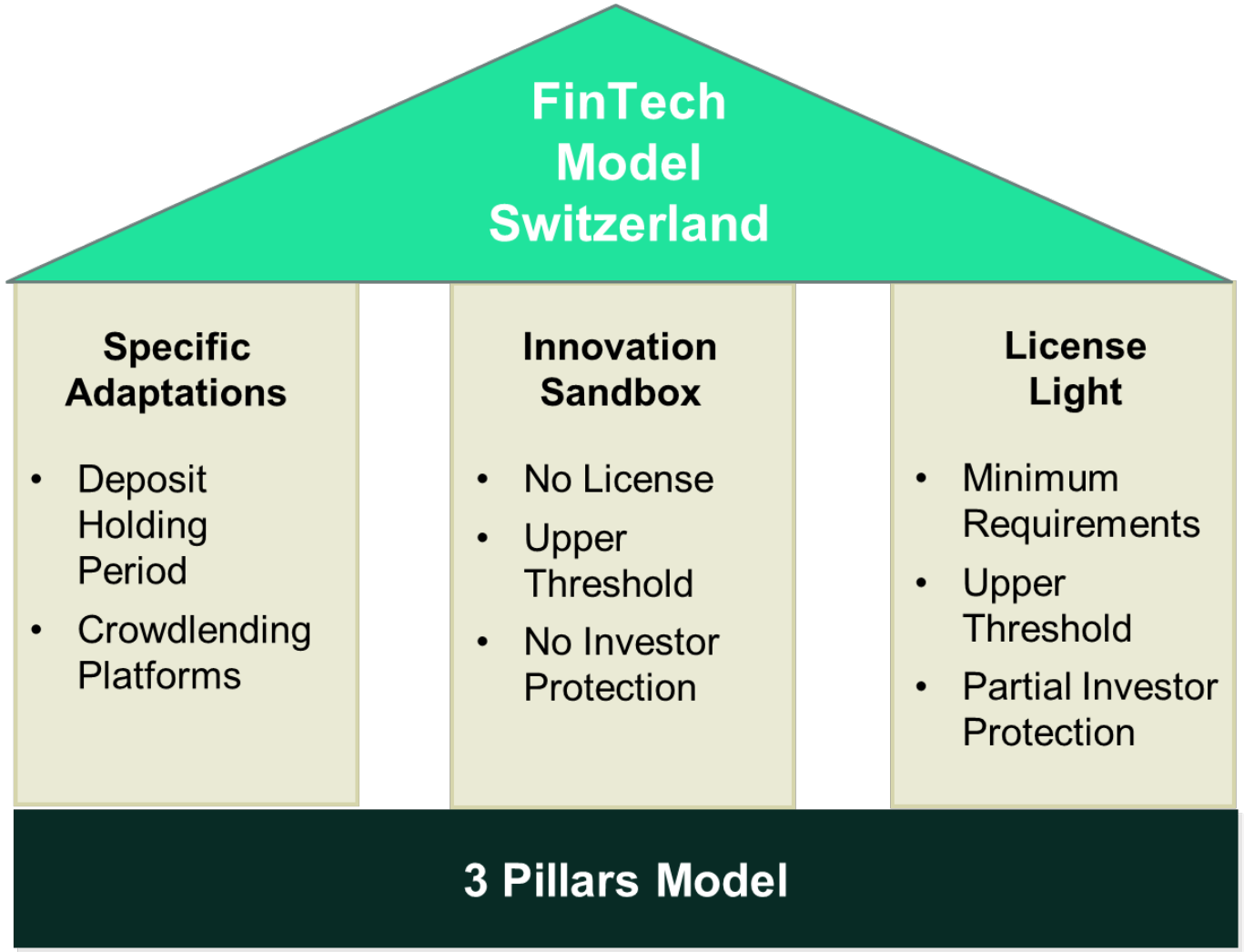
- There are several proposed bills

  - On July 27, 2023, H.R. 4766, the Clarity for Payments Stablecoins Act of 2023, passed out of committee with a bipartisan vote and is now on the floor of the House of Representatives for consideration. The bill would require the U.S. Federal Reserve write requirements for issuing stablecoins while preserving the authority of state regulators.

