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Digital Assets: Closing the Regulatory Net

02 November 2022

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Agenda

- The Financial Stability Board's approach to cryptoassets
- Current approaches to cryptoassets regulation and key future developments in:

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The Financial Stability
Board's approach to
regulation of digital assets

The FSB's views on digital assets and financial stability

- In July 2022, the FSB indicated its concern that recent turmoil in digital asset markets highlighted their intrinsic volatility, structural vulnerabilities and increasing interconnectedness with the traditional financial system. The FSB indicated that in its view, this meant that an effective regulatory framework needed to ensure that crypto-asset activities posing risks similar to traditional financial activities needed to be subject to the same regulatory outcomes – ie the principle of “**same activity, same risk, same regulation**”.
- In the same statement, the FSB also reiterated its view that crypto-asset service providers must at all times ensure compliance with existing legal obligations in the jurisdictions in which they operate, and that any persons and entities operating in crypto-asset markets must be aware that they should meet all applicable regulatory, supervisory and oversight requirements of a particular jurisdiction before commencing any operations. Notably, the FSB also emphasized that its members are committed to using enforcement powers against digital asset firms in order to promote compliance and act against violations.
- The FSB also emphasized its concern that stablecoins must be captured by robust regulations and supervision if they are to play an important role in the financial system.
- The FSB has also made it clear that its members support the “full and timely” implementation of existing international standards, including in particular the FATF travel rule.

The FSB Reports on Cryptoassets and Global Stablecoins

- On 11 October 2022, the FSB published:

- A consultative report on recommendations that promote the consistency and comprehensiveness of regulatory, supervisory and oversight approaches to **cryptoasset activities and markets** and strengthen international co-operation, co-ordination and information sharing; and
- A consultative report on revised high-level recommendations for the regulation, supervision and oversight of "**global stablecoin**" arrangements to address associated financial stability risks more effectively.



The FSB Reports are aimed at minimising the risk of fragmentation and regulatory arbitrage, and will have a significant impact on the global direction of travel in relation to regulation of stablecoins and other digital assets.

FSB Cryptoasset Report - Recommendations

Recommendations
Regulatory powers and tools
General regulatory framework
Cross-border co-operation, co-ordination and information sharing
Governance
Risk management
Data collection, recording and reporting
Disclosures
Addressing financial stability risks arising from interconnections and interdependencies
Comprehensive regulation of cryptoasset service providers with multiple functions

Grounded in the principle of “same activity, same risk, same regulation”.

“Global Stablecoin” - Recommendations

- “Global Stablecoin (GSC)”

- Characteristics that distinguish a GSC from other cryptoassets and other stablecoins:

- (i) the existence of a stabilisation mechanism,
- (ii) the usability as a means of payment and/or store of value, and
- (iii) the potential reach and adoption across multiple jurisdictions.

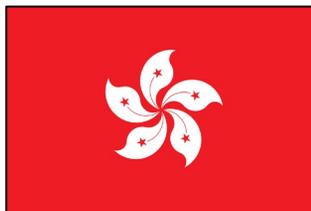
- Revised FSB High-Level Recommendations:

Authorities’ readiness to regulate and supervise global stablecoin arrangements
Comprehensive oversight of GSC activities and functions
Cross-border cooperation, coordination and information sharing
Governance structures and decentralized operations
Risk Management
Data storage and access to data
Recovery and resolution of GSC
Disclosures
Redemption rights, stabilisation, and prudential requirements
Conformance with regulatory, supervisory and oversight requirements before commencing operations

Potential implications of the FSB Reports



FSB FINANCIAL
STABILITY
BOARD



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The US approach to regulation of digital assets

