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Tokenised Funds – Key UK Regulatory Considerations

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In its February 2023 discussion paper (DP23/2) relating to the UK regulatory regime for asset management, the UK's Financial Conduct Authority ("**FCA**") briefly touched on fund tokenisation as an area of technological drive and change in the fund management industry. Please refer here to our update on that discussion paper.

The FCA made clear that it is actively engaging with firms and trade associations in relation to proposals for fund tokenisation, to develop its thinking in this area and consider possible necessary rule changes or guidance.

With this in mind and given the growing trend among traditional funds and asset managers to launch tokenisation programmes for alternative assets, we have set out below some of the key considerations from a UK regulatory perspective.

1. ***Regulatory status of tokens***

In the UK, cryptoassets or "tokens" typically fall within one of the following three categories:

- ***Security tokens:*** these meet the definition of a *"specified investment"* under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("**RAO**") and may also be *"financial instruments"* under Directive 2014/65/EU ("**MiFID II**") – security tokens are tokens that have similar features to shares or debt, and provide similar rights and obligations to shareholders or debtholders;
- ***E-money:*** those tokens that fall within the definition of electronic money under the Electronic Money Regulations 2011 (SI 2011/99); and
- ***Unregulated tokens:*** any tokens that are not a *"security token"* or an *"e-money token",* as referred to above – these are currently unregulated in the UK.

2. ***Regulated activities relating to tokens***

Activities in relation to security tokens and e-money tokens would typically be regulated in the UK, meaning that authorisation from the FCA would need to be obtained by those seeking to carry on any investment activities or services in relation to the same.

It is likely, depending on the relevant structure, that tokens issued in relation to a tokenised private fund would be classed as "security tokens" and the regulatory rules applicable to them would be the same as for other "*specified investments*", such as shares or units in collective investment schemes.

3. ***Financial promotion regime***

Tokenised funds where the tokens are "security tokens", are already in scope of the current UK financial promotion regime. The same considerations in relation to the marketing and financial promotions of other, more traditional funds would apply to these tokenised funds.

However, the FCA has also recently published a policy statement (PS23/6) on the financial promotion rules for cryptoassets, containing the FCA's new rules in this area, including rules relating to risk warnings and a required "cooling-off" period. Please refer here to our recent update on this. The final rules are expected to be confirmed and to take effect from 8 October 2023.

4. ***Future developments***

As noted above, the FCA (as part of its wider review of the potential for more technology and innovation in the asset management industry) is actively engaging with market participants on fund tokenisation. However, it is primarily focussed on this from a retail investment funds perspective. The FCA has made clear that it welcomes input from stakeholders about any areas where rules or guidance would be necessary or helpful to enable fund tokenisation, with particular emphasis on the potential for more practical and cost-efficient opportunities for private investors to hold tokenised units in funds.

We anticipate that there may be further guidance issued by the FCA in due course, which may include a consultation on updates to its rules and guidance with respect to fund tokenisation proposals.

If you have any questions on this topic, please do not hesitate to reach out to our UK Regulatory team.

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