Feature

KEY POINTS

- The cryptoassets market has been embroiled in turmoil following a series of negative market events in 2022, which caused billions of dollars' worth of investor losses and catalysed the wider meltdown of the cryptoassets market.
- The turmoil has exposed vulnerabilities in the cryptoassets market such as risky business models, a high degree of interconnectedness within the crypto ecosystem and the lack of capacity by market players to absorb losses.
- In the wake of these events, regulators globally have expedited proposals to regulate cryptoassets service providers, to address the risks and vulnerabilities that have come to the fore.

Authors Elaine Chan and Sion Yoong Tian

Crypto headwinds: an overview of regulations in Singapore, the EU, UK and US

This article provides an overview of the recent developments in the regulation of cryptoassets across several jurisdictions, with a focus on consumer protection and stablecoin regulation. The importance of regulating cryptoassets has been underscored by their growing market capitalisation. Discussions for bespoke stablecoin regulations are also underway, as regulators become increasingly cognisant of the potential for stablecoins to be incorporated into mainstream financial systems. This article examines the cryptoassets regulatory proposals which have been made across various jurisdictions, and highlights opportunities for harmonisation of such regulations on an international front.

2022: THE BEGINNING OF THE "CRYPTO WINTER"

Within the crypto community, the year 2022 has become synonymously associated with the beginning of the "crypto winter". The meltdown of the cryptoassets market came as a bolt from the blue, given that the capitalisation of the cryptoassets market had hit its all-time high of US$3trn in November 2021. The series of negative market events which ensued in 2022 precipitated into a perfect storm that wiped out US$2.2trn in value from the cryptoassets market, and triggered increased regulatory scrutiny across various jurisdictions.

The ominous rainclouds in the distance: unravelling of the Terra ecosystem

The warning signs first emerged with the collapse of the Terra ecosystem, a blockchain-based project created in 2018. At its peak, Terra's native token, LUNA, boasted a market capitalisation of over US$41bn and was among the top 10 largest cryptocurrencies in the world. A key aspect of the Terra network was the issuance of LUNA and TerraUSD (UST), an algorithmic stablecoin pegged to the US dollar. Both LUNA and UST were connected through a burn-and-mint price stabilisation mechanism, under which one UST may be bought and burnt to mint LUNA tokens worth US$1, where the trading price of UST is less than US$1.

On 7 May 2022, approximately US$2bn worth of UST was unstaked from the Anchor Protocol, and a large amount of UST was sold at around the same time, which caused the price of UST to fall below US$1. Holders of UST either capitalised on this and began burning their UST to obtain LUNA in return, or sold their UST due to a loss in confidence in the project. At the same time, the supply of LUNA in the market increased drastically, which led to a corresponding fall in price. Eventually, UST completely depegged and LUNA lost almost all of its value, which came as a shock to many. After all, UST had long been touted as a stablecoin designed to maintain its value.

THE STORM SURGES: FURTHER COLLAPSE OF MAJOR CRYPTO INSTITUTIONS

The Terra-Luna collapse sent shockwaves across the cryptoassets market, and resulted in huge losses sustained by major crypto players with positions in UST and LUNA. By June 2022, a deluge of liquidation proceedings against these players was underway, which in turn had a spill over effect on crypto lenders, who were unable to recover the loans they extended to these now-insolvent crypto players.

Unfortunately, the events surrounding the Terra-LUNA collapse were only the start of the cryptoassets market's woes. Following subsequent collapses of other major players, we find ourselves in an extended period of negative investor sentiment towards the cryptoassets market and depressed prices of cryptocurrencies, which taken together spells a potentially long and dark crypto winter.

FRAGILITY OF THE CRYPTOASSETS MARKET: RISKS AND VULNERABILITIES OF CRYPTOASSETS EXPOSED

The series of events has exposed, among others, the following risks which cryptoassets pose to consumers and financial stability:

- extensive use of leverage;
- risky business models;
- a high degree of interconnectedness within the crypto ecosystem;
- lack of capacity by players to absorb losses; and
- under-collateralisation of stablecoins.

