E-BOOK

Crypto regulatory highlights and developments

Overview

This e-book highlights key changes in crypto regulation that took place around the world in 2022 and looks forward to new trends and developments in 2023.

Introduction

2022 was a turbulent year for the crypto-assets industry (hereinafter “crypto” or “crypto-assets”), illustrated with high profile crashes, such as Luna in May and FTX in November, or through price volatility in crypto-currencies with Bitcoin losing nearly 75% of its value between November 2021 and November 2022.

These changes, together with the fact that the rising use of crypto-assets and the blockchain technology is creating a financial revolution, have led to a strong increase in rulemaking to better regulate crypto-assets. This is especially the case in many jurisdictions that saw a sharp increase in retail investors, who invested in those assets, especially crypto-currencies.

Whether at supranational (e.g. EU), national (e.g. UK or USA.) or agency level (e.g. IOSCO), many new or updated frameworks were announced globally to protect users and investors. In addition, the keys to effective Anti-Money Laundering (“AML”)/Counter-Terrorist Financing (“CTF”) practices in an ever-changing environment are legal predictability, accurate oversight, and enforcement on a national and international level.

Key vulnerabilities

Crypto continues to present new and emerging risks, some of which are:

Anonymity in transactions

Crypto enables greater anonymity than traditional non-cash payment methods and therefore is more likely to be used for money-laundering (“ML”)/Financial Transactions (“FT”) purposes, including the evasion of international sanctions and use of “mixers” to mask origin of funds.

Cyber Security

Cryptocurrencies are vulnerable to hacks as most of them are stored in online wallets. Weak cybersecurity controls present security challenges and safeguarding of client funds and crypto.

Volatility

The cryptocurrency market thrives on speculation, which can result in higher losses over shorter periods. This is further exacerbated by a lack of understanding and weak financial promotion controls around the sale of crypto.

Chain-hopping/Cross-chains

Chain-hopping or cross-chains is the process of moving different crypto currencies across different blockchains (or “chains”). Movement across chains makes it easier to make transactions anonymous and obscure the source of funds heightening AML risks and then convert these back to fiat via exchanges in less-regulated jurisdictions.

Virtual Asset Service Provider (“VASP”) Liquidity

VASPs play a key role in the crypto industry and should be subject to appropriate due diligence controls, including their prudential status. A lack of liquidity can signify an approaching bankruptcy and a general final harm to the market.

Index

1. Financial Stability Board assessment of risks to financial stability from crypto-assets

In February 2022, the FSB issued a report "Assessment of Risks to Financial Stability from Crypto-assets" to examine the threat of the fast evolving Crypto-asset markets to the global financial stability.

Institutional involvement in crypto-asset markets, both as investors and service providers, has grown over time. Just in 2021 crypto-asset market capitalisation raised by 3.5 times to $2.6 trillion. The FSB concluded that crypto-assets could represent a threat to global financial stability due to their scale, structural vulnerabilities, and increasing interconnectedness with the traditional financial system.

The report examines developments and associated vulnerabilities relating to three segments of crypto-asset markets:

- Unbacked crypto-assets
- Stablecoins
- Decentralized finance (DeFi) and crypto-asset trading platforms

The FSB notes the close, complex, and constantly evolving interrelationship between these three segments.

Crypto-assets

Crypto-assets, as the term is used in this report, are a type of digital asset that depends primarily on cryptography and distributed ledger or similar technology.

Characteristics

- Digital means of exchange that are not backed by an issuer (such as Bitcoin), or other digital tokens, including securities tokens;
- Asset-backed tokens representing ownership interests in property, so-called utility tokens used to obtain access to goods or services on a particular digital platform;
- Nonfungible tokens ("NFTs") used as collectibles or investment instruments.

Stablecoins

A category of crypto-assets that aim to maintain a stable value with reference to a specified asset, or basket of assets, and provide perceived stability when compared to the high volatility of unbacked crypto-asset.

Uses of Stablecoins

- Acting as a bridge between traditional fiat currencies and a variety of (typically more volatile) digital assets;
- Serving as collateral in crypto-asset derivative transactions;
- Facilitating trading/lending/borrowing and acting as collateral in DeFi.

Decentralised Finance ("DeFi")

DeFi is based on distributed ledger technology (DLT) (typically public and permissionless blockchains) to offer financial services and products purportedly without the need for intermediaries.

Distinguishing DeFi from traditional finance

- Openness: DeFi relies on open-source technology;
- Trustless: DeFi platforms allow anyone who can provide the requisite amount of collateral to use the platform in an automated transaction;
- Permissionless: anyone can use DeFi protocols as long as they can fulfil the protocol's requirements;
- Claims of decentralised ownership and governance structure: Some DeFi protocols purport to rely on voting by governance token holders to make decisions.

1. Continued...

Vulnerabilities associated with crypto-asset markets:

- Increasing linkages between crypto-asset markets and the regulated financial system;
- Structure of stablecoins means they are exposed to liquidity mismatch, credit and operational risks, which makes them susceptible to sudden and disruptive runs on their reserves;
- Increased use of leverage in investment strategies;
- Concentration risk of trading platforms;
- Need of effective regulation and oversight commensurate to the risks they pose, both at the domestic and international level;
- Low levels of investor and consumer understanding of crypto-assets, money laundering, cyber-crime and ransomware.

2. Dubai Financial Services Authority consults on the regulation of crypto tokens - CP143

In March 2022, the DFSA released its consultation relating to the regulation of crypto tokens with consumer protection, market integrity, custody and financial resources for service providers in mind. The scope of the proposed regime is as follows.

In Scope

- Investment token, security token and derivative token
- Accepted crypto token
- Defined based on an eligibility criterion and application process

Excluded Token

- Non-Fungible Token (NFT)
- Central Bank Digital Currency
- Utility Token

Prohibited Token

- Privacy token and algorithmic token

Financial Services that can be conducted with Accepted Crypto Tokens

- Authorised market institutions
- Multi-trading facility
- Dealing as principal
- Dealing as agent
- Asset manager
- Fund manager
- Providing custody
- Arranging custody
- Arranging deals
- Advising

Crypto Token

Token that is used, or intended to be used, as a medium of exchange or for payment or investment purposes but excludes Investment Tokens, any other investment or Excluded Tokens.

