



Deadline: 30 April 2023

## FIA EPTA response to the HM Treasury Consultation and Call for Evidence on the Future financial services regulatory regime for cryptoassets

<b>Introduction</b>	<p>The European Principal Traders Association (<a href="#">FIA EPTA</a>) welcomes the opportunity to respond to the HM Treasury (HMT) Consultation and Call for Evidence on the Future financial services regulatory regime for cryptoassets.</p> <p>FIA EPTA represents 24 independent European Principal Trading Firms (PTFs) which deal on own account, using their own capital for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including equities, bonds, options, futures, ETFs and cryptoassets. Our members are important sources of liquidity and stability for end-investors and markets across Europe. FIA EPTA members are becoming a part of the digital/crypto-assets space, using their existing knowledge to improve the liquidity in these products.</p> <p>FIA EPTA members believe that the market will benefit from further clarity by regulatory bodies with a global perception. Working jointly with market participants to reduce the current void in regulation and perspective between the market and regulators and policymakers.</p> <p>FIA EPTA members are at the forefront of using blockchain technology to transform more traditional parts of the financial market industry. Our members are, for example, closely involved with the development of the Pyth network<sup>1</sup> which aims at consolidating financial market data to DeFi applications and making it available to the general public.</p>
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<sup>1</sup> Pyth Data Association, Pyth Network: A first-Party Financial Oracl, 4 January 2022, <https://pyth.network/whitepaper.pdf> (Website: Pyth Network, <https://pyth.network/>).

	FIA EPTA is committed to supporting policymakers and regulators in the DeFi space to develop a dynamic, innovative and resilient part of the financial market industry. We would welcome the opportunity to provide further background to HMT on the issues raised in our response.
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## Chapter 2: Definition of cryptoassets and legislative approach

<b>Questions:</b>	<b>FIA EPTA Response:</b>
1. Do you agree with HM Treasury's proposal to expand the list of "specified investments" to include cryptoassets? If not, then please specify why.	FIA EPTA members agree that it is preferable to include cryptoassets in the existing financial services framework rather than creating a bespoke piece of legislation. We strongly value the stated commitment to a level playing field and "same risk, same regulatory outcome". However, FIA EPTA members are mindful that the use of technology such as DLT does present some material differences in trading and settlement that will need to be borne in mind when applying the framework and will no doubt necessitate further guidance.
2. Do you agree with HM Treasury's proposal to leave cryptoassets outside of the definition of a "financial instrument"? If not, then please specify why.	FIA EPTA members note that HMT does not intend to include presently unregulated cryptoassets under the definition of financial instruments in Part 1 of Schedule 2 to the RAO. Security tokens already fall within the perimeter of the RAO if they provide the requisite rights and obligations akin to shares or debt instruments, more clarity is welcome on whether they therefore also qualify as financial instruments. Therefore, FIA EPTA members would welcome further guidance on the delineation between the existing specified investments, "financial instrument" and "cryptoasset", and we would encourage HMT to ensure that regulatory outcomes are consistent across the board (e.g. in terms of pre- and post-reporting, market abuse rules, etc) whilst taking into account the specificities caused by the DLT structure (i.e. custody, settlement as mentioned in the FCA's PS 19/22).
3. Do you see any potential challenges or issues with HM Treasury's intention to use the DAR to legislate for certain cryptoasset activities?	FIA EPTA members would welcome more background to understand the considerations that would lead HMT to consider supervision through the DAR more suitable than FSMA authorisation. Separate regimes with different requirements risk the appearance of an unlevel playing field and different rules for similar activities.

