

A New Sheriff in Town? UK MPs Call for Regulation of “Wild West” Crypto-assets

The House of Commons Treasury Committee has published its recommendations for the regulation of crypto-assets in the UK.

Key Points:

- The House of Commons Treasury Committee has proposed that the UK government should introduce a new category of regulated activity to the UK financial regulatory regime, relating explicitly to crypto-assets.
- If implemented, the proposal would provide welcome legal certainty as to the application of the UK financial regulatory perimeter to crypto-assets and may help the crypto-asset market mature, potentially paving the way for institutional investment in this nascent but rapidly developing sector.
- However, a number of interpretative questions are likely to arise in relation to the application of existing UK financial regulatory concepts to crypto-assets more generally.
- Whether the UK government will implement the proposal and the timing for any such implementation is not yet clear, but crypto-asset market participants and stakeholders should monitor developments and, if appropriate, factor in the potential need to obtain authorisation from UK regulators in due course.
- A discussion paper from the UK Financial Conduct Authority (FCA) on crypto-assets is also anticipated later this year.

As part of its ongoing *Digital Currencies* inquiry, the House of Commons Treasury Committee (the Committee) has published a report on crypto-assets¹ (the Report), calling on the UK government to introduce regulation for crypto-assets. In the Report, the Committee argues that the current “wild west” situation in relation to crypto-assets should not be allowed to continue. The Committee believes that regulation is needed primarily to help protect consumers, but may also help the crypto-asset market mature and, ultimately, lead to the UK becoming a global centre for crypto-asset activity. The Committee proposes that regulation should be achieved by extending the scope of existing UK financial regulation to crypto-assets through the introduction of a new regulated activity relating explicitly to crypto-assets.

The implications of the proposal are potentially significant. The proposal signals the potential for crypto-assets that are currently unregulated in the UK (including, for example, cryptocurrencies — such as

Bitcoin and Ether — and so-called utility tokens issued in initial coin offerings (ICOs)) to be brought within the regulatory perimeter. It also represents a stark contrast with the approach taken by the UK financial regulators to date, which has been to regulate crypto-assets only if the rights and obligations attaching to those assets bring them within the definition of an existing regulated investment.

Analysis of the Committee's Proposal

A New Regulated Activity

The Committee proposes that crypto-asset activities (which, at this stage, it does not define) should be specified as a new regulated activity through the Financial Services and Markets Act 2000 (Regulated Activities Order) 2001 (the RAO). This would require any person carrying out those activities in the UK to become authorised by the relevant regulator (which, in the case of crypto-assets, appears likely to be the FCA), unless they are able to rely on an exemption from UK authorisation requirements. It would also allow the FCA to apply its existing regulatory rules and guidance to any person carrying out activities in relation to crypto-assets, potentially subjecting them to various ongoing organisational, regulatory capital, conduct of business, anti-money laundering, market conduct, and other requirements.

Currently, only crypto-assets that, because of the rights and obligations attaching to them, fall within the definition of a regulated investment under the existing regulatory regime are regulated in the UK.

Interpretative Issues

From the Report, it is not clear how far-reaching the Committee's proposal is intended to be. As a minimum, the Committee states that the "issuance of ICOs" and the "provision of crypto exchange services" should be activities specified in the RAO.² However, beyond this the Committee offers no specificity as to how its proposal might be implemented. Indeed, in arriving at its recommendation to introduce a new regulated activity covering crypto-asset activities, the Committee considered and rejected the alternative approach of proposing the introduction of a new bespoke regulatory framework for crypto-assets, on the basis that such a framework would take considerably more time to design and implement.

This gives rise to a number of interpretative issues, including:

What Will Be Regulated?

- It is not clear which activities in relation to crypto-assets would be regulated. Introduction of a new regulated activity for crypto-asset activities could be limited to those examples stated by the Committee in the Report, or could extend to activities such as advising on investment in crypto-assets, dealing in or arranging deals in crypto-assets, performing investment management activities in relation to crypto-assets, or providing custody services in relation to crypto-assets.
- The potential impact on crypto-assets that are currently regulated in the UK, such as security tokens or certain kinds of "stablecoins", is unclear. For example, would a stablecoin pegged to a fiat currency and structured in a way that means it would currently be regulated as electronic money in the UK remain subject to regulation under the electronic money regime? Or would this stablecoin become subject to regulation as part of a new regulated activity included in the RAO?

Who Will Be Regulated?

