

## **REGTECH LIVE**

**16 June 2021**

### **Elisabeth Wallace, Senior Manager, Strategy, Policy and Risk Crypto Asset Update**

Good afternoon, and thank you all for attending today. I am going to give a very brief update on where the DFSA is at in relation to the regulation of Crypto Assets, often called Digital Assets, Virtual Assets, or cryptocurrencies. While the language used can be different, they all have very similar characteristics.

#### **So, what have we done?**

The DFSA has spent the good part of the last year looking into the nature, characteristics and markets associated with Crypto Assets. We have talked to many other regulators who are “dipping their feet” in this water, to identify where they see risks and what they are thinking of doing to address those risks. We have also talked to regulators who have done something in this area to hear about their experiences and what we could learn from them.

We have talked to many market participants – exchanges, custodians, wallet providers, Crypto Asset infrastructure providers - to further our understanding and obtain feedback on how things really work in practice. This has been a valuable process for us, as we were able to get a better understanding of what these firms are looking for in a regulatory framework, and how we can constructively work with them as we look to licence their activities in the future.

Why have we done this? Because regulators have a difficult job. We need to take an objective approach, we want to support and encourage innovation, but we do not encourage or support any innovation that compromises our regulatory objectives – ensuring consumer protection, and maintaining market integrity, and financial stability – which Justin touched on earlier.

This Crypto Asset market is new to us, it is new to many regulators, and we see risks. These include:

- AML/CFT,
- challenges around market liquidity and volatility (which we have seen more than once with, for example, Bitcoin),
- technical and operational difficulties
- fraud and cyber risks;
- client suitability and understanding; and
- the global nature of this whole ecosystem.

I could go on.

So, while the proposals we are developing include a certain amount of flexibility and allow for innovation, our regulatory objectives are not flexible, they do not adapt to new products and services. Managing all these objectives takes some juggling.

However, we have been busy and this has resulted in the first phase of work being published, that is the framework for regulating Security Tokens as set out in [Consultation Paper 138](#) which was issued earlier this

year. The second phase will look at all other types of Crypto Assets that do not meet the criteria for being Security Tokens.

### **Regulation of Security Tokens**

We decided to tackle the regulation of Security Tokens first for three reasons:

1. Because this is the area in which we have seen significant interest.
2. Because this is an area which has a closer affinity to conventional investments that are regulated by the DFSA, and it provided a clear opportunity for us to expand our existing regulatory regime to address the regulation of these Tokens.
3. Finally, it offered us an opportunity to “test the waters” so to speak, and see if we had proposed measures that provided the right balance between encouraging innovation and addressing potential risks in the market.

I won't go into the finer details of CP 138, you can find that on our website, but we set out detailed guidance to assist market participants to determine whether the tokens they propose to issue, offer or market in or from the DIFC are in fact Security Tokens.

We then proposed additional requirements to regulate Security Tokens. Our proposals focused on promoting investor protection and market integrity and stability, whilst also addressing AML/CFT and the other risks I have mentioned, in a proportionate manner, so as not to inhibit innovation.

Some of the key aspects of the proposed regulation for Security Tokens include:

- a) facilitating the admission to trading of Security Tokens on DFSA regulated exchanges and multilateral trading facilities;
- b) systems and controls related requirements applicable to trading venue operators, including a requirement for an independent technology audit;
- c) allowing direct access to trading venues, including by retail clients, which is a significant deviation from the current intermediated model of trading;
- d) additional requirements for Digital Wallet providers, who hold Security Tokens;
- e) additional disclosure for prospectuses and other offer documents which are used for offering and marketing Security Tokens; and lastly
- f) additional requirements for other financial services providers who are dealing, arranging, advising on, and conduct asset management activities that involve, Security Tokens.

We are going through the responses to the CP, which have been very favourable, and hope to come out with the final framework soon.

### **Plans for the rest of the Crypto Asset ecosystem**

I will now set out our plans for phase two of our work. The types of Crypto Assets we are looking at for our second phase of work include:

- Exchange Tokens – also known as cryptocurrencies – for example Bitcoin, Litecoin, Ether, Ripple.

- Utility Tokens – typically offering access to a good or service.
- Stablecoins – depending on the characteristics these can also be called Asset Referenced Tokens or E-Money Tokens in the EU. These are Crypto Assets aimed at maintaining a stable value by reference to a single currency or a basket of assets, for example, currencies, commodities and other types of Crypto Assets.

There will be some Crypto Assets we won't allow, for example Crypto Assets which are created to allow transactions to take place anonymously, and which would not comply with our AML requirements.

What are we considering? Much like our work on Security Tokens, we are looking at:

- How to appropriately define these Crypto Assets without being too restrictive, so that we can accommodate the evolving nature of the underlying technology, but also balancing the need to provide legal certainty – this was a clear request during our engagement with market participants.
- How to treat the issuance of these Crypto Assets and what type of disclosure needs to be provided – typically a Whitepaper is issued, but is this enough?
- How to treat those carrying out activities relating to Crypto Assets like trading platforms, exchanges, custodians – we are looking at whether the rules we have in place are sufficient, and whether we need to add additional requirements to address the risks we have identified; and
- How these Crypto Assets should be marketed and to whom?

We intend to cover other issues such as Market Abuse, AML/CFT, consumer protection and IT governance and security.

We are also giving thought as to how we deal with firms that are already licensed by the DFSA and wish to engage with these types of Crypto Assets.

We hope to come out with proposals in the third quarter of this year.

If you have any questions, we will address these at the end of this event.

Thank you.