

The taming of the crypto Wild West: a look at the UK's alternative to MiCA

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It has been over two years since the UK's Cryptoassets Taskforce – which brought together the Financial Conduct Authority (**FCA**), the Bank of England (**BoE**) and the UK government (via HM Treasury (**Treasury**)) – put out its final report.¹ In it, the Taskforce confirmed² that crypto-assets³ merited no special treatment in the UK's regulatory landscape: they either fitted pre-existing types of regulated products – e-money, specified investments, financial instruments – or they did not. If they did, they would be treated as any other such product; if they did not, no dedicated regime existed to pull them into the regulatory fold, notwithstanding the Cryptoassets Taskforce's recognition of the need for a more tailored approach.⁴ Although UK-regulated firms would still need to comply with certain conduct rules in respect of their unregulated crypto-business (including systems and controls provisions in the FCA's Handbook, and the UK's Senior Managers and Certification Regime), the split between regulated and unregulated business followed familiar lines.

By contrast, other jurisdictions in Europe at the time were beginning to put in place their dedicated regimes, including the British Overseas Territory of Gibraltar. From January 1, 2018, firms carrying out 'DLT activities'⁵ by way of business in or from Gibraltar needed to be authorized by the Gibraltar Financial Services Commission as 'DLT Providers'. The regulations⁶ creating this authorization regime also set out nine

dedicated Regulatory Principles⁷ applying to 'DLT providers'.⁸ Further east, Malta was also enacting a package of laws, including its Virtual Financial Assets Act, aimed specifically at regulating crypto-assets and their public offering. Like the new Gibraltar framework, Malta's Virtual Financial Assets Act created a licensing regime in respect of activities conducted in or from within the country, catching, among others, virtual financial asset service (including wallet) providers; the Act also covered initial coin offerings.

Fast forward to January 2021, when the Treasury published a consultation and call for evidence on the UK regulatory approach to crypto-assets and stablecoins⁹. There, the UK government proposed to bring many stable tokens into the UK regulatory perimeter under a new regime. Comments on the consultation were due by March 21, 2021.

This Client Alert assesses the UK's new proposed approach to crypto-asset regulation, its impact on firms, and draws parallels to the EU's proposed Markets in Crypto-Assets Regulation (**MiCA**).¹⁰

AML, 'cryptoasset exchange providers' and 'custodian wallet providers' in the UK

The UK left the EU on January 31, 2020, and a transition period which maintained the status quo followed, lasting until the end of 2020. Well before this, the UK had implemented the Money Laundering and Terrorist Financing (Amendment) Regulations 2019, amending

1 Cryptoassets Taskforce: final report (October 2018). Available [here](#).

2 Table 2.A: Cryptoassets and the current regulatory perimeter (p.17).

3 The Cryptoassets Taskforce recognized the fluidity of the term, broadly defining "cryptoasset" as a cryptographically secured digital representation of value or contractual rights that uses some type of distributed ledger technology and can be transferred, stored or traded electronically (para. 2.10). The definition has since splintered, leading to slightly different definitions being used across various new rules and legislative initiatives – something crypto-businesses and their advisers alike would do well to be mindful of. Businesses in the UK should note, in particular, the definition of crypto-asset used by the Treasury in its consultation on the new regulatory approach to crypto-assets and stablecoins (p.4) does not – unlike the MLRs (see below) – specify that distributed ledger technology and cryptography are necessary features.

4 E.g. the potential prohibition on the sale of crypto-derivatives to retail consumers – see below – was already being contemplated (Table 5.A: Actions to be taken by the authorities, p.48).

5 I.e. the use of distributed ledger technology (**DLT**) for storing or transmitting value belonging to others.

6 Available [here](#).

7 These broadly mirror the FCA's Principles for Businesses, and require, for example, that "DLT Provider[s] must maintain adequate financial and non-financial resources" (third Regulatory Principle).

8 Gibraltar is currently proposing to introduce a tenth Regulatory Principle addressing market standards for exchanges operating in the digital asset space. The working group tasked with delivering the new principle aims to adapt and apply standards from traditional marketplaces to marketplaces in the digital asset space operating on a peer-to-peer basis (details available [here](#)).