United States

Current regulatory approach

- **Executive Order 14067:** In March 2022, President Biden issued the First-Ever Comprehensive Framework for Responsible Development of Digital Assets.
 - The Executive Order directs various agencies and departments to prepare reports on various matters in the digital assets space.
 - The Executive Order calls for a “whole-of-government” approach to regulating digital assets.
 - The Administration followed up the Executive Order with a **Fact Sheet** on September 16, 2022 that proposes a seven-pronged framework for responsible development of digital assets:
 1. Protecting consumers, investors, and businesses;
 2. Promoting access to safe, affordable financial services;
 3. Fostering financial stability;
 4. Advancing responsible innovation;
 5. Reinforcing the United States’ role in global financial leadership and competitiveness;
 6. Fighting illicit finance; and
 7. Exploring a U.S. Central Bank Digital Currency (CBDC).
- Some of the key takeaways from the Executive Order and Fact Sheet:
 - Increased focus on customer complaints
 - Increased attention to law enforcement
 - Cybersecurity
 - Considerations to call on Congress for legislation

United States

Current regulatory approach

- The regulation of cryptoassets in the United States is still developing and despite the call for a whole-of-government approach it finds several agencies covering different areas of regulation, battling for jurisdiction, or lacking the appropriate authority to promulgate rules.



Financial Crimes Enforcement Network (FinCEN)



Department of Justice (DOJ)



Consumer Financial Protection Bureau (CFPB)



Federal Trade Commission (FTC)



Securities and Exchange Commission (SEC)



Commodity Futures Trading Commission (CFTC)



Office of Foreign Assets Control (OFAC)



Prudential Regulators: Federal Reserve Board, FDIC, OCC



State Regulators

United States

Current regulatory approach

- All of these regulators have different jurisdictional limitations and have different regulatory mandates, creating a complicated web of oversight and regulation.
- The jurisdiction of many of these federal regulators is determined through legislation which must be passed by the United States Congress (the House of Representatives and the Senate).
- Regulation and jurisdiction over fraud, manipulation and criminal activity in the cryptocurrency space is relatively clear.
- However, the regulation of spot cryptoasset activity remains unclear in the United States given the limited statutory authority of certain regulatory agencies to write a regulatory framework for the regulation of spot cryptoasset activity.
- Accordingly, the approach from many U.S. regulators has been a “regulation by enforcement” approach.
- When analyzing the regulatory requirements around a particular digital asset, or activity, one of the most critical questions in the United States is whether a digital asset is a “security” or a “commodity?”
 - CFTC has enforcement authority over the digital asset pursuant to its anti-fraud and anti-manipulation authority with respect to spot transactions.
 - While the CFTC has enforcement authority over spot market commodity transactions, the CFTC’s regulatory authority is limited to futures, swaps, retail leveraged transactions and certain other derivatives products.
 - As a result, the CFTC does not regulate spot transactions in digital assets even if the assets are commodities.
 - This means that the trading of digital assets that are commodities remains largely unregulated (other than fraud and manipulation) in the United States.

United States

Key future developments

- U.S. regulators have been called upon by the White House to continue to be aggressive on the enforcement front.
- We may see regulators try to amend or interpret existing regulations to account for cryptoassets; however, their authority may be limited by statute.
- Accordingly, there has been significant activity on the legislative front, including bipartisan legislative efforts:
 - S.4760: Digital Commodities Consumer Protection Act of 2022 (Stabenow/Boozeman): Would grant the CFTC authority over spot markets for digital asset commodities.
 - S.4356: Responsible Financial Innovation Act (RFIA) (Lummis/Gillibrand): Broadest introduced digital asset legislation covering a range of issues, but not addressing other issues.
- Given the upcoming US elections in November and the realities of this Congress, it seems very unlikely that any broad digital asset legislation will pass in the next several months.
 - Next year we will have a “new” Congress so bills introduced this year and last year will “die” if they are not passed and will need to be re-introduced in the new Congress.
- Continued interest and development in Stablecoin rules.
- Continued interest by state regulators.

