

Guidance on Cryptoassets

Feedback and Final Guidance to CP 19/3

Policy Statement

PS19/22

July 2019

This relates to

CP19/3

Please send any comments or queries to:

Parma Bains
Financial Conduct Authority
12 Endeavour Square
International Quarter
London E20 1JN

Innovate Telephone:

0207 066 4488

Email:

fcacrypto@fca.org.uk

Contents

| | | |
|-------------------|--------------------------------------|----|
| 1 | Summary | 3 |
| 2 | Unregulated tokens | 9 |
| 3 | Regulated tokens | 15 |
| 4 | Market observations | 20 |
| | | |
| Annex 1 | | |
| | List of non-confidential respondents | 24 |
| | | |
| Annex 2 | | |
| | Abbreviations used in this paper | 27 |
| | | |
| Appendix 1 | | |
| | Perimeter Guidance | |
| | | |
| Appendix 2 | | |
| | Q&A | |

1 Summary

- 1.1** In our Guidance on Cryptoassets Consultation Paper (CP 19/3), we set out our position on cryptoassets in relation to the regulatory perimeter.
- 1.2** The Guidance we consulted on aims to give market participants and interested stakeholders clarity on the types of cryptoassets that fall within the FCA's regulatory remit and the resulting obligations on firms (in this paper, firms means market participants rather than 'authorised persons') and regulatory protections for consumers. It also provides information on those cryptoassets that are outside our perimeter, and what this means for firms and consumers.
- 1.3** This Policy Statement (PS) is our response to CP 19/3. It summarises the feedback we received to the consultation and our responses. It also sets out our Final Guidance.

Who this affects

- 1.4** This guidance is relevant to:
- firms issuing or creating cryptoassets
 - firms marketing cryptoasset products and services
 - firms buying or selling cryptoassets
 - firms holding or storing cryptoassets
 - professional advisers
 - investment managers
 - recognised investment exchanges, multi-lateral trading facilities and organised trading facilities
 - consumers and consumer organisations
- 1.5** This is not an exhaustive list, and it is likely that the consultation will be relevant to additional stakeholders.

The wider context of this policy statement

Our consultation

- 1.6** The aim of our consultation was to provide clarity on the FCA's regulatory perimeter for market participants carrying on activities in this area. The cryptoasset market and its underlying distributed ledger technology (DLT) is developing quickly, so participants need to be clear on where they are conducting activities that fall within the scope of our regulatory remit and for which they require our authorisation.
- 1.7** We also want to help consumers better understand the cryptoasset market and the resulting implications for the protections they have, depending on the product.

1.8 Through consulting on Guidance, we feel that market participants will be better able to understand whether certain cryptoassets are within the regulatory perimeter or fall outside regulation. This will alert them to relevant issues and should help them better understand whether they need to be authorised and what rules or regulations apply to their business.

1.9 In CP 19/3, we consulted on Guidance based on the different categories of cryptoassets initially defined in the UK Cryptoasset Taskforce Report (CATF), and set out whether or not they fall within the regulatory perimeter. These categories were:

- **Exchange tokens:** These are not issued or backed by any central authority and are intended and designed to be used as a means of exchange. They tend to be a decentralised tool for buying and selling goods and services without traditional intermediaries. These tokens are usually outside the perimeter.
- **Utility tokens:** These tokens grant holders access to a current or prospective product or service but do not grant holders rights that are the same as those granted by specified investments. Although utility tokens are not specified investments, they might meet the definition of e-money in some circumstances (as could other tokens). In this case, activities involving them may be regulated.
- **Security tokens:** These are tokens with specific characteristics that mean they provide rights and obligations akin to specified investments, like a share or a debt instrument (described in more detail in Chapter 3) as set out in the Regulated Activities Order (RAO). These tokens are within the perimeter.

1.10 In CP 19/3, we examined whether the CATF categories of cryptoassets can fall within regulation as:

- specified investments under the RAO
- financial instruments under the Markets in Financial Instruments Directive (MiFID)
- e-money under the E-Money Regulations (EMRs)
- within the scope of the Payments Services Regulations (PSRs)

1.11 Our consultation Guidance outlined where cryptoassets may fall within our regulation and remit, and the resulting obligations that may apply. We shared an indicative list of permissions market participants may need to hold, as well as other rules and regulations that may apply.

1.12 CP 19/3 covered where we may have oversight over unregulated cryptoassets when used by authorised firms. It also explained what actions we can take if unauthorised firms carry on regulated activities without the right permissions.

How it links to our objectives

Consumer protection harms

1.13 Our Final Guidance will make it clear that firms carrying on certain specified activities in relation to cryptoassets in the UK must get the appropriate authorisation from us. Consumers should be able to identify if a cryptoasset falls within our FSMA perimeter or is otherwise regulated (for example, under the EMRs). They can use services like the FCA Register to make sure the firms they are dealing with have the necessary permissions for the regulated activities they are undertaking.

- 1.14** The Guidance highlights some of the requirements and permissions that participants such as custodian wallet providers, and exchanges and trading platforms need to consider when carrying on regulated activities.
- 1.15** The Guidance also highlights forthcoming consultations on how cryptoasset market participants may be affected by the transposition of the EU Fifth Anti-Money Laundering Directive (5AMLD). Firms should make sure they know how existing anti-money laundering (AML) requirements apply to their business.

Market integrity harms

- 1.16** A combination of market immaturity, volatility, and a lack of credible information or oversight raises concerns about market integrity, manipulation and insider dealing within cryptoasset markets. This may prevent the market from functioning effectively and damage its reputation.
- 1.17** The aim of the Guidance is to clarify what is regulated by the FCA, where regulation applies and what this means for firms. This means that firms that carry on regulated activities will need to be authorised. Firms and other market participants will also need to make sure they know, and comply with, the relevant regulatory obligations (including under the Market Abuse Regulation) that apply to them.

Competition harms

- 1.18** Final Guidance should reduce legal uncertainty and help firms to develop legitimate cryptoasset activities and business models. This may improve participation in the cryptoasset market and enhance competition in the interest of consumers.

What we are changing

- 1.19** Following our consultation, we are proceeding with the Guidance that was consulted on, with some drafting changes to improve clarity based on responses. This includes reframing our taxonomy of cryptoassets to help market participants better understand whether tokens are regulated, and where they fall outside our remit.

Outcome we are seeking

- 1.20** This Guidance should clarify our expectations for firms carrying on cryptoasset activities within the UK.
- 1.21** If a firm acts in line with the Guidance, we will treat them as having complied with the relevant rule or requirement. This Guidance represents our views. It does not bind the courts, but it can be a persuasive factor in the courts' determinations, for example enforcing contracts.
- 1.22** The Final Guidance will enable market participants to understand whether certain cryptoassets fall within our perimeter or are otherwise regulated. This should allow firms to have increased certainty about their activities while meeting our own regulatory objectives of consumer protection, enhancing market integrity and promoting effective

competition in consumers' interest. We encourage firms to seek expert advice if they are unsure whether their products, services or activities fall within the regulatory perimeter or are otherwise regulated.

Measuring success

1.23 We want this Guidance to provide regulatory clarity for firms, and by doing so create greater market integrity and consumer protection for the cryptoasset market. We can measure our success in achieving these outcomes in several ways, including:

- evaluating feedback from stakeholders to the Final Guidance
- an increase in the number and accuracy of authorisations submissions from firms undertaking regulated cryptoasset activities
- fewer referrals to our Unauthorised Business Division (UBD) and Financial Promotions team which indicates that persons (and their advisers) are clearer about when they need authorisation and where our financial promotion rules apply
- fewer calls and/or requests for support through Innovate on matters regarding the regulatory application to cryptoassets

1.24 A secondary outcome this Guidance aims to achieve is to help consumers better understand the cryptoasset market. We can potentially measure this by:

- conducting a follow up consumer survey in 12 months
- analysing calls through the FCA Consumer Hub (previously known as the Contact Centre) to assess consumer understanding of cryptoassets in relation to the regulatory perimeter

Summary of feedback and our response

1.25 We received 92 responses to CP 19/3 from across the financial services sector and beyond including:

- large banks
- trade associations
- consultancies
- fintechs
- token issuers
- cryptoasset exchanges
- custody service providers law firms
- technology firms
- academia
- individuals

1.26 Most respondents supported our proposals. We are, therefore, proceeding on the basis on which we consulted, with some drafting amendments in a few areas to improve clarity and ensure that the policy intention is achieved.

1.27 While the Final Guidance does not differ significantly from the drafts we consulted on, we have reframed the taxonomy to better reflect market observations and ensure our

Guidance is clear and accurate. We have also provided further clarity on tokens commonly referred to as 'stablecoins'. Minor drafting changes have been made throughout the Guidance, particularly to provide more clarity where tokens might be e-money.

- 1.28** In Chapters 2 and 3 we lay out and summarise the feedback to our draft Guidance and our response. In Chapter 4 we summarise the feedback to the Market Observations section of the Guidance and our response. The Final Guidance can be found in Appendix 1, and Q&A in Appendix 2.
- 1.29** We would like to thank all respondents for taking the time to share their views.

Equality and diversity considerations

- 1.30** We have considered the equality and diversity issues that may arise from our proposals, which aim to provide clarification about our existing regulatory perimeter and regulation.
- 1.31** The technological aspect of cryptoassets could potentially create equality and diversity considerations for certain consumers. We are considering the complex nature of cryptoassets, and the misinformation targeted at certain groups of consumers as part of our wider consumer research work into cryptoassets. We will continue to consider the equality and diversity implications following implementation of the Final Guidance.

Implications for EU Withdrawal

- 1.32** In March 2018, the UK and the European Union (EU) reached agreement on the terms of a prospective implementation (or transitional) period following the UK's withdrawal from the EU.
- 1.33** The implementation period is intended to operate from exit day until at least the end of December 2020. During this time, EU law will still apply in the UK, in accordance with the overall withdrawal agreement. This means that firms, funds and trading venues will continue to benefit from passporting between the UK and the European Economic Area (EEA) as they do today. Obligations derived from EU law will continue to apply and firms must continue with implementation plans for EU legislation that is still to come into effect before the end of December 2020, including 5AMLD.
- 1.34** The implementation period forms part of the withdrawal agreement, which is still subject to ratification. We continue to work to ensure the UK's legal and regulatory framework for financial markets will also continue to function in the absence of a withdrawal agreement or implementation period.
- 1.35** The transposition of 5AMLD is relevant to firms across financial services, including firms carrying on activities involving cryptoassets. We will also be monitoring other work in hand by European and international regulators on the scope and detail of the regulation of cryptoassets.

Next steps

1.36 We set out our Final Guidance in Appendix 1. We expect market participants to take our Guidance on cryptoassets into consideration when carrying on business in the United Kingdom. The Final Guidance provides a basis on which we can proactively engage with any cryptoasset firms to see whether they are carrying on regulated activities.

1.37 The Final Guidance will inform further work being carried out in this area, including:

- our consultation on potentially banning the sale of derivatives linked to certain types of unregulated cryptoassets to retail clients
- Treasury's consultation on whether further regulation is required in the cryptoasset market, particularly in relation to unregulated cryptoassets
- Treasury and FCA work on transposing 5AMLD

2 Unregulated tokens

- 2.1** In this chapter, we summarise the responses to our consultation on unregulated tokens and what this means for firms and consumers using them. We have numbered questions based on their order in CP 19/3 for consistency.

Exchange tokens

- 2.2** Our consultation broadly described exchange tokens as those types of cryptoasset that are usually decentralised and primarily used as a means of exchange. These tokens are sometimes known as 'cryptocurrencies', 'crypto-coins' or 'payment tokens'. These tokens are designed to provide limited or no rights for tokens holders, and there is usually not a single issuer to enforce rights against.
- 2.3** CP 19/3 explained that we consider these tokens to be outside the regulatory perimeter. This means that market participants like crypto exchanges, which only provide a platform for the trading of exchange tokens (like Bitcoin, for example), are outside our remit. We asked:

Q1: *Do you agree that exchange tokens do not constitute specified investments and do not fall within the FCA's regulatory perimeter? If not, please explain why.*

Feedback received

General feedback

- 2.4** Almost all respondents that answered the question agreed that exchange tokens fall outside the regulatory perimeter. Respondents broadly agreed that firms carrying on activities involving exchange tokens would not need existing regulatory permissions.

A regime for exchange tokens

- 2.5** A third of those who answered the question felt that there should be some form of regime for exchange tokens. Of these, most supported some type of an Anti-Money Laundering regime. A smaller number of respondents said the regulatory perimeter should be widened to capture exchange tokens.