Accepted Crypto Token Process

The criterion to be considered as part of the application for accepted crypto token includes:

- Regulatory status of Crypto Token in other jurisdictions and appropriateness of centralized or decentralized governance;
- Size, liquidity and volatility of Crypto Token;
- Sufficient transparency around the technology, protocols and significant stakeholders in the ecosystem around the Crypto Token;
- Adequacy and suitability of the technology used in relation to the Crypto Token
- Risks associated with the use of the Crypto Token and appropriateness of controls to mitigate these risks;
- Adequacy arrangements around the reserves, stabilization and redemption mechanisms of a Crypto Token that purport to be used as a Fiat Crypto Token.

Financial Promotions

The DFSA proposes amendments to the Financial Promotions regime to:

- Enhance Financial Promotion controls around Crypto Tokens;
- Prohibit Financial Promotions that are not Accepted Crypto Tokens, not Algo Tokens and not Privacy Tokens;
- Expand the definition of financial product to include Crypto Token.

Governance and Substance

To recognise the risks across Crypto Tokens, certain enhancements to the legal form and management of Applicants are proposed:

- Applicants intending to offer financial services in relation to Crypto Tokens must be established as legal entities in the DIFC (no branches will be permitted);
- Day to day management of such businesses must be in the DIFC.

2. Continued...

Restriction on offering both Accepted Crypto Token and Excluded Tokens

- Authorised persons are not to be permitted to offer both Accepted Crypto Tokens and Excluded Tokens from the same legal entity - the position remains open to discussion with regards to custodians as to whether they should be permitted to service bother Crypto Token and Excluded Tokens.

Trading Venues and Related Controls

- Permit direct access to Crypto Token trading venues;
- Annual technology audit for assurance relating to the trading venue.

Digital Wallets & Custodians

- Enhanced governance and technology requirements are proposed to apply to digital Wallets and custodians, including further detailed information in related client agreements.

Base Capital & Custodians

- The DFSA proposed that custodians that provide Crypto Token custody should be subject to a higher base capital requirement of USD1 million.

Collective Investment Funds

In the context of collective investment funds:

- Funds can only hold themselves out as being Crypto Token Funds if the main purpose of investing is in Accepted Crypto Funds;
- Details of valuation, including the price information provider details to be used to support the valuation of the Crypto Tokens to be disclosed until more guidance can be developed through regulation;
- Self-custody will not be permitted in the case of Crypto Tokens;
- Crypto Funds cannot be managed by external fund managers, nor through an external fund;
- Foreign funds that are Crypto Tokens cannot be marketed in or from the DIFC;
- Additional disclosures relating to the Crypto Token as well as disclosures relating to the DLT used to issue, store or transfer the Accepted Crypto Token as well as wider issues in relation to the DLT to be provided in the relevant investor disclosures/offer documents.

Retail Clients

Several additional safeguards are proposed in relation to retail clients, including consideration of whether holdings of Crypto Tokens should form part of the assessment of net assets as part of the client classification process:

- Determining the monetary threshold for Professional Client status;
- Further consultation is sought with regards to the scope of and extent of application of Crypto Tokens to retail clients;
- Enhancements to appropriateness assessments before allowing retail clients to transact with a Crypto Token;
- Prohibit use of credit cards by retail clients to fund their accounts;
- Restrict leverage offered to retail clients in relation to Crypto Tokens Derivatives
- Prohibit offering incentives linked to Crypto Tokens to retail clients.

The consultation period ended in May 2022 and firms were reminded that no crypto activity should take place in the DIFC until the outcome of the consultation is determined by the regulator. If you'd like to further read the results and feedback statement following the consultation of Article 8, please click here. Or read page 8.

3. EU Financial Regulators Warn Consumers on the Risks of Crypto-Assets

In March 2022, The European Supervisory Authorities (EBA, ESMA, and EIOPA – the ESAs) warned consumers that many crypto assets are highly risky and speculative.

This warning seems to echo the sentiments and concerns of other regulators, such as MAS and the UK FCA, due to growing consumer activity and interest in crypto assets. In addition to the aggressive promotion of these assets and related products to the public, including through social media.

The ESAs warning highlighted that these assets are not suited for most retail consumers as an investment or as a means of payment or exchange because these customers:

- Face the very real possibility of losing all their invested money if they buy these assets;
- May not be alert to the risks of misleading advertisements, including those via social media and influencers;
- May make investment decisions based on promised fast or high returns, especially those that look too good to be true.

Consumers may not fully understand the various types of crypto-assets and that there may be a lack of recourse or protection available to them, as crypto-assets and related products and services typically fall outside of existing protection under current EU financial services rules.

As of today, there are more than 17,000 different crypto-assets, some of them being sometimes referred to as so-called 'virtual currencies' or digital 'coins' or 'tokens'. The most prominent crypto-assets to date include Bitcoin and Ether, which together represent about 60% of the total market capitalization of crypto assets.

Key Risks:

➢ **Extreme Price:**
Many crypto assets are subject to sudden and extreme price movements and are speculative because their prices often depend solely on consumer demand.

➢ **Misleading information:**
Some crypto assets and related products are aggressively advertised to the public using marketing material and other information that may be unclear, incomplete, inaccurate, or even purposefully misleading.

➢ **Absence of protection:**
Most crypto assets and the selling of products or services in relation to crypto-assets is unregulated in the EU. Therefore, rights and protections may not be available in the same way they are for regulated financial services.

➢ **Product complexity**
Some products providing exposure to crypto assets are very complex, sometimes with features that can increase the magnitude of losses in the event of adverse price movements.

➢ **Fraud and malicious activities**
Numerous fake crypto assets and scams exist that consumers can fall victim to.