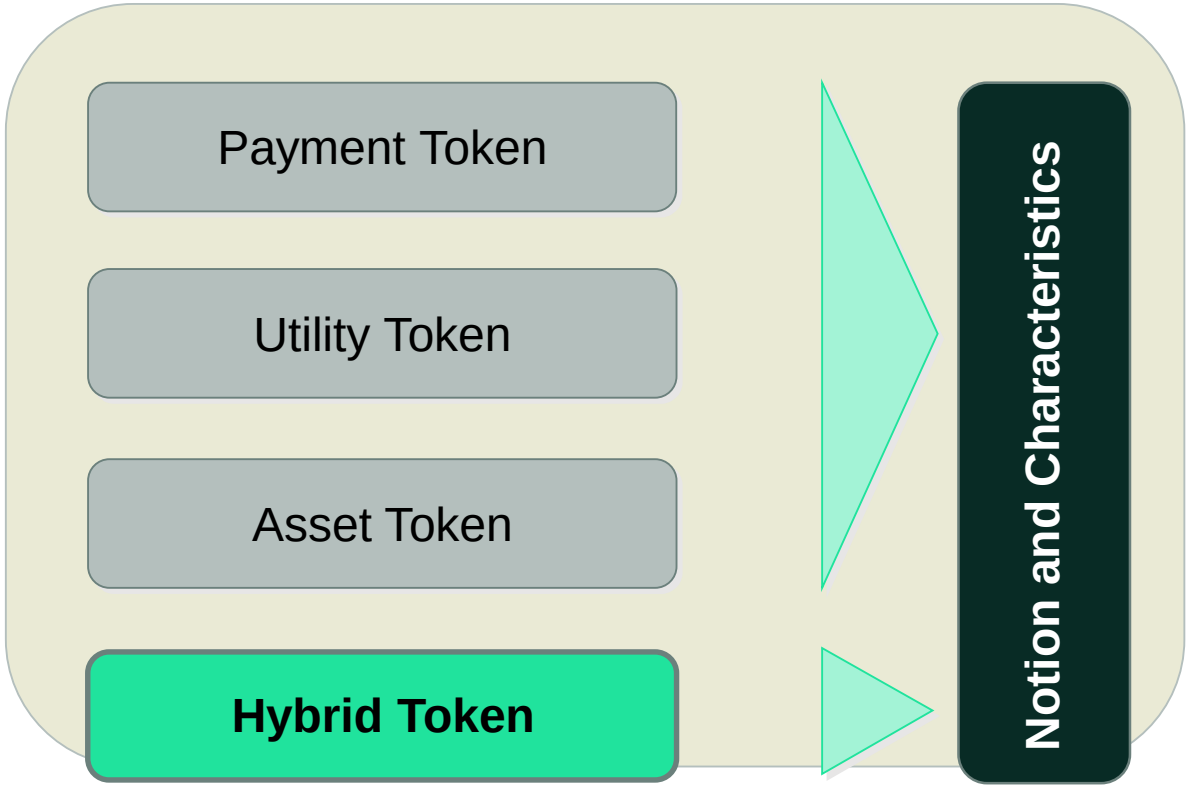
State Regulation of Stablecoins

- Several states have adopted legislation permitting entities to issue stablecoins.
- For example, in New York, stablecoin issuers can operate as a state-chartered trust company, such as a limited purpose trust company under the New York Banking Law. On June 8, 2022, the New York Department of Financial Services ("DFS") issued its Guidance on the Issuance of U.S. Dollar-Backed Stablecoins ("DFS Guidance"), which outlined general requirements for USD-backed stablecoins issued by issuers subject to DFS oversight.
- The DFS Guidance focused on three areas of requirements: redeemability; reserves; and attestations.
- In September 2023, Paypal (that holds Bitlicense issued by DFS), in partnership with Paxos, launched PayPal USD (PYUSD).

