



10 April 2023

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Future Regulatory Regime for Cryptoassets (Consultation)  
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## The British Blockchain Association's response to HM Treasury's Future Financial Services Regulatory Regime for Cryptoassets Consultation and Call for Evidence (2023)

***Q. Do you agree with HM Treasury's proposal to expand the list of "specified investments" to include crypto assets? If not, then please specify why.***

Agreed, subject to redefining non-fungible tokens for the purposes of legislation and associated guidance as a matter of urgency.

We note that the cryptoassets listed in Box 2.A could in future be subject to financial services regulation under the regulatory framework established by FSMA. We take issue with the following definition of non-fungible tokens or 'NFTs' in Box 2.A:

*"Non-Fungible Tokens (NFTs) are cryptoassets which confer digital ownership rights of a unique asset (e.g., a piece of digital art), using a technology such as DLT to support the recording or storage of data. NFTs do not provide the rights or features associated with a security token and do not function as a means of payment (emphasis added)".*





It follows from this definition that HM Treasury considers that all NFTs:

- (a) convey 'ownership rights' (i.e., legal title) in respect of the underlying asset; and
- (b) are *incapable* of having the features of security tokens with the implication that they will likely fall into the unregulated tokens category.

We do not consider that this definition is accurate or fit for purpose and, going further, we are of the view that the definition in its current state serves to perpetuate misinformation as to what NFTs are and in so doing, endangers consumers.

NFTs are code recorded by way of DLT or associated technology that represent something tangible or intangible, capable of conveying rights and obligations, as provided for under the associated smart legal contract. These tokens are assets distinct from the tangible or intangible underlying asset. When defined in this sense, one gains an appreciation for how versatile these assets are in actual fact.

The High Court of England and Wales has acknowledged the versatility of NFTs as vehicles for assigning rights and obligations in the recent judgment of Mr Justice Healy-Pratt in *Lavinia Deborah Osbourne v (1) Persons Unknown Category A and others* [2023] EWHC 340 (KB) at [19]:

*"NFTs are a type of cryptoasset that represent an underlying asset, whether tangible or intangible. In that sense, they are digital representations of value. The value of an NFT is, in large part, governed by the provisions of the underlying smart contract that conveys rights to, and in some instances, imposes obligations on the holder..."*

The BBA advisors (legal /regulatory) are frequently called upon to provide regulatory taxonomy advice for NFTs prior to 'drops' (i.e., launches). It is simply not the case that *all* NFTs convey legal title in respect of the underlying asset. Indeed, an NFT may operate so as to represent an underlying asset (e.g., a fractionalised piece of digital art) and entitle the holder to an 'experiential' entitlement (e.g., akin to membership rights) and/or access to special discounts without conveying legal title to the fractionalised piece of digital art. Equally, the NFT may simply convey an intellectual property licence in respect of the underlying asset without conveying legal title to the holder. In this sense, the first element of the definition is plainly wrong.

Secondly, and of the utmost importance for the purposes of this Consultation, we often

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encounter NFTs that, under the smart legal contract, convey to token holder's rights akin to a specified Investment, such as a share or debenture. At present, the definition at Box 2.A of the Consultation Paper provides a definition for NFTs too limited in scope by stating that NFTs do not provide rights or features associated with security tokens for the reasons we have cited above. In fact, this definition is inconsistent with paragraph 4.28 of the Consultation Paper where it is recognised that NFTs may qualify as a security token:

*“If an NFT or utility token is not used in such a way, it would not fall into scope of financial services regulation unless – as a result of the particular structure and characteristics of the NFT or utility token – it constitutes a specified investment and the activities carried on in relation to the token constitute regulated activities that fall within the existing perimeter”.*

We strongly recommend that HM Treasury revises the definition to bring it in line with industry practice and would propose the following definition:

*“NFTs are a type of cryptoasset that represent an underlying asset, whether tangible or intangible and convey rights and/or obligations to the token holder. As assets, they are digital representations of value distinct from the underlying tangible or intangible asset they represent. An NFT's value is detailed in its underlying smart legal contract detailing the rights and/or obligations conveyed to the token holder. Dependent upon the particular rights being conveyed, an NFT may fall within the Security Token taxonomy (if they are akin to those conveyed by a Specified Investment) or may simply convey rights of access to goods and/or services, such that they fall under the Utility Token taxonomy”.*

Broader guidance should reflect the potential for NFTs to be regulated security tokens. It follows that we would endorse a finding that NFTs may expose consumers to harms such that their promotion ought to be regulated also.