### Chapter 3: Overview of the current regulatory landscape for cryptoassets

Questions:	FIA EPTA response:
<p>4. How can the administrative burdens of FSMA authorisation be mitigated for firms which are already MLR-registered and seeking to undertake regulated activities? Where is further clarity required, and what support should be available from UK authorities?</p>	<p>FIA EPTA members believe this consultation paper indicates that while the regulatory regime for cryptoassets becomes effective, HMT expects MLR-registered firms to adhere to FSMA financial crime standards that would apply to equivalent/similar traditional financial service activities. FIA EPTA members would welcome a communication from the regulator to MLR-registered firms, clearly laying out the additional requirements that are posed by FSMA as compared to their current registration and notifying firms of this new expectation. This will provide the industry with clear expectations and time to adequately prepare for the additional registration.</p>
<p>5. Is the delineation and interaction between the regime for fiatbacked stablecoins (phase 1) and the broader cryptoassets regime (phase 2) clear? If not, then please explain why</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>6. Does the phased approach that the UK is proposing create any potential challenges for market participants? If so, then please explain why.</p>	<p>FIA EPTA decided not to respond to this question.</p>

### Chapter 4: Cryptoasset Activities

Questions:	FIA EPTA response:
<p>7. Do you agree with the proposed territorial scope of the regime? If not, then</p>	<p>FIA EPTA members note the proposal to capture activities provided in or to the United Kingdom. In addition, FIA EPTA members note the availability of certain exceptions (for example reverse</p>

<p>please explain why and what alternative you would suggest.</p>	<p>solicitation) and would welcome further guidance on whether overseas persons could avail themselves of the Overseas Person Exemption in this regard.</p>
<p>8. Do you agree with the list of economic activities the government is proposing to bring within the regulatory perimeter?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>9. Do you agree with the prioritisation of cryptoasset activities for regulation in phase 2 and future phases?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>10. Do you agree with the assessment of the challenges and risks associated with vertically integrated business models? Should any additional challenges be considered?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>11. Are there any commodity-linked tokens which you consider would not be in scope of existing regulatory frameworks?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>12. Do you agree that so-called algorithmic stablecoins and cryptobacked tokens should be regulated in the same way as unbacked cryptoassets?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>13. Is the proposed treatment of NFTs and utility tokens clear? If not please explain where further guidance would be helpful.</p>	<p>FIA EPTA decided not to respond to this question.</p>

## Chapter 5: Regulatory Outcomes for Cryptoasset Issuance and Disclosures

<b>Questions:</b>	<b>FIA EPTA response:</b>
14. Do you agree with the proposed regulatory trigger points – admission (or seeking admission) of a cryptoasset to a UK cryptoasset trading venue or making a public offer of cryptoassets?	FIA EPTA decided not to respond to this question.
15. Do you agree with the proposal for trading venues to be responsible for defining the detailed content requirements for admission and disclosure documents, as well as performing due diligence on the entity admitting the cryptoasset? If not, then what alternative would you suggest?	FIA EPTA decided not to respond to this question.
16. Do you agree with the options HM Treasury is considering for liability of admission disclosure documents?	FIA EPTA decided not to respond to this question.
17. Do you agree with the proposed necessary information test for cryptoasset admission disclosure documents?	FIA EPTA decided not to respond to this question.
18. Do you consider that the intended reform of the prospectus regime in the Public Offers and Admission to Trading Regime would be sufficient and capable of accommodating public offers of cryptoassets?	FIA EPTA decided not to respond to this question.

## Chapter 6: Regulatory Outcomes for Operating a Cryptoasset Trading Venue

Questions:	FIA EPTA response:
19. Do you agree with the proposal to use existing RAO activities covering the operation of trading venues (including the operation of an MTF) as a basis for the cryptoasset trading venue regime?	FIA EPTA decided not to respond to this question.
20. Do you have views on the key elements of the proposed cryptoassets trading regime including prudential, conduct, operational resilience and reporting requirements?	FIA EPTA decided not to respond to this question.

## Chapter 7: Regulatory Outcomes for Cryptoasset Intermediation Activities

Questions:	FIA EPTA response:
21. Do you agree with HM Treasury's proposed approach to use the MiFID derived rules applying to existing regulated activities as the basis of a regime for cryptoasset intermediation activities?	Yes, FIA EPTA members agree with HMT that additional guidance will likely be required in order to account for the specificities of this market.

