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CP22/2: Strengthening our financial promotion rules for high risk investments, including cryptoassets – FCA Public Consultation Paper

22 March 2022

Dear Sir / Madam

Introduction

CryptoUK is the UK's self-regulatory trade association representing the cryptoasset sector. Our members comprise leading companies from across the sector.

We set out below our responses to the specific questions set out in CP22/2. We preface those responses with the following introductory comments regarding the overall effect of the proposals together with the proposed amendments to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("**FPO**").

We acknowledge that the FPO is not the subject of the consultation and that amendments to primary and secondary legislation are a matter for HM Treasury and Parliament, rather than the FCA. Nevertheless, the proposals in CP22/2 plainly do not exist within a vacuum. The FCA recognises this in CP22/2, which makes numerous references to the FPO including (for example) acknowledgement that the FCA "*must also bear in mind the impact of the FPO exemptions when considering changes to our rules*".[1] In view of this we address here the position under the FPO and are copying this response to John Glen MP and Alisdair Mcdade Head of Crypto Assets at HM Treasury.

We and our members are concerned that the proposed amendments to the FPO would, when operating in conjunction with the proposals set out in CP22/2, amount to a *de facto* ban on financial promotions relating to Qualifying Cryptoassets. In order to fully understand why this is the case it is important to consider the broader context to the proposals.

- Since 7 November 1986[2] the financial services regulatory regime in the United Kingdom has operated on the basis of a distinction between activities that are regulated and the making of advertisements or financial promotions concerning investments. Despite being distinct, these regimes always operated in tandem with one another; investment products which would trigger a requirement to be authorised where activities are performed in respect of them would generally also trigger the restriction on financial promotions where invitations or inducements are made in respect of them. The rationale for this is clear: if a product or service presents risks that justify the regulation of activities relating to it, then promotions of that product should equally be subject to regulation. This also has the practical advantage that the same persons come within the scope of both regimes, hence the disapplication of the financial promotions restriction for persons who are authorised to carry on regulated activities.

[1] Paragraph 2.42.
[2] Royal Asset to the Financial Services Act 1986.

- However, the proposed amendments to the FPO for the first time divorce the application of the regulated activities regime from the application of the financial promotions regime in the case of a particular product or service. It is unclear what the underlying policy rationale for this is, or whether the practical implications of departing from the regime as originally conceived and operated for the past 35 years have been fully considered.

- One practical effect of divorcing regulated activities from financial promotions in the case of Qualifying Cryptoassets is that the first of the three bases for lawfully making financial promotions is removed. Since there is no regulated activity for which a crypto firm can obtain Part 4A permission under FSMA solely as a crypto firm, there are no authorised firms that are solely crypto firms. To the extent that any crypto firms do possess Part 4A permissions, that is only because they also conduct other (non-crypto) activities which are separately regulated.

- Accordingly, unless an exemption applies, a financial promotion concerning Qualifying Cryptoassets can only be made if approved by an authorised person.

- The proposed FPO exemptions in respect of promotions concerning Qualifying Cryptoassets will be very limited. In practice, they will only permit invitations or inducements to prospective customers who are investment professionals and sophisticated investors. Notably, FPO exemptions which are available in respect of other 'Restricted Mass Market Investments' will be disapplied in the case of Qualifying Cryptoassets, despite the FCA categorising those products as equivalent for the purposes of determining the level of regulation that should apply to them. No cogent explanation for this discrepancy is provided.

- A second practical effect of divorcing regulated activities from financial promotions is that the number of firms who might be in a position to approve financial promotions relating to Qualifying Cryptoassets is very limited, since there are no firms that possess Part 4A permissions solely by virtue of being crypto businesses. The pool of firms who might be in a position to approve financial promotions relating to Qualifying Cryptoassets is reduced still further when one accounts for:

    - The FCA's proposal of a new competence and expertise requirement for firms communicating or approving financial promotions. In the case of Qualifying Cryptoassets, this would likely only be satisfied in the case of an authorised firm which is itself engaged in business in the crypto market. For the reasons set out above, there are likely to be very few such firms and it will not necessarily be the case that such firms will operate their crypto and regulated businesses together in a way that allows them to satisfy the competence and expertise requirement; and

    - The fact that firms who both possess Part 4A permissions *and* can satisfy competence and expertise requirement in respect of qualifying cryptoassets may in practice be unwilling to approve *any* financial promotions made by others. Any authorised firms who are willing to promote financial promotions made by others are, moreover, likely to have a dominant position in the newly-created market for approving financial promotions relating to Qualifying Cryptoassets and/or will have a strong incentive not to approve financial promotions on behalf of their competitors. Such an outcome would plainly be contrary to the FCA's competition objective.