9 Available [here](#).

10 Details of which are available [here](#).



the UK's Money Laundering Regulations 2017 (**MLRs**)¹¹ to transpose the EU's Fifth Money Laundering Directive¹². Amendments to the MLRs, which came into force on January 10, 2020, brought into the UK's statute books – and into the FCA's purview – two types of crypto-businesses: 'cryptoasset exchange providers' (which, in short, exchange or facilitate the exchange of crypto-assets) and 'custodian wallet providers' (which safeguard crypto-assets and cryptographic keys).¹³

This means requirements in the MLRs, including on customer due diligence measures, began to apply to crypto-businesses dealing in unregulated products, which had managed to avoid the need to become authorized further to the Financial Services and Markets Act 2000 (the cornerstone of UK financial services regulation). Our offices continue to assist

some of the leading crypto-businesses in the UK manage this new, steep learning curve.

A trend emerging with the updated MLRs was the differentiated – ultimately more onerous – treatment of crypto-businesses in law. For example, the MLRs give the FCA three months to make an initial decision on a completed application for registration of a crypto-business – as opposed to only 45 days otherwise. Another important trend displayed by the amended MLRs was the putting in place of additional protections for would-be customers, reflecting the regulators' view of crypto-asset related investments as high risk.¹⁴ Under the MLRs, crypto-businesses are required to flag in advance¹⁵ where their crypto-asset activity does not fall within the scope of the UK's Financial Ombudsman Services or Financial Services Compensation Scheme.

¹¹ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692)

¹² Fifth Money Laundering Directive ((EU) 2018/843

¹³ Summarized [here](#)

¹⁴ Available [here](#).

¹⁵ Reg. 60A.

No crypto-derivatives for retail consumers in the UK

As the price of Bitcoin continued to climb to approach its (then) all-time high of two years prior, a regulatory crackdown of sorts on crypto-business was also taking shape.

Further to a July 2019 consultation paper, the FCA confirmed its ban of the marketing, distribution and sale of derivatives and exchange-traded notes referencing certain types of crypto-assets to retail consumers.¹⁶ The FCA's final policy statement justified this measure by stressing that unregulated crypto-assets "have no intrinsic value" and that "it is impossible for retail consumers reliably to value crypto-derivatives".¹⁷ The ban came into effect as proposed on January 6 of this year.

Regulation of crypto-promotions in the UK

The FCA was far from the only Cryptoassets Taskforce member to take aim at crypto-businesses in 2020. On July 20 the Treasury put out a consultation on its proposal to bring the promotion of certain types of crypto-assets within the scope of UK financial promotions regulation.¹⁸ The proposal would catch investment activities in respect of many crypto-assets which are not currently regulated products. Crucially for EU crypto-businesses targeting UK clients, the proposal would bite them even if marketing were carried out from outside the UK, as long as it were capable of having an effect in the UK. The consultation has closed and the Treasury is expected to publish its findings soon.¹⁹

Stablecoins under fire in the UK

Crypto-assets have come under fire by the Cryptoassets Taskforce members in varying measure. Stablecoins,²⁰ in particular, have attracted the scrutiny of the BoE and the Treasury. Because stablecoins are – owing to their lower volatility – more suitable as a means of exchange and store of value than other crypto-assets,²¹ they have become a more credible alternative (and serious competitor) to traditional, regulated forms of money. Yet despite their rise in use, many stablecoins are currently not subject to the same safeguards as their more established alternatives.

The BoE's discussion paper *Central Bank Digital Currency: Opportunities, challenges and design* (March 2020)²² envisages its proposed central bank digital currency (**CBDC**) as a counter to the rise of stablecoins:

"Stablecoins will only be widely adopted if they provide functionality and efficiency benefits over existing payment systems. But given the risks they could pose, it may be worth asking if CBDC can be designed to better meet those needs. CBDC may be able to provide better payment services, backed by riskfree central bank money, and reduce the demand for new privately issued money-like instruments."²³

¹⁶ Para. 1.1 (see [here](#)). Para. 1.1 also explains 'retail consumers' as 'retail clients'.

¹⁷ Para. 2.8.