<p>22. Do you have views on the key elements of the proposed cryptoassets market intermediation regime, including prudential, conduct, operational resilience and reporting requirements?</p>	<p>FIA EPTA members would expect the existing client categorisation regime to persist, and therefore would expect that categorization of regulated institutional counterparties as ECP would continue to be possible under these permissions, and conduct requirements to apply as they currently do. Given the public nature of the blockchain, FIA EPTA members would encourage supervisory authorities to investigate RegTech solutions in order to potentially streamline reporting requirements.</p>
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## Chapter 8: Regulatory outcomes for cryptoasset custody

<b>Questions:</b>	<b>FIA EPTA response:</b>
<p>23. Do you agree with HM Treasury's proposal to apply and adapt existing frameworks for traditional finance custodians under Article 40 of the RAO for cryptoasset custody activities?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>24. Do you have views on the key elements of the proposed cryptoassets custody regime, including prudential, conduct and operational resilience requirements?</p>	<p>FIA EPTA decided not to respond to this question.</p>

## Chapter 9: General Market Abuse Requirements

<b>Questions:</b>	<b>FIA EPTA response:</b>
<p>25. Do you agree with the assessment of the challenges of applying a market abuse</p>	<p>FIA EPTA members believe that the limited market data is another significant challenge to successfully applying a market abuse regime to cryptoassets. Cryptocurrency trading data is often fragmented and incomplete, making it difficult to gain a comprehensive view of market activity.</p>

<p>regime to cryptoassets? Should any additional challenges be considered?</p>	<p>Furthermore, many cryptoasset exchanges do not provide the same level of transparency as traditional exchanges, which can make it challenging to meet the requirements of the market abuse regime to identify suspicious trading activity.</p>
<p>26. Do you agree that the scope of the market abuse regime should be cryptoassets that are requested to be admitted to trading on a cryptoasset trading venue (regardless of where the trading activity takes place)?</p>	<p>FIA EPTA members agree with HMT and point to our response to question 7.</p>
<p>27. Do you agree that the prohibitions against market abuse should be broadly similar to those in MAR? Are there any abusive practices unique to cryptoassets that would not be captured by the offences in MAR?</p>	<p>FIA EPTA members believe that the prohibitions against market abuse in crypto assets should be broadly similar to those in Market Abuse Regulation (MAR) because both aim to prevent the same types of market abuses and protect investors from abusive activities. Moreover, since the market abuse prohibitions in MAR have been tested and refined over time, applying similar prohibitions in the crypto asset market would benefit from the lessons learned from applying them in traditional financial markets.</p>
<p>28. Does the proposed approach place an appropriate and proportionate level of responsibility on trading venues in addressing abusive behaviour?</p>	<p>Yes - Trading venues, such as cryptocurrency exchanges, play a crucial role in the cryptoasset ecosystem by providing a platform for users to buy, sell, and trade cryptocurrencies. As such, these platforms have a unique insight into user activity and are well-positioned to detect and prevent abusive behavior. The level of responsibility placed on trading venues should be appropriate and proportionate to their role in the cryptoasset ecosystem. This requires taking into account the size, complexity, and risk profile of each platform when establishing regulatory requirements.</p>
<p>29. What steps can be taken to encourage the development of RegTech to prevent, detect and disrupt market abuse?</p>	<ol style="list-style-type: none"> <li>1. Encourage collaboration: Regulators could collaborate with RegTech companies that specialise in developing solutions for cryptoasset regulation to identify the most effective approaches to prevent, detect, and disrupt market abuse. This partnership can help to identify areas where RegTech solutions can be applied to enhance regulatory compliance and oversight in the cryptoasset industry.</li> <li>2. Promote information sharing: Financial regulators could promote information sharing between regulated entities and RegTech companies to facilitate the development of effective regulatory</li> </ol>