Alongside growing risk appetites of retail investors and consumers, regulators have begun expediting efforts to regulate cryptoassets. In August 2022, the Chairman of the Monetary Authority of Singapore (MAS), Mr Ravi Menon, cautioned that

cryptocurrencies are highly hazardous for retail investors who use them as a vehicle for speculation. In relation to stablecoins, Mr Menon stated that such cryptoassets can realise their potential only if there is confidence in their ability to maintain a stable value.

By the end of October 2022, the MAS had released two consultation papers on cryptoassets, namely the Consultation Paper on Proposed Regulatory Measures for Digital Payment Token Services (MAS DPT Consultation) and the Consultation Paper on Proposed Regulatory Approach for Stablecoin-Related Activities (MAS Stablecoin Consultation).

In the European Union (EU), the European Parliament passed the Markets in Crypto-assets Regulation (MiCA) on 20 April 2023. Once the MiCA is formally endorsed by the Council of the EU, it will be published in the Official Journal of the EU and will enter into force 20 days later. Following which, there will be a transitional period of 12 or 18 months before the provisions in MiCA apply.

In the UK, the HM Treasury recently published its consultation and call for evidence on the future financial services regulatory regime for cryptoassets on 1 February 2023 (2023 HM Treasury Consultation). This follows the HM Treasury's previous publication on its response to the consultation and call for evidence on the UK's regulatory approach to cryptoassets, stablecoins and distributed ledger technology in financial markets (2022 HM Treasury Consultation).

Finally, in the US, the Stablecoin Transparency Bill was introduced in the US Senate on 31 March 2022. If passed by Congress, the Stablecoin Transparency Act would be the first congressional statute to regulate stablecoins. The Bill was last heard by the Senate Committee on Banking, Housing and Urban Affairs in October 2022.

WHEELS IN MOTION: REGULATORY RESPONSES TO THE CRYPTO FIASCO

Broadly speaking, the measures being proposed by the various regulators can be bundled into three categories:

- **informational regulation**: curating the flow of information within the cryptoassets market;
- **gatekeeping regulation**: managing consumers' participation in the cryptoassets market; and
- **safety net regulation**: protecting consumers from potential insolvency of crypto players.

The discussion below will elucidate the positions that regulators have adopted in relation to the proposed measures.

INFORMATIONAL REGULATION

National regulators have proposed or introduced regulations to curate the flow of information between cryptoasset service providers and customers, to allow the latter access to more relevant information to make informed decisions vis-a-vis their crypto investments.

Based on the regulations discussed in this section, the applicable disclosure requirements for cryptoasset service providers would appear to depend on the classification of the cryptoasset, and generally differ in the following aspects: (i) the degree of disclosure; (ii) whether the disclosure is an ongoing requirement; and (iii) the party that is subject to it.

Prospectus requirements for offers of security tokens

In Singapore, offerors of cryptoassets which constitute securities, securities-based derivatives contracts or units in a collective investment scheme are required to prepare a prospectus to accompany the offer, in accordance with the Securities and Futures Act 2001. Similarly, the EU subjects security tokens to prospectus requirements where they fall within the scope of the Markets in Financial Instruments Directive. In the US, cryptoassets which satisfy the three criteria of the Howey Test will constitute securities and be subject to US securities laws, which would include prospectus requirements.

Interestingly, the UK appears to be proposing a different approach. For public offers of cryptoassets which meet the definition of a security offering, the HM Treasury has proposed in the 2023 HM Treasury Consultation to not require offerors of such tokens to issue prospectuses. Instead, offerors or platforms seeking to offer such assets above the *de minimis* monetary threshold would have to conduct due diligence and publish a corresponding report based on the platform's rules, which will be made publicly available to consumers. Further, the HM Treasury has emphasised that it does not expect these reports to take the same shape and form as traditional prospectuses, given the specific characteristics and investor profiles of cryptoassets.