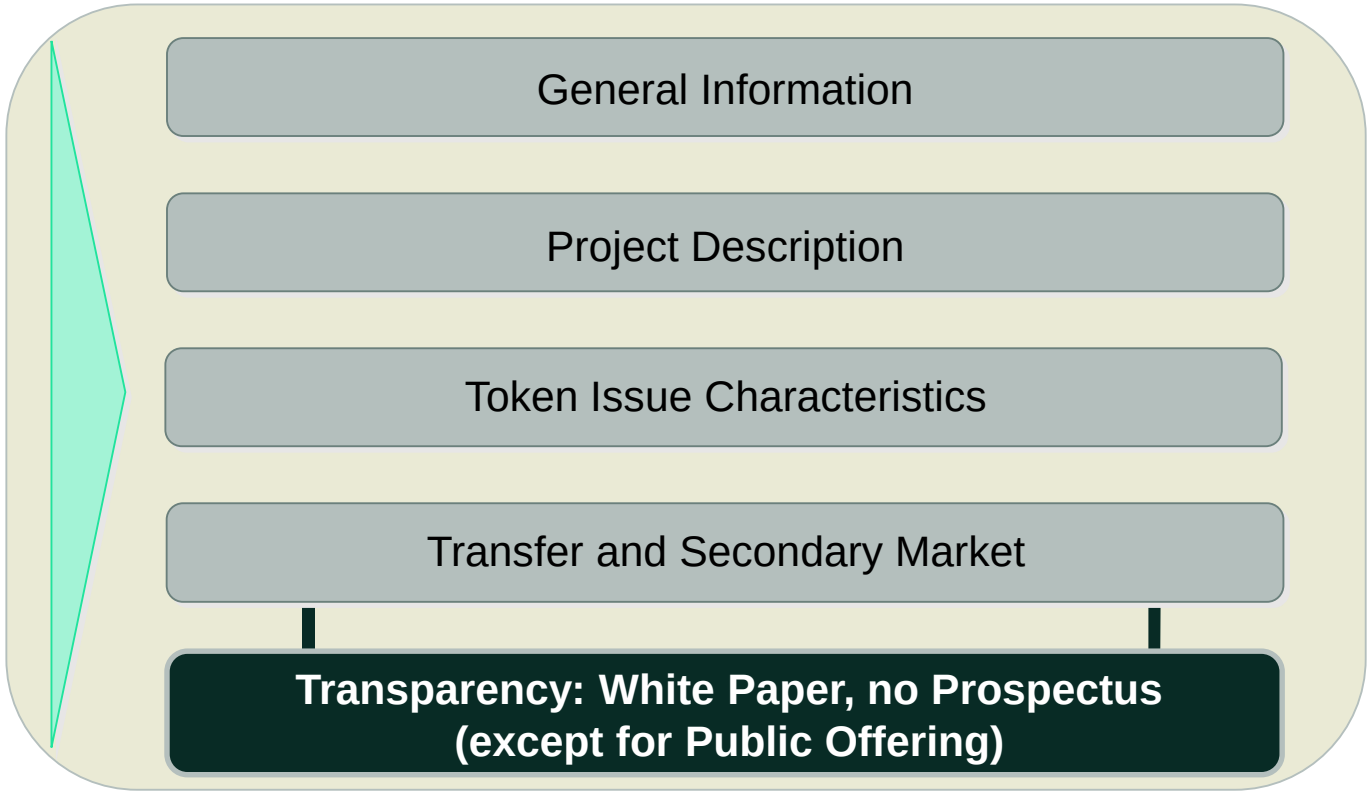
Regulation in Switzerland`



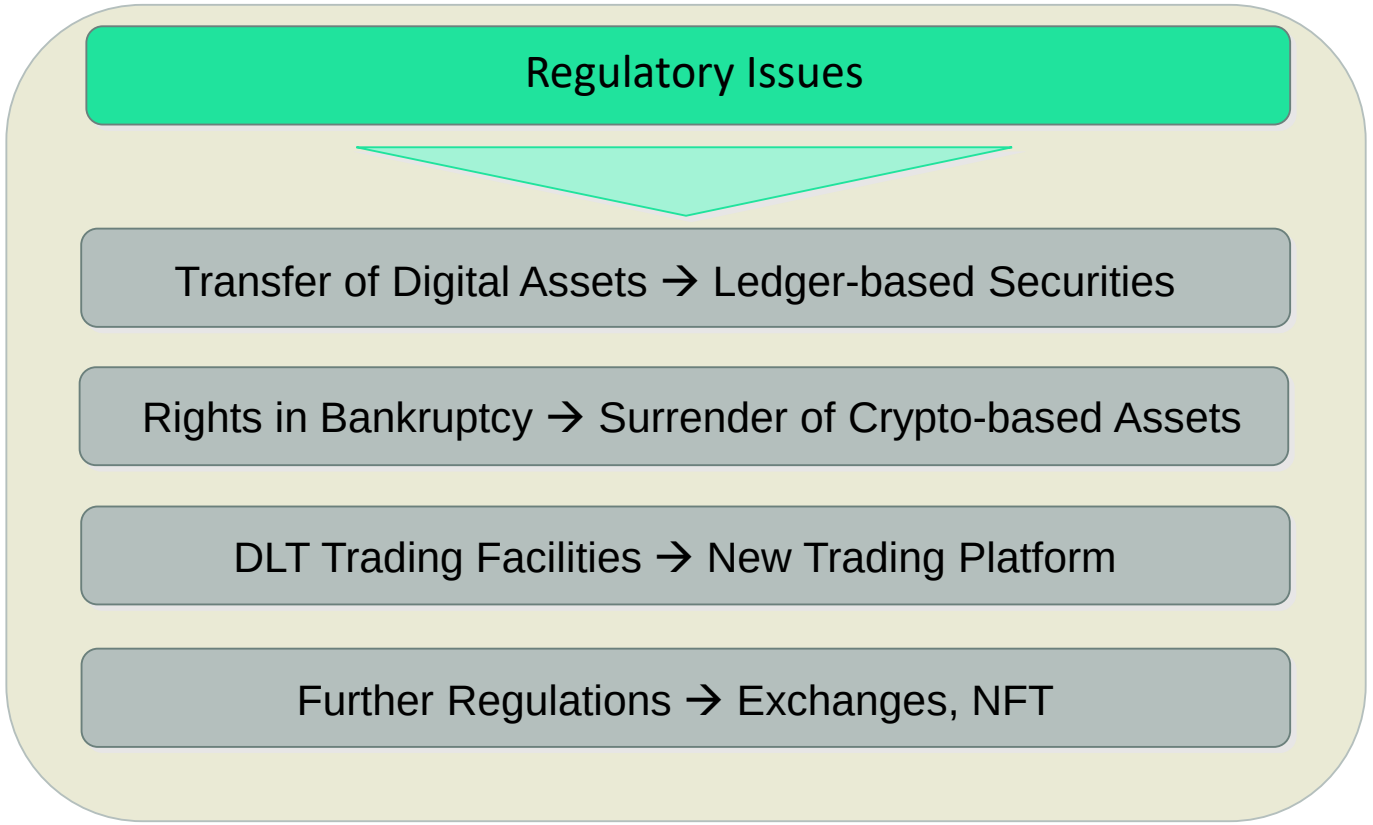
FINMA Guidelines of Feb. 16, 2018: Token Categories