Delineation between exchange and utility tokens

- 2.6** A minority of respondents felt that there was not enough clarity on the differences between exchange and utility tokens. We address this feedback in more detail in the utility tokens section.

Our response

Responses to CP 19/3 suggest that most respondents agree with our assessment of exchange tokens and the perimeter. The location of the regulatory perimeter is a matter for legislation and the courts, and we can only provide guidance on how we believe the current

perimeter applies to cryptoassets. However, there are clearly issues raised by respondents that should be considered.

While keeping our approach on exchange tokens the same as the draft Guidance, ie. that exchange tokens do not fall within the regulatory perimeter, we have decided to make drafting changes to make it clearer where tokens are regulated and when they are potentially unregulated.

A regime for exchange tokens

Some respondents raised issues with exchange tokens sitting outside our remit. Most concerns were about consumer harm, but a small number of respondents also raised potential market integrity issues.

The draft Guidance focuses on cryptoassets and the existing perimeter, and views on a potential new perimeter are out of scope of this Guidance. However, responses will help inform the Treasury's work on unregulated cryptoassets. Ultimately, we cannot change the perimeter, but feedback can help inform whether legislative change is required.

The 5AMLD will bring in an AML regime for cryptoassets including exchange tokens. The Government has announced that the FCA will be the supervisor for this regime, and the FCA will consult later this year on our approach.

The AML regime is separate to an extension of the regulatory perimeter, and exchange tokens will remain outside the perimeter.

Delineation between exchange and utility tokens

Some respondents said there was a lack of clarity between our definitions of exchange and utility tokens. This concern was brought out more clearly in the section on utility tokens, and we will address this later in this chapter.

Other rules that may apply to authorised firms using unregulated cryptoassets

2.7 Where an FCA authorised firm carries on unregulated activity (for example, in relation to an unregulated cryptoasset), while that activity may not require a permission in itself, it is possible in certain circumstances that some FCA rules, like the Principles for Business (PRIN) and the individual conduct rules under the Senior Managers and Certification Regime (SMCR), may apply to that unregulated activity. Unregulated activities may also be relevant in assessing whether the firm continues to comply with the Threshold Conditions for authorisation.

Senior Managers and Certification Regime (SMCR)

2.8 FSMA requires that individuals performing controlled functions within authorised firms must be approved by the regulator. The FCA's (and PRA's) role has been to designate these functions, assess whether individuals are fit and proper to perform the functions, and take disciplinary action against individuals who break the regulators' rules.

2.9 The SMCR regime currently applies to all UK deposit takers and dual regulated investment firms, insurers and will extend to all FCA FSMA solo-regulated firms in December 2019.

2.10 The individual conduct rules under the SMCR, which apply to all relevant individuals within an authorised firm covered by those rules, apply to both regulated and unregulated

activities. For the UK deposit takers and dual regulated investment firms, the individual conduct rules apply to all regulated and unregulated activities. For insurers and other FCA regulated firms, these rules apply to activities within the definition of 'SMCR financial activities', which are:

- regulated activities;
- an activity carried on in connection with a regulated activity (whether current, past or contemplated);
- an activity held out as being for the purposes of a regulated activity (whether current, past or contemplated);
- activities that constitute dealing in investments as principal, disregarding the exclusion in article 15 of the Regulated Activities Order (Absence of holding out etc); or
- activities listed in points 2 to 15 of Annex I to the CRD (List of activities subject to mutual recognition).

2.11 Accordingly, activities by relevant individuals within authorised firms in relation to unregulated cryptoassets may be covered by the conduct rules of the SMCR, and the FCA would be able to take action against those individuals for breaches of those rules where the conduct is covered by these rules.

Principles for Business rules (PRIN)

2.12 Regulatory provisions such as the Principles for Business apply to the regulated activities of authorised firms but can also apply to unregulated activities authorised firms are carrying out in certain circumstances, and the FCA can take action against firms for breaches of these provisions.

2.13 The FCA's Principles for Business are 11 high level principles which apply to all FCA regulated firms. They include requirements that firms must conduct their business with integrity, exercise due skill and care, treat their customers fairly, and observe proper standards of market conduct.

Working with other agencies

2.14 Where the FCA is made aware of potentially fraudulent or harmful activity in the cryptoasset market being conducted in the unregulated space, we can, and will work with other agencies to mitigate that harm. This includes working with the Advertising Standards Agency, local police forces and other relevant entities.

Exchange tokens to facilitate regulated payments

2.15 As set out in CP 19/3, exchange tokens can be used to facilitate regulated payment services, such as international money remittance. We shared an example of a firm who had tested this business model in our regulatory sandbox.

2.16 We proposed Guidance stating that the use of exchange tokens as a vehicle for remittance does not mean the exchange tokens themselves will be within the regulatory perimeter. The PSRs would, instead, apply to each side of the remittance. Firms using exchange tokens to facilitate regulated payments would need to consider the PSRs, but the tokens themselves would not be regulated. We asked two questions about cryptoassets and payments:

- Q2:** *Do you agree with our assessment that exchange tokens could be used to facilitate regulated payments?*
- Q3:** *Are there other use cases of cryptoassets being used to facilitate payments where further Guidance could be beneficial? If so, please state why.*

Feedback received

General feedback

- 2.17** Most respondents agreed that exchange tokens can be used to facilitate regulated payments, and where they are, the tokens themselves remain outside the regulatory perimeter. Some respondents highlighted this as an area of key growth for cryptoassets and DLT technology, but some felt the volatility of cryptoassets inhibited their effective use as a vehicle for remittance.
- 2.18** Other responses highlighted issues of disclosure by payment service providers, as well as the potential for cryptoassets other than exchange tokens to facilitate regulated payments.

Disclosure by payment service providers

- 2.19** Some respondents highlighted the need for these firms to ensure they consider and communicate the risks that consumers may run when using these services.

Other cryptoassets to facilitate regulated payments

- 2.20** A small number of respondents highlighted that certain utility tokens can also be used to facilitate regulated payments, particularly where their volatility has been stabilised.

Our response

We have considered the feedback to the above two questions and based on the responses will proceed with the Guidance we consulted on with minor drafting changes.

Disclosure by payment service providers

As set out in CP 19/3, any firms using cryptoassets to facilitate regulated payments must ensure that they have the correct permissions and follow the relevant rules and regulations. This includes, but is not limited to, the PSRs, and from 1 August 2019, PRIN and BCOBS (this is already applicable to FSMA firms).

Other cryptoassets to facilitate regulated payments

We agree that cryptoassets other than exchange tokens can be used to facilitate regulated payments. This is particularly true of tokens commonly referred to as stablecoins. We have decided to make minor drafting changes to the Guidance to reflect this feedback.

Utility tokens

- 2.21** Our consultation described utility tokens as those tokens that provide consumers with access to a current or prospective product or service and often grant rights similar to pre-payment vouchers.
- 2.22** As set out in CP 19/3, we considered utility tokens to be outside the regulatory perimeter. The exception is if they reach the definition of e-money, in which case they would be regulated under the EMRs. In our consultation, we asked:

Q4: *Do you agree with our assessment of utility tokens? If not, please explain why.*

Feedback received

General feedback

- 2.23** Three-quarters of respondents agreed that most utility tokens are outside the regulatory perimeter and that only those utility tokens that reach the definition of e-money fall within it.

Bringing utility tokens into the regulatory perimeter

- 2.24** Some respondents felt that we should consider bringing utility tokens into our regulation. Some respondents felt that any token used as a form of speculative investment should be brought into the regulatory perimeter.

Delineation between exchange and utility tokens

- 2.25** Some respondents requested further Guidance on the distinction between exchange and utility tokens. Respondents felt the definitions were not clear, and found it difficult to decide whether their tokens would be considered exchange or utility tokens

Our response

Based on responses, we will be proceeding with the Guidance we consulted on, with drafting changes to make the distinctions between categories of cryptoassets clearer.

The most important distinction is whether tokens fall inside, or out of, regulation. We will make changes to the Guidance to make the category of unregulated tokens clearer, by repositioning the cryptoasset taxonomy.

We will also separate e-money tokens from the utility tokens and security tokens category. This will create a specific regulated e-money token category and an unregulated category that includes utility tokens.

Bringing utility tokens into the regulated perimeter

Any changes to the regulatory perimeter require legislative change. Feedback to CP 19/3 will help inform the Treasury's consultation later this year, as part of its CATF work on unregulated tokens.

Delineation between exchange and utility tokens

We agree that further clarity in this area is needed so that market participants are clear that the important regulatory distinction lies in whether the token is regulated, or not.

While the UK Cryptoasset Taskforce's taxonomy brought order to a large range of cryptoassets, we feel it is valid to amend it to make it clearer for market participants and interested stakeholders. The taxonomy needs to be accurate and reflect developments in the cryptoasset market.

We have repositioned the taxonomy to do this and ensure our policy objectives are achieved. The regulatory treatment of cryptoassets will not change.

- **Security tokens:** this category does not change materially from the Guidance that we consulted on and refers to those tokens that provide rights and obligations akin to specified investments as set out in the RAO, excluding e-money. We have now specifically removed e-money from the definition of a security token, to create a separate category. These remain within the regulatory perimeter.
- **E-money tokens:** this category refers to any token that reaches the definition of e-money. These tokens are subject to the EMRs and firms must ensure they have the correct permissions and follow the relevant rules and regulations. This category formerly sat within the utility tokens category. These tokens fall within regulation.
- **Unregulated tokens:** this category refers to any token that does not meet the definition of e-money, or provide the same rights as other specified investments under the RAO. This includes tokens referred to as utility tokens, and exchange tokens.
 - These tokens can, for example, be issued centrally or be decentralised, give access to a current or prospective good or service in one or multiple networks and ecosystems, or be used as a means of exchange. They can be fully transferable or have restricted transferability. These tokens fall outside the regulatory perimeter.

We have provided further illustrative examples in the Guidance to support this reframed taxonomy, specifically on tokens referred to as 'bank' or 'settlement' tokens, tokens that might move between categories and clarity on the effects of transferability.

3 Regulated tokens

- 3.1** In this chapter, we summarise the feedback we received on our approach to regulated tokens and what it means for firms and consumers using these tokens. We have numbered questions based on their order in CP 19/3 for consistency.

Security tokens

- 3.2** In broad terms, we described security tokens as those tokens that provide rights and obligations akin to specified investments as set out in the RAO, including those that are financial instruments under MiFID II. For example, these tokens have characteristics which mean they are the same as or akin to traditional instruments like shares, debentures or units in a collective investment scheme.
- 3.3** As set out in CP 19/3, security tokens are within the regulatory perimeter. This means that firms carrying on specified activities involving security tokens need to ensure that they have the correct permissions and are following the relevant rules and requirements. We asked:

Q5: *Do you agree with our assessment of how security tokens can be categorised as a specified investment or financial instrument? If not, please explain why.*

Feedback received

General feedback

- 3.4** Almost all respondents who answered the question agreed with our assessment of security tokens in relation to the regulatory perimeter. Respondents agreed that security tokens are those tokens that give the token holder rights akin to those provided by specified investments. Consequently, firms using these tokens must ensure they have the correct permissions and follow the relevant rules and requirements.

Definition of security

- 3.5** Some respondents disagreed with the notion of a security token category, highlighting that the definition of a security can be quite broad and multi-faceted. One respondent gave the example of the regulatory treatment of tokens in the US where the broad definition of securities means many utility tokens are captured under the securities regime. This focus on a 'harmonised approach' across jurisdictions was shared by several respondents.

Clarity on regulated activities

- 3.6** A minority of respondents asked us for more clarity on other potentially regulated activities as a result of security tokens falling within the regulatory perimeter. Of this subset, respondents most frequently said further Guidance on cryptoasset custody would be particularly useful.

Our response

Having considered the feedback, we are proceeding with the Guidance we consulted on.

We believe it will give market participants sufficient clarity and ensure they know about the key issues related to security tokens. In particular, making sure they know that activities involving security tokens may be regulated activities. Firms should ensure they have the correct permissions when carrying on regulated activities.

Definition of security tokens

For our taxonomy, we specifically refer to security tokens as only those that reach the definition of specified investments under the RAO. The category has been slightly amended to specifically exclude e-money from this definition.

We agree the ideal is to have as harmonised a framework as possible for cryptoasset regulation to reduce the risks of firms gaming the system (regulatory arbitrage) or creating problems for firms that want to operate in different jurisdictions. However, there are some inherent structural differences in different jurisdictions' securities markets and legal/regulatory frameworks that equally affect securities in a tokenised form.

We will continue to work closely with other regulatory agencies; both bilaterally as well as multilaterally through bodies such as the Global Financial Innovation Network (GFIN), the International Organization of Securities Commissions (IOSCO), the European Commission (EC) and the European Supervisory Authorities (ESA) to encourage regulators to approach cryptoassets in a consistent way.