➢ **Market manipulation**
Lack of price transparency and low liquidity: how crypto asset prices are determined and the execution of transactions at exchanges is often not transparent.

➢ **Hacks, operational risks, and security issues**
The distributed ledger technology underpinning crypto assets can bear specific risks. Several issuers and service providers of crypto assets, including crypto exchanges and wallet providers, have experienced cyber-attacks and severe operational problems.

3. Continued...

Russia, Belarus and Crypto Asset

In relation to the current situation in Ukraine, the implementation of sanctions and potential restrictive measures have been imposed against Russian and Belarusian entities and individuals with regards to crypto assets. This is due to other jurisdictions seeing an influx of requests to convert crypto assets into fiat or shift them into real estate to circumvent sanctions.

ESG and Crypto

Another observation noted in the ESA warning, and in line with earlier observations raised by the EU, relates to the extremely high level of energy consumption of some crypto assets, specifically from mining and validation processes. Consumers are reminded to also be aware of their environmental impact.

4. Washington published a comprehensive framework for digital assets and host the second international counter ransomware initiative summit

On September 16, 2022, the White House released its "First-Ever Comprehensive Framework for Responsible Development of Digital Assets". Following President Joe Biden's Executive Order, agencies across the United States government have worked together to develop policies, recommendations, and frameworks relating to digital assets.

The six key priorities identified in the Executive Order released on March 9, 2022, are:

- Consumer and investor protection
- Promoting financial stability
- Countering illicit finance
- Leadership in the global financial system and economic competitiveness
- Financial inclusion
- Responsible innovation

The Framework for Responsible Development of Digital Assets fact sheet is organized around seven main recommendations with respect to cryptocurrencies.

Protecting consumers, investors, and businesses

- Chase investigations and enforcements actions against unlawful practices;
- Monitor consumers complaints;
- Lead public awareness about the risk involved with digital assets.

Promoting financial inclusion

- Use of innovative technologies by payment providers;
- Regulate non-bank payment providers;
- Improve efficiency of cross border payments
- Ensure that the crypto ecosystem is designed to be usable, inclusive, equitable and accessible by all.

Countering illicit finance

- Update the Bank Secrecy Act regulations including digital asset exchanges and NFT platforms;
- Enhance dialogue with the private sector;
- Strengthen US AML/CFT supervision of virtual asset activitie.

Reinforcing US financial leadership and economic competitiveness

- Increase collaboration with agencies in foreign countries;
- Expand leadership roles on digital assets work at international organisations.

Fostering Financial Stability

- Mitigate cyber vulnerabilities;
- Work other international agencies like the OECD and the FSB to identify and analyze emerging risks.

Advancing responsible innovation

- Research to develop methods of informing the public on safe and responsible digital asset use;
- Track and mitigate the environmental harm impacts around digital assets.

Exploring a US central bank digital currency (CBDC)

- A U.S. CBDC (digital form of the U.S. dollar) could bring significant benefits. However, the Federal Reserve is encouraged to continue its ongoing CBDC research, experimentation, and evaluation before implementing.

4. Continued...

Governments against ransomware

The members of the **International Counter Ransomware Initiative** ("CRI") met in Washington at the end of October 2022 to debate on the prevention of cyberattacks, ransomware and money laundering using digital assets.

The CRI members published a joint statement with goals to achieve including:

- Combat ransomware actors' ability to profit from illicit proceeds by implementing and enforcing anti-money laundering and countering the financing of terrorism (AML/CFT) measures for virtual assets and VASPs;
- Collaborate in disrupting ransomware by sharing information to ensure national cyberinfrastructure is not being used in ransomware attacks;
- Hold ransomware actors accountable;
- Disrupt and bring to justice ransomware actors and their enablers.

5. European Union endorses Crypto Assets Regulation Bill (MICA)

On 10 October 2022, the European Parliament Committee on Economic and Monetary Affairs (ECON) voted in favour of progressing the last version of the Markets in Crypto Assets (MiCA). The next steps are for the Council and Parliament to give final approval before it enters into force in 2024.

The Markets in Crypto Assets regulation (MiCA or the 'Regulation') was born out of the European Union's Digital Finance Package which was first released in September 2020. MiCA aims to create an EU regulatory framework dedicated to crypto-assets (including stablecoins), crypto-asset service providers and crypto-asset issuers.

MiCA's 5 main objectives

- To provide legal clarity for non-existent EU financial services regulation crypto assets;
- To establish uniform rules for crypto-asset service providers and issuers at EU level;
- To replace existing national frameworks applicable to crypto assets not covered by existing EU financial services legislation;
- To specify clear guidelines for so-called 'stablecoins,' even when it is e-money;
- To create prohibitions and requirements to prevent market abuse involving crypto assets.

Scope

This Regulation applies to persons that are engaged in the issuance of crypto-assets or provide services related to crypto-assets in the Union. It is important to note that MiCA is relevant to crypto-assets that are not financial instruments defined under MiFID II.

Key MiCA Definitions

Crypto-Assets
A digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology.

Distributed Ledger Technology
A type of technology that supports the distributed recording of encrypted data.

Utility Token
Type of crypto asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.

Asset-referenced token
A type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets.

E-Money Token
A type of crypto asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender.

Crypto-asset service provider
Any person whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis.

5. Continued...

Crypto-asset service
Crypto-asset service' means any of the services and activities listed below:

- The custody and administration of crypto assets on behalf of third parties;
- The operation of a trading platform for crypto assets;
- The exchange of crypto assets for fiat currency that is legal tender;
- The exchange of crypto assets for other crypto assets;
- The execution of orders for crypto assets on behalf of third parties;
- Placing of crypto assets;
- The reception and transmission of orders for crypto assets on behalf of third parties
- Providing advice on crypto assets.

Authorizations of Crypto assets service providers

MiCA will apply to a group of crypto-asset service providers (CASPs) and issuers of crypto-assets who offer such assets to third parties. More stringent additional requirements will be imposed on issuers of asset-referenced tokens and e-money tokens.

