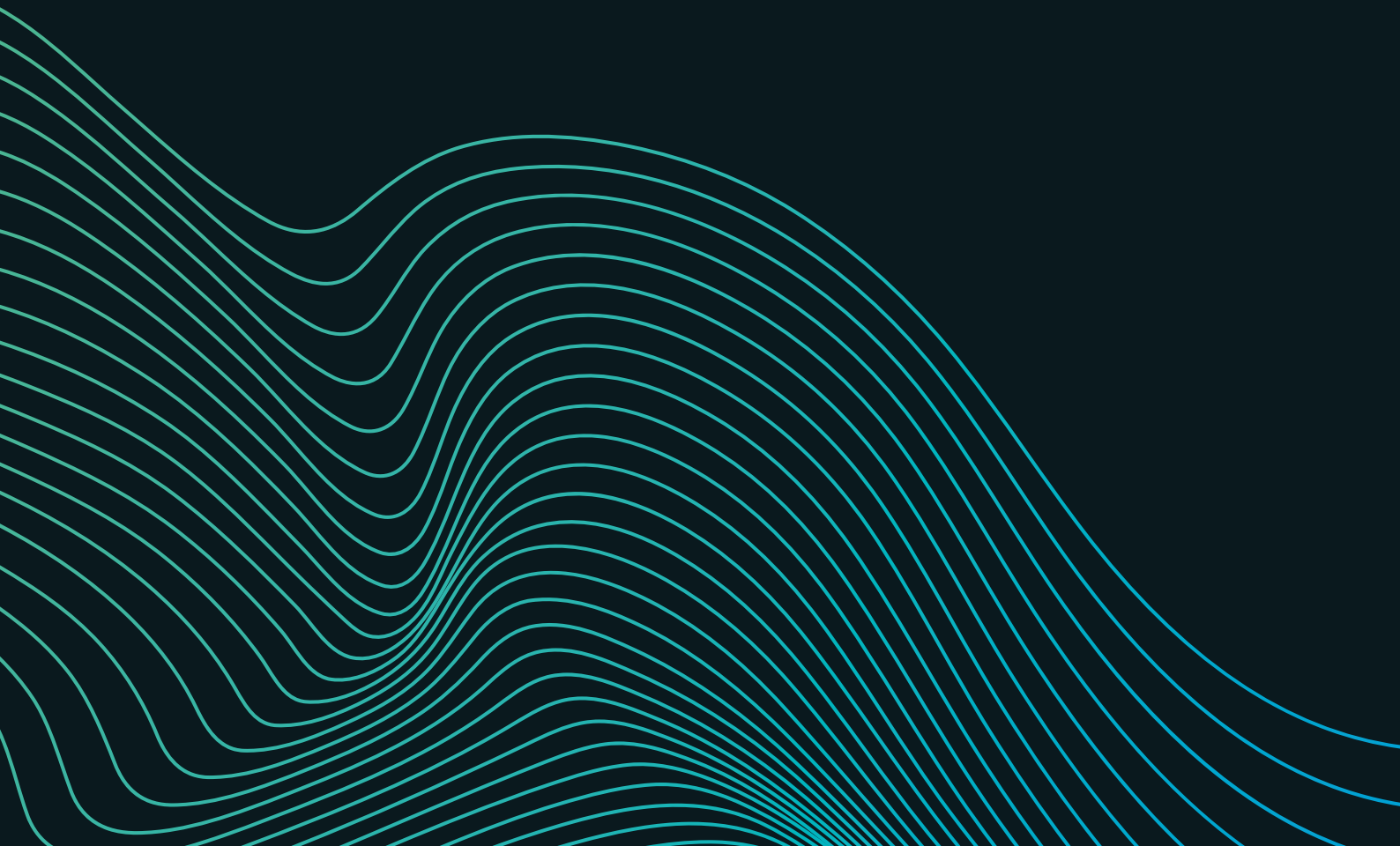


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Demystifying the Crypto
Asset Service Provider
registration process



Licensing and registration regimes for Crypto Asset Service Providers are evolving fast, with new or reinforced regimes coming into force in HK and France very soon. Coupled with reports of low success rates, as seen in the UK, the entire process can be quite daunting for businesses. By studying and deconstructing public guidance and pronouncements from local regulators, firms will be able to form a clearer understanding of what constitutes good practice and have a greater chance at a successful application.