¹⁸ Under the UK's restriction on financial promotions, a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless that person is authorized, or the content of the communication is approved by an authorized person. A separate Treasury consultation published on the same day (*Regulatory Framework for Approval of Financial Promotions*) proposed to establish a regulatory 'gateway' (involving obtaining the consent of the FCA), which a firm must pass through before it is able to approve the financial promotions of unauthorized firms. Note that if unauthorized crypto-businesses must have their financial promotions approved by an authorized person, this second Treasury proposal would, if adopted, raise an additional difficulty for any willing firms. (See [here](#).)

¹⁹ See p.40 timeline, stablecoins consultation.

²⁰ Put shortly and in line with the BoE's discussion paper, 'stablecoins' are asset-backed crypto-assets (Available [here](#)).

²¹ Para. 3.5, stablecoins consultation, Treasury.

²² Available [here](#).

²³ P.17, BoE discussion paper.

While the BoE continues to consider its next steps in respect of CBDC, the Treasury put out a consultation²⁴ and call for evidence on the UK's regulatory approach to crypto-assets and stablecoins (January 2021). In it, the Treasury proposes the introduction of a dedicated regulatory regime for stablecoins that could reliably be used for retail or wholesale transactions (i.e. 'regulated stable tokens' for the purposes of this Client Alert). The Treasury notes the UK's pre-existing strong position but also recognizes the potential of competing regulatory regimes, such as the EU's MiCA (see below), and advises swift action. The consultation also highlights challenges relating to the regulation of stablecoins and other crypto-assets. These include, aside from financial regulatory issues posed by decentralized finance and financial crime, issues related to location, data protection and tax transparency.

The new regulated category of stable tokens would comprise, specifically, tokens that stabilize their value by referencing one or more assets, such as fiat currency or a commodity. The proposal advances an FCA authorization regime based on existing payments regulation for single fiat-linked stable tokens. For asset-linked stable tokens, the FCA authorization regime would include specific requirements on the relevant backing asset(s). Thus the new regime would create new authorization and systemic thresholds requirements and would affect issuers of, and service providers in respect of, those 'regulated stable tokens'. The Treasury also suggests²⁵ that stablecoin issuers and wallet providers would need to comply with certain financial crime requirements – including registration requirements under a new iteration of the MLRs. Stablecoins that are already regulated as specified investments would continue to be so under the general regulatory regimes.



A new EU regime for crypto-assets

On September 24, 2020, as part of its "Digital Finance Strategy Package" (and further to a raft of consultations dating back to December 2019)²⁶, the European Commission adopted three proposals for regulations, namely:

- on markets in crypto-assets²⁷ (i.e. MiCA);
- on a pilot regime for market infrastructures based on distributed ledger technology;²⁸ and
- on digital operational resilience for the financial sector.

The above regulations, as supplemented by an EU directive introducing targeted amendments to existing financial services legislation, are known collectively as the MiCA Regime.²⁹ You can learn more about the MiCA Regime in our November 2020 Background Briefing on the topic.³⁰

On the whole, the new regime draws a line between crypto-assets which fall under the existing financial services regulatory regime, as amended, and those which fall under MiCA's new, dedicated regulatory regime, to replace national frameworks where they exist.³¹

²⁴ Available [here](#).

²⁵ P. 29 (in light of para. 3.20, and also per relevant para. 3.23 bullet point ("financial crime requirements")), stablecoins consultation.

²⁶ MiCA, p. 6.

²⁷ *Proposal for a regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937.*

²⁸ Available [here](#).

²⁹ Background Briefing, p.4.

³⁰ Available [here](#).

³¹ MiCA, p.10.

Differences and similarities between EU and UK approaches

An important difference between the MiCA Regime and UK changes to the regulation of crypto-assets is the treatment of crypto-assets that are neither regulated products under existing financial services legislation nor stablecoins. In the UK, such unregulated crypto-assets are not caught by the Treasury's January 2021 proposal, though relevant crypto-businesses will still need to comply with the MLRs and/or with the UK's financial promotions regime (assuming the Treasury's proposed changes go ahead).