Only legal persons that have a registered office in one of the European Union (EU) Member States and have obtained an authorization from a relevant national competent authority as a crypto-asset service provider will be permitted to provide services in crypto-assets.

MiCA and AML/CFT

MiCA emphasizes that crypto assets' and 'distributed ledger technology should be defined as extensively as possible to capture all types of crypto assets which currently fall outside the scope of EU legislation on financial services.

The Regulation should also contribute to the objective of fighting money laundering and the financing of terrorism. Any definition of 'crypto-assets' should therefore correspond to the definition of 'virtual assets' set out in the recommendations of the FATF.

This includes the FAFT recommendation 16 known as "the Travel Rule.

6. OECD finalises global tax reporting framework for crypto-assets

On 10 October 2022, the Organisation for Economic Co-operation and Development ("OECD") published its Crypto-Asset Reporting Framework ("CARF"). Mandated by the G20, the OECD's CARF aims create a framework for standard reporting of tax information on crypto-assets transactions with a view to automatically exchanging such information with the jurisdictions of residence of taxpayers on an annual basis, in a similar manner to how the Common Reporting Standards ("CRS") operate. The release by the OECD introduces the CARF as well as proposes amendments to the CRS.

The need for a new and separate framework comes in the light of the rapid growth of the crypto-asset market. Crypto-assets can be transferred and held without interacting with traditional financial intermediaries increasing the risk of tax evasion. Therefore, acknowledging and addressing the tax compliance risk with respect to Crypto Asset became a priority for the OECD and the G20.

CARF has four key elements

- Crypto-asset' scope
- Intermediaries and other providers' scope
- Reporting requirements
- Due Diligence requirements

Scope of Crypto-assets

Crypto-assets are defined as a "digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions" (these include stablecoins, derivatives issued in the form of a crypto-asset) and certain non-fungible tokens ("NFTs").

Obligations under CARF would apply to Relevant Crypto-Assets, which are crypto-assets that:

- Give rise to reporting on Relevant Transactions;
- Do not fit any of the below three exemptions due to low tax compliance risks;
- First Category: Crypto-Asset Service Provider ("CASP") has adequately determined cannot be used for payment or investment purposes;
- Second Category: Central Bank Digital Currencies, representing a claim in Fiat Currency on an issuing Central Bank;
- Third category: Electronic Money.

The term Relevant Transaction is defined as either

- Exchange Transaction (i.e., an exchange between and fiat currencies, or a Relevant Crypto-Asset exchange between one or more forms of Relevant Crypto-Assets); or
- Transfer of a Relevant Crypto Asset (includes Reportable Retail Payment Transactions, which are Transfer of Relevant Crypto-Assets in value exceeding USD 50,000).

Intermediaries and other providers' scope

Reporting would apply to CASPs, who are entities or individuals that, as a business, provide services effectuating Exchange Transactions in Relevant Crypto-Assets, for or on behalf of customers. Their positions as intermediaries in transactions would make them best placed to obtain information on their customers (e.g., AML/KYC). The CARF is meant to capture a wide-ranging set of intermediaries, such as exchanges, operators of crypto-asset ATMs crypto broker/dealers.

6. Continued...

Reporting CASPs subject to CARF rules

- Tax resident in
- Both incorporated in, or set up under the laws of, and have legal personality or are subject to tax reporting requirements in,
- Managed from
- Having a regular place of business in
- Effectuating Relevant Transactions through a branch based in, a jurisdiction adopting the rules

Reporting requirements

Relevant Crypto-Asset reporting will be made on an aggregate basis but distinguishing between inward and outward transactions for two types of transactions:

- Crypto-asset to Crypto-Asset
- Crypto-asset to fiat currency

Whilst Crypto-asset to fiat currency transactions will be easily calculated (i.e., fiat gross proceeds from the transaction), CARF rules should also require Crypto-Asset to Crypto-Asset to be reported in fiat currency. Under this approach, the transaction would be split into two reportable elements:

- A disposal of Crypto-asset (the reportable gross proceeds based on the market value at the time of disposal);
- An acquisition of Crypto-asset (the reportable acquisition value based on the market value at the time of acquisition).

Due diligence

Reporting CASPs will be required to follow certain due diligence procedures under CARF. Those procedures will however be largely based on those in place under the CRS framework, especially in relation to the use of self-certifications as well as current AML/KYC obligations forming part of the 2012 FATF Recommendations and their 2019 virtual asset service providers' update.

Crossover with the CRS

The report notes the potential increased burden for entities subject to reporting under both CARF and the CRS. Below are several measures included to reduce such burdens:

- The definition of Relevant Crypto-Assets excludes Specified Electronic Money Products and Central Bank Digital Currencies from the scope of the CARF, as reporting on these assets is ensured under the CRS;
- As there are certain assets that qualify both as Relevant Crypto-Assets under the CARF and as Financial Assets under the CRS (e.g., shares issued in crypto form), the CRS contains an optional provision to switch-off gross proceeds reporting under the CRS if such information is reported under the CARF;
- Indirect investments in Relevant Crypto-Assets through traditional financial products, such as derivatives or interests in investment vehicles, are covered by the CRS;
- To the extent possible and appropriate, the due diligence procedures are consistent with the CRS due diligence rules. In particular, the CARF allows Reporting Crypto-Asset Service Providers that are also subject to the CRS to rely on the due diligence procedures for New Accounts performed for CRS purposes.

Future developments

The OECD is working on an implementation package which will consist in a framework of bilateral/multilateral competent authority agreements or arrangements for the automatic exchange of information collected under the CARF and IT solutions to support the exchange of information. Whilst no formal date was put forward, the OECD did mention it will work on implementation timelines for both CARF and the amended CRS.

7. Financial Stability Board framework and consultation for crypto-asset activities

On 11 October 2022, the FSB issued a consultative report proposing recommendations to promote the consistency and comprehensiveness of regulatory, supervisory and oversight approaches to crypto-assets activities.

