KEY POINTS

- Whilst the EU has opted for a single piece of legislation that will create a comprehensive, new framework for regulating the cryptoasset services sector, the UK will extend existing frameworks (primarily, the Financial Services and Markets Act 2000) to accommodate cryptoassets.
- Certain differences between the two regimes have potentially significant ramifications – for instance in the EU's framework, the distinction between different categories of assets plays a more important role.
- In terms of cryptoasset services, however, Markets in Cryptoassets (MiCAR) and the regime envisaged by HM Treasury should achieve broadly similar outcomes.
- However, much remains to be seen from the eventual details.

Feature

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A MiCAR for the UK? Or something else altogether?

This article compares key aspects of the EU's draft regulation on Markets in Cryptoassets (MiCAR) and the UK's approach outlined in HM Treasury's recent consultation, drawing out key similarities and differences and their implications.

The EU's draft regulation on Markets in Cryptoassets (MiCAR) is the current lodestar for cryptoasset regulatory frameworks among major jurisdictions. However, the UK government has begun to chart its own course.

The Financial Services and Markets Bill 2022-23 (FSMB)[1] proposes, among other things, to regulate fiat-backed stablecoins. On 1 February 2023, HM Treasury (HMT) published a consultation and call for evidence regarding the future financial services regulatory regime for a wider range of cryptoasset-related activities (the Consultation).[2]

In many ways, the EU's and the UK's aims in regulating cryptoasset-related services are similar. At the same time, however, there are certain differences in approach.

Some of these, while fundamental and potentially having practical implications in the short term, are not necessarily likely to result in divergent outcomes in the long term. For example, whilst the EU has opted for a single piece of legislation that will create a comprehensive, new framework for regulating the cryptoasset services sector, the UK will extend existing frameworks (primarily, the Financial Services and Markets Act 2000 (FSMA)) to accommodate cryptoassets. It will also do so in stages:

- **Phase 1**: aimed at regulating services related to fiat-backed stablecoins.
- **Phase 2**: the focus of the Consultation – aimed at high-priority activities relating to cryptoassets other than stablecoins, and later phases for lower-priority activities.

Certain other differences, on the other hand, have potentially significant ramifications.

All that said, with international policy making, including at Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) levels, converging around certain key principles for regulating the cryptoasset sectors, the regulatory frameworks were always unlikely to end up oceans apart.

This article compares key aspects of MiCAR and the UK's approach, drawing out key similarities and differences and their implications. However, much remains to be seen from the details of, in particular, the UK's eventual framework.

BUSINESS SCOPE

Definition of "cryptoasset"

Both the Consultation and MiCAR envisage very broad definitions of "cryptoassets" as starting points.

It should be noted that there are some subtle points of distinction between the respective definitions in MiCAR and in the FMSB. For example, the MiCAR definition presupposes/requires that the relevant asset use(s) distributed ledger technology "or similar technology"; by contrast, the definition in the FSMB does not have that qualification.

That said, MiCAR makes clear that "'[c]rypto-assets' and 'distributed ledger technology' should … be defined as widely as possible to capture all types of crypto-assets which currently fall outside the scope of Union legislation on financial services". It is therefore not clear that the subtle differences in language will have significant practical effect.

Categories of cryptoassets

One crucial difference between the UK's and EU's approach, however, is the role that distinctions between different types of cryptoassets play.

The UK's staged approach means that, practically, some sub-categories of the very broad cryptoasset definition exist. For example, cryptoassets which have characteristics similar to shares or other securities ("security tokens") qualify as "specified investments" under FSMA and are already regulated. The FSMB contains provisions that would bring providers of certain services relating to "digital settlement assets" (initially, this would cover fiat-backed stablecoins) within the regulatory perimeter.

Leaving aside these two categories, however, HMT's intention seems to be that regulatory requirements should depend on the specific *activity*, not the type of *asset*. As such, there is little systematic distinction between different types of cryptoassets.

Indeed, the Consultation clarifies this point expressly in relation to a number of types of assets, such as asset-referenced

tokens. For example, whilst commodity-linked tokens may possess characteristics of existing specified investments (in which case they should be regulated in the same way as such investments), where this is not the case, activities relating to such tokens are considered "adequately catered for through the broader cryptoasset regime".

