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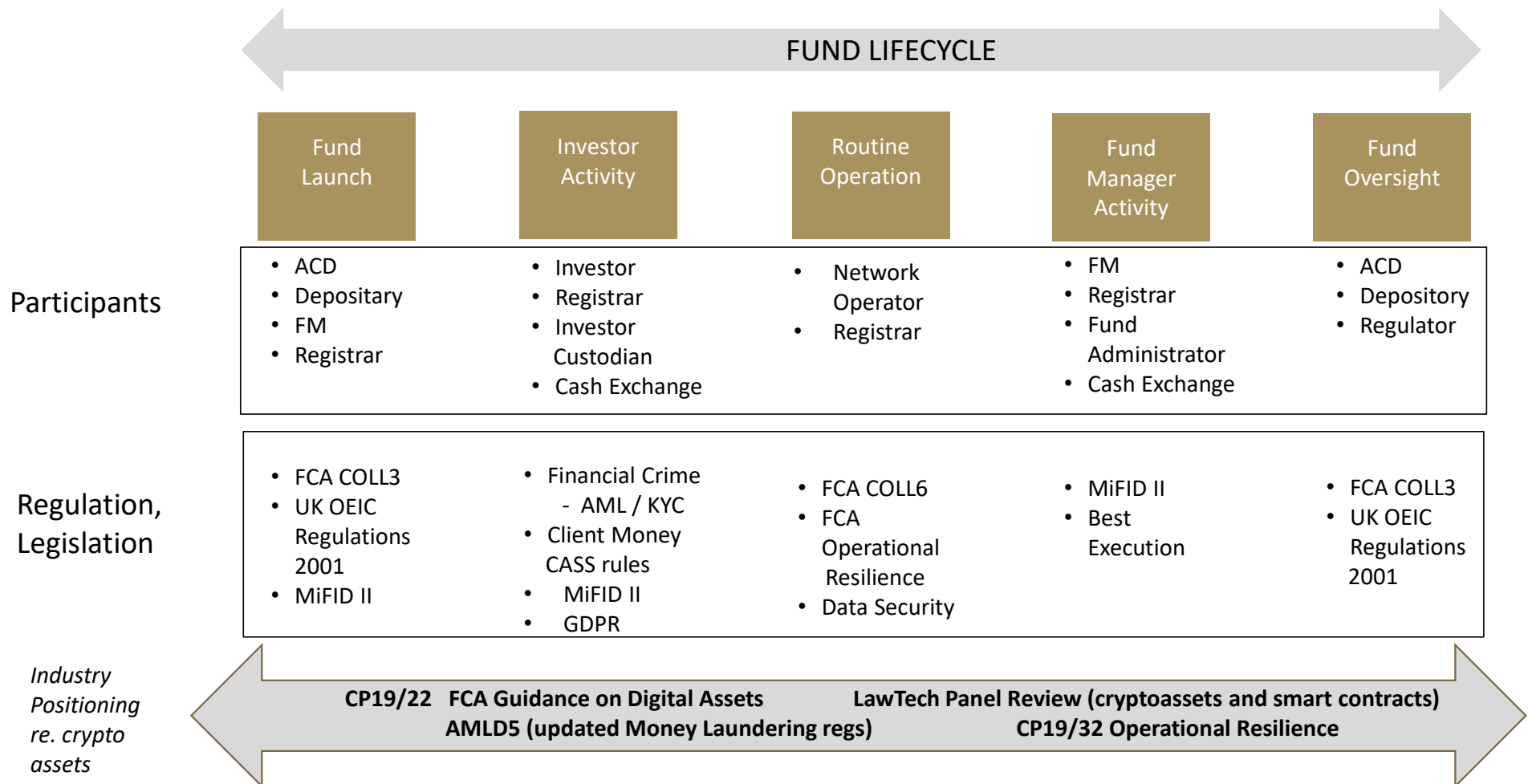
LRWG Update 29th Oct 2020

Agenda



1. Status update
2. OEIC Compliant Registers
3. Changing face of Fund Servicing
4. Operational Resilience
5. Stable Coins

Regulation / Legislation and the Fund Life Cycle



Fund Launch – LRWG Update: Scope of Legal/Reg Touch Points



Register

- Establish distributed register equivalence to conventional register as evidence of shareholder entitlement
- Consensus based updates constrain TA control over register

Role of Authorised Fund Manager (ACD)



- AFM to act as principle in all trades. To be compliant with COLL handbook AFM must operate fund node
- AFM will be the issuer of digital asset tokens
- AFM will need to maintain excess cash and token balances on ledger at own risk

Settlements

- On-ledger atomic settlement, with movement of cash and assets in tokenised form
 - Collapsing the DvP window
 - Binding of delivery / fulfilment with payment
 - Legality of settlement finality
(no current legal definition of when the investor owns the shares)
- Investors renunciation rights

Share Issuance

- A tokenised issuance of a mutual fund share is a regulated security similar in nature to a materialised share certificate
- Clarify status of token in respect to legal title and property rights
- Establish how a conventionally issued OEIC umbrella structure can include a tokenised share class alongside conventional



Cash Issuance



- Cash token must be classified under e-money regulations and right to redeem protected under law
- CASS client money status to be transferrable from fiat deposits to tokenised deposit on investor node
- Operating model for cash exchange to be consistent with existing EMR and AML regulations
- Capability to enhance yield on fiat cash pool

Controls

- Passporting of KYC / AML approvals across ledger participants
- Operational Resilience (FCA COND) & private key security
- Network Notary role and responsibilities



OEIC Compliant Register



“For an ICVC, requirements as to the register of holders and transfer of units are contained in Schedule 3 of the OEIC Regulations (Register of shareholders).”