Crypto-assets are still fast evolving over the years, regardless of their volatility. The need of a harmonized, effective, and comprehensive regularity framework is evidenced by the number of structural vulnerabilities in the market. These weaknesses are amplified by a flawed governance, inadequate consumer and investor protections, and poor risk management.

Below is a summary of the nine recommendations coming out of the FSB consultative report:

1. Authorities need powers, tools, resources to oversee crypto markets, issuers, and services providers.
2. Authorities should apply "same activity, same risk, same regulation".
3. Authorities should cooperate and coordinate domestically as well as internationally to encourage consistency of regulatory and supervisory outcomes.
4. Authorities should require that crypto-asset issuers and services providers have comprehensive governance frameworks
5. Authorities should require that crypto-asset service providers have effective risk management frameworks in place.
6. Authorities should require that crypto-asset issuers and service providers need to have frameworks for data collection, storage, safeguarding and reporting.
7. Authorities should require that crypto-asset issuers and service providers need to have appropriate risk, financial, and product disclosures.
8. Authorities should identify and monitor interconnection and interdependency risks on financial stability between the crypto-asset ecosystem and the wider financial system.
9. Authorities should ensure that crypto-asset service providers that combine multiple functions and activities are subject to appropriate regulation, supervision and oversight to mitigate individual and risks coming from combining activities.

It is important to note that the FSB had previously issued, in October 2020, a report with a set of 10 high-level recommendations on the regulation, supervision, and oversight of so-called "global stablecoin" ("GSC") arrangements ("High-level Recommendations"). The two groups of recommendations are interconnected, reflecting the similarities between stable coins and the wider crypto-asset ecosystem. The groups should provide a base for consistency and cooperation among authorities' approaches to the regulation and supervision of crypto-asset activities across jurisdictions.

October 2020 GSC High-level Recommendations

Authorities should have and must use the necessary or appropriate powers and tools, and adequate resources, to comprehensively regulate, supervise, and oversee a GSC arrangement and its associated functions and activities, and enforce relevant laws and regulations effectively.

7. Continued...

FSB High-level recommendation 1
Authorities should have and must use the necessary or appropriate powers and tools, and adequate resources, to comprehensively regulate, supervise, and oversee a GSC arrangement and its associated functions and activities, and enforce relevant laws and regulations effectively.

FSB High-level recommendation 2
Authorities should apply comprehensive regulatory, supervisory and oversight requirements consistent with international standards to GSC arrangements on a functional basis and proportionate to their risks insofar as such requirements are consistent with their respective mandate.

FSB High-level recommendation 3
Authorities should cooperate and coordinate with each other, both domestically and internationally, to foster efficient and effective communication, information sharing and consultation in order to support each other in fulfilling their respective mandates and to ensure comprehensive regulation, supervision, and oversight of a GSC arrangement across borders and sectors.

FSB High-level recommendation 4
Authorities should require that GSC arrangements have in place a comprehensive governance framework with clear and direct lines of responsibility and accountability for all functions and activities within the GSC arrangement.

FSB High-level recommendation 5
Authorities should require that GSC arrangements have effective risk management frameworks in place especially with regard to operational resilience, cyber security safeguards and AML/CFT measures, as well as "fit and proper" requirements, if applicable, and consistent with jurisdictions' laws and regulations.

FSB High-level recommendation 6
Authorities should require that GSC arrangements have in place robust systems and processes for collecting, storing and safeguarding data.

FSB High-level recommendation 7
Authorities should require that GSC arrangements have appropriate recovery and resolution plans.

FSB High-level recommendation 8
Authorities should require that GSC issuers provide all users and relevant stakeholders with comprehensive and transparent information to understand the functioning of the GSC arrangement, including with respect to governance framework, redemption rights and its stabilisation mechanism.

FSB High-level recommendation 9
Authorities should require that GSC arrangements provide a robust legal claim to all users against the issuer and/or underlying reserve assets and guarantee timely redemption. For GSCs referenced to a single fiat currency, redemption should be at par into fiat. To maintain a stable value at all times and mitigate the risks of runs, authorities should require GSC arrangements to have an effective stabilisation mechanism, clear redemption rights and meet prudential requirements.

FSB High-level recommendation 10
Authorities should require that GSC arrangements meet all applicable regulatory, supervisory and oversight requirements of a particular jurisdiction before commencing any operations in that jurisdiction and adapt to new regulatory requirements as necessary and as appropriate.

Next steps

The FSB will make the proposed recommendations final by mid-2023 considering feedback from the public consultation.

8. DFSA publishes feedback statement on regulation of crypto tokens

On 17 October 2022, the Dubai financial Services Authority (DFSA) released a Feedback Statement in response to an earlier consultation (CP-143), which set out a proposal for a framework to regulate financial services in respect to Crypto Tokens.

The Feedback Statement was issued to explain the final rules, conclusions, and changes made to the initial March 2022 proposal. The rules discussed in the Statement commence from 1 November 2022.

Token Taxonomy clarifications

With the exception of the Central Bank Digital Currencies (CBDCs), the token taxonomy remains largely unchanged from the original consultation paper.

Recognised Crypto Tokens
Financial Services and activities can be carried on in relation to Crypto Tokens that are recognised. DFSA will put on their website an initial list of Recognised Tokens. This means that these Tokens will not need to go through separate recognition via the formal recognition process.

Recognised Fiat and Crypto Tokens
Financial Services and activities can be carried on in relation to Fiat. Crypto Tokens that are recognised.

Prohibited Tokens
Carrying on any financial service or other activity with Prohibited Tokens (Privacy Tokens or Algorithmic Tokens) is strictly prohibited.

Unrecognised Crypto Tokens
Crypto Tokens that have not been assessed and recognised by the DFSA as meeting the recognition criteria. Activities with these tokens are Prohibited besides the provision of custody, by an appropriately licensed Authorised Firm.

Derecognised Crypto Tokens
Crypto Tokens whose recognition status has been revoked by the DFSA due to the Crypto Token no longer meeting the recognition criteria. Activities with these tokens are prohibited besides the provision of custody, by an appropriately licensed Authorised Firm.