The same would apply to crypto-backed tokens (the value of which is tied to other cryptoassets) and algorithmic stablecoins (which aim to maintain a stable price through an algorithm). On the other hand, HMT distinguishes tokenised deposits (unsecured debt claims of banks issued via blockchain) from fiat-backed stablecoins and, implicitly, stablecoins generally.

Despite the fact that all these categories of cryptoassets are designed with the aim of achieving some stability in value, HMT does not consider that crypto-backed and algorithmic tokens should be given any specific regulatory treatment as they are subject to similar risks as unbacked cryptoassets, whereas tokenised deposits seem likely to be regulated as traditional bank deposits.

As a consequence of HMT's approach, even non-fungible tokens (NFTs) or utility tokens (cryptoassets which provide digital access to a specific service or application, such as digital advertising or digital file storage) would fall within the regulatory perimeter if they were used in a way that amounts to a specified activity.

In the EU's framework, the distinction between different categories of assets plays a more important role.

A number of categories of cryptoassets are excluded from the scope of MiCAR on the basis that they are regulated under different frameworks including MiFID financial instruments and deposits.

In respect of those cryptoassets that would be within the scope of MiCAR, the proposal contains specific definitions for certain sub-categories of cryptoassets which will be subject to different levels of regulatory control. The broad categories are:

- e-money tokens, ie single currency fiat-backed stablecoins;
- asset-referenced tokens (other stablecoins); and
- other cryptoassets including utility tokens.

MiCAR does not apply to cryptoassets that are unique and not fungible with other cryptoassets, ie NFTs.

Stablecoins will be most heavily regulated under MiCAR. The text explains that this is due to the possibility of them being "widely adopted by users to transfer value or as a means of payments and thus pose increased risks in terms of consumer protection and market integrity compared to other crypto-assets".

Scope of regulated activities

There are some differences related to activity scope between the two regimes.

Examples of services that would be regulated under MiCAR but may not be under the UK's regime include the provision of advice on cryptoassets or portfolio management services in relation to cryptoassets. Under MiCAR such service providers will, among other things, be required to assess the compatibility of cryptoassets with client needs (in principle, regardless of the client type). By contrast, HMT's approach is based on the risk of harm to *retail* clients (it seems little evidence of such services being offered other than to institutional and high-net-worth individuals).

At the same time, an activity that HMT proposes to bring within the UK's regulatory perimeter as part of its Phase 2, but which would not be regulated under MiCAR, is operating a cryptoasset lending platform. Once more, HMT's approach is risk-based: it cites the case of the failed platform, Celsius, as highlighting the challenges and risks associated with cryptoasset lending. Authorised operators would therefore be subject to a number of rules, including prudential, consumer protection, governance and operational resilience requirements. MiCAR defers the issue to a post-implementation review, by the European Commission, of the necessity and feasibility of regulating crypto-lending and borrowing.

TERRITORIAL SCOPE

One similarity between the regimes is that they both have the potential to apply to firms established outside the respective jurisdictions. This is somewhat surprising given the UK's demonstrably more territorial approach to regulating traditional financial services.

Under MiCAR, the requirements outlined above generally apply where services are provided "in the Union". The regulation is very clear that, subject to a reverse solicitation exception, this also covers services provided by entities established in third countries. The exception applies where a third-country firm provides cryptoasset services at the request, or initiative, of a person established in the EU, in which case the cryptoasset services should not be deemed as provided in the EU. MiCAR makes it clear, however, that the exception does not apply where a third-country firm solicits clients, or promotes or advertises cryptoasset services or activities, in the EU.

The UK's proposed framework would regulate activities provided "in or to" the UK. This would capture activities provided:

- by UK firms to persons based in the UK or overseas; and
- by overseas firms to persons in the UK.

In this regard, HMT has noted that the requirement for a person to be FSMA-authorised currently applies only to activities that are carried out "in the United Kingdom". However, HMT observed that cryptoasset activities are provided and used digitally, and are, therefore, frequently not confined to a specific jurisdiction, since consumers can easily access cryptoasset products and services provided by overseas companies. It therefore sees this broad territorial scope as necessary to ensure adequate consumer protection and to avoid a situation where firms offering services to UK customers could move offshore and thereby evade UK regulations, which would create an unlevel playing field for UK based firms.

