

## Article Information

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Service: Blockchain, FinTech

Sector: Financial Services, IT & Telecommunications

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## **Blockchain Bites: UK responds to consultation on crypto-assets regulation, PayPal navigates clashing regulatory approaches, LBRY checks out: the end point of regulation by enforcement, Ripple Making Waves as XRP approved by Dubai**

*Michael Bacina, Steven Pettigrove, Tim Masters, Jake Huang, Luke Higgins, Luke Misthos and Kelly Kim of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.*

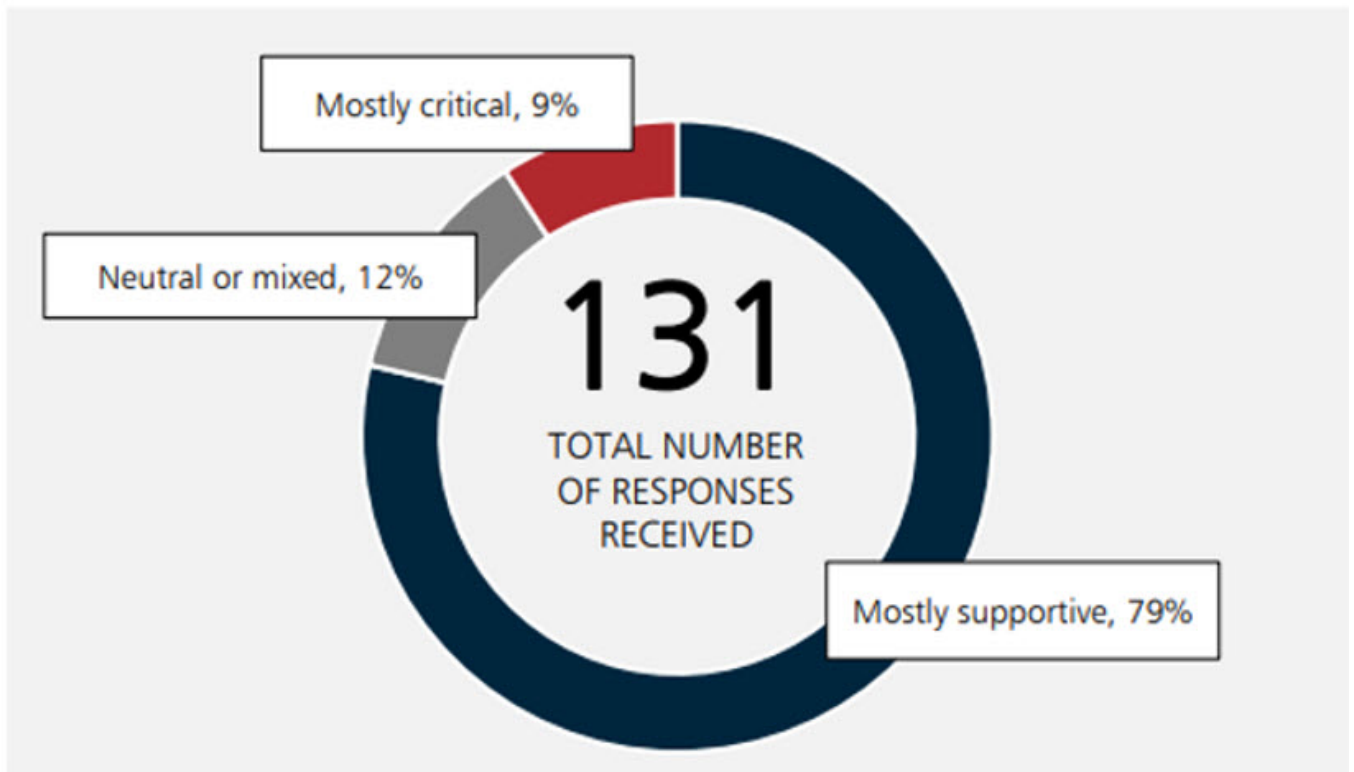
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### **UK responds to consultation on crypto-assets regulation**

His Majesty's Treasury (HMT) [has further detailed its proposals for a future financial services regulatory regime for cryptoassets in the UK](#). The "Future financial services regulatory regime for cryptoassets" consultation paper response represents a forward-thinking approach to the regulation of this rapidly evolving sector. HMT has stated that firms wishing to undertake activities involving cryptoassets will, in future, be required to obtain an authorisation from the Financial Conduct Authority (FCA) where firms are providing a service in or to the UK.