Excluded Token
Non-Fungible Token (NFT) and Utility Tokens (UTs) are excluded, except for:

- Issuers and service providers of NTFT and UTs. Requires registering as a Designated Non-Financial Businesses and Professions;
- Provision of custody, by an appropriately licensed Authorised Firm;
- UT or NFT display characteristics that falls under the DFSA definition of Crypto Token or Investment Token;
- Central Bank Digital Currency.

Financial service activities clarifications

DIFC incorporation
Firms providing services in Crypto. Tokens need be fully incorporated in the DIFC except for:

- Branch firms in the DIFC related to crypto, who are already operating as a branch of a foreign financial institution before the commencement of the new regime, may continue to operate as a branch;
- Technology firms will need to demonstrate to us that they are not providing a financial service by way of business.

8. Continued...

Funds

- Asset management that includes Crypto Tokens must be established in the DIFC and consist only of Recognised Crypto Tokens.
- Funds of Funds must consist of Recognised Crypto Tokens.
- Exchange Traded Funds must consist of Recognised Crypto Tokens,
- Funds investing in Funds must consist of Recognised Crypto Tokens, unless the exposure to Crypto does not exceed 5% of the gross value,
- Foreign and External funds with relation to crypto will not be allowed to be offered or marked in or from DIFC,

Miscellaneous Requirements

Client classification

When determining the monetary threshold for Professional Client status, DFSA have softened the haircut from 80% down to 66% of the market value of the Crypto Token, however, only Recognised Crypto Tokens will count towards the net asset test.

Transitional arrangement

Authorised Persons in the DIFC who have already been engaging in Crypto Token activities will be given six-month transitional period to have the correct permissions and license from the DFSA. The grace period will commence on the date when the rules come into force being 1 November 2022.

9. MAS releases consultation on stablecoin related activities

;The MAS ("'Monetary Authority of Singapore"') seeks to develop an innovative and responsible digital asset ecosystem by protecting the public. To that effect, on 26 October 2022, the regulator issued two consultation papers, both closing by 21 December 2022.

These papers were:

- Proposed Regulatory Measures for Digital Payment Token Services; and
- Proposed Regulatory Approach for Stablecoin-Related Activities.

In 2019, MAS published a consultation paper relating to the scope of e-money and digital payment tokens ("DPT"). International regulatory developments and current industry issues triggered the need for a new consultation.

Stablecoins are defined by the Financial Stability Board ("FSB") as crypto-assets that aim to maintain a stable value relative to a specified asset (typically a unit of fiat currency or commodity), or a pool or basket of assets.

MAS' regulatory approach to stablecoins is framed by three key guiding objectives:

1. Support the development of value-adding payment use cases for stablecoins, and stablecoin issuers;
2. Adopt a progressive regulatory approach that is fit for purpose and provides for stepping up of measures as needed
3. Maintain an open regime to accommodate different forms of stablecoins.

Scope of Regulation

- Single-currency pegged stablecoins ("SCS"). SCS known for having a stronger use case for payment and settlement;
- SCS issued in Singapore – The immediate priority of MAS is to elevate the standard of SCS issued in Singapore.

Proposed regulatory framework and requirements for SCS issuers

Non-bank issuers

- If the SCS in circulation exceeds or is anticipated to exceed S$5 million in value, the issuer will have to obtain a major payment institution ("MPI") license.
- If SCS issuers that do not exceed the size threshold for MPI will only need to obtain a standard payment institution ("SPI") license.

Bank Issuers

- MAS proposes not to impose additional reserve backing and prudential requirements on banks that issue SCS by tokenising liabilities of the bank.

Requirements imposed on regulated SCS issuers

Reserve assets backing of SCS

- Reserve assets must be equivalent to at least 100% of par value of the outstanding SCS in circulation at all times;
- Reserve assets can only be held in the form of cash, cash equivalents, or debt securities;
- Reserve assets must be denominated in the same currency as the pegged currency.

9. Continued...

Reference currencies

- MAS proposes to only allow the issuance of SCS that are pegged to the Singapore dollar or G10 currencies.

Timely redemption at par

- SCS issuers must allow all the holders of SCS to have a direct legal right to redeem the SCS for the pegged currency at par value;
- SCS issuers should return the par value no later than 5 business days from the day of the redemption request.

Prudential requirements for SCS issuers

- Base capital – Higher of S$1 million or 50% of annual operating expenses of the SCS issuer.
- Solvency – To always hold, liquid assets which are valued at higher of 50% of annual operating expenses.
- Business restrictions – An SCS issuer is not allowed to undertake other activities that introduce additional risks to itself. (e.g., lending, trading or staking of SCS or other DPTs).

Disclosure requirements

- Requirement to issue a white paper to disclose details, including description of issuer, its project, rights and obligations related to the token (e.g., redemption, risks).

SCS issued in multiple jurisdictions

- Annual MAS attestation that other issuers of SCS are deemed to meet equivalent reserve backing and prudential requirement standards;
- Establish regulatory cooperation among relevant regulatory bodies of the SCS to exchange information on operations of the SCS.

Implementation

MAS intends to issue final guidelines taking into considerations the responses to the consultation papers and is considering providing a transition period of 6 to 9 months starting from the time of publication for DPTSPS and SCS issuers to implement and comply with the guidelines.

10. MAS consultation on digital payment token services

The MAS seeks to develop an innovative and responsible digital asset ecosystem by protecting the public. To that effect, on 26 October 2022, the regulator issued two consultation papers, both closing on 21 December 2022.

These papers were:
- Proposed Regulatory Measures for Digital Payment Token Services; and
- Proposed Regulatory Approach for Stablecoin-Related Activities.

Since 2017, MAS has consistently warned the public of the risk of cryptocurrencies speculations, however despite the high risks involved, crypto-assets continue to attract consumers. MAS in the consultation paper Proposed Regulatory Measures for Digital Payment Token Services sets out observations, policy consideration and proposed regulatory measures on Digital Payment Tokens Services Providers ("DPTSPs").