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The United Kingdom's approach to regulation of digital assets

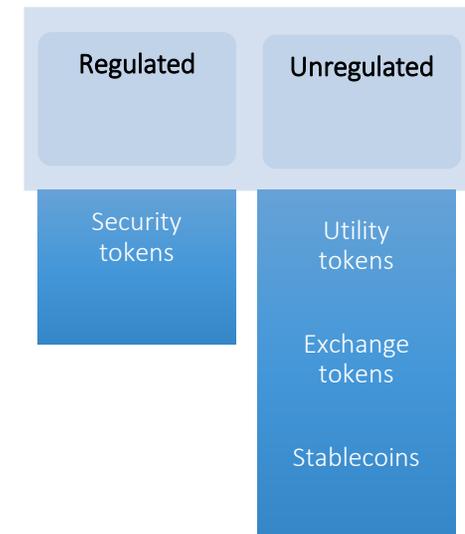
United Kingdom

Current regulatory approach

- Most cryptoassets are currently unregulated
 - **Exception:** Security tokens are regulated under the Financial Services and Markets Act 2000. E-money tokens are regulated under the Electronic Money Regulations
- AML requirements on cryptoasset exchange providers and custodial wallet providers
- August 2022: 25% change in control threshold introduced for cryptoasset firms

Recent extension of the travel rule

- To any payments made in cryptoassets in the UK with a de-minimis threshold of €1,000. Partial exemption to intra-UK transactions (full information not required)
- Information for un-hosted wallet transfers only required to be collected for transactions that pose an elevated risk of illicit finance
- 12 months grace period to implement compliance solutions by **September 1, 2023**.



United Kingdom

Key future developments

- Government intention “to make the UK a global cryptoasset technology hub”
- January 2021: HM Treasury consultation and call for evidence ; April 2022: HM Treasury response:

Stablecoins referencing fiat currency will be brought within the UK’s payment regime:

Financial Services and Markets Bill

- Introduced in July 2022
- Proposes to extend the existing regulatory framework to cover “**digital settlement assets**”, which include any digital representations of value or rights, whether or not cryptographically stored that *(a) can be used for the settlement of payment obligations, (b) can be transferred, stored or traded electronically, and (c) uses technology supporting the recording or storage of data (which may include distributed ledger technology).*
- The inclusion of digital settlement assets will allow stablecoins used as a means of payment to be a regulated form of payment in the UK.
- The new regulatory regime may be, for the time being, of limited scope, however, a proposed consultation later in the year will explore a more comprehensive extension of the regulatory scope to cryptoassets.

United Kingdom

Key future developments

Law Commission Consultation Paper on Digital Assets

- Ongoing consultation on proposed law reforms for digital assets. Open for responses until November 4, 2022.
- Proposals include: Recognizing a third category of personal property – “**data objects**” and clarifying the law around ownership and control of as well as transfers and transactions involving digital assets

Financial Market Infrastructure Special Administration Regime

- To apply to systemic digital settlement asset firms

Financial promotions

- “**qualifying cryptoassets**” to be brought within the scope of financial promotions restrictions.
- Likely to include any cryptographically secured representations of value or contractual rights which is fungible and transferable

Financial market infrastructures sandbox

- To be launched in 2023

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The European approach to regulation of digital assets

European Union

Current regulatory approach

- Currently, no harmonised regulatory framework. Member States have generally taken three different approaches to regulating cryptoassets:

Expansion of scope of
existing regime:
Germany

New dedicated
regime:
Spain

Regulated where within
existing regime:
Italy

- Virtual asset service providers (custodian wallet providers of crypto exchange service) obliged entities required to ensure compliance with AML/CTF requirements
- Change is on the horizon...
 - September 2020: **Proposal for a Regulation on markets in Crypto-Assets (MiCA)** and proposal for a Regulation on a pilot regime for distributed ledger technology (DLT) market infrastructures.