Like under MiCAR, HMT envisages that this aspect of the regulatory scope would be subject to a reverse solicitation exception. Tellingly, HMT makes no mention of possibly applying the UK's famously liberal "overseas persons exclusion".

The fact that both the UK and the EU regimes are designed to have extraterritorial

effect may result in firms' or issuers' having to comply with both regimes and/or market fragmentation. Seeking to reduce those risks, HMT intends to pursue equivalence type arrangements to allow firms authorised in third countries with equivalent standards to provide services in the UK without needing a UK presence.

MiCAR contains some limited provisions relating to co-operation with third countries but no equivalence framework. The Commission is required to prepare a report containing an assessment of whether an equivalence regime should be introduced. However, the report would not be due until 36 months after entry into force of MiCAR, and any legislative amendment would follow even later.

Location policy

Under MiCAR, issuers of e-money and asset-referenced tokens generally would be required to have their registered office in the EU, subject to certain exceptions. Issuance of other MiCAR regulated cryptoassets are not subject to this requirement. Cryptoasset services should also only be provided by legal entities that have a registered office in a member state and that have been authorised as a cryptoasset service provider by the national competent authority.

With regard to the UK, whether firms within the scope of the regulatory perimeter would be required to have a physical presence in the UK in order to obtain authorisation would be for the Financial Conduct Authority (FCA) to determine. HMT expects the FCA's determination to be informed by its existing framework for international firms. Notably, HMT considers that firms operating cryptoasset trading venues play a critical role in the cryptoasset value chain and, on that basis, would expect such service providers likely to require subsidiarisation in the UK.

REGULATORY OBLIGATIONS

Issuance of cryptoassets (other than stablecoins)

Under MiCAR, a number of obligations apply to the issuance of cryptoassets (that are not asset-referenced or e-money tokens[3]), subject to exceptions. These obligations include publication of a "white paper" and certain ongoing obligations.

The concept of the "white paper" is derived from the EU's prospectus regime. MiCAR sets out a number of detailed prescriptions regarding the contents of white papers. For instance, a white paper would need to contain information on the issuer and the main project participants, the issuer's project, the offer characteristics, the rights/obligations attached to the cryptoassets, the technology underpinning the cryptoassets, the risks relating to the issuer, the assets, the offer and the project implementation, and certain specified disclosure items. The white paper does not need to be approved before publication, but competent authorities may require additional information to be included.

There are certain circumstances where the white paper requirements do not apply. These include, for example, where cryptoassets are offered for free; where they are automatically created through mining as a reward; where they are non-fungible; where they are offered to fewer than 150 persons; where, over a period of 12 months, the total consideration of an offer to the public of cryptoassets in the EU does not exceed €1,000,000; or where the offer is made only to qualified investors.

The ongoing obligations of issuers would include certain conduct of business requirements, such as acting in the clients' best interests, acting honestly, fairly and professionally, communicating in a fair, clear and not misleading manner, and certain system and cybersecurity requirements.

In the UK, HMT proposes an issuance and disclosures regime for cryptoassets grounded in the intended reform of the UK prospectus regime, tailored to the specific characteristics and risks of cryptoasset issuance.

Under the intended UK prospectus regime reforms there will be a general prohibition on public offers of securities, subject to exemptions which include where the securities are admitted to trading on a UK regulated market or on multilateral trading facilities (MTFs) operating primary markets, or are offered via a "public offer platform" (a new bespoke permission for platforms facilitating public offers of unlisted securities, such as crowdfunding platforms). In addition, certain exemptions are intended to be available according to the type or scope of public offer, including offers below a *de minimis* monetary threshold, offers made only to "qualified investors" and offers made to fewer than 150 persons.

For admission of cryptoassets to a UK cryptoasset trading venue, HMT proposes to adapt the MTF model from the prospectus regime reform. The FCA would include principles in their rule book for admission and disclosure requirements that cryptoasset trading venues would then be responsible for administering. In other words, we should not see detailed requirements in either primary legislation or statutory instruments. Instead, cryptoasset trading venues would be responsible for writing more detailed content requirements for admission and disclosure documents as well as performing due diligence on the entity admitting the cryptoasset.