Three key measures to address:
- Consumers access
- Business conduct
- Technology

Consumer Access Measures

Scope of Consumer Access Measures

MAS proposes that DPTSPs apply consumer access measures to any customer who is:
- Not an accredited investor or institutional investor;
- Resident or Incorporated in Singapore.

Risk Awareness Assessment

DPTSPs should assess (using multiple choice tests) whether a retail customer has sufficient knowledge of the risks of DPT services before providing any DPT service to that customer.

- Sharp fluctuations in the prices of DPTs and the loss of all monies put into DPTs;
- Inability to readily sell their DPTs, such as during illiquid market conditions or system outages;
- Losing access to their DPTs in the event of a technological or operational issue, such as if private keys are lost or irretrievable;
- Losing their DPTs in the event of fraud, theft, sabotage, or cyber-attack.

Restriction on Offering of Incentives

DPTSPs should not provide to a retail customer any credit facility (fiat currencies or DPTs) to facilitate the retail customer's purchase or continued holding of DPT.

- Enter into any leveraged DPT transaction with a retail customer;
- Accept any payments made by the retail customer using a credit card or charge card, in connection with the provision of any DPT service.

Business Conduct Measures

MAS proposes to introduce business conduct standards for DPTSPs in key areas of concern.

Segregation of Customers' Assets and Risk Management Controls

DPTSPs should provide written disclosures to customers, which may include:
- Terms and conditions;
- Customers' assets being segregated from the DPTSP's own assets and held for the benefit of the customers;
- Whether the customers' assets will be commingled with the assets of other customers and, if so, the risks of such commingling;
- Consequences for the customers' assets if the DPTSP becomes insolvent, and the arrangements by the DPTSP to protect customers' assets.

10. Continued...

Measures to safeguard private keys and storage of customers' DPTs
Management of private keys associated with custodial wallets should be subject to strong controls over producers and staff.

Identification and Mitigation of Conflicts of Interest
DPTSPs should:

- Establish and implement effective policies and procedures to identify and address conflicts of interests;
- Disclose to their customers the general nature and sources of conflicts of interest and the steps taken to mitigate them;
- Prevent the misuse of such information of execute orders by employees.

DPT trading platform operators should not:

- Buy or sell DPTs for their own account; and
- Permit their related corporations to buy or sell DPTs for their own account on the DPT trading platform

Disclosure of DPT Listing and Governance Policies
DPT listing and governance policies that address the following matters:

- Criteria, due diligence, processes, and fees applied in making a DPT available for trading;
- Conditions under which DPTs may remain available for trading;
- Processes by which DPTs are removed from trading, and the rights available to customers;
- Settlement procedures of DPT transactions;
- Requirements to address unfair or disorderly trading practices.

Complaints Handling
MAS proposes that DPTSPs have in place adequate policies and procedures to handle customer complaint.

Managing Technology and Cyber

MAS requires Digital Payment Token Service Providers to:

- Have effective Framework to identify critical systems;
- Ensure that the maximum unscheduled downtime for each critical systems does not exceed a total of 4 hours within any period of 12 months;
- Establish a recovery time objective of not more than 4 hours for each critical system;
- Notify MAS as soon as possible, but not later than 1 hour, upon the discovery of a system malfunction or IT security incident;
- Implement IT controls to protect customer information from unauthorised access or disclosure.

Market Integrity
MAS recognised the crypto market have been susceptible to unfair trading practice of market manipulation, misleading conduct, and insider trading by malicious actors. The regulator also considered the limitations to addressing market integrity risks from cross-border transactions. For this reason, MAS has provided examples of good and bad industry practices to provide guidance.

Implementation
MAS intends to issue final guidelines taking into considerations the responses to the consultation papers and is considering providing a transition period of 6 to 9 months starting from the time of publication for DPTSPS to implement and comply with the guidelines.

11. South Africa classifies crypto-assets as a financial product

On 19 October 2022, the Financial Sector Conduct Authority ("FSCA") released a notice (accompanied with its policy document) to include crypto assets as a financial product under the Financial Advisory and Intermediary Services Act, 2022 ("FAIS Act"). This move, effective immediately, marks a new chapter for South Africa, where crypto assets are regulated and consumers are more protected than before.

On November 2020, the FSCA had published a draft declaration of a crypto asset for financial products (accompanied with its policy document) under the FAIS Act for public comment. After reviewing the responses, the FSCA published the final declaration.

Crypto assets description
Not issued by a central bank but is capable of being traded, transferred, or stored electronically by natural and legal persons for payment, investment, and other forms of utility; applies cryptographic techniques; and uses distributed ledger technology.

Crypto Asset service providers
The FSCA will be regulating and licensing Financial Services Providers ("FSPs") that provide financial services in relation to crypto assets. Also including any person giving advice or servicing as an intermediary.

The FSCA, will support a smooth transition into the FAIS framework and will allow providers of financial services related to crypto assets to apply for the relevant license between 1 June 2023 and 30 November 2023.

Participants exempted from the FAIS Act
- Crypto asset miners;
- Node operators performing functions in respect of the security health of the network;
- Persons only rendering financial services in relation to non-fungible tokens.

Crypto asset derivatives
Providers of crypto asset derivatives remain subject to the Financial Markets Act, 2012 (Act No. 19 of 2012).

Cryptocurrency adoption in South Africa

A report published by Chainalysis in September 2022 showed that South Africa ranked 30th in worldwide cryptocurrency adoption index, however, South Africa was classified as 16th over 154 countries in 2021 by the "2021 Geography of Cryptocurrency Report" - Chainalysis.

South Africa's recognition of crypto as an asset class ranks above countries such as France, Spain and the Netherlands, which means that having a regulatory framework on crypto assets will increase the country's attractivity for end customers.