Minimum Information Requirements for Clearance Proceedings



New DLT Law


Regulatory Issues
Transfer of Digital Assets → Ledger-based Securities
Rights in Bankruptcy → Surrender of Crypto-based Assets
DLT Trading Facilities → New Trading Platform
Further Regulations → Exchanges, NFT

Regulation in the UK: Anti-Money Laundering / Counter-Terrorist Financial Regulatory Regime

Since January 2020, an Anti-Money Laundering and Counter Terrorist Finance (AML/CTF) registration regime has been in place for businesses undertaking cryptoasset exchange or custody wallet services in the UK, in order to regulate compliance with theUK's Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ("**the MLRs**").

The UK's Financial Conduct Authority ("**FCA**") became the supervisory authority for cryptoasset exchange providers and custodian wallet providers ("cryptoasset businesses") in respect of the AML and CTF obligations contained in the MLR.9 These cryptoasset businesses encompass:-

(1). any "cryptoasset exchange provider" which means a firm or sole practitioner who by way of business provides one or more of the following services, including where it does so as creator or issuer of any of the cryptoassets involved, when providing such services:-

(a) exchanging, or arranging or making arrangements with a view to the exchange of, cryptoassets for money or money for cryptoassets;

(b) exchanging, or arranging or making arrangements with a view to the exchange of, one cryptoasset for another; or

(c) operating a machine which utilises automated processes to exchange cryptoassets for money or money for cryptoassets.

Anti-Money Laundering / Counter-Terrorist Financial Regulatory Regime

(2). any "custodian wallet provider" which means a firm or sole practitioner who by way of business provides services to safeguard, or to safeguard and administer:-

(a) cryptoassets on behalf of its customers; or

(b) private cryptographic keys on behalf of its customers in order to hold, store and transfer cryptoassets.

Consequently, cryptoasset businesses (which have not been otherwise required to be FCA-regulated) have had to be registered and comply with the MLR, requiring them to demonstrate that their controls, policies and procedures are adequate to deal with the money laundering and terrorist financing risks of the cryptoasset market, and requiring any officers, managers and beneficial owners of the business to be fit and proper.

UK Regulation of Marketing Cryptoassets

New UK rules designed to make the marketing of cryptoasset products clearer and more accurate, and that ban incentives such as "refer a friend" bonuses, will come into force on 8 October 2023.

The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023 (the "**2023 FPAO**") provides that dealing in, arranging deals in, managing and advising on investing in qualifying cryptoassets as principal or agent will become a "controlled activity". This does not mean it becomes regulated, but it means the FCA's financial promotions regime will apply to it. Generally speaking, financial promotion involves the communication of an invitation or inducement to engage in any investment activity in the course of business. It includes real time (e.g., in person, telephone) and non-real time communications (e.g., by email, letter or in a publication) communications. At the same time, the 2023 FPAO creates a new exemption (Article 73ZA) in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**FPO**") whereby there will be four routes that firms can take when lawfully communicating cryptoasset promotions: 1) an "authorised person" (such as an FCA-regulated investment firm) communicates the promotion. 2) an authorised person approves the promotion which is used by a third party, who may be unauthorised. 3) A cryptoasset business registered under the MLRs communicates the promotion. 4) The promotion otherwise complies with the conditions of an exemption in the FPO.

Marketing Cryptoassets

Anyone who continues promoting cryptoassets to UK customers past that October 2023 deadline without complying with the rules, may be committing a criminal offence punishable by an unlimited fine and/or up to 2 years imprisonment.

The new rules only apply to "qualifying cryptoassets" - any cryptoasset which is—

(a) fungible; and

(b) transferable.

A cryptoasset is to be treated as “transferable” include where—

(a) it confers transferable rights; or

(b) a communication made in relation to the cryptoasset describes it as being transferable or conferring transferable rights.

Marketing Cryptoassets

A number of types of crypto-like assets are excluded e.g. :-

a) a number of existing types of controlled investment that would fall in the above definition;

(b) electronic money;

(c) currency; and

(d) digitally issued fiat currency.

Marketing Cryptoassets

The cryptoasset financial promotion rules apply to both authorised firms and cryptoasset businesses which have been registered for the purposes of the MLRs but which are not authorised firms.

The following FCA Handbook provisions will apply to registered cryptoasset businesses when communicating financial promotions in reliance on the new FPO exemption:

- Principle for Business 7 -Communications with clients;

- Statements about authorisation and regulation by the appropriate regulator;

- COBS 4 (Communicating with clients, including financial promotions); and

- COBS 10 (Assessing appropriateness).

Marketing Cryptoassets

The FCA's Principle for Business 7 will be applied to registered cryptoasset businesses as it applies to authorised firms communicating financial promotions relating to qualifying cryptoassets. It requires that in communications with clients, a firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading.

