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Post-Brexit UK: Open for (Crypto) Business?

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The UK's HM Treasury published its response to last year's consultation on the UK regulatory approach to cryptoassets, stablecoins, and distributed ledger technology ("**DLT**") in financial markets on the 4th of April 2022 (the "**Response Document**"). The Response Document highlights the government's post-Brexit push to drive transformational growth in the UK's FinTech space through cryptoassets and DLT and confirms its plans to enact legislation to recognise stablecoins as a valid means of payment by bringing them into the existing regulatory perimeter. Stablecoins are a type of cryptocurrency that attempts to peg its market value to an external reference, such as the US dollar or the price of gold. To achieve price stability, the creator of such stablecoins seeks to collateralise the coins through an algorithmic mechanism of buying and selling the reference asset or its derivatives.

Key takeaways from the Response Document include:

1. Expansion of the existing regulatory framework

- The Electronic Money Regulations 2011 and Payments Services Regulations 2017 will be extended to capture the use of stablecoins as a means of payment. Such expansion will provide powers to the Financial Conduct Authority ("**FCA**") to regulate and supervise stablecoin issuance and wallet providers through a registration and authorisation framework, mirroring existing arrangements in relation to e-money and payments regulation.
- Part 5 of the Banking Act 2009, which facilitates the regulation and supervision of systemic payment systems and service providers for those systems by the Bank of England ("**BoE**"), will be extended to include stablecoin activities.
- The Banking Act will also be expanded to include certain wallets, exchanges, and custodians of stablecoin reserves in its defined set of service providers that may be subject to regulation. Special attention will be given to the role of wallet providers and custodians who, in the context of cryptoassets, hold the means of access, or the private keys, to those assets. Custody of stablecoins will therefore be brought into the UK's regulatory perimeter and will require FCA authorisation and, in some cases, supervision by the BoE.
- The scope of the Financial Services (Banking Reform) Act 2013 will be extended to ensure stablecoin payment systems are subject to competition regulation by the Payment Systems Regulator ("**PRS**").
- Where regulatory overlaps arise, the BoE will be the lead prudential regulator for systemic stablecoin entities that are also FCA authorised.

2. Financial Market Infrastructure (FMI) Sandbox

- The development of an FMI Sandbox will allow existing regulation to be modified or waived in cases where it does not support new technologies such as DLT. The Sandbox's launch in 2023 will support firms who wish to innovate by providing FMI services through DLT and will inform future legislative changes in this area.

3. Regulatory response beyond stablecoins as a means of payment

- The government intends to work collaboratively with UK financial regulators and industry to consider future regulation of Bitcoin, Ether, and newer technology such as decentralised finance (De-Fi), which requires a high level of technical understanding.
- The Response Document emphasises the need for regulatory frameworks to balance flexibility with clarity, so that market participants can clearly identify their obligations.
- HM Treasury will consult later this year on its approach.

C&G Comment

The Treasury's move to make stablecoins a valid means of payment is the first in an array of measures set to be implemented to secure the UK's status as "*the world's preeminent financial centre*" and "*a global hub for cryptoasset technology and investment*." In his speech at the Innovate Finance Global Summit on the 4th of April, John Glen, the Economic Secretary to the Treasury, outlined the government's strategy to support the development of a "*world-best crypto ecosystem*", unveiling plans, among other things, to issue a Royal Mint NFT and organise a series of FCA-led crypto-sprints next month.

News of the forthcoming measures will be received gladly by industry players who have been putting pressure on regulators to adapt for years. That said, some may be surprised by the government's clear ambition to make the UK a crypto powerhouse given UK regulators' typically hard-line and, at times, sceptical approach towards crypto. In fact, following the Treasury's announcement, the FCA confirmed its cautious stance by warning that consumer and market risk requires appropriate mitigation, which "*may require further crypto asset regulation as the industry evolves*". Nevertheless, the proposed changes should be seen as an effort by the UK to remain relevant in the FinTech space following its exit from the European Union and the damage to its reputation as an attractive business environment that accompanied it. Although "dynamic regulation" appears to be the headline of the Treasury's newfound crypto-enthusiasm, as it proclaims to depart from "prescriptive, inflexible legislation" provided by EU law[1], the question remains how this will take form and the extent regulators will align with the government's vision in practice.

[1] Paragraph 2.12 of the Response Document

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