**Q. Do you agree with HM Treasury's proposal to leave cryptoassets outside of the definition of a "financial instrument"? If not, then please specify why.**



Not completely. It seems contradictory that crypto assets will sit outside the definition of “financial instrument” and yet the crypto assets present similar risks to financial instruments and the “same risk, same regulatory outcome” approach.

We have witnessed fraud cases where victims have had cryptocurrency stolen and moved through onward wallets and become irrecoverable with no recourse. Our view is that if crypto assets were regulated in the same manner as “financial instruments” such fraudulent activity would be more difficult, and the victims would have a compensation framework available to them.

***Q: Does the phased approach that the UK is proposing create any potential challenges for market participants? If so, then please explain why.***

Yes. A phased approach could create some uncertainty with users being uncertain as to the prevailing regulations as they progress through the phased approach.

That said, a key virtue and advantage of crypto assets is that they operate and can be traded presently in an unregulated form which a significant part of the population would prefer. Participants will likely need ongoing legal support during the phased approach. Participants will also need to be aware of deadlines involved to ensure they do not breach any regulations.

***Q: Do you agree with the proposed territorial scope of the regime? If not, then please explain why and what alternative you would suggest.***

The territorial scope of the regime is as wide as can be expected. The scope covers (i) UK businesses where customers are located in the UK or overseas and (ii) overseas business where the customer is located within the UK. There have been significant challenges in the

courts of England & Wales to jurisdiction where crypto assets form an element of the claim, due to the global nature of crypto-related transactions or when crypto asset firms are principally located outside of the UK but operate within the UK.





The territorial scope of the regime ensures that firms located outside of the UK but selling to UK customers are caught by the regime. In order to make the regulatory regime legally sound, it must ensure that potential UK claimants (or citizens and businesses) are protected. The scope of the proposed regime protects individuals conducting business in the UK or those who are domiciled in the UK so far as possible.

***Q: Do you agree with the assessment of the challenges and risks associated with vertically integrated business models? Should any additional challenges be considered?***

As referred to in Paragraph 4.11, there is considerable opacity in crypto asset markets, reflecting their often-pseudonymous nature. There is reference to information being gathered by exchanges being valuable to authorities for the purpose of market abuse and risk monitoring.

We have observed significant legal cases regarding exchanges, where they have been required to disclose information by way of Norwich Pharmacal Orders and Bankers Trust Orders. HM Treasury may want to consider the obligation of exchanges to provide this information and the legal routes available to authorities to obtain KYC/AML disclosure in relation to persons unknown. The current route to obtain disclosure from exchanges is costly to clients and those who have been a victim of fraud. This is something which needs urgent consideration, and we believe it would be proportionate given the amount of illicit activity conducted via exchange platforms that they should be required to produce regular reports on holdings.

There is significant difficulty in monitoring holdings. It would be helpful to have regulatory clarification of the basis and status of the crypto asset held by the exchange for the customer.