The FCA will categorise cryptoassets as "Restricted Mass Market Investments" ("RMMI") which means that although mass marketing is allowed to retail investors, it is subject to certain restrictions. The FCA indicate they wish to clarify that their rules do not limit promotions of cryptoassets only to high net worth or sophisticated investors, and firms can communicate financial promotions to all consumers subject to complying with the relevant requirements. However, firms can only make Direct Offer Financial Promotions ("**DOFPs**") to consumers who have been categorised as (i) "high net worth" investors, (ii) "certified sophisticated" investors or (iii) "restricted" investors (under the FCA's customer classification rules). DOFPs are financial promotions which contain or specify a manner of response by which a recipient of the promotion may make or accept an offer to enter into a "controlled agreement", such as one which invites the consumer to complete an online application form and giving their bank account details or make payment by payment card.

Marketing Cryptoassets

The FCA say they expect most consumers investing in cryptoassets to be categorised as restricted investors. The "restricted investor" category requires the investor to certify that in the past 12 months they have either invested less than 10% of their net assets in high-risk investments or if not, to disclose such higher percentage, and likewise to disclose their intentions over the next 12 months. They must also provide a disclaimer acknowledging they appreciate that they will be exposed to promotions for investments where there is a risk of losing all of their money. The new rules will ban incentives to invest such as "refer a friend" or new joiner bonuses. The new rules will include a mandatory 24 hour "cooling off" period for new investors. A personalised risk warning will need to be included in any such financial promotion:

"Don’t invest unless you’re prepared to lose all the money you invest. This is a high-risk investment, and you should not expect to be protected if something goes wrong."

Where the number of characters contained in the risk warning above exceeds the number of characters permitted by a third-party marketing provider, a shorter risk warning is specified:

"Don’t invest unless you’re prepared to lose all the money you invest."

Marketing Cryptoassets

Where the financial promotion is to be communicated by way of a website, mobile application or other digital medium, the risk warning must also include a link in the form of the text "*Take 2 mins to learn more*" which will take the potential investor to a detailed, cryptoasset-specific risk warning explaining that the FCA considers that the investment is "high risk" and outlining certain key risks including that they could lose all of the money they invest and they should not expect to be protected if anything goes wrong in particular because the FSCS does not protect this type of investment and the FOS will not be able to consider complaints.

The FCA's appropriateness obligations in COBS 10 will apply to both authorised firms and registered cryptoasset businesses when transacting in qualifying cryptoassets with retail customers in response to a DOFP, and a number of obligations specific to assessing appropriateness in relation to qualifying cryptoassets are to be included in the relevant COBS 10 rule Annex.

In terms of enforcement in relation to the unauthorised but registered cryptoasset businesses, the FCA highlight their powers to ban adverts under s.137S of Financial Services and Markets Act 2000 ("**FSMA**") and also to take enforcement action or bring criminal or civil proceedings through the courts. They say they can use powers to impose a disciplinary sanction, including public censures and financial penalties, as well as powers to obtain redress and restitution.

UK Regulation of Fiat-Backed Stablecoins

The UK government has also legislated in the Financial Services and Markets Act 2023 ("**FSMA 2023**") to introduce a regime that will allow for the regulation of fiat-backed stablecoins which are used for payments, similar to that for other payment methods given that these stablecoins have the potential to become widely used as a form of payment. This is part of what HM Treasury refer to as "Phase 1" in relation to cryptoasset regulation. The regime will address issuance and custody activities relating to fiat-backed stablecoins as well as payment-related activities for those fiat-backed stablecoins which are used in payments.

These "digital settlement assets" ("**DSA**") are defined as a digital representation of value or rights, whether or not cryptographically secured, that—

(a) can be used for the settlement of payment obligations,

(b) can be transferred, stored or traded electronically, and

(c) uses technology supporting the recording or storage of data (which may include distributed ledger technology).

UK Regulation of Fiat-Backed Stablecoins

When introduced, the regulatory regime will apply to a "DSA service provider" who is a person who provides one or more services in relation to a payment system that includes arrangements using digital settlement assets where—

(a) the person creates or issues the digital settlement assets involved in the payment system;

(b) the person provides services to safeguard, or to safeguard and administer, digital settlement assets including their private cryptographic keys (or means of access);

(c) the person is directly involved in any of the activities mentioned in paragraphs (a) or (b);

(d) the person is a digital settlement asset exchange provider;

(e) the person sets rules, standards, or conditions of access or participation in relation to the payment system; or

(f) the person provides any service that facilitates, or supports, a transfer of money or digital settlement assets to be made using the payment system, including any infrastructure provider in relation to the system.

Fiat-Backed Stablecoins

In addition, the regime will apply to any "digital settlement asset exchange provider", meaning a person who provides one or more of the following services, including as creator or issuer of any of the digital settlement assets, by—

(a) exchanging, or arranging the exchange of—

(i) digital settlement assets for money,

(ii) money for digital settlement assets,

(iii) digital settlement assets and money for digital settlement assets, or

(iv) digital settlement assets and money for money,

(b) exchanging, or arranging the exchange of, one digital settlement asset for another, or

(c) operating an automated process to carry out any of the activities mentioned in paragraphs (a) and (b).

