

Article Information

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Blockchain Bites: Treasury releases Token Mapping Consultation Paper, UK kicks off crypto consultation, Hong Kong to implement stablecoin licensing regime, White House crypto roadmap drives straight to Congress, Celsius examiner's report burns

Michael Bacina, Steven Pettigrove, Jake Huang, Luke Misthos and Lola Hickey of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Treasury releases token mapping Consultation Paper

Australia's Treasury has released its [Consultation paper on Token Mapping](#) as a foundational step in the Government's plans to develop a regulatory framework for crypto-assets. As [previously foreshadowed](#) by the Treasurer, the Hon. Jim Chalmers, the paper is intended to assist regulators and policy-makers in formulating regulation of the crypto-asset industry.

According to the paper, token mapping is a process of identifying the key activities and functions of products in the crypto ecosystem and mapping them to existing regulatory frameworks. The paper outlines the concept of the 'functional perimeter', which forms the basis of Australia's financial services regulation and is intended to capture any facility through which a person makes a financial investment, manages financial risk or makes non-cash payments.

While the 'functional perimeter' is designed to be flexible, the paper notes the difficulty of fitting some existing crypto projects within this framework and concedes further regulation is necessary.

In discussing potential opportunities in the space, the paper comments:

To capitalise on these opportunities and ensure consumer and business trust and confidence in the crypto ecosystem, regulation is required. This includes...ensuring that any additional regulation is appropriately robust, fit-for-purpose, and can keep pace with the rapidly evolving ecosystem.

The paper also considers three different concepts which could inform regulation:

1. A crypto token, which performs a record keeping role for projects;
2. A token system, which is the business or social protocol of the project; and
3. A function, which is the product or benefit provided by the token system.

The paper maintains that the process of assessing crypto related products, like crypto tokens, against the functional perimeter is no different than the process of assessing any other product, such as a fiat currency.

Notwithstanding the above, the Treasury has acknowledged that existing regulatory frameworks will undoubtedly fall short in regulating some existing crypto projects, and as such a framework for custody and licensing is set to be released for consultation in mid-2023.

The Treasury's long-awaited consultation paper on token mapping is a step forward in Australia's journey to establish a

regulatory regime for cryptocurrencies which supports innovation and safeguards users. Consultation response are due by 3 March. The difficult work of turning the results of this exercise into draft legislation remain to be done.

UK kicks off crypto consultation

The Treasury of the United Kingdom (**UK**) has released a report outlining its plans for regulating the cryptocurrency and crypto asset industry. The report, titled "[Future financial services regulatory regime for cryptoassets](#)," confirms the UK's ambition to [harness the opportunities](#) presented by crypto technologies.

We believe that crypto technologies can have a profound impact across financial services. By capitalising on the potential benefits offered by crypto we can strengthen our position as a world-leader in fintech, unlock growth and boost innovation.

The report outlines the potential benefits of cryptocurrencies, such as increased financial inclusion and access to finance, as well as increased efficiency and reduced costs. The Treasury suggest that regulation should focus on activities rather than specific types of assets and should be adaptable to changes in the market.

While the UK plans to develop its regulatory framework within existing financial services laws, in practice, the country's lead regulator, the Financial Conduct Authority, will be given powers to write tailored rules as opposed to existing rules automatically applying to cryptocurrencies.

The proposed new regulatory regime for cryptoassets would include licensing requirements for firms engaged in crypto-related activities, such as trading, custody, and issuance. The regime would also require these firms to meet standards for governance, risk management, and security.

The government recognises the potential benefits of cryptoassets and DLT (distributed ledger technology), including increased financial inclusion and access to finance, as well as increased efficiency, reduced costs and increased market integrity

Meanwhile, the Government's thinking on DeFi appears to be at a relatively early stage. While indicating an intention to tackle regulatory arbitrage, the Treasury plans to embrace the opportunities posed by DeFi.