Publication of White Paper for offers of cryptoassets

In Singapore, offerors of digital payment tokens (DPT) are currently not required to publish any kind of prospectus or White Paper. Instead, DPT service providers are required to provide specified risk warning statements in a clear and conspicuous manner to their customers, pursuant to MAS' Notice PSN08.

In contrast, under the MiCA, offerors of cryptoassets must publish a White Paper before such tokens may be offered to the public or admitted onto a trading platform, unless exemptions apply.

In the UK, for public offers of cryptoassets which do not fall within the scope of a security token offering, the HM Treasury has indicated in its 2023 HM Treasury Consultation that it may prohibit such offers unless they are conducted via a regulated platform. Where such offers are conducted via a regulated platform, the platform would be obligated to conduct due diligence according to its rules.

Publication of White Paper for offers of stablecoins

In Singapore, the MAS has proposed in its MAS Stablecoin Consultation to regulate certain single-currency pegged stablecoins (SCS) under a new regulatory regime. Under this proposal, a SCS issuer would be required to publish a White Paper on its corporate website, containing information such as a description of the SCS, the rights and obligations of the SCS issuer and the SCS holders, and the risks that can affect the value of the SCS and the ability of its issuer to fulfil

Feature

Biog box
Elaine Chan is the Joint Head of the Financial Services Regulatory Practice at WongPartnership LLP. She is a specialist in Financial Services Regulatory, Compliance and Governance and advises financial institutions on regulatory, licensing, compliance, governance and transactional matters. Email: elaine.chan@wongpartnership.com

its obligations. In relation to other classes of stablecoins (including stablecoins pegged to a basket of currencies or other assets such as commodities, as well as those which are algorithmically-pegged), the MAS has stated in its MAS Stablecoin Consultation that they will continue to be regulated as DPTs under the Payment Services Act 2019 (PSA). The MAS has clarified that the reason for its focus on SCS is their stronger use case for payment and settlement.

In contrast, the MiCA has been drafted to regulate both SCS (referred to in the MiCA as "e-money tokens") and other types of stablecoins that reference other assets (referred to in the MiCA as "asset-referenced tokens"), separately from other cryptoassets. Issuers of both e-money tokens and asset-referenced tokens will be required to publish White Papers. The White Paper requirement for offers of asset-referenced tokens would appear to require more information compared to offers of other cryptoassets and SCS, as they require a description of the issuer's governance arrangements and its reserve of assets. For e-money tokens, the summary of the White Paper must also indicate that the holders of e-money tokens have a redemption right at any moment and at par value, and the conditions of redemption, if any.

The HM Treasury has proposed in its 2022 HM Treasury Consultation to expand the scope of the UK's existing Electronic Money Regulations 2011 (EMR) to include SCS. The government has indicated that it intends to expand the regime of the Financial Conduct Authority (FCA), to include SCS by H1 2023. Thus, whether SCS issuers will be subject to any White Paper publication or disclosure requirement will depend on the legislative amendments the FCA eventually proposes.

In the US, the Stablecoin Transparency Bill has made clear that payment stablecoins are exempted from prospectus requirements under the Securities Act of 1993. Nevertheless, the Bill proposes to subject issuers of payment stablecoin to ongoing, periodic disclosure requirements, including monthly public disclosures of the assets backing the payment stablecoin and disclosures of the results of quarterly attestations by a registered public accounting firm.

GATEKEEPING REGULATIONS

Gatekeeping regulations are being explored as potential solutions to reduce the risks to consumers associated with speculative trading in cryptocurrencies, through regulating the type and extent of retail customer participation in crypto investments.

Consumer risk assessment

In Singapore, the MAS has long adopted the position that trading in cryptocurrencies and digital tokens is highly risky and not suitable for the general public. However, it acknowledged that banning cryptocurrencies would not be feasible given that they play a supporting role in the broader digital assets ecosystem.

As such, the MAS has proposed in its MAS DPT Consultation to require DPT service providers to assess that a retail customer has sufficient knowledge of the risks associated with DPT services before providing such services. The MAS is of the view that as these DPT service providers are the key access points to the cryptoassets market, they have a responsibility to guard against consumers participating in a market that they do not fully understand.