The scope of this is expected to cover, at a minimum, GBP and other fiat-backed stablecoins which are issued in the UK. The Bank of England and the UK's Payment Systems Regulator (PSR) will also have a regulatory remit for DSAs.

UK Regulation of Cryptoassets

More significantly, Section 69 of FSMA 2023 will allow HM Treasury to use its existing powers in Section 22 of FSMA 2000 to regulate cryptoassets in the future. It amends the definition of "investment" contained in section 21(14) of FSMA 2000. The existing definition is ""investment" includes any asset, right or interest." The amendment inserts "…(including where an asset, right or interest is, or comprises or represents, a cryptoasset)".

In what is described as Phase 2 by HM Treasury, this regime will be focused on targeting the activity areas associated with (i) a higher degree of risk from a consumer and overall market perspective and (ii) greater opportunities to support the UK's growth agenda. As a consequence, not all cryptoasset activities are proposed to form part of Phase 2.

In section 417 of FSMA 2000, (definitions), "cryptoasset" is defined to mean 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)."

However, HM Treasury may amend the definition of "cryptoasset" by regulations.

HM Treasury proposes to capture cryptoasset activities provided both in or to the United Kingdom. This would capture activities provided by UK firms to persons based in the UK or overseas (natural and legal), as well as those provided by overseas firms to UK persons (natural or legal). The proposed scope of cryptoasset activities to be regulated encompasses:

UK – Issuance and Other Activities

1. Issuance activities

Admitting a cryptoasset to a cryptoasset trading venue; and

Making a public offer of a cryptoasset.

2. Exchange activities

Operating a cryptoasset trading venue which supports:

(i) the exchange of cryptoassets for other cryptoassets;

(ii) the exchange of cryptoassets for fiat currency;

(iii) the exchange of cryptoassets for other assets (e.g., commodities);

(Future Phases)

Post-trade activities in cryptoassets (to the extent not already covered)

3. Investment and risk management activities

Dealing in cryptoassets as principal or agent;

Arranging (bringing about) deals in cryptoassets ;

Making arrangements with a view to transactions in cryptoassets;

Future Phases may include (or exclude from regulatory perimeter))

Advising (to the extent not already covered) on cryptoassets

Managing (to the extent not already covered) cryptoassets

Issuance and Other Activities

4. Lending, borrowing and leverage activities

Operating a cryptoasset lending platform.

5. Safeguarding and /or administration (custody) activities

Safeguarding or safeguarding and administering (or arranging the same) a cryptoasset other than a fiat backed stablecoin and/or means of access to the cryptoasset (custody);

Future Phases may include

Validation and governance activities

Mining or staking

UK HM Treasury Consultation Response on regulating cryptoassets – October 2023

Proposed “Phase 2” secondary legislation in 2024.

Jurisdictional scope of UK regulation – generally it will apply to crypto-related services provided both in *and to* the UK.

A new market abuse regime for cryptoassets will be introduced broadly similar to the current UK-onshored version of the EU Market Abuse Regulation.

No decision on whether to regulate crypto-related investment advice - under review.

“Mining” not to be regulated at present.

New regulatory treatment for staking is being considered – a carve out from staking constituting regulated collective investment schemes proposed.

European Union Markets in Crypto Assets Regulation (MiCA)

- MiCA is the Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets.

- The EU is among the first major jurisdictions worldwide to design a comprehensive regulatory framework for crypto-assets. The objectives of the regulation are:
  - Consumer protection.
  - Market integrity.
  - Financial stability.
  - Facilitate innovation on a safe and sound basis.

- The MiCA framework covers crypto-assets that are not already regulated by other EU financial legislation. In particular, it provides three different categories of cryptoassets (defined as a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology (DLT) or similar technology:
  - 'Utility tokens': type of crypto-asset that is only intended to provide access to a good or a service supplied by its issuer.
  - 'Asset-referenced tokens (ARTs)': type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies.
  - 'Electronic money tokens' (EMTs): type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency.

- MiCA does not apply to securities, financial instruments, deposits, insurance products, funds, pension products and NFTs. It does not apply to public authorities.

Markets in Crypto Assets Regulation (MiCA)

- MiCA is applicable to the issuance of cryptoassets and crypto-asset service providers (CASPs).

- **Issuance of utility tokens -** Requirements to be complied with by a person intending to make an offer to the public of utility tokens in the EU:
  - To be a legal person;
  - To draw up and publish a crypto-asset white paper in respect of that crypto-asset;
  - To notify the crypto-asset white paper to a competent authority before its publication.

- These requirements are not applicable to the following offers:
  - An offer to fewer than 150 natural or legal persons per Member State where such persons are acting on their own account;
  - over a period of 12 months, starting with the beginning of the offer, the total consideration of an offer to the public of a crypto-asset in the Union does not exceed EUR 1 000 000, or the equivalent amount in another official currency or in crypto-assets;
  - an offer of a crypto-asset addressed solely to qualified investors where the crypto-asset can only be held by such qualified investors;
  - those in which the crypto-asset is offered for free; or the crypto-asset is automatically created as a reward for the maintenance of the distributed ledger or the validation of transactions; or the offer concerns a utility token providing access to a good or service that exists or is in operation; or the holder of the crypto-asset has the right to use it only in exchange for goods and services in a limited network of merchants with contractual arrangements with the offeror.