A link with FATF

As a member of the Financial Action Task Force ("FATF"), South Africa must adhere to the recommendations put forward by this international body in order to remain off its grey list. In 2019, FATF noted that South Africa had deficiencies in the supervision, licensing, and registration of Virtual Assets and Virtual Asset Service Providers. The introduction of a crypto-asset specific regulatory framework is an important step towards addressing the earlier findings by FATF.

12. Brazil Congress moves to regulate virtual assets

On 29 November 2022, Brazil's parliament approves new regulatory framework to enhance virtual currencies.

The lower house of Brazil's parliament approved a bill that seeks to enhance regulatory framework on virtual currencies along with including virtual currencies and air mileage programs in the definition of "payment arrangements" under the supervision of the Central Bank.

The law requires the creation of licenses for Virtual Asset Service providers as well as demanding exchanges to make a clear distinction between company and user funds, in line with recent regulatory developments in virtual assets.

While this makes significant development for crypto within Brazil, the law still needs the signature of the president of Brazil for it to be fully passed.

Brazil Crypto Adoption:

A report published by Chainalysis, in September 2022, showed that Brazil ranked 7th in the worldwide cryptocurrency adoption index. Having a regulatory framework on crypto assets in Brazil will protect the public, increase the country's attractivity for investments and will encourage other Latin American countries to further regulate the market.

Regulatory landscape

Crypto regulation by jurisdiction UK and Europe

Regulatory Body and crypto regulation	Definition of Crypto	Restrictions	Application of tax laws	Subject to AML/CFT regulation	VASP License required
United Kingdom					
The Financial Conduct Authority (FCA)	The lower house of the British Parliament recognized crypto assets as regulated financial instruments.	▪ Crypto derivatives trading is banned. ▪ Cryptocurrency ATMs are illegal.	Yes	Yes	Yes
European Union					
Markets in Crypto-Asset's regulation (MICA) – *to come into force by 2024*	A digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology (including NFTs issued in a large series or collection).	▪ Travel rule must be implemented ▪ Whitepapers for new tokens are going to be regulated under MICA.	Yes	Yes	Yes
Isle of man					
Isle of Man Financial Services Authority (IOMFSA)- *is not regulating crypto assets only for compliance with AML*	Virtual currency digital representation of value which can be traded digitally. The nature of a virtual currency means that it does not need to be centrally controlled or administered.		No	Yes	No
Malta					
Malta financial Service Authority (MFSA)- Virtual Asset framework	A medium of exchange, a unit of account, or a store of value.		Yes (only fiat to crypto)	Yes	Yes

Crypto regulation by jurisdiction
Middle East and Africa

Regulatory Body and crypto regulation	Definition of Crypto	Restrictions	Application of tax laws	Subject to AML/CFT regulation	VASP License required
UAE- DIF					
The Dubai Financial Services Authority (DFSA)	(FATF definition)	▪ Financial Services and activities can be carried on in relation to Crypto Tokens that are recognised.	No	Yes	Yes
UAE-Dubai					
Virtual Assets Regulatory Authority (VARA)	(FATF definition)	▪ Marketing restrictions and penalties for non-compliance.	No	Yes	Yes
UAE-ADGM					
The Financial Services Regulatory Authority (FSRA)	(FATF definition)	▪ Each crypto asset is required to meet certain criteria to be designated an 'Accepted Crypto Asset' and thus eligible for trading.	No	Yes	Yes
South Africa					
The Financial Sector Conduct Authority (FSCA)	Crypto asset: Financial product. Digit al representation of value.	▪ Full Regulatory framework to be published.	Yes	Yes	Yes, From 1st of June 2023
Mauritius					
Financial Services Commission of Mauritius (FSC)	Digital representation of value that may be digital traded or transferred.		No	Yes	Yes

Crypto regulation by jurisdiction America

Regulatory Body and crypto regulation	Definition of Crypto	Restrictions	Application of tax laws	Subject to AML/CFT regulation	VASP License required
USA					
Regulated by different Government Agencies	Digital or virtual currency is an electronic medium of exchange that is not a representation of U.S. or foreign currency.	▪ CFTC under Commodity exchange ACT is regulating and enforcing virtual asset consumer protection.	Yes	Yes	Yes
Cayman Islands					
Cayman Island Monetary Authority (CIMA)	(FATF definition)	▪ the Companies Act prohibits any exempted company formed in the Cayman Islands and not listed on the Cayman Islands Stock Exchange from offering its securities to the Cayman Islands public.	No	Yes	Yes
Bermuda					
Bermuda Monetary Authority (BMA)	Own definition - Bermuda's Digital Asset Business Act 2018.	▪ Detailed in the Digital Asset Business Act framework .	No	Yes	Yes

Crypto regulation by jurisdiction
Asia

Regulatory Body and crypto regulation	Definition of Crypto	Restrictions	Application of tax laws	Subject to AML/CFT regulation	VASP License required
Singapore					
The Monetary Authority of Singapore (MAS)	Digital Payment Tokens: Digital representations of value that do not Have a physical form and are typically maintained using blockchain technology.	▪ Discourage Cryptocurrency Trading by General Public and intents to restrict access.	Yes	Yes	Yes
India					
No specific regulatory body or crypto regulation		▪ The Advertising Standards Council of India announced new guidance related to the advertising of cryptos and NFTs in February 2022.	Yes	No	No

2023 year ahead

The pace behind regulatory frameworks on digital assets will continue to increase into 2023, as the asset class will remain under high scrutiny worldwide. Investors, fund managers and other financial players will need to ensure their own regulatory frameworks remain compliant, or are set to be ready for compliance. This is because new regulations will either come into force or be announced.

How Apex Group can help

We offer a range of services to support and assist firms to navigate through the emerging and evolving regulatory landscape for crypto:

- **VASP / CASP Due diligence**
- **Crypto/Virtual Asset/ VASP- CASP Licensing**
- **Crypto AML & Compliance support**
- **Crypto AML Business Risk Assessment (AML BRA)**
- **Crypto Risk management**
- **Crypto Training**

Contact us

To discuss your crypto regulatory needs or for additional insights, please contact:

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