In the EU, the MiCA has been drafted to impose consumer risk assessment requirements on service providers authorised to advise on cryptoassets. Such advisors are required to assess the compatibility of the cryptoasset with the needs of the client and recommend products only where it would be in the interest of the client. In carrying out this assessment, cryptoasset service providers are expected to consider factors such as the client's knowledge of, and experience in, cryptoassets, objectives, financial situation including their ability to bear losses and understanding of the risks involved in purchasing cryptoassets.

In the UK, firms are restricted from making Direct Offer Financial Promotions of Restricted Mass Market Investments (RMMI), which is a class of investment products, to clients unless the firm assesses the RMMI as appropriate for the client (appropriateness assessment). In general terms, a Direct Offer Financial Promotion refers to a financial promotion containing an offer which specifies the manner of response, or includes a form to respond to the offer. In consultation paper CP 22/2, the FCA expressed its intention to expand the definition of RMMI to include cryptoassets, such that the appropriateness assessment will apply equally to cryptoasset service providers. The timing of this expansion hinges on when the Financial Services and Markets Bill 2022 (FSM) is passed, which will expand the FCA's regulatory authority to include cryptoassets.

Restrictions on inducement to invest

Regulators are also proposing to restrict cryptoasset service providers from providing inducements to customers to invest in their products. The MAS has proposed in its MAS DPT Consultation to prohibit DPT service providers from offering any monetary or non-monetary incentives to retail investors to participate in a DPT service, or to any person to refer a DPT service to retail customers. The MAS indicated that this restriction is intended to minimise the undue influence that external incentives may have on customers' investment decisions.

The MiCA does not prohibit cryptoasset service providers from offering incentives to investors to participate. Nevertheless, there have been growing calls across the EU to prohibit the offer of inducements to invest in financial products generally. Mairead McGuiness, the European Commissioner for financial services, financial stability and the Capital Markets Union, highlighted in a speech delivered to the European Commission on 24 January 2023 that there has been growing concerns and desire among its members to ban inducements to invest, given the risks that such inducements pose to consumers.

In the UK, the FCA has proposed in CP 22/2 to restrict firms from offering retail clients any monetary or non-monetary incentives to invest in cryptoassets. Similar to the appropriateness assessment discussed above, the FCA will only be able to introduce this restriction on incentives when the FSM is passed to expand the FCA's regulatory authority to include cryptoassets.

Restrictions on leveraged trading of cryptoassets

In Singapore, payment services licence holders are currently already prohibited from carrying

Biog box
Sion Yoong Tian is a partner in the Financial Services Regulatory, the Derivatives & Structured Products and the FinTech Practices. His main practice areas are financial services regulatory, FinTech, blockchain, and derivatives & structured products (both transactional and regulatory). Email: sionyoong.tian@wongpartnership.com

on a business of granting any credit facility to any individual in Singapore under the PSA. The MAS has proposed in its MAS DPT Consultation to extend the restriction on the provision of leverage to DPT service providers that are not licensed under the PSA. In doing so, the MAS hopes to mitigate the risk of customers suffering from magnified losses in their DPT trading activities.

Similarly, the US' Stablecoin Transparency Bill also contemplates restricting entities licensed under the Bill from engaging in any activities such as making loans or other extensions of credit, unless they are licensed to do so.

In contrast, the UK FCA introduced 2:1 leverage limits on contracts for differences with cryptoassets as the underlying asset in 2019. In January 2021, the FCA further updated its Handbook to ban generally the sale, distribution and marketing of cryptoasset derivatives and exchange traded notes that reference certain types of cryptoassets to retail clients, regardless of whether such instruments are leveraged. The introduction of the ban followed the FCA's policy statement PS 20/10, wherein the FCA indicated that it considered the existing leverage limits to be inadequate in addressing harm to retail consumers.