Overall, HM Treasury is looking for a proportionate, innovation friendly approach, which recognises distinct opportunities offered by new business models and encourages a thriving and well-regulated UK DeFi industry.

In addition to the proposed licensing requirements, the UK plans to implement measures to tackle market manipulation in cryptocurrencies. The report also discusses the importance of international cooperation in regulating the crypto asset industry. The UK Government plans to work with other countries to develop a coordinated approach to regulation.

The report provides a comprehensive overview of the UK Government's approach to regulating the cryptocurrency and crypto asset industry. The Treasury advocates for a balanced regulatory regime that encourages innovation while protecting consumers.

The release of this report marks a significant step forward in the UK's efforts to regulate the rapidly growing crypto asset market. The report highlights the UK Government's commitment to promoting the responsible use of cryptocurrencies and crypto assets while also protecting consumers and fostering innovation in the industry.

Hong Kong to implement stablecoin licensing regime

This week, the Hong Kong Monetary Authority (**HKMA**) released a [Consultation Conclusion](#) which confirmed that it will establish a [mandatory licensing regime](#) for stablecoin activities by 2024, including requiring fully-backed reserves and redemption at par at all times.

The Consultation Conclusion follows a [discussion paper](#) on crypto-assets and stablecoins released over a year ago. The HKMA had received 58 submissions to the discussion paper, including from Ant Group's Alipay Financial Services, the Hong Kong arm of Tencent Holding's WeChat Pay, the world's biggest crypto-exchange Binance, and Hong Kong-based blockchain gaming unicorn, Animoca Brands.

In the Consultation Conclusion, HKMA said it will take a “risk-based approach” in implementing stablecoin regulation. The regulator will first target stablecoins purportedly backed by one or more fiat currencies, as they pose “[more imminent monetary and financial stability risks](#)”. But the HKMA also said flexibility will be built in to the regime to enable them to regulate other stablecoins in the future.

According to the HKMA’s paper:

- The mandatory licensing regime will cover key risks such as stablecoin governance, issuance, stabilization and reserve management, and stablecoin wallets.
- Entities undertaking stablecoin activities in Hong Kong or actively marketing to Hong Kong will need to be licensed. Stablecoins that purport to reference the value of the HK dollar are also in scope.
- A comprehensive regulatory framework will be developed on topics such as ownership, governance and management, financial resource requirements, risk management, anti-money laundering and counter-terrorist financing, user protection, and regular audits and disclosure requirements.
- Full backing and redemption at par will be required at all times. Stablecoins that derive their value based on arbitrage and algorithm will not be accepted.
- Regulated entities should not conduct activities that deviate from their principal business as permitted under their relevant licenses. For example, wallet operators should not engage in lending activities.

The HKMA said its target implementation date will be by 2023 or 2024. It is still weighing the pros and cons between introducing new legislation and amending existing laws for implementation of the regulatory regime.

The HKMA’s paper follows several announcements by the Hong Kong government aimed at boosting its virtual asset sector, including a new [licensing regime for virtual asset service providers](#) (which will take effect in June) and plans to allow greater retail participation in cryptocurrencies. It appears that recent market turbulence following [FTX’s implosion](#) hasn’t stopped, but rather accelerated Hong Kong’s [plans to establish a broadly based regulatory regime for cryptocurrency and digital assets](#).

White House crypto roadmap drives straight to Congress

The White House has [published a “roadmap”](#) outlining steps to mitigate the perceived risks identified as being associated with cryptocurrencies. The Administration’s “Roadmap to Mitigate Cryptocurrencies’ Risks” takes the form of a blog post cataloguing the actions which it has taken to date to progress crypto regulation and detailing further measures the Administration believes will help protect investors, prevent money laundering and the financing of illegal activities, and promote fair competition in the crypto market. Unfortunately it is heavy on platitudes but light on the detail which the industry has been seeking for years.