We estimate that there are presently three firms who possess Part 4A permissions and might satisfy the proposed competence and expertise requirement (on the basis that they have crypto businesses), with another four potential firms are on the temporary register. It is unclear what proportion of those three firms would actually possess the requisite competence and expertise and be willing to approve others' financial promotions. As a proxy for the likely cost to the sector of needing to obtain approval for their financial promotions we have surveyed a group of professional

services firms who have estimated that the cost of approving a client's financial promotion would be in the range of £3,000 to £5,000 for a basic website or digital print review. For the full service *"cradle to grave"* review would be in the range of £20,000 to £30,000. The sample size survey respondents also discussed the risk premium attached to signing off on the advertising. Therefore, adding additional costs to market participant's over and above standard financial promotions gateway.

This of course does not account for the potential for any firm that is willing to approve financial promotions to engage in price-gouging in view of the lack of any competition. The costs of approving the promotions would naturally be passed on by crypto firms to their end-users in the United Kingdom, who would ultimately receive poorer value and poor outcomes as a result.

When the proposed amendments to the FPO are considered in conjunction with the proposals in CP22/2 it becomes apparent that, in practice, it will be almost impossible for financial promotions to be made in respect of Qualifying Cryptoassets, save to investment professionals and sophisticated investors. Without the ability to promote their products and services, it is difficult to see how crypto businesses in the UK will be able to continue trading. This will inevitably have a deleterious effect on the market for cryptoassets in the UK, on competition and on consumer choice. It will destroy thriving businesses and the employment they provide in the UK and will stifle innovation. It will also have a detrimental impact on the image of the UK as a welcoming and innovative jurisdiction in which to do business, which could have a wider impact on the UK's standing as a financial centre more broadly. We understood that post-Brexit, the UK would be seeking to develop its position in this respect, rather than diminish it.

The FCA intends to provide a very limited transitional period for firms to comply with the new requirements. We are not aware that the FCA has treated any other newly regulated sector with such rapid implementation of FCA Handbook rules, triggering significant changes to the business operations of the firms concerned. This would leave the UK crypto industry at a significant disadvantage compared to other jurisdictions, including those are Member States of the EU.

This state of affairs is made all the more perverse when one considers HM Treasury's proposal to bring *activities* relating to stablecoins within the regulatory perimeter.[3] Depending upon the outcome of HM Treasury's consultation, that proposal may result in activities relating to cryptoassets (in the form of stablecoins) being regulated, whether under Part 4A of FSMA or a regime equivalent to the payments or e-money regimes. Accordingly, the body of firms active in the crypto market *and* performing activities regulated by the FCA could increase radically. Indeed, many of the firms that will be affected by CP22/2 will also be affected by HM Treasury's consultation and may seek authorisation in respect of their stablecoin activities. This change might occur only relatively shortly after the proposed amendments to the FPO and the proposals in CP22/2 come into force, meaning that there will be a window of time during which it will be impossible for most crypto firms to carry on business in the UK.

Our members understand that greater regulation of Qualifying Cryptoassets is necessary for consumer protection and would welcome the introduction of clear and consistent regulation of their sector. In the majority of instances our members are in favour of what is proposed by CP22/2 in respect of Qualifying Cryptoassets. However, the well-crafted regulation of cryptoasset promotions will ultimately be entirely redundant if no firm is in a position to lawfully make *any* financial promotions. For this reason, while we have provided what we believe to be constructive and positive responses to the questions in CP22/2, we wish to be clear that those responses are premised upon a solution being found to the impasse described above.

Together with our members, we have looked at possible solutions and respectfully suggest that these be considered by the FCA, and where appropriate HMT, alongside this consultation.

[3] UK regulatory approach to cryptoassets and stablecoins: Consultation and call for evidence - January 2021.

Interim solutions would include removing the competence and expertise requirement for approving financial promotions of Qualifying Cryptoassets, or at least delaying it until there is a sufficient pool of s.21 approvers with expertise in cryptoassets. This will allow a longer transition time, before this change severely impacts the industry. We would suggest having an 18-month transition with a requirement on the FCA to review the market place after 12 months to assess whether the market for s.21 approvers is sufficient to meet the needs of the industry.