European Union

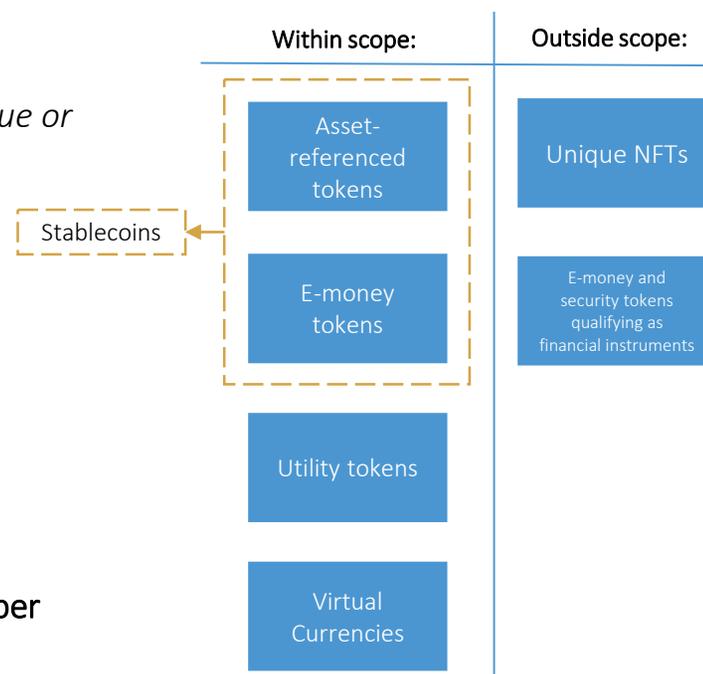
Key future developments

Regulation on Markets in Crypto-Assets (MiCA)

- Single harmonised regulatory framework for cryptoassets. Effectively applies MiFID II, Prospectus Regulation and MAR standards to cryptoassets
- Broad definition of a cryptoasset *“a digital representation of value or rights which may be transferred and stores electronically, using distributed ledger technology or similar technology.”*

Key Features
Rules on the offering of cryptoassets to the public
Regulatory regime for cryptoasset service providers
Bespoke regime for stablecoins

- Compromise text approved and released by the Council in **October 2022**
- Expected entry into force: **some time in 2024**



European Union

Key future developments

Extension of travel rule

- June 2022, provisional agreement on the extension of the travel rule to cover: Any payments made in cryptoassets, at any amount, with no exemptions for low-value transfers
- Transactions from un-hosted wallets covered if in interaction with hosted wallets managed by cryptoasset service providers exceeds €1,000
- Expected to come into force mid-2024

DLT pilot regime

- Regulatory sandbox to be in force from March 2023.
- Aim: Remove obstacles under the current regulatory framework to the implementation of DLT in financial market infrastructures
- National Competent Authorities entitled to grant targeted exemptions from provisions restricting market infrastructures

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UAE's and DIFC's approach to regulation of digital assets

United Arab Emirates Dubai International Financial Centre

Current regulatory approach

Numerous Regulators in the UAE

- In the UAE, there are five main regulatory authorities with, at times, overlapping jurisdiction over virtual/crypto assets and tokens:
 - UAE Central Bank (UAE-wide except in DIFC/ADGM)
 - UAE Securities and Commodities Authority (UAE-wide except in DIFC/ADGM)
 - Dubai Virtual Assets Regulatory Authority (Dubai-wide except DIFC)
 - ADGM Financial Services Regulatory Authority (ADGM only)
 - DIFC Dubai Financial Services Authority (DIFC only) – see below
- To varying degrees, these regulators are concerned with persons carrying on business in connection with virtual/crypto assets and tokens in their jurisdictions.



Dubai International Financial Centre

- Regulated by the Dubai Financial Services Authority – most established “Western-style” regulator in the UAE. (Note, the ADGM FSRA is newer but has a similar approach and regime.)
- Created an investment tokens regime in October 2021 and started a consultation process on a crypto tokens regime in early 2022.

United Arab Emirates Dubai International Financial Centre

Recent developments in the Dubai International Financial Centre – The Crypto Tokens Regime

- The DFSA’s new Crypto Tokens regime came into effect on 1 November 2022. It augments the DFSA’s existing investment tokens regime introduced in 2021.
- The DFSA considers a token to be a Crypto Token if it: (a) is used, or is intended to be used, as a medium of exchange or for payment or investment purposes; or (b) confers a right or interest in another token that meets the requirements in (a). However, certain tokens are not Crypto Tokens (i.e. “investment tokens”, NFTs, “utility tokens” and digital currencies issued by any government, government agency, central bank or other monetary authority)
- In general, only Crypto Tokens that are “recognised” by the DFSA may be used in connection with a financial service, public offering or financial promotion in the DIFC.
- Use of Privacy Tokens/Devices and Algorithmic Tokens is prohibited.
- A DFSA authorised firm may not carry on both a DFSA regulated crypto business and business relating to NFTs and Utility Tokens (unless providing custody) to avoid any misconception by users of a service that regulatory requirements for financial services apply to the unregulated part of the business.
- Significant protections have been introduced for retail clients (e.g. use of credit for transactions and extensive information requirements)