***Q: Is the proposed treatment of NFTs and utility tokens clear? If not, please explain where further guidance would be helpful.***

No. For the reasons cited above, we do not consider that the proposed treatment of NFTs is clear in light of the contradictory statements in the Consultation Paper as to





the potential for an NFT to convey rights akin to a Specified Investment, which they can. There needs to be clear guidance to this end as it has become industry practice to commonly refer to *all* NFTs as unregulated utility tokens when this is simply not the case. It is clear from the paper that if an NFT was used to perform one of the activities in table 4A, it should sensibly be included in the future regulatory regime otherwise it may be seen as a gateway to circumvent the regulatory regime. However, many NFTs are issued in the genuine belief that they are utility tokens. It follows that careful consideration needs to be given as to the definition of an NFT and what triggers the need for it to be regulated. Whilst many NFTs are purchased or produced for the purpose of profit and/or as an investment, there is a developing market of NFTs being used for community engagement and trading as well as providing a record of authentication. We have found that artists or NFT “creators” are generally quick to announce that their NFT is a utility token without assessing its attributes and the associated risks.

***Q: Do you agree with the proposed necessary information test for cryptoasset admission disclosure documents?***

The information test for crypto asset disclosure/admission documents may need to be widened. There is considerable ambiguity around what is required to be disclosed. Currently, investors are making life changing investment decisions without sufficient information.

***Q: Do you agree with the assessment of the challenges of applying a market abuse regime to cryptoassets? Should any additional challenges be considered?***

Our experience of dealing with crypto assets has largely been as a result of financial crime, “pump and dump” schemes, and illicit activity purported by unknown persons (due to the anonymised characteristics of crypto wallets). The risk of financial crime appears to have been downplayed within the report and the pseudonymised nature of crypto transactions is not included as a significant factor. The anonymised nature of wallets and transactions will need to be assessed and addressed.







**Qs: Do you agree that the prohibitions against market abuse should be broadly similar to those in MAR? Are there any abusive practices unique to cryptoassets that would not be captured by the offences in MAR? Does the proposed approach place an appropriate and proportionate level of responsibility on trading venues in addressing abusive behaviour? What steps can be taken to encourage the development of RegTech to prevent, detect and disrupt market abuse? Do you agree with the proposal to require all regulated firms undertaking cryptoasset activities to have obligations to manage inside information?**

Much of this section is predicated on the development of RegTech. It would be helpful if advice was provided on suitable RegTech as the current regime is entirely theoretical.

**Q: What types of regulatory safeguards would have been most effective in preventing the collapse of Celsius and other cryptoasset lending platforms earlier this year?**

As referred to at 10.3 and 10.4, the current practice around collateralisation is opaque. Customers of both Celsius and FTX's have suffered due to lack of regulation and transparency within crypto firms. Sufficient disclosure obligations should have been in place to ensure that customers were aware of the risks associated with investing and the subsequent losses which could be incurred in the event of insolvency.

There are significant issues, which have been addressed in the courts of England and Wales, around the legal ownership of assets once invested with an exchange platform. The main issue being whether there is a constructive trust in place between exchanges and customers when assets are being held by exchanges on behalf of customers. A recent case which addressed this is *Jones v Persons Unknown* [2022] EWHC 2543, although there is still ambiguity.

Lending platforms should ensure that they have clear terms on ownership which are made available to customers and confirm to customers what would happen in the event of insolvency. Also, it should be clear as to whether there is any regulatory compensation scheme i.e., there should be a positive statement that there is no scheme.





***Q: Do you agree with the assessment of the challenges of regulating DeFi? Are there any additional challenges HM Treasury should consider?***

We agree that DeFi is evolving at an unprecedented rate, therefore it is difficult to keep up with its pace and regulate. The DeFi landscape is ever-changing. That said, we believe steps should be taken now to regulate DeFi as set out in the report.

Other challenges include the globalised nature of DeFi transactions, which provide for significant jurisdictional issues. With DeFi, there are not always necessarily inputs from institutions which are domiciled in the jurisdiction of England and Wales. It is difficult to understand which laws will apply unless agreed by voters. On-chain voting, for example, where individuals voting rights are determined by their holdings could in the future determine which governing law applies when a dispute arises. If there is a significant holding in England & Wales then the laws of England and Wales may apply, subject to voting, but alternatively, if there is a large holding outside of the jurisdiction, the voting could sway that decision leaving individuals domiciled in this jurisdiction subject to court proceedings elsewhere.