SAFETY NET REGULATION

Authorisation/licensing regime for stablecoin issuers

In Singapore, the MAS has proposed in its MAS Stablecoin Consultation to introduce a separate category of licensable regulated services catering to SCS issuers under the PSA, known as "Stablecoin Issuance Service". SCS issuers will have to obtain a major payment institution licence where its SCS in circulation exceeds or is anticipated to exceed S$5m in value. Otherwise, SCS issuers will only need to obtain a standard payment institution licence, which is subject to less onerous regulatory requirements.

Similarly, there have been proposed authorisation regimes in the EU and UK, and a proposed licensing regime in the US. In the EU, SCS may only be offered to the public in the EU or admitted to trading on a trading platform for cryptoassets where the issuer of the SCS satisfies the authorisation requirements of the MiCA, read together with the EU's Directive 2009/110/EC (E-Money Directive). Likewise, the UK's HM Treasury proposed in its 2022 HM Treasury Consultation to establish an FCA authorisation and supervision regime that would capture stablecoins which could be used as a means of payment. In the US, the Stablecoin Transparency Bill proposes to require payment stablecoin issuers to obtain a licence before they may be permitted to issue and redeem payment stablecoins or engage in any activities incidental to such issuance or redemption.

Reserve assets backing stablecoins

In Singapore, the MAS is proposing for Stablecoin Issuance Service providers to have reserve assets that are valued on a marked-to-market basis daily and be equivalent to at least 100% of the par value of the outstanding SCS in circulation at all times. Further, these reserve assets have to be held in segregated accounts held with certain specified financial services licence holders, separate from the SCS issuer's own assets. If an SCS issuer wishes to invest its reserve assets, it may only do so in cash equivalents, or debt securities with no more than three months residual maturity and are issued by the central bank of the pegged currency, or organisations that are of both a governmental and international character with a credit rating of at least "AA-".

For issuers of SCS in the EU, the MiCA requires them to comply with requirements applying to electronic money institutions set out in Titles II and III of the E-Money Directive. Under the E-Money Directive, funds must either be held separately from the issuer's own assets in a segregated account and invested in secure, liquid low-risk assets, or alternatively covered by an insurance policy or some other comparable guarantee from an insurance company or a credit institution, subject to certain requirements.

In the UK, the HM Treasury has clarified in the 2022 HM Treasury Consultation that it intends for the safeguarding requirements, which exist today under the EMR, to apply to customer funds received in exchange for issuing SCS. Thus, similar to the EU, funds received in exchange for SCS issued will have to either be held in a segregated account invested in secure, liquid low-risk assets, or be covered by an insurance policy or guarantee, subject to certain requirements.

THE WAY FORWARD: INTERNATIONAL HARMONISATION OF NATIONAL REGULATIONS

In conclusion, this cross-jurisdictional overview of crypto regulations reveals similarities and differences in the proposed regulatory frameworks in Singapore, the EU, the UK and US. While there has been increasing regulatory scrutiny of cryptoassets, there has been no uniform approach towards the regulation of such assets and their service providers.

As has been pointed out by several international bodies, including the Financial Stability Board, the cross-sector and cross-border nature of cryptoassets limits the effectiveness of unco-ordinated national approaches. In response to this, initiatives on an international front are underway to analyse and harmonise national regulations of the crypto space. Notably, the IOSCO Board-level Fintech Taskforce (FTF) was established in March 2022 to, among other things, ensure that efforts to address crystallised and emerging risks across the sector are connected and adopted in a coherent and co-ordinated cross-sectoral approach. The FTF comprises of 27 members from Board member jurisdictions and is chaired by the MAS.

Given the rapid and dynamic developments in the cryptoassets market, initiatives such as the FTF will undoubtedly be pivotal in steering national crypto regulations away from being mere paper tigers, and giving cross-jurisdictional regulations bite. ■

Further Reading:

- A MiCAR for the UK? or something else altogether? (2023) 4 JIBFL 255.
- Regulating cryptocurrency by policing advertisements: the approach in the UK, Singapore, India and Spain (2022) 5 JIBFL 340.
- Lexis+® UK: Banking & Finance: Practice Note: Supranational and EU regulation of cryptoassets.