HMT's commitment to furthering regulatory clarity is apparent from its detailed response to the [February 2023 consultation paper](#) and call for evidence. The majority of submissions in response to the initial consultation paper in February expressed support for its proposals, signalling a widespread consensus on the need for a well-regulated cryptoasset sector in the UK.

## High-level sentiment analysis



*Source: HM Treasury analysis of responses received*

Key points from HMT's response include:

- Regulated Activities and Tokens:** HMT provides a clear demarcation between "phase 1" and "phase 2" activities and tokens, as outlined in the separate [Stablecoins Update policy paper](#). "Phase 1" of HMT's regulatory action plan will deal with the regulation of fiat-backed stablecoins, whereas "phase 2" will deal the other activities related to cryptoassets.
- Non-Fungible Tokens (NFTs):** HMT acknowledges the unique nature of NFTs and non-fungible assets, ensuring that they are not inadvertently included in the regulatory framework. The response affirms that the intended regulatory framework is not designed to encompass activities involving cryptoassets categorised as specified investments, which are already subject to regulation, such as security tokens. Similarly, it excludes activities connected to genuinely unique NFTs or NFTs that bear greater resemblance to digital collectibles or artwork rather than conventional financial services or products.
- Retail Trading and Investment:** HMT firmly rejected the idea of categorising retail trading of unbacked cryptoassets as gambling.
- Facilitating Liquidity:** HMT acknowledges the need to mitigate potential fragmentation of cryptoasset liquidity and aims to enable access to international liquidity pools under specific circumstances, with the intention of promoting a more liquid and efficient market.
- Issuance and Disclosures:** HMT notes that recklessness and negligence liability standards will enable market participants to manage their liability provided they make reasonable enquiries.
- Market Abuse Obligations:** HMT acknowledges the complexity of market abuse obligations on crypto exchanges and is considering a staggered implementation to ensure a smooth transition, benefiting both market participants and regulators.
- Staking:** HMT outlines its strategic direction and the roadmap for addressing staking, aiming to shape the government's perspective on essential queries and deliver regulatory transparency to the industry in a swift manner. HMT highlights the initiation of an engagement initiative with external stakeholders, aimed at providing valuable insights and input for this endeavour.

Unlike the EU's MiCA regime, [the world's first set of comprehensive cryptoasset market rules](#), HMT does not intend to create a bespoke regulatory regime for cryptoassets, instead opting to regulate cryptoassets and cryptoasset activities by bringing them within the definition of "specified investments" which are considered regulated assets under existing financial services laws in the UK. It will then seek to tailor existing regulations to the unique features of digital assets.

HMT also published two stablecoins-related papers in late-October. The “[Managing the failure of systemic digital settlement asset \(including stablecoin\) firms](#)” paper confirmed the UK’s plans to legislate to address risks that may arise from the failure of “digital settlement assets” such as stablecoins. On the other hand, the “[Update on Plans for the Regulation of Fiat-backed Stablecoins](#)” paper provided an update on the HMT’s legislative approach for bringing fiat-backed stablecoins into the UK’s regulatory perimeter for financial services (as part of its phase 1 regulatory plan).

The thorough and thoughtful approach to blockchain regulation proposed by HMT is another positive step toward establishing a robust regulatory framework for crypto-assets in the UK, aimed at fostering innovation and safeguarding financial stability. The importance of striking the right balance cannot be overstated as we navigate this transformative era of digital finance. With a focus on clarity, responsibility, and consumer protection, the UK is blazing a trail for other jurisdictions to follow by seeking to harness the benefits of Web3 while mitigating consumer harms.