DAOs will also be subject to significant jurisdictional issues as well as issues around the legal structure which should be adopted. We would suggest that a strict legal structure in respect of DAOs is adopted immediately to avoid future legal issues.

***Q: What reliable indicators are useful and / or available to estimate the environmental impact of cryptoassets or the consensus mechanism which they rely on (e.g., energy usage and / or associated emission metrics, or other disclosures)?***

An industry standard used to calculate energy usage and associated emissions. Yearly reports may also assist understanding of the ESG impact of crypto assets.

***Q: What methodologies could be used to calculate these indicators (on a unit-by-unit or holdings basis)? Are any reliable proxies available?***

A holdings basis may be more appropriate. The consensus mechanism will be different for each holding so there may need to be an aggregate calculation.







***Q: How interoperable would such indicators be with other Recognised sustainability disclosure standards?***

It is important to note that there are significant legal issues around ESG and business' disclosure obligations. ESG has become a marketing tool for businesses looking to attract clients or customers. Operation and management teams are now under pressure to consider these issues on a day-to-day basis and the same will apply for crypto asset businesses.

Those operating in this area will need to consider the following when disclosing ESG related information and reporting:

- The Green Claims Code. The Competition and Markets Authority's Green Claims Code which is aimed at protecting consumers from misleading environmental claims and related concerns about unfair competition.
- Financial Conduct Authority (FCA) Action. In October 2022, the FCA announced its proposed measures to enforce greater scrutiny over ESG representations to protect consumers and improve trust in sustainable investment products. These should be implemented in mid-2023.
- ASA's Climate Change and Environment Project - In 2021, ASA launched their own Climate Change and Environment Project which is aimed at reviewing how effective their rules are in governing greenwashing claims and other environmental claims. As part of this project, they will look at new ways they can be more proactive in tackling green claims and will aim to develop the advice for advertisers so they can advertise their alleged "eco-friendly" products or services more responsibly and accurately. The above will be applicable to any person or entity promoting crypto assets.

***Q: At what point in the investor journey and in what form, would environmental impact and / or energy intensity disclosures be most useful for investors?***

This should be provided from the outset along with disclosures around risk, legal ownership together with it being an obligation to extend to director duties.

***Q: Is the proposed treatment of NFTs and utility tokens clear? If not, please explain where further guidance would be helpful.***





No. For the reasons cited in answer to questions above, we do not consider that the proposed treatment of NFTs is clear in light of the contradictory statements in the Consultation Paper as to the potential for an NFT to convey rights akin to a Specified Investment, which they can. There needs to be clear guidance to this end as it has become industry practice to commonly refer to *all* NFTs as unregulated utility tokens when this is simply not the case.

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If you have any questions relating to this response, please contact BBA Secretariat at [Secretary@britishblockchainassociation.org](mailto:Secretary@britishblockchainassociation.org)

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### About the British Blockchain Association:

Established in 2017, [The British Blockchain Association](#) (The BBA) is the world's leading industry body advancing evidence-based adoption of Cryptoassets and Distributed Ledger Technologies (DLT). The BBA has advisors, ambassadors, members, partners, and editorial board network in 78 countries across six continents. In 2021, BBA authored the [UK's National Blockchain Roadmap](#). BBA is home to the world's first peer-reviewed blockchain research journal [The JBBA](#) - Journal of The British Blockchain Association; The world's first [Centre for Evidence-Based Blockchain](#) (CEBB); the world's first trans-national collaboration consortium of 53 countries - BAF - [The Blockchain Associations Forum](#), as well as BBA [Fellowships](#) (FBBA), Blockchain [International Scientific Conferences](#) (ISCs), and a host of other world-class blockchain initiatives. BBA also has its [headquarters in the Metaverse](#). BBA president was awarded the [UK's most prestigious National Honour](#) (King's Honour) for services to Blockchain, in New Year's Honours 2023. Check out BBA's [2022 Year-in-Review](#).