- The white paper must provide information about the issuer, the crypto-asset, the rights and obligations attached to the crypto-asset, the risks, etc.

Markets in Crypto Assets Regulation (MiCA)

Issuance of ARTs

- Issuers of ARTs must be either:
  - Credit institutions;
  - Legal persons or other undertakings established in the Union and authorized by the competent authority of its home EU Member State for the purpose of issuing the ARTs. Requirements on good governance, internal control, risk management, own funds, etc. are applicable.

- A white paper must also be published and authorized by the competent authority.

- Issuers must constitute and at all times maintain a reserve of assets, composed and managed in such a way that (i) the risks associated to the assets referenced by the ARTs are covered; and (ii) the liquidity risks associated to the permanent rights of redemption of the holders are addressed.

- Where, for an ART, the estimated quarterly average number and average aggregate value of transactions per day associated to its uses as a means of exchange within a single currency area is higher than 1 million transactions and EUR 200 000 000, respectively, the issuer shall: (i) stop issuing that ART; and (ii) within 40 working days of reaching that threshold, submit a plan to the competent authority to ensure that the estimated quarterly average number and average aggregate value of those transactions per day is kept below 1 million transactions and EUR 200 000 000 respectively.

Markets in Crypto Assets Regulation (MiCA)

Issuance of EMTs

- Issuers of ARTs must be either credit institutions or e-money institutions.
- A white paper must also be published and authorized by the competent authority.
- Holders shall have a claim against the issuers of EMTs. Issuers of EMTs shall issue them at par value and on the receipt of funds. Upon request by a holder of an EMT, the issuer shall redeem it, at any time and at par value, by paying in funds, other than electronic money, the monetary value of the EMT held to the holder of the EMT.
- Issuers of EMTs and ARTs may not grant interest in relation to those tokens.

Markets in Crypto Assets Regulation (MiCA)

Crypto-asset service providers (CASPs)

- Crypto-asset services are:
  - custody and administration of crypto-assets on behalf of clients;
  - operation of a trading platform for crypto-assets;
  - exchange of crypto-assets for funds or for other crypto-assets;
  - execution of orders for crypto-assets on behalf of clients;
  - placing of crypto-assets;
  - reception and transmission of orders for crypto-assets on behalf of clients;
  - providing advice on crypto-assets;
  - providing portfolio management on crypto-assets;
  - providing transfer services for crypto-assets on behalf of clients;
- A person shall not provide crypto-asset services, within the EU, unless that person is:
  - a legal person or other undertaking that has been authorized as CASP (requirements in terms of capital, sound governance, internal control, conflict of interests, etc. are applicable); or
  - a credit institution, central securities depository, investment firm, market operator, electronic money institution, UCITS management company, or an alternative investment fund manager that is allowed to provide crypto-asset services (by submitting the relevant notification to its authority).
- CASPs must incorporate a company (or branch) in the EU.
- The effective management must be in the EU and at least one of the directors shall be resident in the EU. Non-EU CASPs can rely on the so-called exemption, i.e. if a client located in the EU initiates at its own exclusive initiative the provision of a crypto-asset service by a non-EU CASP.

Presenter - David Capps

DAVID CAPPS – partner at STEPHENSON HARWOOD (UK)

David is a partner at Stephenson Harwood who specializes in financial regulatory and banking matters including regulatory investigations and enforcement matters, internal investigations, financial regulatory compliance and advice and representation in relation to complex financial disputes.

His experience extends to investment banking product and trading disputes and IBD and research matters. He also has experience in dealing with matters involving alleged fraud, insider dealing and market abuse, complex jurisdictional disputes and injunction issues.

He also has extensive experience advising and representing clients in relation to financial regulatory enforcement matters and allied investigations, including interactions with various regulators. He is a recognized expert in relation to UK and EU financial services regulation. David is frequently engaged to carry out or advise upon internal (including whistle-blowing) investigations.

Presenter - Miguel Sanchez Monjo

MIGUEL SANCHEZ MONJO – partner at CUATRECASAS (Spain)

Miguel is a partner at Cuatracasas who specializes in fund formation of national and international open and closed-ended investment vehicles: UCITS, hedge funds, private equity, venture capital, direct lending, real estate, and master-feeder structures.

Miguel also advises on corporate transactions of a sectoral nature in which financial regulation plays an important role.

From 2009 to 2012, he was on secondment at Barclays Capital, the investment banking division of Barclays Bank PLC, advising on financial derivatives.

Miguel is a member of the Madrid Bar Association. He lectures at the *Universidad Carlos III de Madrid* (Master in Legal Consultancy for Businesses, Master in Regulated Sectors Law and Master for Admission to the Practice of Law) and at the Institute of Stock Exchange Studies. He speaks at conferences and seminars organized by financial sector associations, such as the Chartered Alternative Investment Analyst Association (CAIA) and contributes to the journal *Revista de Derecho del Mercado de Valores*.