Clarity on regulated activities

We appreciate that areas such as custody operate differently on DLT networks than with traditional securities.

However, as our Guidance focuses on providing perimeter guidance (ie whether cryptoassets fall within or outside the perimeter), this is out of scope of the PS. The use of DLT systems creates questions around certain activities and processes like custody, and settlement. While not perimeter issues (and therefore out of scope for the PS), we recognise these areas are impacted by DLT. We are monitoring developments in these areas, and stand ready to engage with market participants as the market matures.

Market participants should use the Guidance as the first step in understanding how they should treat certain cryptoassets, however definitive judgements can only be made on a case-by-case basis. Firms should supplement the Guidance with the FCA's Perimeter Guidance Manual (PERG).

Where firms still have questions, they can apply for support using our Innovate services. The Direct Support service can provide regulatory feedback for firms developing innovative propositions, as long as they reach the eligibility criteria for support.

Firms should seek independent legal advice if they are still unsure of how the Guidance relates their specific case.

E-money tokens

3.7 E-money tokens are tokens that meet the definition of electronic money in the EMRs. That is:

- electronically stored monetary value that represents a claim on the issuer
- issued on receipt of funds for the purpose of making payment transactions
- accepted by a person other than the issuer
- not excluded by regulation 3 of the EMRs

3.8 In CP 19/3, we set out where cryptoassets may meet the definition of electronic money and fall within the scope of EMRs. We described that they are likely to be certain types of utility tokens, including those referred to as 'stablecoins'. Our draft Guidance identified where tokens may be considered e-money, and the permutations for firms. We asked:

Q6: *Do you agree with our assessment of stablecoins in respect of the perimeter?*

Feedback received

General feedback

3.9 The majority of respondents who answered the question agreed with our assessment on tokens where there is an attempt to stabilise their volatility. Respondents agreed that certain types of tokens can meet the definition of e-money and so fall under the EMRs.

Stablecoins

3.10 A large minority of respondents asked for further clarity on tokens where there is an attempt to stabilise volatility, whether through backing the token with fiat funds, a basket of cryptoassets, other types of assets, or algorithms.

An e-money category

3.11 Some respondents felt that the Guidance could go further to explain precisely when utility tokens meet the definition of e-money. Respondents said that categorising e-money tokens within the utility tokens category was less helpful. This is because utility tokens are largely unregulated, although with exceptions for e-money tokens. Respondents found this combination of regulated and unregulated token types within one overarching category confusing.

3.12 Respondents felt that a separate category for e-money tokens would make it clear that firms using these types of tokens would have to follow appropriate rules and regulations, as well as making sure they have the correct permissions.

Our response

We have considered the feedback and based on this we agree that we need to make minor drafting changes in the Guidance to achieve the policy objectives of this PS.

We believe the Final Guidance will cover the concerns respondents raised, while ensuring market participants ongoing agreement with our broad approach to the question in CP 19/3.

Stablecoins

We have observed tokens in the market where there are attempts to stabilise their value using a variety of mechanisms. These tokens are commonly referred to as 'stablecoins'. However, while they may have a common purpose, they vary greatly in their structure and arrangement, making them inappropriate for any single classification. Therefore, not every 'stablecoin' will meet the definition of e-money, or a security token.

For instance, it may be a derivative, a unit in a collective investment scheme, a debt security, e-money, or another type of specified investment. Or, it might fall outside our remit.

- Many tokens are "backed with" fiat currencies, most commonly the United States Dollar (USD), but we have seen tokens backed with other fiat currencies, including the British Pound (GBP) or a basket of currencies. In some cases, this involves the issuer "pegging" the value to that currency – i.e guaranteeing the value of the token, while holding a reserve of fiat currency(ies) to ensure it can meet any claims. In other cases, the token gives the token holder an interest or right to the custodied fiat currency(ies), with the value of the tokens being directly linked to the value of the fiat currency held. These distinctions are also relevant for the models described below.
- Some tokens are backed with different types of cryptoassets with the aim of providing stabilisation through diversification given by different cryptoassets, in an attempt to spread risk and reduce price volatility.
- Other tokens are backed with assets that could include specified investments, commodities, or other types of assets. One example involves cryptoassets backed by relatively stable commodities, like gold.
- Some firms have experimented with algorithms to control the supply of tokens, increasing supply when a token's value rises above a pre-programmed 'peg' (such as 1:1 with USD). Alternatively, they could decrease the supply when the value of the token falls below the set parameters, making them scarcer. But respondents were clear in informing us that working models in the market are not yet at sufficient size or scale to require specific guidance.

CP 19/3 describes how only those tokens that meet the definition of e-money will be e-money tokens. This is made clear in paragraph 3.7 above.

It's important to note that not all tokens where attempts have been made to stabilise their value will be e-money. Tokens must also meet the other criteria in the definition of e-money set out in the EMRs.

For example, a token that is backed with fiat currency, but can only be spent with the issuer will not constitute e-money, as it is not accepted by a person other than the issuer (point 3 in paragraph 3.7).

While these tokens may not meet the definition of e-money, they could fall inside the perimeter in other ways, for example, as security tokens. Depending on structure and arrangement, tokens could meet the definition of units in a collective investment scheme, debt securities or other types of specified investments. Given the structure of rights attached to such tokens varies greatly, judgements on whether they fall under the scope of regulation can only be made on a case-by-case basis. Tokens that do not meet the definition of an e-money token, or the definition of a security token, will be unregulated tokens.

Market participants that are unsure about the regulatory treatment of their tokens should speak with the FCA or seek legal advice.

An e-money category

Our consultation explained that while utility tokens are likely to fall outside regulation, some of them (as well as some exchange tokens) may meet the definition of e-money.

This approach allowed us to accurately reflect the business models and tokens we are seeing in the market, and describe how they interact with the UK Cryptoasset Taskforce's taxonomy.

However, as the cryptoasset market evolves, we need a flexible approach to ensure our regulation remains accurate and appropriate. We have decided to make drafting changes to the Guidance to create a category of cryptoasset in the taxonomy that reflects those tokens that reach the definition of e-money.

A new e-money token category will better illustrate where tokens fall under regulation. Any token that is not a security token, or an e-money token is unregulated. However, market participants should note certain activities that use tokens may nevertheless be regulated, for example, when used to facilitate regulated payments.

This new taxonomy is covered in greater detail in Chapter 2 and Appendix 1.

4 Market observations

- 4.1** In this chapter, we summarise the feedback on our questions on the cryptoasset market, including different types of tokens, business models, participants and activities. We have numbered questions based on their order in CP 19/3 for consistency.

Tokens and business models

- 4.2** CP 19/3 provided several case studies; from the regulatory sandbox, our direct support function and broader market observations. We demonstrated how these tokens and business models fit within the UK Cryptoasset Taskforce's taxonomy, and how they interacted with the perimeter.

- 4.3** We asked two questions about different tokens and business models:

Q7: *Do all the sections above cover the main types of business models and tokens that are being developed in the market?*

Q8: *Are there other significant tokens or models that we haven't considered?*

Feedback received

General feedback

- 4.4** Most respondents who answered the question agreed that CP 19/3 covered the main types of business models and tokens being developed in the cryptoasset market. However, they were keen to share with us different types of tokens in the market and the presence of DLT specific mechanisms such as airdrops.

Variety of tokens

- 4.5** Some respondents referred us to different tokens already in the market, as well as those being developed. These included what respondents called 'bank settlement tokens', 'non-fungible tokens' and 'equity and debt tokens', as well as tokens stabilised in ways we had not specifically mentioned in CP 19/3.

Airdrops

- 4.6** A small number of respondents requested further guidance on airdrops. Airdrops refers to the distribution of tokens, usually for free, to consumers. They are primarily used by new networks to attract more users but have also been used by existing networks to get additional users or generate further attention.

Our response

The responses we received have confirmed that the Guidance covers the main tokens and business models. The Guidance is not an exhaustive list of tokens but an indication of how we consider and treat different categories of cryptoassets.

We agree that further clarity is needed on airdrops and we will make minor drafting changes.

Variety of tokens

Our consultation aimed to provide clarity on the types of tokens that fall within the regulatory perimeter, or are otherwise regulated, and those that are unregulated. The Guidance gave indicative case studies of different tokens. However, the feedback to the consultation did not provide any tokens that would fall outside the taxonomy.

Some respondents highlighted 'equity' or 'debt tokens' as an area where splitting out the categories further could provide more clarity. These tokens are types of security tokens and so the perimeter analysis will be the same.

Other respondents highlighted various forms of utility tokens. Some of these attempt to stabilise their volatility through different means, and others that are non-fungible utility tokens. The regulatory treatment of these tokens does not change depending on their label. If they do not meet the definition of e-money tokens or security tokens, then these tokens will be unregulated.

A few respondents highlighted 'dual tokens'. We know that tokens can move between categories during their lifecycle, and sometimes work in tandem with other tokens during the launch of a new network. In either case, the regulatory treatment depends on the token's intrinsic structure, the rights attached to the tokens and how they are used in practice. If the token at a point in time reaches the definition of an e-money token or a security token, then it will fall under regulation. We have provided additional case studies on the fluidity of tokens within the Guidance.

A couple of respondents asked for further clarity on 'bank tokens', or 'settlement tokens'. These tokens are usually used by financial institutions to increase back-office efficiency, mainly for settlements. Again, these tokens fall within the taxonomy described in CP 19/3. For example, a token used with only the issuer and not for the purposes of making payments transactions will not meet the definition of e-money and unless it confers on the token holder the rights akin to another specified investment, we will treat it as an unregulated token.

We are therefore proceeding with Guidance on which we consulted.

Airdrops

Airdrops are a mechanism for issuers to distribute their tokens to a broad user-base. A specified investment is not contingent on it being purchased for value, and a token can be a security token even if nothing is received for it.

We have made minor drafting changes to include references to airdrops in the Final Guidance.

Activities and participants

4.7 CP 19/3 set out some of the participants in the cryptoasset market, as well as the types of activities they are likely to carry on. We asked two questions on activities and participants:

Q9: *Are there any other key market participants that are a part of the cryptoasset market value chain?*

Q10: *Are there activities that market participants carry on in the cryptoasset market that do not map neatly into traditional securities?*

Feedback received

4.8 While feedback suggests we have considered the key market participants and activities in the cryptoasset market, a small majority of respondents highlighted various participants and activities that we did not reference in the Guidance.

Other participants

4.9 Respondents highlighted miners, non-mining nodes, credit referencing agencies, decentralised exchanges, and social media influencers as participants that CP 19/3 did not cover in detail.

Other activities

4.10 More than one respondent asked for greater clarity on custody, settlement, clearing, tokenisation of assets and the treatment of cryptoassets.

Our response

The cryptoasset market is dynamic and fast moving. New participants are constantly joining the market, and their activities are constantly evolving. To maximise public value, we must be selective in the issues that we address and prioritise. While CP 19/3 does not try to reflect all participants and activities, we believe that certain areas require further monitoring. However, these areas are unlikely to be perimeter issues and so fall out of the scope of this PS.

Other participants

CP 19/3 gives interested stakeholders an overview of the types of participants in the market, and an indicative list of permissions they may require when interacting with regulated tokens, such as security and e-money tokens.

The consultation's main aim is to provide guidance on the perimeter. Whether described in the Guidance or not, all participants should ensure they have the correct permissions. They also need to follow the relevant rules and regulations when interacting with regulated tokens such as security and e-money tokens and where they are carrying on regulated activities involving these tokens.

We understand it can be difficult for market participants to be completely sure whether or not their business models require authorisation. This is particularly true in a fast-evolving market like cryptoassets. The Guidance should act as a first step for market participants to understand whether authorisation is required and should be read in conjunction with PERG. Where market participants are unsure and require regulatory feedback, Innovate support functions such as the Sandbox or Direct Support can provide this help for requests that meet the eligibility criteria for support. Market participants should also consider obtaining appropriate external advice.

Other activities

The use of DLT systems creates questions about certain activities and processes like custody, and settlement. While not perimeter issues (and therefore out of scope for the PS), we recognise these areas are impacted by DLT. We are monitoring developments in these areas, and stand ready to engage with market participants as the market matures.

Annex 1

List of non-confidential respondents

AFME

AlBit Ltd

Alex Haigh

Alternative Investment Management Association

Archax Ltd MTF

BCB Group

Bitstamp

Blockchain For Europe

BlockFacts Ltd.