In January 2023, the UK's Financial Conduct Authority (FCA) published much-awaited guidance on what constitutes good and poor practice for registration applications. Crucially, it included an interesting figure: only 15% of the about 300 applications received, as of that time, had been successful. Unfortunately, regulators in other countries, such as France and Hong Kong, have not published equivalent figures. However, industry discussions and anecdotal evidence suggest that the registration path is an arduous one, not only in terms of low success rates, but also in terms of overall time commitment, making guidance like the FCA's very welcome.

With the vast amount of scattered, and not always clear, information available, those undertaking the registration process may not always have a clear picture of what is needed to submit a complete and successful application. Our purpose with this paper is to parse existing guidance and other publicly available information in select jurisdictions (the UK, France, and Hong Kong) and translate it into a practical guide which can help Crypto Asset Service Providers (CASPs) have a higher probability of success when submitting an application.

Which firms are subject to the registration process?

At the time of writing [end-May 2023], licensing and registration requirements apply to Cryptoasset Service Providers that carry out the following activities¹

Exchange activities (crypto-to-fiat or vice versa, crypto-to-crypto, operation of a trading platform)

- **France:** Mandatory registration, with reinforced requirements from July 1, 2023. (Optional license also possible)
- **United Kingdom:** Mandatory registration
- **Hong Kong:** Mandatory licensing, with a new regime for Virtual Asset Trading Platforms from June 1, 2023

Custody of digital assets for third parties

- **France:** Mandatory registration, with reinforced requirements from July 1, 2023. (Optional license also possible)
- **United Kingdom:** Mandatory registration
- **Hong Kong:** Mandatory TCSP license for “Associated Entities” holding Client Assets for Platform Operators

Others (Reception and transmission of orders on behalf of third parties, portfolio management, advice, underwriting)

- **France:** Optional license

¹The terms used are standardised and simplified for purposes of establishing a convenient classification, and may differ from those in each country's regulation.

What is required?

An analysis of the requirements for registration or licensing in these three jurisdictions shows several key similarities. Some examples are the following:

Theme	Rationale
Business Plan	Regulators will want to understand the intended activities (including how it fits with the applicant's non-crypto activities, if any) and the organisational structure of the business - both at the level of the applying entity, but also in relation to beneficial ownership, close links, and related entities. The purpose of this is to provide a framework against which to assess the risks of the business model and the effective consideration of these risks in the governance and control framework that will be put in place.
Ultimate Beneficial Owners / Directors / MLRO	The main purpose is to know who is behind the company and assess their fitness, propriety, and honourability, as well as assessing their knowledge and competency, including through interviews.
Governance arrangements and Internal Control mechanisms	This includes information on the systems, controls, and management information that the Board and top management will have at their disposal to assess risks and effectively manage the business.
Business-wide risk assessments	Documentation on the inherent risks of the business and the methodology used for evaluating these risks, as well as the risk mitigation measures in place. The purpose being to get a clear view on the mitigation measures and evaluate how clearly the company is thinking about risk management.
Description of IT systems and other technical means, well as outsourcing arrangements	To understand the adequacy of these means vis-à-vis the business plans, but also to identify third-party dependencies and how the applicant oversees and monitors the activities of the third parties that they rely on (this could even include providing the agreements with outsourced 3rd party service providers). Additionally, business continuity plans also feature prominently in the requirements, and are notably one of the key elements that have been added to France's requirements as part of the "reinforced registration" regime.
AML/CTF Framework	Given how AML/CTF rules were the first to be extended to cover CASPs, they remain a key piece of the registration and licensing requirements and must include details on all aspects of the framework, including the assessment of money laundering, terrorist/proliferation financing risks, customer risk assessments, customer due diligence, sanctions screening, transactions monitoring, and suspicious activity reporting.
Other policies	Topics like Conflicts of Interest, Cybersecurity, Custody of client assets, Business continuity, Token admission / listing, Risk management, etc. are amongst the elements required under the new or reinforced regimes in France and Hong Kong.