Miguel is **Recommended** lawyer by Chambers FinTech, Legal 500, Leaders League and Best Lawyers in Banking & Finance and FinTech.

Presenter - Rolf H. Weber

of counsel at BRATSCHI LTD (Switzerland)

- Rolf H. Weber advises companies as well as private individuals in particular on international banking law, antitrust law, corporate law, IT- and Internet law, blockchain law (crypto assets) as well as media law. He is a professor at the University of Zurich, works as an arbitrator and is an expert for state authorities. Admitted to the Bar since 1978 and Admitted to the Swiss Bar since 1978.
- Professional background
  - Attorney-at-Law/Consultant at Bratschi Ltd., Zurich (since 1995)
  - Professor of civil, business and European law at the University of Zurich (1995-2016)
  - Professor (titular) at the University of Zurich (1992)
  - Private lecturer at the University of Zurich (1986)
  - Partner Wiederkehr Forster, Zurich (1985-1995)
  - Attorney Wiederkehr Forster, Zurich (1982-1984)
- Other activities
  - Ombudsman in financial services disputes of the Swiss Arbitration Centre
  - Member of the Board of Swiss Blockchain Federation
  - Expert of Federal Council for the new DLT-Act and to the topic of «data processing and data security»
  - Chairman of the Appeals Board of the SIX Swiss Exchange
  - Co-director of Blockchain Center at the University of Zurich
  - Co-director of Center for Information, Society, and Law at the University of Zurich (since 2015), before director of the Center for Information and Communication Law
  - Co-director of the University Research Priority Program Financial Market Regulation (since 2013)
  - Member of the Board at the European Institute of the University of Zurich
  - Author of a large number of publications (books, essays)

Presenter - Arina Shulga

Arina is a Partner at Nelson Mullins. She represents startups and emerging growth companies, often acting as their outside general counsel and building long-lasting relationships that span the life of a company. Her services in this area include, but are not limited to, entity formation, advice and counseling regarding operations in the United States, employment law and IP-related matters, structuring complex joint ventures and distribution agreements, and investment and exit opportunities. Further, Arina represents her clients when they are raising capital through SAFE, convertible note, Series Seed, Series A financings, and equity crowdfunding.

An important focus of Arina's work is representing fintech startups, including those companies that operate in the blockchain space (including NFT platforms, DAOs, gaming companies, and others). For her crypto clients, she advises on the regulatory aspects of operations, issuance of digital tokens, NFTs, creation of platforms, and other aspects of operations in the Web3 space. She also advises angel investors and venture capital funds when making investments into startups.

In addition, Arina represents emerging fund managers on fund formation and setting up management and GP company structures, whether they are in the venture capital, hedge fund, or real estate fund space, including special purpose investment vehicles and Delaware series LLCs.

Arina holds a J.D. degree from the University of Pennsylvania Carey Law School (summa cum laude) and a B.A. degree from Mount Holyoke (magna cum laude).

Moderator - Richard B. Levin

Richard is a partner at Nelson Mullins and is the chair of the FinTech and Regulation Practice and was one of the first lawyers to focus on the regulation of blockchain and digital assets. He is considered a thought leader in the FinTech space. Richard brings his experience as a senior legal and compliance officer on Wall Street and in London to bear in advising clients on corporate, FinTech, securities, and regulatory issues. A problem-solver by nature, he has been advising FinTech clients on legal and regulatory issues since the start of electronic trading in the late 1990s. His practice focuses on helping financial services and technology clients identify and address regulatory issues as they build their businesses. Richard's practice focuses on the representation of early stage and publicly traded companies in the FinTech space, including investment banks, broker-dealers, investment advisers, peer-to-peer lending platforms, digital currency trading platforms, alternative trading systems (ATSs), exchanges, and custodians. He represents these firms before the U.S. Securities and Exchange Commission (SEC), the U.S. Commodity Futures Trading Commission (CFTC), the Financial Industry Regulatory Authority (FINRA), the U.S. Department of the Treasury, Office of the Comptroller of the Currency (OCC), state regulators, and Congress. Richard has represented clients before regulators in Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Singapore, South Korea, and the United Kingdom. His current and past clients include leading national financial institutions, multinational financial services holding companies, leading firms in the FinTech space, and institutions engaging in global investment banking, investment management, securities, and other financial services with institutional clients.

Richard has been identified by Chambers and Partners as one of the leading lawyers in the Blockchain and Cryptocurrencies category since the inception of the category. He has been recognized by Chambers for his knowledge on regulatory matters, great relationships with regulators, for helping clients push the boundaries of the FinTech sector, and for his advice on matters such as broker-dealer licensing and alternative trading systems. Richard is routinely quoted by leading publications including Bloomberg, the New York Times, Reuters, and the Wall Street Journal and is a frequent speaker at conferences around the world on the regulation of FinTech, blockchain, and digital assets.

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