	<p>compliance solutions. This can help to address the challenges of limited market data and the complexity of the cryptoasset market</p> <p>3. Engage in regulatory sandboxes: Financial regulators could engage in regulatory sandboxes, which provide a safe environment for RegTech companies to test and develop their solutions. This can help to accelerate the development of innovative RegTech solutions for cryptoasset regulation.</p>
<p>30. Do you agree with the proposal to require all regulated firms undertaking cryptoasset activities to have obligations to manage inside information?</p>	<p>FIA EPTA members believe that mandating regulated firms engaging in cryptoasset activities to manage insider information can prevent market abuse and enhance market integrity within the industry. Nevertheless, enforcing such obligations will present certain challenges for the firms. For instance, the cryptoasset sector is decentralized and global, and detecting insider information can be challenging due to the anonymity of some transactions. Furthermore, ensuring compliance with this requirement may prove difficult and challenging as the industry employs various non-standard communication channels that may be technically complex to monitor i.e. Social Media platforms, peer - to -peer networks , Decentralized applications (DApps), Dark web forums</p>

## Chapter 10: Regulatory outcomes for operating a cryptoasset lending platform

<b>Questions:</b>	<b>FIA EPTA response:</b>
<p>31. Do you agree with the assessment of the regulatory challenges posed by cryptoasset lending and borrowing activities? Are there any additional challenges HM Treasury should consider?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>32. What types of regulatory safeguards would have been most effective in preventing the collapse of Celsius and</p>	<p>FIA EPTA decided not to respond to this question.</p>

other cryptoasset lending platforms earlier this year?	
33. Do you agree with the idea of drawing on requirements from different traditional lending regimes for regulating cryptoasset lending? If so, then which regimes do you think would be most appropriate and, if not, then which alternative approach would you prefer to see?	FIA EPTA decided not to respond to this question.
34. Do you agree with the option we are considering for providing more transparency on risk present in collateralised lending transactions?	FIA EPTA decided not to respond to this question.
35. Should regulatory treatment differentiate between lending (where title of the asset is transferred) vs staking or supplying liquidity (where title of the asset is not transferred)?	FIA EPTA decided not to respond to this question.

## Chapter 11: Call for Evidence: Decentralised Finance (DeFi)

<b>Questions:</b>	<b>FIA EPTA response:</b>
36. Do you agree with the assessment of the challenges of regulating DeFi? Are there any additional challenges HM Treasury should consider?	FIA EPTA members agree with the assessment of the challenges, notably the difficulty in applying typical, localized financial services regulation to such a globalized and borderless proposition.

<p>37. How can the size of the “UK market” for DeFi be evaluated? How many UK-based individuals engage in DeFi protocols? What is the approximate total value locked from UK-based individuals?</p>	<p>FIA EPTA members believe it is difficult to fully determine the size of the UK Market or indeed any other market. Most chains are operated through a network of nodes. These nodes are mostly run from cloud-based locations, which are difficult to attribute to any given jurisdiction. An additional challenge is that the actual user of a specific protocol can only be easily identified by its wallet address which is not easily linked to a specific location. A crude estimate could be made based on activity during certain hours on a certain platform to determine in which timezone most of the activity occurs or where platforms track locations of their users. Large decentralized exchange operators may be able to provide indications of how much UK traffic comes through their GUI.</p>
<p>38. Do you agree with HM Treasury's overall approach in seeking the same regulatory outcomes across comparable "DeFi" and "CeFi" activities, but likely through a different set of regulatory tools, and different timelines?</p>	<p>FIA EPTA members agree with the approach of firstly focusing on CeFi activity as this is the main “on and off ramp” for fiat in the wider crypto space. It will be very difficult to have a UK-specific approach to DeFi as mentioned the decentralized nature of the DeFi makes it a space that should be approached on an international level. If the UK were to develop a regime ahead of international developments in this area, we believe that there is a risk of stifling innovation in the UK. Given the open-source nature of the code that governs such decentralized offerings, it would be simpler for actors to replicate the activity outside of the regulatory perimeter.</p>
<p>39. What indicators should be used to measure and verify “decentralisation” (e.g. the degree of decentralisation of the underlying technology or governance of a DeFi protocol)?</p>	<p>FIA EPTA members believe that the two main indicators should be:</p> <ol style="list-style-type: none"> <li>1. Power of the ‘team’ or a certain individual behind a protocol to make changes to the protocol unilaterally. (Through holding a significant portion of governance tokens or through access to the underlying code)</li> <li>2. Degree of decentralization of a chain by assessing the power distribution in verifying transactions on chain.</li> </ol>
<p>40. Which parts of the DeFi value chain are most suitable for establishing "regulatory hooks" (in addition to those already surfaced through the FCA-hosted cryptoasset sprint in May 2022)?</p>	<p>FIA EPTA members believe that trading platforms and exchanges are most suited to establish a regulatory hook.</p> <p>Assigning such a responsibility to the software development team fails to consider the role that subsequent open-source contributions can play in shaping the future of the code. Token holders could be another potential point of regulation, however, thresholds would need to be established and it is unclear how feasible it would be to monitor or enforce this in practice, given the previously mentioned difficulties in locating such individuals. We believe the interface provider to be a weak “hook”, given this is often a layer added to the protocol but not strictly required to participate on</p>