Brave New Coin

BTA Consulting

CAPAG (UK&I)

Capital Law

CEX.IO LTD

Charles Stanley & Co Limited

Circle

CoinSchedule Limited

Compliance Services

ConsenSys

CryptoUK

Cyberian Defence Ltd

Daedalus

Digax Limited

Diginex

Dr. Aurelio Gurrea-Martínez, Singapore Management University

Eversheds Sutherland (International) LLP

Fina Cyberis Limited

Financial Services Consumer Panel

Fintelum

GIDE

Global Digital Finance

International Organisation for Standardisation

Israel Cedillo Lazcano (Edinburgh University)

James Spence

Koine Money Ltd

Laven Partners

London BlockChain Foundation

Lori Jo Underhill (LJU Associates Consulting)

MAX Markets Limited, GMEX Group Limited & DAG Global Limited

Michael Hall

Mike Beaver

Monerium

Moneybox Ltd

Neufund

NKB Blockchain Investment and Advisory

Piers Casimir-Mrowczynski

Prime factor Capital

R3

Radix

Ripple

ShapeShift

Sigmania Limited

Simmons & Simmons

Standard Chartered

State Street

The London Stock Exchange Group (LSEG)

Tritum Digital Assets

Trustology Ltd

UCL LLM

UK Finance

University College London

University of Dublin/ University of Leeds

Utocat

Wall Street Blockchain Alliance

World Federation of Exchanges

World Gold Council

Annex 2

Abbreviations used in this paper

| | |
|----------------|---|
| 5AMLD | The Fifth Anti-Money Laundering Directive |
| AML/CTF | Anti-Money Laundering/Counter Terrorist Financing |
| CfD | Contract for Difference |
| CP | Consultation Paper |
| CP 19/3 | Guidance on Cryptoassets consultation |
| DLT | Distributed Ledger Technology |
| EC | European Commission |
| EEA | European Economic Area |
| EMRs | E-Money Regulations 2011 |
| ESMA | European Securities and Markets Authority |
| EU | European Union |
| FATF | Financial Action Taskforce |
| FCA | Financial Conduct Authority |
| FOS | Financial Ombudsman Service |
| FSCS | Financial Services Compensation Scheme |
| FSMA | Financial Services and Markets Act 2000 |
| FX | Foreign Exchange |
| GDPR | General Data Protection Regulations |
| HMT | Her Majesty's Treasury |
| ICO | Initial Coin Offering |
| KYC | Know Your Customer |
| MAR | Market Abuse Regulations |

| | |
|----------------------|--|
| MiFID II | Markets in Financial Instruments Directive |
| MTF | Multilateral Trading Facility |
| OTF | Organised Trading Facility |
| PERG | Perimeter Guidance Manual |
| PRIN | Principles for Business |
| PS | Policy Statement |
| PSRs | Payment Services Regulations 2017 |
| RAO | Regulated Activities Order |
| SMCR | Senior Managers & Certification Regime |
| SME | Small and Medium sized Enterprise |
| The Guidance | Guidance on Cryptoassets consultation |
| The Taskforce | UK Cryptoasset Taskforce |
| UBD | Unauthorised Business Division |

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London E20 1JN

Appendix 1

Perimeter Guidance

Overview of the regulatory perimeter

1. The Financial Conduct Authority's (FCA) aim and purpose is set out in the Financial Services and Markets Act 2000 (FSMA). We have a single strategic objective – to make sure that the relevant markets function well. The strategic objective is underpinned by three statutory 'operational objectives':

 - to secure an appropriate degree of protection for consumers
 - to protect and enhance the integrity of the UK's financial system
 - to promote effective competition in the interest of consumers
2. The 'regulatory perimeter' describes the boundary that separates regulated and unregulated financial services activities. Activities that fall within the FCA's perimeter are regulated and require authorisation from us (or the Prudential Regulatory Authority if they relate to certain deposit-taking/insurance activities) before a firm can carry them out. The perimeter includes specified activities and investments set out in FSMA and the Regulated Activities Order (RAO). Regulated activities are often defined under EU law, which is then transposed into domestic law or applied directly. The Markets in Financial Instruments Directive (MiFID II) recognises various 'Financial Instruments'; these are certain categories of investments to which MiFID applies, which have been mapped to the RAO. For example, providing advice in relation to a specified investment like a share may amount to the regulated activity of 'advising on investments' which would likely require authorisation. Whereas providing advice in relation to something other than a specified investment, such as a commodity, like gold, is not within the regulatory perimeter, and is not a regulated activity, and will not require authorisation.
3. Activities can also fall within the FCA perimeter by virtue of other legislation. For example, providing payment services is regulated under the Payment Services Regulations (PSRs). Issuing e-money is regulated under the Electronic Money Regulations (EMRs), but is also a regulated activity under FSMA when it is carried on by credit institutions, credit unions and municipal banks. Market participants that carry on regulated activities involving e-money tokens will need to ensure they have the correct permissions and follow the relevant rules and regulations.
4. This Guidance focuses on the FSMA perimeter, but provides signposting, where appropriate, to relevant e-money and payments rules and regulations. The FCA publication, Payment Services and Electronic Money – Our Approach provides a more comprehensive overview.
5. We appreciate that people may purchase cryptoassets for speculative purposes, anticipating that their value will increase. We also appreciate that there are a number of factors that may increase their value, including speculative trading on secondary markets (usually cryptoasset exchanges). This is similar to the purchase of other assets, the value of which the investor expects to increase over time (residential or commercial property, wines, cars, artwork etc).

6. However, the fact that a cryptoasset is acquired for value (in exchange for other cryptoassets or for payment in fiat currency) does not necessarily make it a specified investment under the RAO, nor a financial instrument under MiFID.

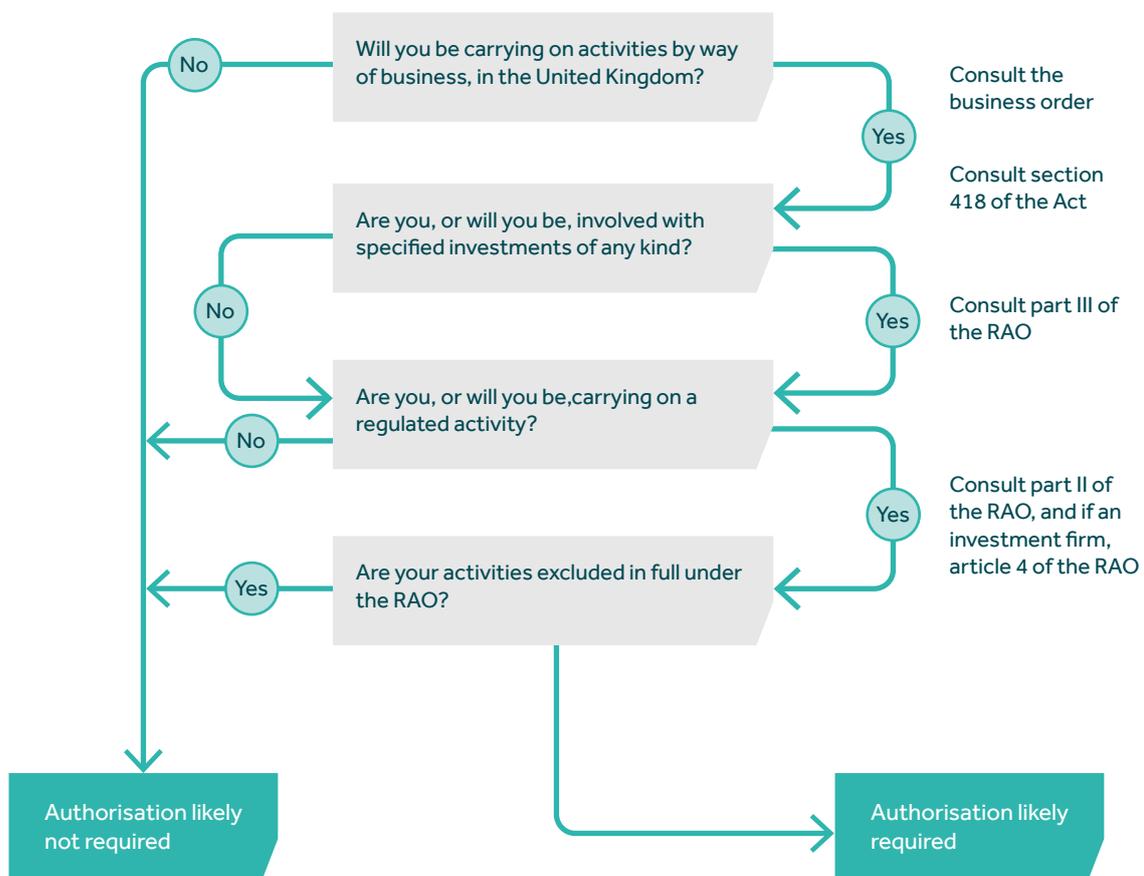
Understanding this Guidance

7. The Guidance clarifies where the different categories of cryptoasset tokens fall in relation to the FCA's regulatory perimeter. It outlines where tokens are likely to be:

- Specified investments under the RAO
- Financial instruments under MiFID II
- E-Money under the EMRs
- It also sets out when the use of cryptoassets may be captured under the PSRs

8. There are several different elements that firms need to take into account when considering the regulatory perimeter. Figure 1 shows some of these considerations with respect to the FSMA perimeter; however, the focus of this Guidance is predominantly on the second step, understanding specified investments. This is the area market participants have told us they struggle the most to understand and we agree that it warrants further regulatory clarity. However, references and signposting has also been provided in relation to payments services for additional clarity.

Figure 1: Do I need to be authorised by the FCA?



9. Before we examine specified investments in more detail, we have provided below a brief overview of what we mean when describing 'by way of business' and 'territoriality' under

FSMA. Similar considerations apply when considering the EMR and PSR perimeter, and PERG 3A and PERG 15 provide further guidance on these.

By way of business

10. By way of business is covered in detail in PERG 2.3 but some of the key factors in determining where an activity is carried on by way of business is whether a person receives remuneration (monetary or non-monetary) and whether a person is carrying on that activity with a degree of regularity and for commercial purposes (so they are gaining some sort of direct financial benefit of some kind). For instance, if an individual were to advise a few friends occasionally about which security tokens they recommend their friends buy, and they receive no benefit for doing this, this may not satisfy the by way of business test. However, if an individual holds themselves out as an adviser and advises people on a regular basis as to which security tokens to buy, and they receive some benefit as a result, such as charging a fee or receiving a reward from the issuer of the tokens, this is more likely to be considered activity by way of business.
11. PERG 15.2 provides further guidance on when authorisation or registration is likely to be required when providing payments services.

Territoriality

12. The general prohibition provides that the requirement to be authorised only applies in relation to activities that are carried on by way of business in the UK. Given the decentralised nature of cryptoassets with a large cross-border element, it can be difficult to determine where the activity is carried on.
13. PERG 2.4 provides details around the link between regulated activities and the United Kingdom. It sets out that even where part of the activity is outside the UK, a person may still be carrying on a regulated activity in the UK. For example, a firm that is situated in the UK and is safeguarding and administering security tokens that are securities or contractually based investments for clients overseas will be carrying on activities in the UK even though the client may be situated outside the UK.

Approach to Guidance

14. The PERG manual in the FCA Handbook gives further details about specified investments and financial instruments including transferable securities. Further details to help businesses navigate the PSRs and EMRs can be found in PERG as well as the FCA's Approach to Payment Services and Electronic Money.
15. The Guidance takes a step-by-step approach to help firms determine whether certain cryptoassets fall within the perimeter:
 - Step 1: Key examples of investments set out in the RAO, including where these are by reference to MiFID that a cryptoasset might constitute
 - Step 2: Guidance on how these apply to cryptoassets for the areas where we have observed greater market development
 - Step 3: Case studies to give practical examples of how the Guidance works in practice
 - Step 4: An indicative list of market participants that carry on cryptoasset activities, and the types of permissions they may need if they are using tokens that are within our perimeter

- Step 5: Q&A section to give guidance on more nuanced, complex, or frequently asked questions

16. The Guidance reflects some of the business models we have observed in the UK market through tools available to the FCA like the sandbox, as well as our broader policy, authorisation, supervision and enforcement work.

Application of this Guidance

17. While the use of a certain technology will not usually have an impact on the permissions the firm requires, it might have an impact on the unique risks associated with the carrying on of certain regulated activity.

18. For example, the fact that a business model uses DLT does not impact on our assessment in relation to the perimeter. However, the use of DLT may raise operational issues that are unique and novel to that technology and we consider these as part of our ongoing regulation.

19. In this Guidance, we have used the term 'tokens' to denote different forms of cryptoassets. For us, 'cryptoasset' is a broad term that captures the different types of tokens. It is also a neutral term that does not denote a direct comparison with fiat currency.

