



FAC

LRWG Update 24th Sept 2020

Agenda



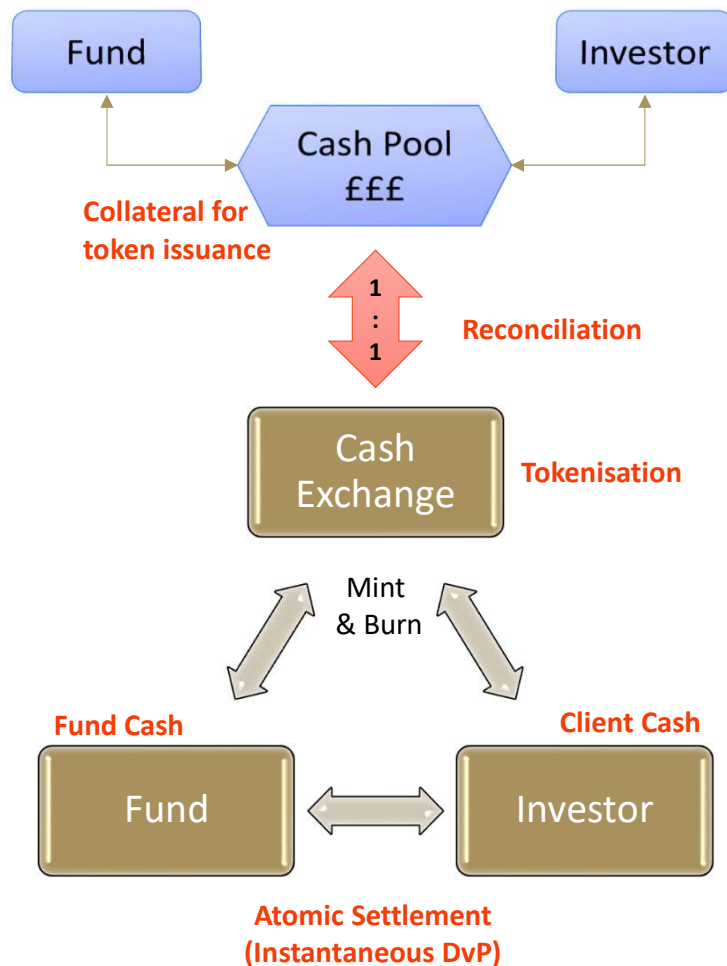
1. Actions from Previous Meeting
 - Private Keys
2. FAC compliance with client money rules (CASS)
3. Fund launch progress (OEICs)
4. General items
 - Updates from the legal world
 - Defining the role of the AFM on FAC (COLL)

Action Point - Private Keys



- Public key cryptography is a fundamental technical component of blockchain and distributed ledger systems.
- Losing your private key means you lose your assets, they still exist but your ability to control them is lost. This means on FAC we'll have zombie tokens, issued but irretrievable.
- As well as an individual responsibility there is a collective obligation to the whole network not to disrupt or undermine it by losing a private key.
- Our approach on FAC needs to be:
 1. Set minimum technical controls and standards for the protection of private keys (includes digital custodians).
 2. Contractually define mutual and enforceable obligations for all participants to adhere to strict standards for key protection.
 3. Define a "broken arrow" protocol for what happens if a key is lost which addresses liabilities and responsibilities.

FAC - Client Money Overview



CASS Compliance

1. CASS requires client and corporate money to be segregated.

FAC enhances segregation by holding cash tokens on independently controlled nodes.

2. Funds already rely on a CASS exemption for the DvP window.

FAC reduces this requirement and enables funds to collapse DvP window towards zero

3. CASS rules do not prevent a firm transferring client money into the firm's own account, provided this is done for the purpose of making a payment on the same day

The cash pool can safely be considered exchange money provided tokens are issued to the investors promptly.

Insolvency: Investor protection increased as no longer exposed to fund. If investor node operator fails administrator can take control of node and return cash. Cash Exchange operator is a bank providing a high degree of protection to fiat deposits.

Legal Issues for Fund Launch



- Focus on a regulated OEIC product. Either a stand alone fund or sub fund / class of an existing umbrella.
- Creating a tokenised share: OEIC Regulations, no. 46 and 47 allows an exemption to section 46

Company must issue share certificated unless it states in its articles of incorporation that certificates will not be issued and details the alternative process for evidencing a persons entitlement.

- General questions:
 - OEIC Regulations, no. 51 - Power of court to rectify register. How is this impacted by a distributed ledger with tokenised assets? Consensus removes dispute. Can a network dispute mechanism play a role?
 - Switching rules are commonly defined in the OEICS articles of incorporation – What are the implications on switching rules where a tokenised asset is switched either natively or against conventional shares?
 - General observation (credit to IA) “When does an investor get ownership of shares or units?”

FAC implements a very clear answer, at the point of atomic settlement. There does not appear however to be a generally accepted industry consensus on this point and the legal and regulatory framework does not, at present, provide absolute certainty on a definition. We are relying on the FAC definition being accepted.

What's happening in the Legal World?



1) Law Society Report on Blockchain



Essential Reading

- Published in early September.
- Produced in association with Tech London Advocates Blockchain Legal and Regulatory Working Group
- Recognises accelerated use of technology and the need to the legal profession to respond
- Addresses best practice and guidance for legal professionals on a broad range of blockchain related subjects (including smart contracts, data protection, intellectual property, consortia formation, dispute resolution and crypto assets) and identifies areas in which further clarity is needed.

<https://www.lawsociety.org.uk/topics/research/blockchain-legal-and-regulatory-guidance-report>

2) Upcoming European Regulations – MiCA



Keep an eye on this

- Draft regulations expected this month for a harmonisation of laws related to digital assets in the EU.
- It's MiFID II for the crypto world.
- Defines the regulatory boundaries for different types of digital asset including e-money and securities.
- Targeted to be in force in 2023 making the entire EU block a regulated market for digital assets.
- Legislation fosters broader adoption and growth but only for those that meet the requirements.

Defining the Role of Authorised Fund Manager (ACD)



- FCA Handbook - COLL defines the roles and responsibilities of the Authorised Fund Manager (AFM) and Depositary in relation to an ICVC. Our aim is to remain within the rails defined within COLL.
- For FAC to retain the principle dealing model defined by COLL, with the AFM having the dealing and settlement obligations (COLL6.2.16) the FAC Fund node must be operated by the AFM under the oversight of the Depositary.
- The distributed ledger records each transaction and the associated crypto assets relating to it. The AFM participates in this update and must consent to all changes but it must exercise its role in consensus not unilaterally.
- The AFM controls the issue and cancellation of tokenised shares on ledger including any holdings retained on node (i.e. for operational liquidity). On FAC the AFM is the default owner of any shares issued but not allocated to investors.
- The AFM's ability to compel an investor to transfer or sell shares (investor deemed unsuitable, holds more shares than permitted, fund is closing or merging) may be restricted on a distributed ledger.
- The AFM will need rely on the network and other nodes on the network to provide a complete set of standards and controls over KYC and AML.