FCA COLL Section 6.4.3 (2)

Regulations

General – Establishes the need to keep a register, its prima facie status as evidence and the duty to keep it up to date and complete at all times

Content – For each shareholder, their name, address and date of first entry and the aggregate number of shares held by class updated at least once a day. Also defines entry for ‘designated person’ who holds all shares in the company which are in issue but not registered to a shareholder.

Location – The register must be kept at the fund companies head office or the office of a company who maintains the register for the fund company.

Index – An index to be maintained alongside the register which must contain, in respect of each shareholder, a sufficient indication to enable the account of that shareholder in the register to be readily found.

Inspection – A shareholder should be able to request a copy of their entry on the register and be able to request to inspect the full register

Agents default – Defines failing to comply with a request for inspection of the register as an offence.

OEIC Compliant Register



- Regulations written at a time of less automation during earlier phase of dematerialisation and as a result are fairly broad, emphasising who and what not how.
- The fund has direct access to all the data needed to comply with its obligations directly from it's own node.
- A decentralised register is arguably a more reliable and up to date register than a centralised one as the transactions on the ledger directly create the record in real time and investors maintain their own data.
- A companies obligation to maintain a register and take all reasonable steps to ensure the information is up to date and complete is not inconsistent with a distributed ledger.
- We don't see anything in these regulations that deters use of a distributed ledger for maintaining a register of shareholders and we will seek confirmation from the FCA for this.

Changing Face of Fund Servicing



Redefine the Transfer Agents Role:

- Investors directly on ledger transforms onboarding, transaction management and settlement processes
- Consistent and standardised technology and data stack breaking down silos and removing IT complexity.
- Self maintaining register with consensus driven updates and real time registration.
- Immediate DvP with tokenised cash and assets removing client money concerns, cash management and reconciliations
- Reduced servicing of Fund Managers
- AML/KYC pushed to network boundaries and based on federated data sharing

Future Fund Servicing role:

- Dealing as principal and acting as counterparty to investor trades
- Managing issuance of tokenised shares
- Pricing investors orders
- Orchestrating settlement and maintaining liquidity with Fund Custodian
- Providing regulatory oversight and tax reporting

New Relationships

- Cash Exchange
- Business Network Operator
- Network Governance

Operational Resilience



Increasing Regulatory Focus on Operational Resilience – Current FCA priority
Firms required to identify and manage risks and put in place robust recovery plans

Outsourcing Risks

- Changing relationship between investors and fund servicing entities
- New role of cash exchange
- New role of Business Network Operator
- Network governance – rules of the road for membership, change management and dispute resolution.

Collaboration
Network members
will need align risk
assessments and
recovery plans

Cyber and Technology Resilience

- New technology needs to be understood and validated
- Operation and resilience of shared network services
- Increasingly integrated across the value chain – simplified stack but more interdependent
- Legal certainty of digital asset ownership and claim on issuer of cash tokens
- Mutuality of obligation – chain is only as strong as its weakest link
- Private key use and protection

Stable Coins – Emerging use and regulation



- Significant attention paid historically to crypto currencies such as bitcoin which have no inherent value but are algorithmically priced and can be traded on exchanges. Crypto currencies are highly volatile and largely unregulated.
- Stable coins are digital tokens whose value is directly linked to a pool of fiat currency or a basket of assets. As a method to stabilise their value. These have more predictable prices back by tangible assets and are seen as a more reliable instrument for settlement in regulated digital markets.
- Not all stable coins are equal and the FCA sets a narrow definition for its guidance on 'e-money'. To be regulated in the UK a stable coin must meet the FCA's definition and these are supervised within the existing Electronic Money and Payment Services regulations.
- Issuers of any form of crypto currency or e-money in the UK are required to register with the FCA under the Money Laundering and Terrorist Financing Regulations 2019. This is a separate regulatory regime and relates to AML. Being a registered as a digital asset issuer does not mean the token you issue is a regulated instrument.
- The draft EU MiCA regulations recognise a broader definition of stable coins within the regulated boundary and extend the electronic money regulations, defining a new regime for issuers of electronic money in the EU.
- Stable coins are a 'bridge' towards Central Bank issued digital currencies. Widespread issuance and adoption of fiat digital currencies will replace many stable coins.