20. We use the term 'security token' to define those tokens that constitute specified investments excluding e-money tokens. The term 'e-money token' is used for those tokens that meet the definition of e-money.

21. We use the expression 'issuers of tokens' to cover a number of entities including developers, designers, firms who issue tokens and certain intermediaries, since determining precisely who the issuer or issuers are is not always easy or possible. While we use the term 'issuers' in this paper in these ways, 'issuer' under the Prospectus Regulation means something narrower and refers to the legal issuer of the securities e.g. the company. Where this applies, we make it clear by linking the term to regulatory requirements like those under the Prospectus Regulation.

22. Cryptoassets can take many forms and be structured in different ways. Although we recognise three broad categories of cryptoassets: e-money, security and unregulated tokens, they may move between categories during their lifecycle.

23. Assessing whether a cryptoasset is within the FSMA perimeter, or within the scope of the EMRs, can only be done on a case by-case basis, with reference to a number of different factors. Although one or more of these factors might indicate that the cryptoasset in question is, or is not, within the perimeter, they are not always determinative. Ultimately, it is a firm's responsibility to make sure that it has the correct permissions for the activities it intends to engage in and we encourage market participants to obtain independent advice if they think the position remains unclear.

Do I need to be authorised by the FCA?

- 24.** If you carry on a specified activity, by way of business in the UK, involving a cryptoasset which is a specified investment (i.e. security tokens or e-money tokens) you may require authorisation and the relevant permission. If you are a credit institution, credit union, or municipal bank then issuing e-money tokens will be a regulated activity. In other cases issuing e-money is regulated under the EMRs and market participants will need to make sure they are appropriately authorised, registered or exempt. This requirement is not influenced by the choice of technology – if you are carrying on a regulated activity, it is likely you will need to be authorised. You will also need to ensure you have appropriate authorisation if your token is used to facilitate regulated payments services.
- 25.** Issuers of tokens may themselves not need to be authorised, however certain requirements related to the issuance of the tokens may still apply, for example prospectus and transparency requirements. Where a token constitutes e-money, issuance may itself be a regulated activity.

What happens if I carry on regulated activities without any permissions

- 26.** Section 19 of FSMA sets out the 'general prohibition'. The general prohibition states that no person may carry on a regulated activity, or purport to do so (claim to do so), unless they are an authorised person, or they are an exempt person. Firms carrying on regulated activities in relation to cryptoassets, as with any firms carrying on regulated activities generally, must make sure they have the correct permissions.
- 27.** Section 23 of FSMA sets out the legal consequences for breaching the general prohibition. It provides that a person who contravenes the general prohibition is guilty of an offence and may face up to 2 years' imprisonment or an unlimited fine, or both.
- 28.** For example, if a person provides advice in relation to security tokens that amounts to the regulated activity of advising on investments (article 53 of the RAO), but is not authorised or exempt, they may be in breach of the general prohibition.
- 29.** Regulation 63 of the EMRs sets out a prohibition on issuing e-money without the correct authorisation or registration. It further states that any person that contravenes the prohibition is guilty of an offence and may face up to 2 years' imprisonment, or a fine, or both.

How do I know if my token is a specified investment?

- 30.** Given the complexity of many tokens, it is not always easy to determine whether a token is a specified investment, specifically those types of specified investment that are securities, like shares or debt instruments. There are a few factors that are indicative of a security. These factors may include, but are not limited to:
- the contractual rights and obligations the token-holder has by virtue of holding or owning that cryptoasset
 - any contractual entitlement to profit-share (like dividends), revenues, or other payment or benefit of any kind
 - any contractual entitlement to ownership in, or control of, the token issuer or other relevant person (like voting rights)

- the language used in relevant documentation, like token 'whitepapers', that suggests the tokens are intended to function as an investment, although it should be noted that the substance of the token (and not the label used) will determine whether an instrument is a specified investment
 - For example, if a whitepaper declares a token to be a utility token, but the contractual rights that it confers would make it a share or a unit in a collective investment scheme, we would consider it to be a security token.
- whether the token is transferable and tradeable on cryptoasset exchanges or any other type of exchange or market
- a direct flow of payment from the issuer or other relevant party to token holders may be one of the indicators that the token is a security, although an indirect flow of payment (for instance through profits or payments derived exclusively from the secondary market) would not necessarily indicate the contrary.
 - If the flow of payment were a contractual entitlement we would consider this to be a strong indication that the token is a security, irrespective of whether the flow of payment is direct or indirect (or whether other ownership rights are present).

31. You can see the full list of specified investments in Part III of the RAO.

Financial promotions and cryptoassets

32. Section 21 of FSMA provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless that person is an authorised person or the content of the communication is approved by an authorised person. Issuing a financial promotion in breach of section 21 FSMA is a criminal offence.

33. We expect market participants to apply the financial promotion rules and communicate financial promotions for products and services, whether regulated or unregulated, in a way which is clear, fair and not misleading. It is a legal requirement that firms make clear in their promotions which activities are, and are not, regulated, especially when highlighting their FCA authorised status. For example, an authorised firm may decide to offer access to unregulated cryptoassets (such as exchange tokens, like Bitcoin or Ether). The firm must not, in any way, communicate that their authorisation extends to those unregulated cryptoassets, and communication should be transparent to ensure consumers are aware which activities the firm is authorised for.

What are unregulated tokens

34. Unregulated tokens are those tokens that do not provide rights or obligations akin to specified investments (like shares, debt securities and e-money).

35. These tokens can be centrally issued, decentralised, primarily used as a means of exchange, or grant access to a current or prospective product or service. They might be used in one or many networks or ecosystems. They can be 'privacy tokens', 'fungible utility tokens', 'non-fungible tokens', 'access tokens' etc. They can be fully transferable or have restricted transferability.

36. The key thing to note is that any token that is not a security token, or an e-money token is an unregulated token.
37. Below we provide further details based on the two broad categories of unregulated tokens identified in the UK Cryptoasset Taskforce report, and a further category specific to this Guidance; exchange tokens, utility tokens, and tokens referred to as 'stablecoins'. Each of these categories can be further subdivided based on characteristics, such as transferability, fungibility, function, degree of centralisation etc.

Exchange tokens

38. Exchange tokens are used in a way similar to traditional fiat currency. However, while exchange tokens can be used as a means of exchange, they are not currently recognised as legal tender in the UK, and they are not considered to be a currency or money.
39. They are generally more volatile than any currencies and commodities in general use, and as such they are not widely accepted as a means of exchange in the UK outside crypto and digital communities, and they are not typically used as a unit of account or a store of value.
40. These factors mean that very few merchants accept exchange tokens as a payment tool; numbers are limited to fewer than 600 in the UK.
41. Exchange tokens typically do not grant the holder any of the rights associated with specified investments. This is because they tend to be decentralised, with no central issuer obliged to honour those contractual rights – if any existed.
42. We are aware that exchange tokens can be acquired and held for the purpose of speculation rather than exchange, as token-holders may anticipate that the value of these tokens will increase in the future on cryptoasset markets. However, we do not view this as being sufficient for exchange tokens to constitute specified investments. The analogy would be an individual holding different fiat currency or a commodity, both of which are unregulated, in the hope of a gain.

Does the FCA regulate exchange tokens?

43. Exchange tokens currently fall outside the regulatory perimeter. This means that the transferring, buying and selling of these tokens, including the commercial operation of cryptoasset exchanges for exchange tokens, are activities not currently regulated by the FCA.
44. For example, if you are an exchange, and all you do is facilitate transactions of Bitcoins, Ether, Litecoin or other exchange tokens between participants, you are not carrying on a regulated activity.
45. This is in line with our approach to other assets that remain outside our regulatory perimeter, but could nonetheless be purchased speculatively by some consumers with a view to realising profits if their value increases (eg fine wine or art).
46. However, firms should note that 5AMLD will be transposed into UK law by 10 January 2020 to introduce AML requirements to certain cryptoasset activities. The Government has announced that in the UK they will go beyond the scope of 5AMLD which proposes to extend AML/CTF regulation to entities carrying out the following activities:

- exchange services between one cryptoasset and another, or services allowing value transactions within one cryptoasset exchange or peer-to-peer exchange service provider
- cryptoasset Automated Teller Machines
- transfer of cryptoassets (In this context of cryptoassets, transfer means to conduct a transaction on behalf of another natural or legal person that moves a cryptoasset from one cryptoasset address or account to another)
- issuance of new cryptoassets, for example through ICOs
- the publication of open-source software (which includes, but is not limited to, non-custodian wallet software and other types of cryptoasset related software)

47. It should be noted that this refers to an AML regime, and does not have the effect of bringing any participant into the full FSMA regulatory perimeter. The Financial Action Task Force (FATF) has [published guidance for cryptoasset firms](#) that may assist firms, and the FCA has a [Financial Crime Guide in our Handbook](#).

Utility tokens

48. Utility tokens provide consumers with access to a current or prospective service or product and often grant rights similar to pre-payment vouchers. In some instances, they might have similarities with, or be the same as, rewards-based crowdfunding. Here, participants contribute funds to a project in exchange, usually, for some reward, for example access to products or services at a discount.

49. Much like exchange tokens, utility tokens can usually be traded on the secondary markets and be used for speculative investment purposes. This does not in itself mean these tokens constitute specified investments if they do not have the characteristics of relevant specified investments.

Does the FCA regulate utility tokens?

50. As utility tokens do not exhibit features that would make them the same as security tokens, they won't be captured in the regulatory regime.

What this looks like in practice

- **Case study 1:** Firm AB issues a token that grants the holder early access to a new line of clothing to be released by the firm, at a discounted rate. This would be similar to rewards-based crowdfunding where consumers have contributed to a project in exchange for early access to items from the firm's new clothing line. This token will not be a specified investment. It would therefore be an unregulated token.
- **Case study 2:** Firm CD operates an online casino. It issues tokens through an ICO that allows the token holders to use the casino. Any winnings are paid out in the CD Tokens. CD Token holders are also able to vote on which new betting games to add to the online casino's products, however the accompanying whitepaper to the ICO expressly states that Firm CD is not obliged to honour the outcome of any such vote. The tokens grant no additional rights in respect of any payments, ownership or control.
 - The rights these tokens grant token holders are not the rights we associate with specified investments. The tokens are not security tokens or e-money tokens.
 - This would not be a specified investment. It would be an unregulated token.

- **Case Study 3:** Firm EF, a well-known luxury car manufacturer, issues a token that allows the token holder the right to test drive a new limited-edition car for an hour. The token will be tradable on secondary markets where the price can increase or decrease depending on the demand for the limited-edition car, but will not confer any additional rights on the token-holder like payments, ownership or control etc. This will be an unregulated token.
- **Case study 4:** Firm GH is a cryptoasset firm that is raising funds to build a network for data. The firm issues tokens that give the token holder the right to data held within the network, but the tokens do not confer additional rights on the token-holder like profit, ownership or control. The tokens are not tradable on secondary markets. This will be an unregulated token.
- **Case study 5: unregulated tokens:** Firm AV is issuing a token that is fully transferable and used to access products and services within their own network/ ecosystem, but it cannot be used as a means of exchange across other networks (i.e. only spent with the issuer). The token does not provide any rights akin to a specified investment. The firm is unsure whether their token is classed as a utility or exchange token.
 - From a regulatory perspective for the purposes of the perimeter, it is largely irrelevant whether the token is a utility token or an exchange token. If it is not a specified investment it will not be regulated. This token may be considered a type of fungible utility token – but importantly from a regulatory perspective it is an unregulated token.
- **Case study 6: settlement tokens:** Firm AW is experimenting with a token to improve the speed of their back-office functions through a permissioned DLT system. The token is only used within the firm's own internal network and accounting system, and is not used as a means of payment in any other network or ecosystem. It cannot be transferred to other individuals. No other financial rights are offered.
 - From a regulatory perspective for the purposes of the perimeter, it is not important whether the token is labelled a utility token with restricted transferability, or a settlement token – the important distinction is that this token is unlikely to be a specified investment. This will be an unregulated token.
- **Case study 7: securities and unregulated tokens:** Firm AX is issuing tokens that are used as a rewards mechanism for loyal customers. The token holder will be able to claim a reward after they have concluded a set number of transactions using the tokens. Only the token holder is able to claim the reward and there is no cash equivalent that can be used. The token holder is not allowed to sell the token to other individuals or entities. No other financial rights are offered.
 - This token operates similar to rewards based crowdfunding and will be an unregulated token. It may be labelled as a non-fungible utility token with restricted transferability, but the important distinction is that it is unlikely to be a specified investment. This will be an unregulated token.
- Firm AX has altered the rights conferred by the token to provide further rewards for customers, so that token holders are now entitled to share in the company's profits in proportion to their token holding, in addition to being entitled to claim any rewards for loyalty.
 - This token now provides rights similar to a specified investment, and is likely to be a security token. Firms carrying on specified activities in relation to the token need to ensure they have the correct permissions, and that they follow the relevant rules and regulations.