While noting the administration’s efforts to step up enforcement action tackling bad actors in the industry, the roadmap also reiterates the need for legislative action:

Congress, too, needs to step up its efforts. For example, Congress should expand regulators’ powers to prevent misuses of customers’ assets—which hurt investors and distort prices—and to mitigate conflicts of interest. Congress could also strengthen transparency and disclosure requirements for cryptocurrency companies so that investors can make more informed decisions about financial and environmental risks.

Curiously, the White House cautions against enacting legislation which may deepen ties between cryptocurrencies and the broader financial system, looking to take a containment approach to crypto-assets which may prevent innovation and efficiencies spreading from innovative crypto-products into mainstream offerings.

The White House promises to work closely with regulatory agencies and other stakeholders to address the risks posed by cryptocurrencies. The roadmap also emphasizes the importance of international cooperation, which will of course be essential but, without details on what approach the US is taking (other than the hint of a containment only approach) it’s hard to see how this promotes cooperation. The administration plans to engage with international partners to “promote consistency” in regulation and to share information and best practices. With the UK pushing to become a crypto-friendly hub and MiCA in the EU pushing in sensible directions while the US remains a “regulation by enforcement” jurisdiction, consistency of approach may be an increasing challenge.

The roadmap concludes by reiterating the Administration’s support for “responsible technological innovations that make financial services cheaper, faster, safer, and more accessible”. This appears to contrast with the containment approach also asserted.

While crypto regulation remains high on the US policy agenda in 2023, the administration's roadmap might be unfairly called more of a cul-de-sac given the lack of tangible details. The White House may be giving the wheel to Congress to drive legislation, which will risk knee-jerk reactions to collapses like FTX, and may push back the benefits of blockchain technology for the world's largest economy.

Celsius examiner's report burns

The Court appointed examiner investigating Celsius Network, the bankrupt US crypto lender, has accused the company of misleading investors, misappropriating client assets and using new customers' assets to pay for other customers' withdrawals, the typical definition of a Ponzi scheme.

In her final report filed on Monday, Shoba Pillay, wrote that:

In every key respect – from how Celsius described its contract with its customers to the risks it took with their crypto assets – how Celsius ran its business differed significantly from what Celsius told its customers.

Celsius promised customers high returns and financial freedom, through a community-led lending system. The examiner found that the business was conducted in a starkly different manner than it was marketed and that Celsius' management were aware of these inconsistencies.

The report cites misleading representations with respect to the company's earn product and market making activities in relation to its native CEL token which would have enabled Celsius to inflate its balance sheet. By the time of its bankruptcy, Celsius could no longer afford to prop up the value of the CEL token. In the meantime, senior management reportedly netted millions by selling their CEL token holdings.

The examiner found that Celsius started using customer deposits to pay for operational expenses and rewards as early as 2020. Further, from May 2022, Celsius began using customer deposits as collateral for borrowings which enabled it to meet customer withdrawals. It is alleged that management justified this decision on the basis that customer deposits were not directly being used to pay customer withdrawals.

On 12 June, Celsius stopped customer withdrawals and [according](#) to Pillay, if this measure was not taken:

New customer deposits inevitably would have become the only liquid source of coins for Celsius to fund withdrawals...In some instances, however, between June 9 and June 12, Celsius did directly use new customer deposits to fund customer withdrawal requests.

The report amounts to an indictment of Celsius' operations and business practices. It [follows news last month](#) that the company's founder, Alex Mashinsky, has been charged with defrauding investors of billions by making misleading statements in the lead up to its bankruptcy. The civil suits seeks banning orders against Mashinsky and damages.

The examiner's findings underscore the need for enhanced regulation of centralized cryptocurrency platforms to reduce the risk that practices like those which Celsius allegedly engaged will be repeated. As 2023 begins, we continue to see strong legislative momentum globally as regulators move to address bad practices exposed by this crypto winter. It remains to be seen if Australia can keep up with the legislative race.