- It is not clear which crypto-asset market participants would be required to become authorised to perform crypto-asset activities. For example, would issuers of utility tokens be required to obtain authorisation, or would a specific exemption be provided for their benefit (similar to those exemptions which exist currently for companies when issuing their own securities)? It is also unclear whether

firms which are already authorised would require additional regulatory permissions in order to carry on crypto-asset activities, or whether new requirements would focus on unregulated crypto-asset market participants.

Potential Consequential Regulatory Obligations

- It is likely that many aspects of the FCA's existing regulatory rules and guidance, which may apply wholesale to those who become authorised to carry on crypto-asset activities, will require careful consideration and interpretation in order to determine their precise application to crypto-asset activities. For example, will investor protection requirements derived from MiFID, such as best execution, product governance, suitability and appropriateness, and restrictions on inducements, apply to crypto-asset activities? Will rules relating to client money and assets apply in relation to crypto-asset activities?
- It is not clear whether and how the existing rules on marketing of financial promotions in the UK would apply in relation to crypto-assets.
- It is not clear whether crypto-assets would be treated as a form of transferable security under UK law. If so, this could result in issuances of crypto-assets falling within the UK prospectus regime, as well as other market structure requirements, such as the MiFID requirement to trade certain instruments on regulated EU trading venues, and the requirement under the EU Central Securities Depositories Regulation for transferable securities to be dematerialised in a central securities depository.
- Would the proposal have the effect of going further than the EU Fifth Money Laundering Directive, which brings cryptocurrency exchanges and custody wallet providers within the scope of the EU anti-money laundering regime?

Context of the Report and Potential Impacts

Following publication of the Report, the UK government must now consider the Committee's proposal and decide whether it wishes to take the proposal forward. Notwithstanding the kinds of interpretative questions raised above, extension of the UK financial regulatory regime to all crypto-assets would likely provide welcome legal certainty and comfort for crypto-market participants and stakeholders. It may also provide the impetus required for financial institutions and institutional investors to participate in the crypto-asset market more widely. Authorisation of crypto-asset market participants may lead to greater confidence for financial institutions when dealing with them, generating greater investment in or facilitation of crypto-asset activity (for example, it may become easier for crypto-asset market participants to open bank accounts with UK banks, or for UK banks to make markets in crypto-assets). It may also facilitate the creation of crypto-asset products which depend on the liquidity that can be provided through the involvement of institutional investors in crypto-asset markets (for example, crypto-asset exchange-traded funds).

Extending the UK financial regulatory perimeter to crypto-assets in order to create a clear legal framework applying to all crypto-asset activity also has the potential to be the first example of UK lawmakers legislating in relation to financial services independent of the EU following Brexit. The EU is currently considering its own separate proposals for regulating ICOs as part of a proposed crowdfunding regulation.

The Report comes ahead of an FCA discussion paper on crypto-assets, which is currently expected in October 2018. This paper will be a product of the FCA's participation in a tripartite "Cryptoassets

Taskforce” announced by the UK government in March 2018, involving the Bank of England, HM Treasury, and the FCA.

Next Steps and Timing

Crypto-asset market participants and stakeholders should monitor developments and, in particular, any response to the proposal from the FCA in its forthcoming discussion paper. The FCA may provide further information on the timeframe or content of the possible changes, however UK legislators will be hard-pressed to implement any such changes before the second half of 2019.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

David Berman

david.berman@lw.com
+44.20.7710.3080
London

Anne Mainwaring

anne.mainwaring@lw.com
+44.20.7710.1018
London

Brett Carr

brett.carr@lw.com
+44.020.7710.4695
London

Sam Maxson

sam.maxson@lw.com
+44.20.7710.1823
London

Charlotte Collins

charlotte.collins@lw.com
+44.20.7710.1804
London

Ella McGinn

ella.mcginn@lw.com
+44.20.7710.4649
London

Stuart Davis

stuart.davis@lw.com
+44.20.7710.1821
London

Frida Montenius

frida.montenius@lw.com
+44.20.7710.1161
London

Nicola Higgs

nicola.higgs@lw.com
+44.20.7710.1154
London

Rob Moulton

rob.moulton@lw.com
+44.20.7710.4523
London

Gabriel Lakeman

gabriel.lakeman@lw.com
+44.020.7710.4645
London

Jonathan Ritson-Candler

jonathan.ritson-candler@lw.com
+44.20.7710.1815
London

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Endnotes

- ¹ Treasury Committee, *Crypto-assets*, 19 September 2018, HC 910 2017-19 available at <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/910/910.pdf>
- ² Treasury Committee, *Crypto-assets*, p. 36.