- **Case study 8: transferability:** Firm AY is issuing a transferable token that allows the token holder storage rights on their network. No other financial rights are offered.
 - This token may be described as a non-fungible utility token that is fully transferable. However, the key distinction is that it does not offer the same rights as a specified investment and is unlikely to be considered a security token. While transferability is one factor that we will consider when deciding whether a token is a security token, transferability alone does not make the token a security token.

Attempts to stabilise token volatility

51. Attempts might be made to stabilise the volatility of cryptoassets, where the resulting token is commonly referred to as a 'stablecoin'.
52. These 'stablecoins' are a type of token, and depending on what they are backed with, how they are arranged and how they are structured, will fall in different categories of our taxonomy. For instance, a 'stablecoin' could be considered a unit in a collective investment scheme, a debt security, e-money or another type of specified investment. It might also fall outside of the FCA's remit. Ultimately, this can only be determined on a case-by-case basis.
53. The most popular observed methods of stabilisation are:
 - **Fiat-backed:** these tokens are backed with fiat currencies, most commonly the United States Dollar (USD), but we have seen tokens backed with other fiat currencies, including the British Pound (GBP) or a basket of currencies. In some cases, this involves the issuer "pegging" the value to that currency – i.e. guaranteeing the value of the token, while holding a reserve of fiat currency(ies) to ensure it can meet any claims. In other cases, the token gives the token holder an interest or right to the custodied fiat currency(ies), with the value of the tokens being directly linked to the value of the fiat currency held. These distinctions are also relevant for the models described below.
 - **Crypto-collateralised:** these tokens are backed with a basket of cryptoassets with the aim of spreading risk and reducing price volatility.
 - **Asset-backed:** these tokens are backed with a tangible or intangible asset that usually has some economic value.
 - **Algorithmically stabilised:** these tokens attempt stabilisation through algorithms that may, for example, control the supply of the tokens to influence price.
54. Where attempts have been made to stabilise the volatility of cryptoassets these tokens will be regulated where they provide rights or obligations akin to specified investments as security tokens and e-money tokens do. If they do not, they will be unregulated tokens, but some of the activities performed may still be subject to regulation, for instance AML requirements.
55. Tokens might be backed by financial assets, physical assets, or other cryptoassets. These tokens may in certain circumstances be security tokens or e-money tokens, depending on among other things, the rights granted by such tokens, the nature of the underlying assets and other relevant arrangements. For example, while gold itself is not a specified investment, a token that gives token holders a right or interest to gold held by a token issuer, or rights to payments from profit or income generated from the holding, buying or selling of gold may in certain circumstances be a specified

investment. For example this could be a unit in a collective investment scheme or a debt security.

56. Other arrangements might cause the token to meet the definition of e-money. Further information on when a product constitutes e-money can be found in the [Payment Services and Electronic Money – Our Approach](#) document.

Can cryptoassets be used to facilitate regulated payments services

57. Tokens can be used to facilitate regulated payment services such as international money remittance, and we have seen several use cases in the sandbox where unregulated tokens have been used like this to make things cheaper and faster on a small scale.
58. In the UK, the PSRs set out 8 different payments services in Schedule 1 Part 1. These regulated payments services include, amongst other things, services relating to the operation of payment accounts – for example, cash deposits and withdrawals from current accounts – execution of payment transactions, card issuing, merchant acquiring, and money remittance.
59. Schedule 1 Part 2 of the PSRs includes a list of activities that do not constitute a payment service in the UK, like payment transactions executed wholly in cash and directly between the payer and the payee, without any intermediary intervention.
60. Services relating to cryptoassets themselves, such as the operation of a cryptoasset account or transmission of cryptoassets are not within the scope of the PSRs (unless the cryptoasset in question meets the definition of e-money) because they only regulate activities with regards to funds which are defined as 'banknotes and coins, scriptural money and electronic money' (regulation 2 of the PSRs). However, a payment service that relates to funds will be in scope, even if cryptoassets are used to facilitate the service. The regulated payment service is the payment service provided to specific clients (for example clients at each side of a money remittance services) and not the dealings among payment service providers to deliver the end payment arising from that service. For more information see [PERG 15.5 Q37](#).
61. Where a payment service is being provided, the PSP remains responsible for that service until the payee or payee's PSP receive the funds, even if it uses cryptoassets as a vehicle for the provision of that service.

What this looks like in practice

- **Sandbox case study 1.** Unregulated tokens can be used to facilitate cross-border payments which are regulated by the FCA such as money remittance services and this business model has been tested in our regulatory sandbox. In one test, a firm received fiat funds (e.g. GBP) from a payer to transfer to a payee in a different jurisdiction and in another fiat currency. After receiving the fiat funds from the payer, the firm converted them to a cryptoasset which was then converted to the target fiat currency (e.g. ZAR). The payee received a pay out in fiat currency. Neither payer nor payee took any direct exposure to cryptoassets; the cryptoasset was

only used as an intermediary with the aim to make fiat cross-border transfers faster and cheaper.

- The firm was registered as a Small Payments Institution (money remittance). As part of the parameters of their test, the firm was restricted to 25 retail clients. The firm held cash reserves to cover the full amount of any retail transfer. The test with retail customers was limited to £5000 per transaction and a maximum of 1000 transactions.

What are regulated tokens?

62. These are tokens that are regulated by the FCA, either under FSMA or the EMRs. Security tokens, i.e. those tokens which are specified investments, excluding e-money tokens are within the FSMA perimeter. E-money tokens are within the FSMA perimeter if issued by a credit institution, a credit union or a municipal bank, and are also regulated under the EMRs.
63. There are two broad types of regulated tokens:
- Security tokens
 - E-money tokens

Security tokens

64. Security tokens are those tokens that provide rights and obligations akin to specified investments as set out in the RAO excluding e-money. These tokens may also be financial instruments under MiFID II. For example, these tokens have characteristics which mean they are the same as or akin to traditional instruments like shares, debentures or units in a collective investment scheme.
65. Security tokens include tokens that grant holders some, or all, of the rights conferred on shareholders or debt-holders, as well as those tokens that give rights to other tokens that are themselves specified investments.
66. We consider a security to refer broadly to an instrument (i.e. a record, whether written or not) which indicates an ownership position in an entity, a creditor relationship with an entity, or other rights to ownership or profit. Security tokens are securities because they grant certain rights associated with traditional securities.
67. Security tokens are the type of cryptoasset which falls within the regulatory perimeter. However, the details depend on the type of specified investment and so we have provided more detailed guidance below.

The most relevant specified investments for tokens

68. The full list of specified investments is in the RAO with detailed guidance provided in PERG 2.6. Given the market we have observed, the following specified investments are likely to be most relevant in the security market context:

Shares

- The specified investment category of shares etc under article 76 of the RAO includes shares or stock in the capital of
 - any body corporate (wherever incorporated); and
 - any unincorporated body constituted under the law of a country or territory outside the UK.
- Whether a particular form of overseas body is a body corporate depends on whether the law under which it is established confers on it the status of incorporation. Separate legal personality is a significant but not determinative factor; another significant factor is that the body survives a change of member. The definition also applies to overseas unincorporated bodies, but these bodies must have a share capital.
- Shares can also be transferable securities under MiFID. We consider that all shares and (securitised debt) that are negotiable on the capital markets fall within the definition of transferable securities; we do not take the view that the shares must be listed to be a transferable security under MIFID. Negotiability means that the tokens must be capable of being traded on the capital markets. Factors that may suggest a token is negotiable on the capital markets include: it can be transferred from one person to another and so ownership of the token is transferred, and, it gives the person who acquires it good legal title to the token.

How this applies to tokens

- Tokens that give holders similar rights to shares, like voting rights, or access to a dividend of company profits or the distribution of capital upon liquidation, are likely to be security tokens. Tokens that represent ownership or control are also likely to be considered security tokens, as shares tend to represent ownership (through dividends and capital distribution) and control (through voting).
- However, this is not always the case as some tokens give voting rights on direction without it being considered control. For example, a token that provides the token holder with the right to vote on future ICOs the firm will invest in but no other rights would likely not be considered a share as the voting rights do not confer control-like decisions on the future of the firm.
- The voting rights that are typically associated with being a shareholder are quite specific and governed by company law. Whether a token represents a share in the capital of a body corporate or similar entity incorporated outside the UK will depend on the operation of company and corporate law. A right to vote in general meetings of shareholders may be one indicator but voting and other rights may differ from share to share.
- For a token to be considered a transferable security for MIFID purposes, it must be negotiable on the capital markets (that is, capable of being traded on the capital market), therefore tokens that confer rights like ownership and control (amongst others), and, importantly, are capable of being tradable on the capital markets are likely to be considered transferable securities. It is also important to note that even if a token which acts like a share is not a transferable security under MiFID (for instance, it has restrictions on transferability), it may still be capable of being a specified investment.
- Ultimately, whether a token is a share will also depend on the operation of, amongst other things, company and corporate law. It may be that even if a token is considered a share by the issuer, as a matter of law this might not be possible or accurate (e.g. if the issuer is not an incorporated entity), but the token may constitute another type of specified investment nonetheless (like a debenture).

What this looks like in practice

- **Case study 9:** Firm IJ issues tokens that provide the token holder with a share of the company's profits to be paid annually. The tokens also provide the holder with voting rights. The tokens are structured so they can be easily transferred between two individuals and a change of ownership can be recorded. The tokens can also be traded on cryptoasset exchanges.
 - This token confers rights similar to those given by shares and is likely to be considered a specified investment. The negotiability suggests that the token will also be considered a transferable security. This token will be considered a security token.
- **Case study 10:** Firm KL, incorporated in the UK, has created a social trading platform, called the KL Platform, for users to easily exchange fiat currencies for exchange tokens. The firm issues 'KL Tokens' which are exchanged for fiat funds and these tokens are used to purchase other exchange tokens.
 - This alone is not enough to categorise the KL Tokens as security tokens. However, the KL Tokens also confer on the holder a right of ownership of the KL Platform proportionate to the number of KL Tokens held, and a right to participate in the profits of KL Platform (if any), to be paid annually in the form of a dividend.
 - These tokens are likely to be the same as or similar to shares and the tokens are therefore security tokens.
- **Case study 11:** Firm MN issues a token that it describes in its whitepaper document as a 'pure utility token'. The token allows the holder to access a product the firm is still developing. The token also allows the holder to share in profits in line with their holdings, once the product launches. The developers have been careful to make sure the token will not be able to be traded on the capital markets.
 - Despite the token being described as a utility token in the whitepaper, its lack of tradability and the fact that it offers access to a future product – this token would likely still be considered a specified investment given it confers on the holder rights similar to specified investments, i.e. conferring on the holding the right to share in profits in line with their holdings. This token is likely to be a security token.

Debt instruments

- Article 77 (debentures) includes debentures, debenture stock, loan stock, bonds, certificates of deposit, and any other instrument creating or acknowledging indebtedness (subject to certain exclusions).
- All forms of debt securities (other than government and public securities) that are negotiable on the capital markets also fall within the definition of transferable securities under MiFID. Debt securities do not need to be listed. As there is no restriction on maturity, this category also includes some money market instruments.

How this applies to tokens

- A token that creates or acknowledges indebtedness by representing money owed to the token holder is considered a debenture and constitutes a security token. Suggestions that a token represents debt owed by the issuer or other relevant person to the token holder may be an indicator that the token is a debenture.

- If a token is negotiable on the capital markets (for example because it can be transferred from one person to another who then acquires legal title of the token), then it might be considered a transferable security under MiFID too.

What this looks like in practice

- **Case study 12:** To generate working capital, company OP issues tokens that grant holders the right to be repaid their investment in full by a certain date and also entitle holders to regular payments of interest on the capital amount. The OP tokens are freely traded on cryptoasset markets.
 - These tokens are likely to be considered instruments that create or acknowledge the debt owed by the issuer to the token holder and are therefore likely to qualify as debt instruments. Because they are negotiable on the capital market, they are also likely to constitute transferable securities.

Warrants

- Article 79 of the RAO provides for the specified investment category of warrants. Warrants are one of several categories of specified investments that are expressed in terms of the rights they confer in relation to other categories of specified investment. The rights conferred must be rights to 'subscribe' for the relevant investments. This means that they are rights to acquire the investments directly from the issuer of the investments and by way of the issue of new investments rather than by purchasing investments that have already been issued.