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Hong Kong's approach to regulation of digital assets

Hong Kong

[Hong Kong government's updated policy on virtual assets \(31 Oct 2022\)](#)

During Hong Kong FinTech Week 2022, the Hong Kong government announced its updated policy stance to promote the development of a vibrant sector and ecosystem for virtual assets. The SFC also made a number of positive statements on its approach to regulating virtual asset service providers and virtual asset-related products.

[Current regulatory approach](#)

1. Regulation of virtual asset products

- Spot trading in virtual assets currently unregulated
- Funds investing in virtual assets and derivatives linked to virtual assets are regulated the same as funds and derivatives in traditional asset classes

2. Regulation of licensed firms carrying on virtual assets business

- Regulation of Virtual Asset Portfolio Managers and Virtual Asset Trading Platforms

3. 2022 HKMA and SFC joint circular on virtual asset-related activities

- Introduced new regulatory requirements for (i) distribution of virtual asset-related products; (ii) provision of virtual asset dealing services, and (iii) provision of virtual asset advisory services
- Additional HKMA circular for licensed banks



Financial Services and the Treasury Bureau
The Government of the Hong Kong Special Administrative Region
of the People's Republic of China



HONG KONG MONETARY AUTHORITY
香港金融管理局

Hong Kong

Key future developments

1. Virtual Asset Service Provider (VASP) licensing regime

- Amendment to the AML legislation in Hong Kong
- Objective and scope of VASP regime
- Consumer protection under VASP regime
- Anticipated timing for implementation
- SFC consultation

2. Virtual asset futures ETFs

- SFC Circular on Virtual Asset Futures ETFs (31 Oct 2022)

3. Consultation on the regulation of stablecoins

- HKMA's proposal to regulate stablecoins

4. Next steps on introducing e-HKD

- HKMA's plans for developing a Central Bank Digital Currency (CBDC)



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**SECURITIES AND
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HONG KONG MONETARY AUTHORITY
香港金融管理局

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Singapore's approach to regulation of digital assets

Singapore

Current regulatory approach

1. Regulation of digital payment tokens (“DPTs”)

- The dealing in (i.e. buy or sell) DPTs or the operating of an exchange for the buying or selling of DPTs, where the operator of the exchange takes possession of money or DPTs are regulated under the Payment Services Act 2019 (“PS Act”)
- All providers of DPT services must comply with the AML/CTF requirements issued under the Payment Services Regulations 2019

2. Regulation of ‘security tokens’

- The listing and/or trading of security tokens (e.g. digitalisation of valuable assets into fragmented securities representing right of ownership or right to dividends) is regulated under the Securities and Futures Act 2001



Monetary Authority
of Singapore

Key future developments

1. Payment Services (Amendment) Act 2021 (“PSAA”)

- Widening of the regulatory ambit of licensable DPT services under the PS Act carried out in Singapore
- Will regulate the (a) transfers of DPTs; (b) DPT custody services; and (c) brokerage of DPT transactions

2. Financial Services and Markets Act 2022

- Reflects the expanded regulatory ambit of licensable DPT services under the PS Act as amended by the PSAA
- Applies to Singapore-incorporated entities that carry on licensable DPT services outside of Singapore (i.e. businesses that specifically exclude the Singapore market)
- Regulated for AML/CFT purposes to align with the enhanced FATF standards



Monetary Authority
of Singapore

Singapore

Key future developments

MAS Consultation Papers

- PSAA subsidiary legislations / proposed changes to the existing PS Act subsidiary legislations
- FSMA subsidiary legislations
- Consumer protection regulations
- Safeguarding / custody security of DPTs
- Token Listing best practices for DPT-exchanges
- Stablecoins
- Technology risk management
- Market integrity



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Questions