The above summary should not be used as a sole resource, and instead should be consulted alongside the official publications of regulators and the detailed requirements for each (France, United Kingdom, Hong Kong). Its objective is to give applicants an idea of the extent to which requirements are similar in different jurisdictions, and to help understand the purpose of these requirements. Applicants will then be able to present the information in the application in a way that considers these questions, thus avoiding unnecessary delays and further exchanges that will only make the process take longer.

What guidance currently exists?

The amount of time it takes to process an application and the low rates of success, are a common source of concern in the industry in these three countries.

The 15% success rate in the UK guidance was the object of many headlines and has been followed by numerous actions on the part of the regulator to communicate its expectations to the industry, stressing that the registration process acts as a robust gateway before entities pass to the supervision phase, and in that sense, weak applications are likely to be rejected outright.

In France, where the regulator has been known to engage in continued exchanges with applicants to get an application to a state where it passes muster, the successful registration of more than 70 PSANs since the first registration has led some observers to estimate a much higher success rate.

In Hong Kong, on the other hand, with only two firms having successfully registered under the soon-to-be-replaced framework, the approach has been widely regarded as intentionally very stringent. The consultation for the new VATP regime acknowledged the longer application assessment period as compared to other assessments, attributing this to the complexity of the business models and observations that applicants do not seem to fully understand the regulator's expectations (a concern shared by regulators in the other two countries). Consequently, the new regime requires that applicants engage an external assessor to issue two reports:

1. **Phase 1 report** intended to evaluate whether the policies and procedures are clearly written and in compliance with applicable legal and regulatory requirements; and
2. **Phase 2 report** to be handed in after in-principle approval is granted, to assess the implementation and effectiveness of the policies, procedures, systems, and controls after their adoption.

Public pronouncements and publications² from the three regulators point to some of the questions that applicants must consider when preparing their application. In addition to the core requirements of an application, and the reminder that from the regulator's point of view, the clock only starts running upon receipt of a complete application, there are other key points that firms should keep in mind, to have the best chances of a successful application:

DO

Ensure that the presentation of your business model evidences that you have considered all risks related to your crypto-related activities, and that it covers compliance oversight, risk mitigation and financial controls

Conduct a thorough business-wide risk assessment that, especially in the case of AML/CTF risks, covers the risks related to products/services, distribution channels, transaction conditions, client characteristics, and country of origin / destination of the funds.

Prepare clear policies and procedures that appropriately mitigate the risks identified in the Business Wide Risk Assessment and that are tailored to your business model. You must evidence that you are familiar with these documents and that you have thought about their implementation and be ready to answer detailed questions on them and stand by them after registration.

Make sure that your management and the teams that will be tasked with the implementation of your policies and procedures are appropriately trained and aware of their responsibilities and legal obligations and that they dispose of appropriate resources to discharge them effectively.

Show how the tools you plan to deploy (e.g. blockchain analytics tools) are appropriate to mitigate the business model's identified risks, how they fit into the control framework, and how to assess their efficiency to ensure continued compliance.

DON'T

Forget to include forecasts - and don't include unrealistic ones - but also don't just focus the description of your business plan on its commercial aspects.

Leave out important risk considerations that are becoming mandatory, like proliferation financing risk, or operational risks like cybersecurity or business continuity, as these are part of the standard requirements for registration under the new reinforced regimes.

Recycle generic or off-the-shelf policies that do not provide sufficient detail about how systems and controls work in practice, or, if you belong to a group, policies from linked entities that do not share your business model or risk profile.

Neglect to plan and staff and equip your control functions appropriately to accommodate the expected growth in activity.

Think that it is enough to say that you have a compliance automated solution, without describing how you will use it as part of your controls (e.g., in transactions monitoring: scenarios you will use, risk thresholds, procedures for investigating and escalating alerts, management information to assess pertinence and continued review of the scenarios, etc.)