How this applies to tokens

- If a firm issued A tokens that grant token holders the right to subscribe for B tokens in the future, and B tokens are themselves specified investments (for example, shares or debentures), A tokens will likely constitute warrants and will therefore be a security token.

Certificates representing certain securities

- Article 80 of the RAO covers certificates or other instruments that confer contractual or property rights over other investments (like shares or debentures), subject to the two following conditions:
 - the investment must be owned by someone other than the person on whom the certificates confer the rights
 - the consent of that person is not required for the transfer of those investments
- We consider that depository receipts also fall within this category.

How this applies to tokens

- A token might confer rights in relation to tokenised shares or tokenised debentures, including depository receipts on the holder. These are likely to be security tokens.

Units in collective investment schemes

- A collective investment scheme means any arrangement, the purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the investment or sums paid out of

such profits or income. The participants do not have day-to-day control over the management of the investment and contributions of the participants, and profits from which payments are to be made, are pooled and/or the investment are managed as a whole by or on behalf of the operator of the scheme. Certain arrangements are excluded.

- The specified investment category under article 81 of the RAO is units in a collective investment scheme and includes units in a unit trust scheme or authorised contractual scheme, shares in open-ended investment companies and rights in respect of most limited partnerships and all limited partnership schemes.
- Shares in, or securities of, an open-ended investment company are treated differently from shares in other companies. They are excluded from the specified investment category of shares. This does not mean that they are not investments but simply that they are treated in the same way as units in other forms of collective investment scheme.

How this applies to tokens

- A token that acts as a vehicle through which profits or income are shared or pooled, or where the investment is managed as a whole by a market participant, for instance the issuer of tokens, is likely to be a collective investment scheme. References to pooled investments, pooled contributions or pooled profits in a whitepaper could also be a factor in a token being considered a security.

What this looks like in practice

- **Case Study 13:** Firm QR invests in fine art using the funds it receives and pools from investors and hires it out for use at corporate events for a fee. It issues tokens to investors in proportion to their contributions. These tokens also entitle the investors to receive a share of the fees generated by the art rental, and the profits it makes when it sells the art from time to time. The token holders have no day to-day control over the art or the rental fees. The token holders' contributions are pooled, so are the rental fees and profits from art sales, and the art is managed as a whole by QR. The tokens that represent the participants' share in the investment are therefore likely to constitute units in a collective investment scheme.

Rights and interests in investments

- Right to or interests in certain investments, including those listed above from shares to units in a collective investment scheme, also constitute specified investments under the RAO in their own right. Tokens that represent rights to or interests in other specified investments are therefore likely to constitute securities.

How this applies to tokens

- A firm may issue a token that represents a right in a share, although the token itself does not represent or have characteristics of a share. This token is a security token.

What this looks like in practice

- **Case study 14:** Firm ST issues a token that references a share in firm PB. The token is structured so it can't be traded in the capital markets or transferred from one person to another.

- This token is considered a specified investment, but not a transferable security. The token is classified as a security token.

Other considerations

- Tokens can be considered transferable securities under MiFID as well as specified investments under the RAO. When identifying transferable securities, in addition to those considerations discussed above, we take into consideration the answers the European Commission (EC) has provided in the [Q&A on MiFID](#). We will also have regard to material from the EC and the European Securities and Markets Authority (ESMA).
- Firms and consumers can also gain exposure to exchange tokens through financial instruments which reference these tokens like CFDs, options, futures, exchange traded notes, units of collective investment schemes, or alternative investment funds. These instruments derive their value from referencing the cryptoasset, but may not be cryptoassets themselves.
- Products that reference tokens, like derivative instruments, are very likely to fall within the regulatory perimeter as specified investments (either as options, futures or contracts for difference under the RAO). These products are also capable of being financial instruments under MiFID II.
- A specified investment is not contingent on it being purchased for value, and a token can be a security token even if nothing is received for it. So, whether a token is sold at value, or distributed for free via an airdrop will not factor into deciding whether a token is a security token or not.

E-money tokens

- 69.** These are tokens that meet the definition of e-money under the EMRs. Firms issuing e-money must ensure they are appropriately authorised or registered.
- 70.** E-money issuance is regulated under the [EMRs](#) and is a regulated activity under [article 9B of the RAO](#) when carried on by credit institutions, credit unions and municipal banks. E-money is electronically stored monetary value as represented by a claim on the electronic money issuer which is:
- issued on receipt of funds for the purpose of making payment transactions
 - accepted by a person other than the electronic money issuer
 - not excluded by regulation 3 of the EMRs
- 71.** E-money must enable users to make payment transactions with third parties, so must be accepted by more parties than just the issuer. E-money includes fiat balances in various types of online wallets or prepaid cards.
- 72.** Electronic storage of monetary value includes the possibility of using DLT and cryptographically secured tokens to represent fiat funds, e.g. GBP or EUR. Cryptoassets that establish a new sort of unit of account rather than representing fiat funds are unlikely to amount to e-money unless the value of the unit is pegged to a fiat currency, but even then it will still depend on the facts of each case.
- 73.** Within the sandbox many firms have facilitated DLT-based e-money to provide more efficient, automated and transparent services, including for international payments.

74. Some tokens might be stabilised by being pegged to a fiat currency, most commonly the USD, and most commonly with a 1:1 backing. This is a form of 'stablecoin' known as a 'fiat backed', 'fiat collateralised' or 'deposit backed' stablecoin. This stablecoin looks to hold a consistent value with the fiat currency, and is theoretically 'backed' by fiat currency. Any token that is pegged to a currency, like USD or GBP, or other assets, and is used for the payment of goods or services on a network could potentially meet the definition of e-money. However, the token must also meet the requirements above.

What this looks like in practice

- **Sandbox case study 2:** We have seen sandbox firms testing tokens pegged to fiat currency, and these firms, depending on the structure and service provided, have been authorised either as e-money or payments services institutions. One firm is preparing to test a digital payments system that incorporates a transaction monitoring and profiling tool to identify transactions that may involve money laundering or terrorist financing. The consumer sends the remittance amount to the testing firm. The firm then tokenises the funds and transmits the tokens across their proprietary blockchain system. The tokens are exchanged into the recipient country's currency and sent to the recipient. Transfers take place while being monitored by the firm's sophisticated monitoring system. The testing parameters include a restriction of pegging the firm's token to the USD at 1:1 to minimise foreign exchange (FX) risk.

What does all of this mean for my firm?

75. Where a person is engaged in activity by way of business in the UK, that relates to a security token, or to a token that constitutes e-money, or is involved in payment services, they should consider whether those activities require authorisation or registration.
76. This activity will determine what 'permissions' a firm requires from the FCA. The permissions that apply as a consequence of carrying on a regulated activity in relation to security tokens is not different to traditional securities. The list of market participants and regulated activities in this section is an indication of the types of market participants that should be considering if they need permissions, and the types of activities that would be regulated.
77. Regulation may apply to any market participants carrying out regulated activities, including, but not limited to:
- exchanges and trading platforms
 - payments providers
 - custodians / wallet providers
 - advisers, brokers and other intermediaries
78. Securities issuance is not regulated in the same way we would regulate other market participants (like exchanges, intermediaries and advisers). Issuers of security tokens which are equivalent to shares or debentures would usually not be carrying on a regulated activity but still would need to have regard to other regulatory obligations such as the Prospectus Directive and Market Abuse Regulation (amongst others).

- 79.** For example, a firm wanting to create infrastructure for the buying, selling and transferring of security tokens (commonly known as exchanges or trading platforms) must ensure it has the appropriate permissions for the activities it wants to carry on. These will likely include arranging deals in investments (article 25(1) of the RAO), and making arrangements with a view to investments (article 25 (2) of the RAO). If the tokens also constitute Financial Instruments under MiFID, the firm may also need to have permission to operate a multi-lateral trading facility or, an organised trading facility (article 25D and 25DA of the RAO), depending on how the exchange operates. In the cryptoasset space, these firms often provide custody services as wallet providers too. The provision of custody services in relation to securities or contractually based investments may be a regulated activity, and firms must make sure they have the relevant permissions like safeguarding and administering investments (article 40 of the RAO).
- 80.** Exchanges and trading platforms may be carrying on other related regulated activities and firms should consult PERG for the full list of regulated activities that exchanges and trading platforms may be carrying on and the permissions required.
- 81.** Table 1 indicates some of the main market participants that are likely to be carrying on regulated activities in the cryptoasset space where the cryptoasset itself (or the instrument referencing the cryptoasset) is a specified investment. It also provides a high-level overview of some of the more common services they are likely to provide, and the permissions required to carry these out. The table is not exhaustive and should only be used as an indicative aid. Firms might also carry on a number of these activities, not just one. The table does not cover instances where exclusions might apply for certain market participants carrying on certain activities. We encourage firms to consult PERG for a more detailed list, and seek legal advice. Firms providing innovative propositions with genuine consumer benefits can contact the Innovate team if they are unsure about which regulated activities apply to their business models.

Table 1: Indicative list of market participants and permissions

| Market Participants | Potential activities | Indicative list of permissions |
|---------------------|--|--|
| Issuers of tokens | Issue tokens, including issuing tokens through ICOs. | <p>A company does not usually need regulatory permissions specifically to act as issuer of its own security tokens where these are equivalent to shares or debentures, but will need to consider regulations that may apply to the issuance. Such rules and regulations include, but are not limited to:</p> <ul style="list-style-type: none"> • Prospectus Regulation • Disclosure Guidance and Transparency Rules • Money Laundering Regulations • if the offer is made available internationally, local laws in each jurisdiction where the offer is available • for companies seeking listing on a regulated exchange, the Listing Rules • rules of the relevant trading exchange or platform <p>Issuers of e-money tokens are likely to need permission either under FSMA (if a credit institution, credit union or municipal bank) or under the EMRs.</p> |

| Market Participants | Potential activities | Indicative list of permissions |
|-----------------------------------|--|---|
| Advisers and other Intermediaries | Provide advice to consumers regarding different tokens and may help facilitate the purchasing of tokens. | For those advising, permissions may include, but are not limited to: <ul style="list-style-type: none"> • advising on investments • If the intermediaries facilitate the purchasing of tokens, permissions may include, but are not limited to: <ul style="list-style-type: none"> • dealing in investments as principal • dealing in investments as agent • arranging deals in investments • making arrangements with a view to investments • sending dematerialised instructions |
| Exchanges and trading platforms | Facilitate transactions between market participants. | Depending on the operation/scope of the exchange, permissions may include, but are not limited to: <ul style="list-style-type: none"> • operating a multi-lateral, or, organised trading facility • dealing in investments as principal • dealing in investments as agent • arranging deals in investments • safeguarding and administering investments • making arrangements with a view to investments • sending dematerialised instructions |
| Wallet providers and custodians | Provide the secure storage of tokens. | Depending on the scope of activity, relevant permissions may include, but are not limited to: <ul style="list-style-type: none"> • managing investments • safeguarding and administering investments |
| Payments providers | Enable customers to pay merchants in fiat currency, or transfer fiat currency via a cryptoasset. | Depending on the nature and scope of the activity, and identity of the issuer, relevant FSMA permission may include, but are not limited to: <ul style="list-style-type: none"> • issuing e-money • Permission may also be required under the Payments Services Regulations, including, but not limited to: <ul style="list-style-type: none"> • money remittance • operating a payment account • execution of payment transactions Depending on the structure of the tokens, permission under the Electronic Money Regulations may also be required. |

82. Figure 2 sets out some of the key market participants in the cryptoasset market and the types of regulated activities they are likely to be carrying on.

Cryptoasset market participants

Issuers of tokens:



including issuing tokens through ICOs. When issuing tokens that come within the regulatory perimeter, issuers may need to consider: Prospectus Regulations, Market Abuse Regulations, Disclosure Guidance and Transparency Rules, and AML/KYC, among others. Depending on the type of issuance, they may also need to consider the Listing Rules and those of the relevant exchange or platform.



Financial intermediaries:

includes advisers and brokers

Advisers: give advice to consumers on different tokens. When advising on tokens that fall within the regulatory perimeter, relevant permissions may include but are not limited to: 'advising on investments'.

Miners and transactions processors:



are incentivised by fees or other rewards to verify transactions by solving cryptographic puzzles and adding transactions to the ledger. Miners and transactions processors engaging with decentralised tokens are unlikely to be carrying out regulated activities.

Brokers: enable buyers to purchase tokens. When dealing with tokens that fall within the regulatory perimeter, relevant permissions may include but are not limited to: 'dealing in investments as principal', 'dealing in investments as agent', 'arranging deals in investments', 'sending dematerialised instructions', and 'making arrangements with a view to investments'.