	the chain, and is not necessarily connected to governance or decision-making.
41. What other approaches could be used to establish a regulatory framework for DeFi, beyond those referenced in this paper?	<p>FIA EPTA members believe that compliance tools such as blockchain screening can be used to check for unwanted wallet activity on the chain.</p> <p>We also note the development of certain natively driven “regulatory” options within the validation chain itself. For example, on Ethereum, it is possible since “the Merge”(reference our paper on this here) to opt for relays that only propose blocks for validation that are composed of transactions that fit certain criteria.</p>
42. What other best practices exist today within DeFi organisations and infrastructures that should be formalised into industry standards or regulatory obligations?	<p>FIA EPTA members believe that blockchain screening can be an immensely powerful tool to understand the risks involved in the decentralized activity that is being contemplated. In many ways, the blockchain can be considered more transparent than traditional finance and provides a wealth of information-gathering and monitoring opportunities. We believe that this should be taken into account when providing guidance on fulfilling regulatory identification requirements where traditional KYC is not possible due to the decentralized nature of the activity.</p>

## Chapter 12: Call for Evidence: Other Cryptoasset Activities

<b>Questions:</b>	<b>FIA EPTA response:</b>
43. Is there a case for or against making cryptoasset investment advice and cryptoasset portfolio management regulated activities? Please explain why.	FIA EPTA decided not to respond to this question.
44. Is there merit in regulating mining and validation activities in the UK? What would be the main regulatory outcomes beyond sustainability objectives?	FIA EPTA decided not to respond to this question.

45. Should staking (excluding “layer 1 staking”) be considered alongside cryptoasset lending as an activity to be regulated in phase 2?	FIA EPTA decided not to respond to this question.
46.What do you think the most appropriate regulatory hooks for layer 1 staking activity would be (e.g. the staking pools or the validators themselves)?	FIA EPTA decided not to respond to this question.

### Chapter 13: Call for evidence: Sustainability

<b>Questions:</b>	<b>FIA EPTA response:</b>
47.When making investment decisions in cryptoassets, what information regarding environmental impact and / or energy intensity would investors find most useful for their decisions?	FIA EPTA decided not to respond to this question.
48.What reliable indicators are useful and / or available to estimate the environmental impact of cryptoassets or the consensus mechanism which they rely on (e.g. energy usage and / or associated emission metrics, or other disclosures)?	FIA EPTA decided not to respond to this question.
49.What methodologies could be used to calculate these indicators (on a unit-by-	FIA EPTA decided not to respond to this question.

<p>unit or holdings basis)? Are any reliable proxies available?</p>	
<p>50. How interoperable would such indicators be with other recognised sustainability disclosure standards?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>51. At what point in the investor journey and in what form, would environmental impact and / or energy intensity disclosures be most useful for investors?</p>	<p>FIA EPTA decided not to respond to this question.</p>
<p>52. Will the proposals for a financial services regulatory regime for cryptoassets have a differential impact on those groups with a protected characteristic under the Equality Act 2010?</p>	<p>FIA EPTA decided not to respond to this question.</p>