Trading venues would also be expected to have in place rules governing the accuracy and fairness of marketing materials and advertisements. Where marketing materials or advertisements are available to retail investors, they will need to comply with the financial promotion regime, subject to certain exceptions.

The FCA will also consider whether ongoing disclosures should be required subsequent to cryptoassets being admitted to a trading venue in order to ensure a minimum standard of information is available to investors.

Where there is no issuer (eg Bitcoin), both regimes require that the trading venue would effectively be required to take on responsibilities of the issuer if they wish to admit the asset to trading.

Cryptoasset services

MiCAR and the regime envisaged by HMT also lay down requirements for a number of other cryptoasset investment services and activities, such as custodial services, the

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operation of a cryptoasset trading platform, dealing in cryptoassets, arranging deals in cryptoassets and making arrangements with a view to transactions in cryptoassets (MiCAR correspondents include exchange services, execution or reception and transmission of orders and placing).

In order to obtain authorisation under MiCAR, applicant service providers will need to provide wide-ranging information to the competent authority. Once authorised, cryptoasset service providers will be subject to significant ongoing obligations. These include general conduct of business requirements, prudential requirements, organisational requirements, requirements relating to safekeeping of clients' cryptoassets and funds, requirements relating to conflicts of interest, and requirements relating to operational risk management in connection with outsourcing arrangements. Further, there are additional requirements applicable to specific cryptoasset services.

The HMT proposals should achieve broadly similar outcomes.

For the activities of dealing in cryptoassets, arranging (bringing about) deals in cryptoassets, and making arrangements with a view to transactions in cryptoassets, HMT proposes to base the regime on requirements applicable to analogous regulated activities under FSMA. These would subject such activities to an authorisation requirement, as well as to regulatory rules relating to consumer protection and governance, data reporting, prudential management, operational resilience, and certain specific rules relating to resolution and insolvency.

In respect of safeguarding client assets, the existing custody provisions in the FCA's Client Assets Sourcebook (CASS) would form the starting point for bespoke cryptoasset custody requirements. CASS is considered the gold standard for client asset protection so this was to be expected. Core components of the custody provisions would include adequate arrangements to safeguard investors' rights to their cryptoassets (eg restricting commingling of investors' assets with the custodian's assets), organisational arrangements to minimise risk of loss or diminution of investors' custody assets, and controls and governance over safeguarding arrangements.

MiCAR's custody rules provide for cryptoasset custodians to be liable to clients for the loss of cryptoassets or keys as a result of an incident that is attributable to the provision of the service or the operation of the custodian (which would exclude any event that the custodian could show occurred independently of the provision of its service or operations, such as a problem inherent in the operation of the distributed ledger that the custodian does not control). Liability would be capped at the market value of the lost cryptoassets (at the time of the incident).

HMT and the FCA are also considering liability standards for custodians. However, HMT has emphasised that the government would not look to impose full, uncapped liability on the custodian in the event of a malfunction or hack that was not within the custodian's control.

Operating a cryptoasset trading platform would be based on the current regulation of trading venues, including operating an MTF. Applicable requirements would cover a lot of the same ground mentioned above; however, the regulatory requirements would emphasise data reporting obligations. Specifically, cryptoasset trading venues would be expected to have the capability to make accurate and complete information readily accessible for both the on- and off-chain transactions which they facilitate. The FCA is therefore likely to require order book data and transaction information, information concerning management of large positions and market abuse reporting. ■

1 Accessible here: https://bills.parliament.uk/publications/49063/documents/2625

2 Accessible here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1133404/TR_Privacy_edits_Future_financial_services_regulatory_regime_for_cryptoassets_vP.pdf

3 This section specifically considers the disclosure regimes for cryptoassets other than stablecoins. Issuances of asset-referenced and e-money tokens are also subject to similar white paper requirements.

Further Reading:

- The European Commission's Digital Finance Package from the perspective of private law (2021) 2 JIBFL 126.
- Regulating the distributed ledger: the EU's attempt (2021) 9 JIBFL 648.
- LexisPSL: Banking & Finance: Practice Note: Supranational and EU regulation of cryptoassets