

# WFE Response to the Financial Conduct Authority – Guidance on Cryptoassets



# Background

We are grateful for the opportunity to respond to the Financial Conduct Authority's (FCA) consultation paper on Guidance on cryptoassets.

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 250 market-infrastructure providers, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~21%). Some of our members are highly invested in the crypto space through the offerings of coin-backed ETFs or the operation of their own cryptoasset-platforms.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to raise capital and manage financial risk.

We seek outcomes that maximise financial stability, consumer confidence and economic growth. We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

# Introduction

Cryptoassets are becoming increasingly important in all sectors of the capital market space. Their use in capital-raising processes, peer-to-peer lending, investment strategies and as means of exchange have grown gradually. Globally, regulators are becoming more proactive in dealing with cryptoassets by reviewing existing regulation, creating new frameworks, building task forces and enhancing investor education.

The FCA's consultation on future Guidance on cryptoassets is timely. Not only is the cryptoasset market maturing, but there are several reasons why the cryptoasset space should be under closer inspection. Mainly, there is a need for tighter oversight of crypto-platforms from the viewpoint of investor protection and market integrity. Risks such as the threat of hack attacks also call for stricter regulation.

The WFE believes that a danger, often overlooked, lies in calling cryptocurrency platforms "exchanges" which might lead investors into thinking that these platforms are regulated or meet the regulatory standards of traditional exchanges.

The issue of systemic risk is also present in the crypto-economy, mainly through bubbles. Regulators are rightfully worried that if the cryptoasset environment continues to grow unrestrained, and without clear regulatory guidance, it could threaten financial stability globally. Accordingly, the WFE believes that any regional debate should inform international debates to ensure regulatory coherence across jurisdictions.

The WFE welcomes this consultation paper and the associated work of the FCA to develop frameworks for the sound Guidance on cryptoassets.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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## Questions

**1. 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.**

**YES** - The WFE agrees with the FCA's reasoning that exchange tokens, namely tokens whose main intended use it is to be employed as a means of exchange (i.e. a substitute to government-backed currencies), are not a specified investment instrument.

We acknowledge that some individuals may hold exchange tokens as a form of speculative investment. However, exchange tokens do not provide their holders with any of the rights usually associated with specified investments and, due to their decentralised nature, are not supported by a central issuer. Accordingly, we agree that exchange tokens are lacking the core characteristics of a specified investment.

**2. 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.**

**YES** - The WFE agrees that, in contrast to exchange tokens, security tokens do meet the definition of a specified investment and therefore fall within the regulatory perimeter of the FCA.

Securities tokens grant their holders rights similar to that of traditional securities. They can be considered equal to those and should therefore be regulated as such. Additionally, in contrast to exchange tokens, security tokens derive their value not from themselves (Bitcoin's value derives purely from its use and acceptance as a payment) but from an underlying element which is coordinated through a specified issuer and presents the holder with some form of ownership (and hence the aforementioned rights). Security tokens are therefore just as centralised as traditional investment instruments.

As noted in the FCA's analysis, for a security token to be a transferable security under MiFID, it must be "negotiable" on the capital markets. We believe that this requirement of MiFID is beneficial in transforming a new element of capital market structures into a regulated environment.

Requiring that shares are negotiable in order to consider them specified investment, ensures that the trading of innovative (and hence unknown) instruments are kept in regulated and supervised environments. This can help to safeguard the integrity of the market as new instruments develop.

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

**YES** - The WFE agrees with the FCA's assessment of utility tokens. Similar to exchange tokens, some utility tokens are traded on secondary markets and can be used for speculative investment purposes. However, utility tokens are not the same as security tokens. They are not akin to traditional instruments and do not grant their holders with any of the rights that usually accompany the holding of traditional instruments.

The WFE agrees with the FCA, that the nature of utility tokens is often similar to that of pre-payment vouchers instead of investment instruments. As such, they are not subject to the same regulatory regime.

**4. Do you agree with our assessment that exchange tokens could be used to facilitate regulated payments?**

**YES, But** - The WFE agrees that exchange tokens could be used to facilitate regulated payments such as money remittance services, cash deposits or withdrawals from current account, execution of payment transactions card issuing, merchant acquiring, and money remittance under some circumstances, if the tokens are stabilised (or fulfil the definition of e-money).

While cross-border payments facilitated through cryptoassets are cost-efficient and their use may be beneficial to the wider financial system, exchange tokens, such as Bitcoin, tend to be more volatile than traditional fiat currencies or commodities. When the crypto market reached its high in late 2017, the Bitcoin price reached just above US\$ 20 000. Since then, it has fallen more than 80%.

Due to the volatility associated with exchange tokens, the WFE believes that coins considered e-money (stablecoins) would be better suited to facilitate regulated payments than “normal” exchange tokens.

**5. Are there other use cases of cryptoassets being used to facilitate payments where further Guidance could be beneficial? If so, please state what they are.**

**NO** - In general, the WFE believes that the use of cryptoassets to facilitate payments is well regulated. Further guidance may be beneficial with regards to the acceptable underlying of stablecoins (see below).

**6. Do you agree with our assessment of stablecoins in respect of the perimeter?**

**YES** - The WFE believes stablecoins are better suited to facilitate regulated payments than “normal” exchange tokens. (For reasons laid out in our answer to Question 4).

Tokens that are being stabilised through exchange tokens, are not as stable as those stabilised and pegged to fiat currencies or securities tokens, given the volatility of some exchange tokens. Accordingly, the WFE believes that further clarification with regards to the acceptable type of underlying asset for stablecoins would be beneficial.

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

**YES** - The sections of the consultation paper cover most types of business models and tokens that are currently in use.

**8. Are there other significant tokens or models that we haven't considered?**

**YES** - The WFE would like to note that the FCA's consultation offers a valuable taxonomy and detailed definition of cryptoassets. However, some instruments may not fit neatly in the described categories as they are hybrids or have changed their definition over time (i.e. an exchange token may become a utility token etc).

**9. Are there other key market participants that are a part of the cryptoasset market value chain?**

**YES** - The WFE would like highlight importance of distinguishing between so-called "cryptoasset exchanges" and the regulated, secure and lit markets that traditional exchanges provide.

Since the emergence and popularity of cryptocurrencies (Bitcoin, Ethereum, and many more), cryptoasset platforms (crypto-platforms) have been referred to as "exchanges" in the traditional sense, which can deceive investors into thinking that they are regulated or meet the regulatory standards of traditional national exchanges (traditional exchanges).

While some crypto-platforms enforce their own standards, they are often not recognised by regulatory authorities and hence do not offer the same security to market participants.

With consumer protection and market integrity in mind, cryptoasset platforms and their users would benefit from greater clarity when navigating regulatory obligations e.g. registration, consumer rights, licensing, and investor disclosure.

We also believe that a clear distinction should be made between these two institutions through a form of regulatory recognition in order to not deceive investors and present them with a sense of false security.

Additionally, if crypto-platforms are going to continue to be referred to as "exchanges", we urge regulatory authorities to enforce traditional exchange-place regulations to ensure these crypto-platforms are compliant with the regulations pertinent to traditional exchanges.

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

N/A