*Written by Michael Bacina, Steven Pettigrove and Luke Higgins*

### **Oceans apart: PayPal navigates clashing regulatory approaches**

Global payments provider, PayPal, is facing two starkly different realities in the United Kingdom (UK) and the United States (US). While the UK’s Financial Conduct Authority (FCA) has approved PayPal’s [registration as a crypto asset firm under AML/CTF regulations](#), across the pond the Securities and Exchanges Commission (SEC) has [issued a subpoena](#) to PayPal inquiring about its USD stablecoin.

[PayPal’s foray into stablecoin issuance](#) is being met with heightened regulatory scrutiny Stateside. The subpoena requests documentation pertaining to PayPal’s U.S. dollar-pegged stablecoin, PYUSD.

The SEC has pursued an industry wide “regulation by enforcement” approach (see [Ripple](#), [Grayscale](#), [Stoner Cats](#), [Coinbase](#), [Binance](#) to name a few) and has now set its sights on PayPal’s stablecoin project, after months of operation. It is unclear whether the SEC issued the subpoena as part of an investigation into alleged breaches of US securities laws or potential enforcement action.

Across the North Atlantic, the UK offices of PayPal are having a better week, with the firm’s UK unit entering the FCA’s registry of cryptoasset firms that provide “certain cryptoasset activities”. Landing on the register means PayPal can create and approve its own advertising communications relating to crypto under a [newly imposed marketing regime](#).

The UK has been one of the more progressive jurisdictions when it comes to crypto asset adoption and regulation. Just this year the UK has [adopted the Financial Services and Markets Act 2023](#), [finalised its ‘travel rule’ plans](#) for crypto, and launched a [digital securities sandbox](#) to trial asset tokenisation under tailored regulatory settings.

This tale of two countries demonstrates the divergent approaches adopted by the US (predominantly) and the rest of the world on crypto-assets regulation. On the one end, there are countries who are willing to trial and regulate by establishing regulatory frameworks and guidance with a goal of fostering innovation and consumer protection. On the other hand, there are countries which are pursuing “regulation by enforcement” stifling innovation and prompting innovators to seek more friendly shores.

*Written by M Bacina, S Pettigrove and L Misthos*

### **LBRY checks out: the end point of regulation by enforcement**

LBRY Inc., the blockchain-based file-sharing network [said in its last post](#) that it would wind down following enforcement action by the US Securities and Exchange Commission (SEC). According to LBRY, its assets including the popular video sharing channel [Odyssey](#) will be auctioned.

LBRY originally announced that it would wind down LBRY and its assets after losing a New Hampshire court decision in November 2022 in favour of the SEC. In that case, the SEC obtained summary judgment on its allegations that the “LBRY Credits” or “LBC” crypto tokens issued by the firm were securities, and that LBRY breached the registration requirements of US federal securities law by offering and selling these tokens. The SEC originally sought a financial penalty of US\$44 million, but pared that down to a significantly lower \$111,614 after court hearings.

In September 2023, perhaps motivated by [Ripple Labs’ partial victory](#) against the SEC, LBRY backtracked on its decision to wind down by filing a notice of appeal against the SEC. However, the company announced in its post last month that it is finally throwing in the towel in its fight against the regulator,

LBRY Inc. must die, there is no escaping this. It has lost a judgment to the federal government, has several million dollars in debts, and has pledged to shut down.

LBRY's assets will be placed in receivership and used to satisfy its debts, including the civil monetary penalty owed to the SEC. The future of the LBRY blockchain remains unclear.

While the SEC [heralded their](#) victory against LBRY, the Commission itself has been split over the LBRY case and its broader implications. On 27 October 2023, Commissioner Hester Peirce, who is famous for voicing dissents to several SEC enforcement actions against crypto firms, issued what she called an ["overdue" statement of dissents](#) on the LBRY case.

According to Commissioner Peirce, the case against LBRY "unsettled" her. She asks:

Are investors and the market really better off now after the Commission's litigation contributed to the demise of a company that had built a functioning blockchain with a real-world application running on top of it?

Commissioner Peirce points out that the case illustrates the "arbitrariness and real-life consequences" of the SEC's "misguided enforcement-driven approach to crypto". She questions the decision to target LBRY instead of genuinely fraudulent crypto projects that sold tokens with promises they did nothing to fulfill:

Why go after a company that sold a token for a functioning blockchain with an established use when we could have pursued plenty of other projects that were outright frauds and did not attempt to comply with the securities laws?