By contrast, MiCA will impose requirements on issuers of even unregulated crypto-assets, which are similar – if lighter – than those under the EU's Prospectus Regulation.³² They include the need to draw up a 'crypto-asset white paper'³³ and to provide that white paper to the competent authority;³⁴ note the competent authority will, for example, have the power to require the inclusion of additional information in the document.³⁵ As to issuers of 'asset-referenced tokens' (i.e. stablecoins)³⁶, their white paper will require approval by the competent authority.³⁷ No such requirements are envisioned by the UK proposals discussed above and this may be a competitive advantage for the UK.

MiCA will also impose authorization (and other, including prudential) requirements,³⁸ on issuers and providers of services in connection with, crypto-assets – including those crypto-assets that are not stablecoins. The Treasury's 2021 proposal imposes similar requirements on an equally wide range of service providers – but only where those services are provided in respect of stablecoins, rather than other crypto-assets.³⁹

That said, there are many similarities between the EU and UK's proposed approaches. For example, the approval by an authorized firm of a crypto-promotion in the UK will be dependent on that promotion complying with certain financial promotion rules,⁴⁰ including being fair, clear and not misleading, and being clearly identifiable as a financial promotion.⁴¹ White paper requirements aside, MiCA's treatment of marketing communications covers similar ground.⁴²

More generally, both the UK proposals and the MiCA Regime address the potential and dangers of the expected growth in use of stablecoins by imposing requirements on their issuance and transaction⁴³ that go beyond those imposed on other crypto-assets, particularly where those stablecoins are classified as significant⁴⁴ (or, to use the Treasury's lingo, 'systemic'⁴⁵). Similarly to the BoE, the European Central Bank also takes aim at stablecoins in its October 2020 "*Report on a digital euro*".⁴⁶

³² Regulation (EU) 2017/1129.

³³ MiCA, Arts. 4 and 5.

³⁴ In the case of MiCA, this involves a notification of the white paper (Art. 7(2)) rather than the pre-approval of a full-blown prospectus (cf. Art.20(1), Prospectus Regulation).

³⁵ MiCA, Art. 7.

³⁶ MiCA, p. 10.

³⁷ Art. 16(2)(i) MiCA; also, p. 11 MiCA.

³⁸ Title V, via p. 12 MiCA.

³⁹ Stablecoins Consultation, pp. 19-20.

⁴⁰ COBS 4.2.1 R, explained [here](#).

⁴¹ Available [here](#).

⁴² Art. 6, MiCA.

⁴³ Transaction of rights in: Art. 35 via p. 11 MiCA.

⁴⁴ Art. 41 MiCA.

⁴⁵ Stablecoins consultation 3.24

⁴⁶ "All forms of "stablecoins" aim at keeping their value stable over time, but this can only be guaranteed by a digital euro.", p. 51, available [here](#).

Outlook and next steps

MiCA itself may be implemented as early as mid-2021 to early 2022, and aims to be fully operational by 2024.⁴⁷ As to the consultation on crypto-promotions, the Treasury expects to publish its response by the beginning of April.⁴⁸ A response to the consultation on the new regulatory approach to crypto-assets and stablecoins should also appear later in 2021.⁴⁹

One should keep in mind that devising an appropriate regime for stablecoins is not a straightforward task and requires the coming together of various relevant expertise. Will the UK develop a more innovation-driven

bespoke regime to accommodate growing trends, as the Treasury's consultation advises? Is MiCA built on the appropriate foundation of technology, economics and data security? Either way, the impact of the MiCA Regime and the UK proposals cannot be overstated. They represent a 'coming of age' for the industry and will require most players to professionalize and bureaucratize – fast, with a particular onus on stablecoin issuers and providers. That in its own right may present a number of opportunities for crypto-asset service providers and investors. On both sides of the English Channel (and Irish Sea!) the age of the crypto-Wild West is drawing to a close...

Our Eurozone Hub
and UK Banking and Finance
practice work hand-in-hand to provide seamless
advisory and M&A support to crypto-businesses
with an international reach – as well as more traditional
financial firms with an exposure to crypto-asset regulation.

If you would like to discuss any of the items mentioned
above or, more generally, are looking for support in respect
of the post-Brexit landscape and how changes in the EU
and UK may affect your business, please contact any
of our key contacts or the wider team from our

Eurozone Hub.

⁴⁷ Background Briefing, p.4.

⁴⁸ P.40, stablecoins consultation.

⁴⁹ P.40, stablecoins consultation, although this is not made explicit.

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