

# HM Treasury's consultation on a proposed UK regulatory framework for stable tokens

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## Introduction

On 7 January 2021, HM Treasury issued a **consultation** setting out its proposed approach to UK regulation of cryptoassets, including a regulatory framework for "stable tokens". The consultation sets out only high-level proposals, without draft legislative text, on the basis that detailed rules to implement the proposed regime will be consulted on by the Financial Conduct Authority (**FCA**) and Prudential Regulatory Authority in due course. The deadline for responding to the consultation is 21 March 2020.

We summarise various key aspects of the consultation in this note, and compare HM Treasury's proposed approach to other recent initiatives in the UK and EU, including the following proposals referred to in the consultation:

- HM Treasury's July 2020 consultation on extending the financial promotions (ie advertising) regime to cryptoassets (**FinProm Consultation**); and
- the European Commission's proposed regulation on markets in cryptoassets (**MiCA**)

## Proposed extension of regulation

The FinProm Consultation and MiCA would extend regulation to broad ranges of cryptoassets. By contrast, this consultation proposes, *at this stage*, to create a single new category of regulated token, namely "**stable tokens**", which are described as follows.<sup>1</sup>

1. Function: stable tokens "*stabilise their value by referencing one or more assets, such as fiat currency or a commodity... and could for that reason more reliably be used as a means of exchange or store of value.*"
2. Form: "*whilst cryptoassets are typically underpinned by [distributed ledger technology ie **DLT**], stable tokens could be designed using other types of technology. This classification is therefore agnostic on the technology underpinning its use.*"
3. Subsets: a distinction is made between "**asset-linked tokens**", whose value is associated with that of one or more physical or financial assets or cryptoassets; and "**single fiat-linked tokens**", whose value is pegged to a single fiat currency.<sup>2</sup> This is similar to the distinction made between "asset-referenced tokens" and "electronic money tokens" under MiCA.

<sup>1</sup> Table 3.A of the consultation lists tokens within the initial proposed extension of regulation, and those that may become regulated at a later date.

<sup>2</sup> "Algorithmic stablecoins" will not be classified as stable tokens, but may become regulated at a later date. They are described as maintaining a stable value using protocols that change the supply of the token in response to changes in demand, without being backed by a reference asset.

## New proposals regarding stable tokens

The government proposes to regulate the following activities in relation to stable tokens.

Activity	Comparison with other initiatives
i. Issuing, creating (ie minting) or destroying (ie burning) tokens	<p><b>MiCA:</b> activities (i) to (iv) are similar to proposed regulated activities under MiCA; activities (v) to (vii) do not so obviously overlap with MiCA.</p> <p>The <b>FinProm Consultation</b> proposes to extend the financial promotions regime to a range of activities in respect of qualifying cryptoassets that do not directly correspond to activities (i) to (vii). In some respects it appears broader, for example, capturing financial promotions in respect of advising. Some stable token activities listed, however, may not be captured.</p>
ii. Providing token custody and administration services (such as providing wallets with storage of private keys)	
iii. Exchanging tokens for fiat money (such as fiat-crypto exchanges)	
iv. Executing transactions in tokens (conducting transactions on behalf of another)	
v. Value stabilisation and reserve management (such as custody or management of reserve assets backing the value of tokens)	
vi. Facilitating access to a network/infrastructure	
vii. Validation of transactions and transmission of funds (such as by operating a node on a blockchain)	

### Licensing regime for stable token activities

Depending on which activities are carried out, the government proposes that firms be subject to a range of requirements, including<sup>3</sup>:

- Authorisation/licensing;
- Prudential requirements, including capital and liquidity requirements;
- Requirements to maintain and manage a reserve;
- Insolvency obligations;
- Token safeguarding obligations; and
- Financial crime, risk management, security and governance requirements.

Notably, the government proposes that where a cryptoasset constitutes a security token it should be excluded from the scope of the proposals for stable tokens, and similarly, utility tokens will likely also fall outside the scope of the stable tokens proposals. The government recognises that certain stable tokens already fall within e-money regulation, and is therefore considering whether to extend the e-money regime to all single fiat-linked tokens in order to avoid arbitrage and confusion.

<sup>3</sup>Table 3.B of the consultation sets out further details of the applicability of these requirements to different types of activity.

## Regulation of stable token payment systems

The government also proposes to bring stable token payment systems (and related service providers) within scope of the existing UK payment systems regulation, namely within supervision by (i) the Bank of England under the Banking Act if the stable token payment system is of systemic importance (ie when potential disruption could lead to financial stability risks), and (ii) the Payment Systems Regulator under the Financial Services (Banking Reform) Act 2013 if disruption to its operation would have serious consequences for those who use its services.

## Territorial scope

The government is considering whether firms based offshore but actively marketing to UK consumers should be required to have a UK establishment and be authorised in the UK, consistent with the territoriality approach in the FinProm Consultation.

By comparison, MiCA also requires cryptoasset service providers (for example, custody/brokerage service providers) who provide services in the EU (which might be taken to be the case if targeting EU customers) to establish an EU registered office and be authorised in an EU member state.

This may therefore require providers to establish separate operating companies to serve different territories.

## Consultation questions

The consultation invites responses to questions covering matters such as supervision of systemic stable token systems and territorial scope, amongst other things. It also includes a call for evidence on potential extension of regulation to a broader range of cryptocurrencies such as Bitcoin, the use of DLT-based financial markets infrastructure, and decentralised finance.

## Authors



**Ben Regnard-Weinrabe**

Partner – London

Tel +44 20 3088 3207

ben.regnard-weinrabe@allenoverly.com



**Heenal Vasu**

Senior Regulatory PSL – London

Tel +44 20 3088 1447

heenal.vasu@allenoverly.com



**Rory Copeland**

Associate – London

Tel +44 20 3088 1573

rory.copeland@allenoverly.com

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