Exchanges and trading platforms:

facilitate transactions between participants. When engaging with tokens that come within the regulatory perimeter, relevant permissions may include but are not limited to: 'operating an MTF/OTF', 'dealing in investments as principal', 'dealing in investments as agent', 'arranging deals in investments', 'sending dematerialised instructions', 'making arrangements with a view to investments', 'managing investments', and 'safeguarding and administering investments'.



Payment and merchant service providers:

enable consumers to transact with merchants using a cryptoasset, or transfer fiat currency via a cryptoasset. When using tokens that come within the regulatory perimeter, market participants may need to consider: the EMRs and the PSRs. Relevant RAO permissions may include but are not limited to 'issuing e-money'.



Wallet providers and custody service providers:

provide secure storage for tokens. When storing tokens that fall within the regulatory perimeter, relevant permissions may include but are not limited to: 'managing investments', and 'safeguarding and administering investments'.



Investors:

include individuals and institutions.

- 83.** Firms are responsible for making sure they are appropriately authorised for all the regulated activities that they are carrying on. Carrying on a regulated activity without authorisation is a breach of the general prohibition and is a criminal offence. Carrying on regulated activity without the correct authorisation is a breach of Section 20 FSMA. Similar prohibitions apply to issuing e-money under the EMRs and provision of payment services under the PSRs.

Do I need to publish a prospectus?

- 84.** If a token is a transferable security and the tokens will either be offered to the public in the UK or admitted to trading on a regulated market, an issuer will need to publish a prospectus unless an exemption applies.
- 85.** If a prospectus is required, the specific disclosure requirements will depend on the type of security (e.g. equity shares, corporate bonds). The obligations, such as those relating to the provision of historical financial information, are no different for a token issuer to an issuer of traditional securities. Broadly, the prospectus must provide prospective investors with information to make an informed investment decision and is a legal document for which the issuer has legal liability; it is important that all issuers of tokens work carefully with their legal and financial advisers to fully address the disclosure requirements under the Prospectus regime.
- 86.** Issuers of tokens should consider whether any exemptions are relevant. For example, there is an exemption for offers made entirely in the UK for less than €8m in any 12-month period. In the case of cross border offers, there are currently different exemption thresholds in different EU Member States, and the position of such public offers will need to be carefully considered.
- 87.** An issuer undertaking a non-exempt public offer of securities will need to have the prospectus reviewed and approved by the FCA, where the UK is the relevant home state regulator. The document will need to include disclosure on the issuer, the business and the securities. The specific requirements are laid out in [CDR 2019.980](#) and vary depending on the security type (generally with more extensive disclosure for equity than debt securities). Issuers of tokens should take note of the historic financial information requirements; for equity securities, historical financial information is required for 3 years (or since the issuer's incorporation), the last 2 of which must be prepared on a consistent basis and comparable with the issuer's next published accounts, as well as a confirmation that the issuer has sufficient working capital for its present requirements (at least 12 months from the date of the prospectus) and a capitalisation and indebtedness statement dated within 90 days of the document.
- 88.** The above paragraph relates to public offer prospectuses. Similar disclosure requirements apply to companies issuing securities listed on the Official List maintained by the FCA (listed securities) and admitted to trading on a recognised investment exchange (like the London Stock Exchange's Main Market).
- 89.** New listed issuers of tokens also need to complete an eligibility review; in most cases the FCA can carry out the eligibility assessment at the same time as the prospectus review but it is helpful to engage early if there are questions about eligibility, for example, a lack of clarity as to whether the securities will be transferable.
- 90.** Listed issuers of tokens should also consider their continuing obligations, in particular under the Disclosure Guidance and Transparency Rules and Market Abuse Regulation.

Appendix 2

Q&A

Introduction

1. This Q&A supplements the Guidance. It must be considered with the Guidance and our PERG manual.

Regulated tokens

2. **Does a definition of security translate easily to the digital world?**

The definition of a security remains consistent, whether the instrument is physical or digital. However, we appreciate there can be particular difficulty in categorising tokens as security tokens given the potential for tokens to change in structure over the course of their lifecycle (i.e. a utility token becoming an exchange token, or an exchange token becoming a utility token etc.) as well as the sometimes-ambiguous nature of rights conferred by tokens. If you are still unsure whether your cryptoasset is a security token, please refer to PERG 2.6.

3. **If you deem my token a security token, what does this mean for my international business/clients/token holders? Can I still sell, distribute and market my token globally?**

If a token is considered a specified investment under the RAO including a Financial Instrument under MIFID and any activity in relation to it is carried on in the UK, it may be subject to relevant securities regulations in the UK. Even with a cross-border element, a person may still be carrying on an activity in the UK. See [PERG 2.4](#). It is up to the firm to identify whether their token would fall under the definition of a specified investment and (where relevant) a Financial Instrument under MiFID. In general, the MIFID financial instrument categories have been mapped into the existing RAO specified investment categories. See PERG 13 Annex 2, which sets out how the various MIFID financial instrument categories map into the RAO specified investment categories. Whether a token is a MIFID financial instrument or not may have relevance for whether the regulatory requirements which apply to MIFID business will apply (for example, whether a platform trading in tokens could be an MTF or OTF), and for issuers that are issuing tokens which amount to transferable securities, whether prospectus requirements under the EU Prospectus Regime apply. As the definition of a security is not homogenous globally, the nature of the token has to be assessed for every jurisdiction in which the token is sold or in which the firm operates separately to establish whether a specific token constitutes a security in that jurisdiction and therefore triggers the application of any respective securities regulation.

4. Can I issue a security token without being FCA authorised?

The issuance of one's own security tokens where these are equivalent to shares or debentures does not usually require permission and issuers of security tokens will not be regulated in the way that exchanges and advisers are regulated. However, despite the fact that issuers of these tokens don't usually need to be authorised to issue their own tokens, in the course of promoting their issuance, they may be advising on investments or carrying on other activities that may require permission. If an issuer is issuing financial instruments which are admitted to trading on a European venue it must comply with all applicable rules in the FCA's Handbook and any relevant provisions in applicable European Union legislation, including the Prospectus Directive and Commission Regulation, and the Market Abuse Regulation, amongst others, some of which are outlined in Table 1 in the Perimeter Guidance chapter.

5. Would exchanges and other dealers need to be authorised to deal with security tokens? Do I have to ensure that all intermediaries that deal in my security tokens have the appropriate permissions?

Any intermediaries that help with the issuance of securities are likely to need permission. For example, venues that provide a platform for these security tokens may potentially be Multilateral Trading Facilities (MTFs), Organised Trading Facilities (OTFs) or simply arranging investments under the RAO and relevant regulation will apply. If entities are unauthorised but are carrying on regulated activities they may be in breach of the general prohibition which is a criminal offence.

6. If I accept only cryptoassets as a form of payment for my token, can it still be a security token?

Yes. Unlike e-money regulations where a token must be issued on the receipt of fiat funds to fall within scope, security tokens will still be considered security tokens regardless of whether they are exchanged for fiat funds, exchange tokens, or other forms of cryptoassets. In certain cases (like airdrops), a token can also be a security, even if nothing is received for it. We consider a token to be a security based on its structure: the intrinsic nature of the token is important, not the mechanism by which it was acquired.

7. I only pay out cryptoassets as a reward. Can this amount to a security token?

Yes. A token that provides access to a current or prospective product or service is likely to be considered a utility token (and probably outside our regulatory perimeter). However, a token that confers a reward can potentially be considered a security token if the reward has the same or equivalent characteristics as specified investments, as detailed in the Guidance. A utility token can, during its lifecycle, become a security token if the intrinsic characteristics of the token are altered to confer the same rights as a security. If it is clear from the outset that a token will convert to a security token later in its lifecycle, this is likely to be a security token from the outset.

8. I am still not sure whether my token is a security token, what should I do?

The Perimeter Guidance chapter clarifies how we determine a token to be a security token, however definitive judgements can only be made on a case-by-case basis. We recommend referring to PERG 2 for further guidance, and seeking appropriate expert external advice if necessary. The Innovate team also supports innovative propositions, and details on eligibility criteria and how to apply can be found on our [Innovate site](#).

9. If my token is a security token in the UK, is it a security token in the whole of the EU?

The UK RAO sets out 'specified investment' beyond the MIFID II definition of a 'financial instrument'. However, the two regimes are very closely linked, and a security token in the UK is likely to be deemed a security token in the rest of the EU.

10. I think my cryptoasset is a security token, what does this mean?

If you determine that your cryptoasset is a security token, then it will be captured within our regulatory perimeter as a specified investment, and possibly a MiFID financial instrument. This means that certain activities associated with the cryptoasset are likely to be regulated and you will require authorisation and the relevant permissions. For example, relevant regulation may apply to exchanges and trading platforms, advisers and intermediaries, and wallet providers and custodians amongst others. The issuance of securities is not regulated in the way that exchanges and advisers are regulated, however certain regulation may still apply, like the Prospectus Directive and Financial Promotions requirements. For a complete overview of which regulated activities apply to market participants dealing with specified investments, please refer to [PERG 2.7](#).

11. Are stablecoins also securities?

They can be. The term 'stablecoin' describes tokens whose value – measured in a traditional fiat currency, like GBP or USD – is intended not to fluctuate substantially. In order to achieve that, the value of stablecoins is pegged to either; fiat currencies, other commodities or assets (e.g. gold and oil), a basket of other cryptoassets (e.g. Bitcoin and Ether) or determined through sophisticated algorithms. Depending on the design and the rights associated with a specific stablecoin, they might meet the definition of e-money. This does not mean that the tokens will be securities, but the activities that relate to the e-money tokens may be regulated. However, in certain circumstances, the way the stablecoin is structured may mean that it amounts to a specified investment, such as a fund unit, a debt security, or a derivative.

Unregulated tokens

12. Can unregulated tokens like Bitcoin be caught under e-money regulations?

As exchange tokens seldom exhibit features that meet the definition of e-money, for example they are not usually issued on receipt of funds and there is no central authority or body against whom the tokens represent a claim, they are unlikely to be caught under e-money regulations. However, any token that meets the definition of e-money would fall under the scope of the EMRs.

13. My network is/aims to be fully decentralised and I will not have any control over the network anymore. Does this have an impact on whether the tokens could be regulated or not?

No. The nature of the network does not determine whether a token is a security or not. A security token is determined by its intrinsic characteristics and the rights it confers on holders, as detailed in the Guidance chapter. However, the more decentralised the

network the less likely it is that the token will confer enforceable rights against any particular entity, meaning it may not confer the same or equivalent rights as specified investments.

General questions

14. What other consumer protections may apply under UK law to unregulated tokens that are not specified investments (e.g. not subject to financial service regulation)?

An authorised firm that carries on activities in relation to unregulated tokens may be subject to certain limited FCA requirements in respect of that activity in some circumstances. The Principles for Business and requirements under the Senior Managers and Certification Regime may, for example, apply to such activity in some circumstances. Beyond this, certain other non-financial rules and regulations may apply to the activities of both authorised and non-authorised firms. These include the Advertising Codes which are administered and enforced by the Advertising Standards Authority, consumer law, general common law, criminal law and the GDPR, amongst others.

15. What are the expectations for a firm which has or seeks FCA authorisation for certain activities, but also carries on activities related to cryptoassets outside the perimeter?

A firm that is authorised by the FCA, or seeking FCA authorisation, but also carries on activities related to cryptoassets outside the perimeter, must make sure there is sufficient (and for consumers clearly visible) separation between the activities. For instance, when marketing unregulated cryptoasset products, the firm must be careful to ensure that it does not indicate or imply that it is regulated or otherwise supervised by the FCA in respect of business for which it is not so regulated. In the UK, authorised entities can conduct an unregulated activity (e.g. in relation to those cryptoassets that aren't within the scope of regulation) provided those activities do not affect their ability to comply with the rules and requirements to which they are subject as authorised persons.

Firms need to be clear in differentiating their regulated and unregulated activities (including within any marketing materials). As an authorised person, a firm will be subject to a variety of rules and requirements according to the nature of the regulated business which it carries on. Some of these requirements may also apply to any unregulated activity in which the firm engages. For instance, some of the Principles for Business apply to 'ancillary activities' (that is, unregulated activities carried on in connection with, or held out for being for the purpose of, a regulated activity). Principles 3, 4 and 11 apply to unregulated activities of authorised firms more generally (for Principle 3, this is limited to unregulated activities which may have a negative impact on the integrity of the UK financial system, or the ability of the firm to meet the suitability Threshold Condition). The individual conduct rules under the SMCR can also apply to unregulated activity.

