

UK Confirms Proposals for the Future Financial Services Regulatory Rules for Cryptoassets

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On 30 October 2023, HM Treasury (**HMT**) published a response (the **Response**) to its February 2023 consultation and call for evidence on its proposals for the future financial services regulatory framework for cryptoassets used within financial services (the **Consultation**).

The Response summarises the 131 comments received by HMT following the Consultation, and sets out policy decisions based on such feedback. The Consultation set out extensive proposals for UK cryptoasset legislation, which included:

1. extending the existing UK regulatory authorisation framework for financial services under the Financial and Markets Act 2000 (**FSMA**) to cover a range of cryptoasset services;
2. adopting the same definition for the term ‘cryptoasset’ as in the Financial Services and Markets Act 2023 (**FSMA 2023**), being: “[a]ny *cryptographically secured digital representation of value or*

contractual rights that – (a) can be transferred stored or traded electronically, and (b) that uses technology supporting the recording or storage of data (which may include distributed ledger technology)”; and

3. introducing cryptoasset regulation in two phases by firstly, establishing new rules regulating fiat-backed stablecoins (**Phase 1**), and secondly regulating other categories of cryptoassets (**Phase 2**). The Response focuses on issues relating to Phase 2.

In the Response, HMT confirms its intention to bring the regulation of cryptoassets within the FSMA regulatory framework by expanding the list of ‘specified investments’ in Part III of the FSMA (Regulated Activities) Order 2001 (SI 2001/544) (**RAO**), thereby requiring firms undertaking relevant activities involving cryptoassets by way of business to be authorised by the FCA under Part 4A of FSMA. HMT also stated that it does not plan to expand the definition of ‘financial instruments’ in Part 1 of Schedule 2 of the RAO to include presently unregulated cryptoassets. Other notable proposals are summarised in the sub-headings below.

Defining ‘cryptoassets’

The Response confirms that the ‘broad’ definition, as proposed in the Consultation, has been drafted intentionally so as to capture all current types of cryptoasset and ensure that the UK Government has the power to regulate those that may exist in the future. Further, the Response:

1. Confirms that the precise legal mechanism for distinguishing between tokens that are in and out of scope will be set out in the relevant secondary legislation and Financial Conduct Authority (**FCA**) rules.
2. Clarifies that cryptoassets not being used for one of the regulated activities listed in the Consultation within financial services markets or used as a financial services instrument (in the general sense), product or investment should fall outside the future financial services regulatory framework. The Response further provides that such cryptoassets may still fall within existing regulated activities or financial instruments, products or investments, such as where they are the underlying asset or property for a collective investment

scheme.

3. Clarifies that the new regime is not intended to capture cryptoassets which are “specified investments” that are already regulated. HMT provides that this would include security tokens representing debt or equities.
4. Reiterates that HMT ‘firmly disagrees’ with the suggestion that retail trading and investment activity in unbacked cryptoassets should be regulated as gambling rather than as a financial service.

FSMA authorisation process for regulated cryptoasset activities

In line with the Consultation, HMT states its expectation that firms with an existing authorisation under Part 4A of FSMA (for example, those authorised to operate a Multilateral Trading Facility) will need to apply for a Variation of Permission, in order to undertake newly-regulated cryptoasset activities (i.e., no “grandfathering” of existing regulated firms into the new rules). The Response further clarifies that crypto firms already registered with the Financial Conduct Authority (**FCA**) under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (**MLRs**) and carrying out certain activities involving cryptoassets will need to also seek authorisation from the FCA under the new FSMA-based regime. This is because businesses will be assessed against a wider range of measures than they were as part of the MLRs registration process.

Overseas Persons

In relation to overseas firms that carry out regulated activities in the UK on a cross-border basis, many responses to the Consultation had asked for FSMA’s existing overseas persons exclusion (**OPE**) to be expanded to cover regulated activities relating to cryptoassets. The OPE allows non-UK firms to carry out certain activities with wholesale market participants in the UK without an FCA license, usually when acting with or through an authorised or exempt person, or in compliance with the UK’s financial promotions framework. In justification of this position, HMT states that firms dealing directly with UK retail consumers *should* be required to be authorised irrespective of where they are located. We would note however

that this statement is not necessarily at odds with the OPE, which overseas firms generally use in order to deal with wholesale, rather than retail, clients.

Cryptoasset activities

In line with the Consultation, HMT intends to take forward the proposal to base an issuance and disclosures framework for cryptoassets on the impending reform of the UK prospectus rules. Its view is that there should be disclosure documents in place for all cryptoassets that are made available for trading on a UK cryptoasset trading venue.

Activities relating to NFTs and utility tokens

HMT clarifies the intended outcomes for non-fungible tokens (**NFTs**), utility tokens, security tokens and other data objects or ‘things’ which respondents were concerned could be captured unintentionally. It confirms that the proposed regime does not intend to capture activities relating to cryptoassets which are “specified investments” (and so are already regulated) e.g., security tokens, or activities relating to truly unique or non-fungible assets (e.g., NFTs) that are more akin to digital collectibles or artwork than a financial service (in the general sense) or product.

Market Abuse

There will be a modified approach towards market abuse obligations on crypto exchanges, acknowledging the potential need for a staggered implementation for cross-venue data sharing obligations.

Next Steps

HMT notes that the UK Government remains committed to creating a regulatory environment in which firms can “*innovate, while crucially maintaining financial stability and clear regulatory standards so that people can use new technologies both reliably and safely*”. The UK Government aims to lay Phase 2 secondary legislation in 2024, subject to Parliamentary time.

The Consultation and the Response are available [here](#) and [here](#) respectively.

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