Think that reliance on third parties means that you are absolved from any responsibilities if they neglect their controls: the responsibility stays with you.

²Some examples include the following: May 16th FCA roundtable on applications for registration under the MLR (UK), [ACPR report](#) on PSAN registrations on the 2nd anniversary of the PACTE Law (France), [SFC](#), [Banque de France](#), and [AMF](#) recent speeches (HK, France)

DO

Evidence that you have considered the risks arising from recourse to third parties, especially if outsourcing parts of your AML/CTF controls. You must evidence that there is appropriate oversight and monitoring of these third parties and that you have conducted appropriate due diligence when choosing them.

Be proactive and stay on top of regulatory developments on the horizon, including by anticipating how they will impact your business model and procedures, and keep regulators informed of material changes to your business during the registration process.

Ask for independent legal or compliance support to ensure an appropriate understanding of legal or regulatory requirements and get actively involved in the design of the compliance and control framework, ensuring an appropriate transfer of knowledge to your teams.

DON'T

Think that once the policies are drafted and registration is obtained, this is the end of the process. (In fact, it is just the beginning: after registration you must be ready to adapt your framework constantly to accommodate changes in legal requirements, in your activity, or to incorporate the results from internal controls and assessments of the efficacy of your risk management and compliance framework).

Forget that the responsibility for implementing the framework described in your application remains with your firm, and that regulators will expect your teams to demonstrate knowledge of all the components in your application.

Conclusion

Reading through the requirements of a registration process may seem like a daunting task, and for firms that are new to operating as a regulated firm, many of the components may seem unfamiliar. However, understanding the rationale for these, and seeing them as trust-building exercises for regulators, can help applicant firms go through the process with the right mindset.

Registration is only the beginning of life as a regulated firm. Many of the decisions taken at this stage and the investment involved in designing a sound compliance framework are the way to lay strong foundations to run the business after registration is obtained. Above all, these foundations will enable your firm to anticipate and comply with the more stringent requirements that are on the horizon as countries progressively reinforce the regulatory framework for crypto activities in a way that makes it converge towards that of traditional finance.

ABOUT PLENITUDE

Plenitude is a niche consultancy, specialising in Financial Crime Risk and Compliance, and are appointed to the Financial Conduct Authority's Skilled Persons panel for Financial Crime. Our focus is firmly on addressing the legal, regulatory, reputational and social imperative for financial institutions to take diligent and rigorous steps to mitigate financial crime risks.

Plenitude's Digital Assets Practice assembles a team that brings a deep knowledge of regulatory expectations, crypto business models and the associated risks, to help crypto firms navigate the regulatory landscape, the road to registration, and build and implement an effective risk management framework. We also work with traditional finance firms to develop their knowledge of digital assets to make informed decisions about their crypto and risk management strategy and seize the emerging opportunities of this nascent industry.

About the author



Manuel Fajardo is our Digital Assets Practice Lead, with over 17 years of experience in the global asset management industry across control functions like Compliance, Internal Control and Internal Audit, in positions with a global remit based in Paris, London and Los Angeles.

Prior to working with Plenitude, Manuel built the global compliance framework for a major investment management group. This involved designing, deploying and constantly refining processes, tools, policies and procedures. His main areas of focus are Anti-Money Laundering, International Sanctions and Financial Promotions / Distribution, in which he has proved adept at balancing local and global considerations and regulatory constraints, the interest of all stakeholders and firms' risk appetite to build solid frameworks that have proved successful throughout the years.

Manuel has a deep knowledge of the cryptoassets industry, acquired through more than six years of studying, investment and advisory work. In the current phase of his career, he has used this knowledge to train companies in the traditional finance sector about the significance of this nascent industry and its developing regulatory framework, as well as advising crypto firms on their regulatory obligations as they seek registrations or conduct business as regulated firms, and playing an active role in shaping discussions on regulation through industry trade bodies.



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PLENITUDECONSULTING.COM

FOR MORE INFORMATION EMAIL US AT
MANUEL.FAJARDO@PLENITUDECONSULTING.COM