She also criticises the originally disproportionate remedies sought by the SEC, which was not supported by the court:

The Commission's requested remedies were entirely out of proportion to any harm. Indeed, the court stated during the remedies hearing that "the absence of fraud allegations, [and] the fact that there was some measure of uncertainty" regarding the application of the securities laws when LBRY commenced its offering were facts that "should be taken into account when considering a penalty.

Finally, Commission Peirce points out that the application of the securities laws to token projects is not clear, a complaint similarly raised by other crypto firms (e.g. Coinbase) which seek to comply with the laws but find little guidance to do so:

There is no path for a company like LBRY to come in and register its functional token offering. Even if a company did manage to register its token offering, it would not be a particularly useful effort...

She also suggests that the SEC is missing the point of regulation by actively bringing enforcements,

The time and resources that we expended on charging LBRY could have been devoted to building a workable regulatory framework that companies like LBRY could have followed. Then the market could have decided LBRY's fate.

As Commission Peirce suggests, the SEC's actions could hinder innovation in blockchain technology, and alternative approaches to crypto regulation are desperately needed. It is unfortunate to see projects like LBRY which have real-world blockchain-based use cases - LBRY aptly describes this as "technology that enables dissents" - being shut down by enforcement actions. To grasp the opportunities offered by blockchain technology, the US legislature and regulators must hasten their efforts to formulate a tailored regulatory framework for Web3 companies and start-ups.

*Written by J Huang and S Pettigrove*

**Ripple Making Waves as XRP approved by Dubai**

The Dubai Financial Services Authority (**DFSA**) has [approved the XRP Token](#) for incorporation into the virtual asset services provided by firms within the [Dubai International Financial Centre \(DIFC\)](#).

XRP was developed in part by Ripple Labs, who use the open-sourced digital asset for its technological solutions, including RippleNet, a currency exchange network for cross-border payments using XRP. RippleNet provides [payout capabilities in over 40 currencies](#), making it one of the leading providers of blockchain for global payment solutions.

Dubai is a key builder and user of the XRP Ledger and Ripple chose the [DIFC as the location for its Middle East headquarters](#) in 2020. [Approximately 20% of Ripple's customers are based in the Middle East and North Africa.](#)

Dubai is fast gaining a reputation as a leading global financial centre. [It has become a region of choice](#) for crypto businesses due to Dubai's bespoke regulator for crypto assets focused on supporting crypto projects and developing the fintech ecosystem within Dubai. Together with the DIFC, Dubai also has the [Virtual Assets Regulatory Authority \(VARA\)](#), established with the stated goal of creating an easy to replicate framework for regulating the crypto industry.

Ripple Labs CEO, [Brad Garlinghouse said in a press release](#):

Dubai continues to demonstrate global leadership when it comes to the regulation of virtual assets and nurturing innovation. It's refreshing to see the DFSA encourage the adoption and use of digital assets such as XRP to position Dubai as a leading financial services hub intent on attracting foreign investment and accelerating economic growth. Ripple will continue to double down on its presence in Dubai and we look forward to continuing to work closely with regulators to realize crypto's full potential.

The announcement comes on the heels of Ripple's flagship event, [Ripple Swell, which is set to kick-off in Dubai 8 November](#). Alya Al Zarouni, COO of the DIFC, will be a keynote speaker at the event, together with Brad Garlinghouse, Ripple President Monica Long, and Hensen Order, CEO of VARA.

[XRP joins Bitcoin, Ether and Litecoin as crypto-assets approved by the DFSA](#). The Dubai listing of XRP unlocks new regional payment options and potentially other virtual asset use cases on the XRP Ledger and will be seen as a key step in the development of RippleNet.

The news marks a continuing upward trend in regulatory successes for Ripple in 2023, with the company also [enjoying several victories](#) in its ongoing lawsuits against the U.S Securities and Exchange Commission, with a US Court finding that [XRP is not a "security" for the purposes of the US Securities Act](#).

*Written by M Bacina and T Masters*