

The Risks of Digital Token Regulation

On 6th September, Charles Randel, Chair of the Financial Conduct Authority (“FCA”), gave a **speech** entitled “The Risks of Digital Token Regulation”. Although keen to discuss the potential of digital innovation, the FCA’s wary tone towards the cryptoassets sector remains. **Traci Pham, Joe French,** and **Cameron Ross** provide a summary of some of the key highlights in this speech and what it means for firms:

- Speculative crypto tokens are not regulated by the FCA but can be heavily marketed to consumers over social media platforms vulnerable to investment fraud and scams. Online platforms such as Facebook, Instagram, etc. must ensure it does not publish and profit from fraudulent content.
- The FCA has warned about the risks of holding speculative tokens. However, many investors still mistakenly believe these tokens are covered or protected by the Financial Services Compensation Scheme in the event of a loss.
- In tackling the risk of consumer harm arising from purely speculative tokens, it raises a question as to whether the activity of creating and selling the tokens should be regulated by the FCA. Effective regulation should be complemented by robust enforcement by authorities, and greater consumer awareness about online scams. The **Treasury consultation** on the UK approach to cryptoassets which closed earlier this year, and the FCA’s work with Treasury and Bank of England as part of the Cryptoassets Taskforce are some of the regulatory initiatives being undertaken.
- The FCA has published a list of unregistered crypto exchanges that it suspects are operating in the UK, to help consumers avoid using them. Banks and other authorised firms should consult the list to identify customers and transactions which may be used for money laundering.
- The FCA does not currently have a general remit from Parliament to regulate the issue or promotion of speculative tokens. Legislators will need to consider 3 issues: how to make it harder for digital tokens to be used for financial crime, the extent to which consumers

should be free to buy unregulated, purely speculative tokens and to take the responsibility for their decisions to do so, whilst balancing useful innovation in the digital token space.

- The benefits of the innovations in digital tokens include improvements in payments markets ('stablecoins'), and when tokens used to represent regulated investments, such as bonds or shares ("security tokens") that can be used to raise capital for businesses from investors. This provides an alternative means of settling transactions in financial instruments. The FCA noted its **Regulatory Sandbox**, which aims to scrutinise and support innovative business models and projects.
- There are two ways for the FCA to protect consumers from purely speculative tokens: reviewing the regulation of financial promotions of crypto assets which should highlight risks and make clear it is not covered by FCA regulation. Firms should limit the risk of contagion of the regulated business of authorised firms by unregulated activities in digital tokens. The Basel Committee is consulting on a proposal which would ensure that speculative digital tokens attract a full capital charge for banks. Boards of such firms will need to show how they have addressed any conduct and prudential risks. Accordingly, it is anticipated that authorised firms operating in the crypto space can expect increased scrutiny from regulatory bodies and accordingly should evidence sound and prudent risk management frameworks.

IMPACT FOR FIRMS

Firms wishing to offer crypto digital tokens should take care in the way in which these products are promoted particularly over social media platforms. Cryptoassets is an evolving area and due to the potential for it to cause consumer harm and being used for money laundering it is attracting increasing regulatory attention and focus, as set out in **FCA Business Plan 2021/22**.

HOW WE CAN HELP

If your firm is considering offering cryptoassets, Newgate Compliance can assist with providing guidance and advice on navigating the regulatory complexities in this area. We can also assist with getting your firm **registered** as a crypto provider. Newgate Compliance will keep firms abreast of developments in the FCA's approach to regulation of cryptoassets and digital tokens.



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Newgate has an unrivalled combination of experienced professionals, many of whom are ex-regulators.

Our customer focused approach seeks to provide appropriate, pragmatic and flexible solutions to our clients helping them to meet both the regulator's rules but also the spirit, principles and culture of the regulatory regime.

We look to build long-term relationships with our customers helping to encourage business growth, productivity and innovation. Our proactive approach is tailored to each customer's needs changing to meet those needs as the customer progresses and develops.