

The Distributed Ledger

Blockchain, Digital Assets and Smart Contracts

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the next page or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

40 Bank Street, Canary Wharf
London, E14 5DS
44.20.7519.7000

New Consultation on UK Cryptoasset Regulation: Amid Market Turbulence, Government Pursues Plans To Become a Global Crypto Hub

On 1 February 2023, the U.K. Treasury launched a consultation and call for evidence on a series of proposals for the future financial services regulatory regime for cryptoassets. The proposals mark the next stage of the government's project to regulate cryptoassets in the U.K., with a plan for the rules to offer balance between promoting innovation and protecting consumers. The consultation builds on previous publications addressing the topic, including the April 2022 plan proposed by former U.K. Economic Secretary John Glen, MP, to make the U.K. a global hub for cryptoasset technology.

New Framework for Digital Assets Within Financial Services

This consultation focuses on establishing a future U.K. regulatory framework for cryptoassets used within financial services rather than the wider application of distributed ledger technology or the use of cryptoassets more generally outside the financial services sector. The goal of the proposals is to mitigate the most significant risks associated with cryptoasset businesses operating within financial services while harnessing the advantages of cryptoasset technologies to increase jobs and investment in the U.K.'s digital assets space.

The key proposals include:

- **Extending the scope of U.K. regulatory coverage:** Expanding the definition of activities subject to authorisation by the U.K. Financial Conduct Authority (FCA) in order to regulate certain activities involving cryptoassets, including payment activities; exchange activities; investment and risk management activities; lending, borrowing and leverage activities; safeguarding activities; and validation and governance activities.
- **Overseeing cryptoasset issuance and disclosure:** Establishing an "issuance and disclosure" regime for cryptoassets that (i) aligns itself with the intended reform of the U.K. prospectus regime and (ii) is tailored to the specific attributes of cryptoassets.
- **Assigning responsibility to cryptoasset trading venues:** Requiring cryptoasset trading venues to define the detailed content requirements for admission and disclosure documents to ensure that cryptoasset exchanges meet fair and robust standards.
- **Further regulating cryptoasset intermediation activities:** Identifying the risks that can arise from and strengthening the rules that apply to financial intermediaries and custodians of cryptoassets, including in relation to conflicts of interest, governance, capital and liquidity, and segregation of client assets.

The Distributed Ledger

Blockchain, Digital Assets and Smart Contracts

- **Imposing market abuse requirements:** Adopting a crypto-specific market abuse regime. While the technology and channels used to conduct market abuse may be different for cryptoassets as compared to those used in traditional markets, the problematic types of activities and behaviours are similar, highlighting the need for a bespoke market abuse regime.

The U.K. Treasury has also included a call for evidence regarding the sustainability of cryptoassets, recognising that these assets can have a high environmental impact and that, given the parallels between cryptoassets and securities markets, applying similar ESG-related reporting requirements to cryptoassets could be advantageous.

Finally, the FCA has indicated its intention to extend its new financial promotions regime for high-risk investments and firms approving financial promotions, which came into effect on the date of the consultation paper, to cover cryptoassets. The same high standards that apply to other high-risk products will therefore apply equally to cryptoassets.

Impact of Recent Market Conditions on the Approach to Regulation

The consultation paper notes that volatility continues to characterize the cryptoasset sector, with price volatility significantly exceeding that of other, more traditional asset classes. In addressing the risks posed by the sector, U.K. regulators are adopting a “same risk, same regulatory outcome” approach, which is designed to standardize conditions across cryptoasset firms and traditional financial services firms.

The current turbulence in the cryptocurrency market (including the collapse of a number of cryptocurrency exchanges and lending and trading platforms) highlights the need for clear, effective and timely regulation and more proactive engagement with the cryptoasset industry. The U.K. Treasury reports that the collapse of cryptocurrency exchange FTX has inspired important ques-

tions around conflicts of interest, market conduct and operational resilience, which, if poorly managed, increase risk to investors and reduces confidence in the market.

The recent failures in the cryptocurrency sector have resulted in the total global market capitalisation of cryptoassets decreasing around 75% to approximately \$0.8 trillion from a peak of around \$3 trillion in November 2021. Against this backdrop, the U.K. Treasury’s new proposals are designed to create the conditions needed for cryptoasset service providers to effectively operate and thrive in the U.K., prevent reckless practices that increase risks for investors and give potential investors the understanding needed to confidently invest in cryptoassets.

The UK’s Position as Crypto-Friendly Jurisdiction

This consultation is another example of the U.K. positioning itself as a crypto-friendly jurisdiction, in line with Prime Minister Rishi Sunak’s goal to make the U.K. “the jurisdiction of choice for crypto and blockchain technology”.

With approximately 85% of cryptoasset groups that have attempted to obtain FCA registration failing to do so and stakeholders calling for a bolstered regulatory framework and clearer rules, the U.K. Treasury’s proposed reforms have largely been viewed as a step in the right direction. For instance, the former head of fintech at the Bank of England, Varun Paul, has called the proposals a “positive step”.

Whether the reform proposals will strike the right balance of comprehensively regulating the digital assets space and increasing investor confidence without constraining innovation remains to be seen. The consultation closes on 30 April 2023 and the U.K. government plans to implement the new regulatory proposals ahead of the EU’s expected launch of cryptoasset legislation in 2024. In the meantime, companies operating in the cryptoasset space should prepare themselves for regulation that aligns more closely with regulation that applies to other higher-risk investment products.

Contacts

Simon Toms

Partner / London
44.20.7519.7085
simon.toms@skadden.com

Azad Ali

Of Counsel / London
44.20.7519.7034
azad.ali@skadden.com

Abigail B. Reeves

Associate / London
44.20.7519.7282
abigail.reeves@skadden.com

Patrick Tsitsaros

Associate / London
44.20.7519.7081
patrick.tsitsaros@skadden.com

Miranda Iyer

Trainee Solicitor / London
44.20.7519.7000
miranda.iyer@skadden.com