Ultimately, however, it will require the FCA to work with HMT to reappraise the issue of requiring a s.21 approval for an unregulated cryptoasset activity to solve the problem in the longer term. Such solutions may include the creation of a regulated activity under the RAO of making or approving financial promotions, allowing cryptoasset firms to become authorised and so approve their own promotions. Alternatively, other s.21 exemptions should be available for financial promotions in relation to Qualifying Cryptoassets. It is still not clear why HMT has suggested that the exemptions for high-net worth individuals and self-certified sophisticated investors are to be made unavailable to cryptoasset promotions.

We would further suggest that the regulatory framework in respect of financial promotions should take into account the position of those UK firms that are registered by the FCA under the Money Laundering Regulations. In the form presently proposed the financial promotions regime would not recognise the status of registered firms, meaning that a registered firm would not derive any benefit from being registered in relation to financial promotions. Accordingly, firms would have no incentive to choose the UK as a jurisdiction in which to locate their business and become registered, since they would be in precisely same position in terms of their ability to market to UK customers as if they had located their business in another jurisdiction. This is not only damaging to the attractiveness of the UK as a place to do business; it also undermines anti-money laundering efforts by encouraging firms to operate from jurisdictions which do not impose the same level of anti-money laundering requirements as the UK.

For example, if section 21 were amended so as to exempt from the restriction promotions made by persons registered with the FCA under the Money Laundering Regulations, this would provide firms with an incentive to register with the FCA while maintaining the restriction in respect of non-UK firms that communicate promotions capable of having effect in the UK. This would represent a significant enhancement to consumer protection by addressing promotions made by non-UK firms. Promotions made by firms based in the UK and registered with the FCA would, in the interim, continue to be subject to the oversight of the Advertising Standards Authority. In the medium to longer-term, as regulation is introduced in respect of stablecoins and other cryptoasset activities, HMT and the FCA would have the opportunity to reunite the regulation of cryptoassets promotions and activities, providing more a holistic regulatory framework.

The cost benefit analysis conducted by the FCA to deliver this policy change is not robust. We are concerned that the FCA analysis is inadequate and fails to take account of all relevant considerations. In particular, we have concerns regarding the lack of evidence supporting the FCA's analysis of who might act as a s.21 approver, the related costs to firms and this industry, and the competitive challenges that this raises. The costs of the proposed changes will very much reduce the attractiveness of the UK as a jurisdiction for crypto fintech, and, in fact, enhance the relative attractiveness to firms of being established in the EU or elsewhere (particularly when considering EU developments in the cryptoassets sector compared to the UK). The benefit of the proposed changes also appear not to have been properly analysed. A *de facto* ban on financial promotions relating to Qualifying Cryptoassets will of course reduce the potential for non-compliant promotions, but it will also deny UK consumers choice and the benefits of a competitive market for cryptoasset services. The FCA’s cost benefit analysis appears to give insufficient weight to the interests of consumers and the extent to which a de facto ban is in their interest.

The short period in which the FCA apparently intends to analyse consultation responses and respond with made FCA rules also does not, in our members' view, reflect the very significant impact that those rules will have.

With regard to CP22/2, we have outlined our responses in the following section. We have limited our responses to those questions where we are impacted as an industry.

CryptoUK Responses to Consultation CP22/2

1. **Should we rationalise our financial promotion rules in COBS 4 by introducing the concepts of 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

It is not clear why the FCA proposes to include cryptoassets in the same category as NRRS and P2P agreements. Both of those are characterised by a lack of liquidity, with the FCA saying at paragraph 3.5 of the CP "the common feature of NRRS and P2P investments is that consumers may not have frequent opportunities to sell these investments on a secondary market that offers continuous trading." In our view, cryptoassets are in many ways the exact opposite of this. Most major cryptoassets traded on an exchange have a good level of liquidity and low bid/offer spreads, and furthermore have 24-hour trading that even traditional equity markets cannot compete with.

Further, the Consultation Paper states that consumers who buy NRRS and P2P agreements are typically investing in companies or individuals about whom limited public information may be available. Conversely, in the case of cryptoassets there is usually a white paper that sets out the initial offering of what the cryptoassets' features are, as well as a lot more in terms of engagement from the issuer with the public than you would see with NRRS.

We also note that the CP singles out the cryptoasset industry as one where "consumers may suffer sudden, large and unexpected losses from these investments for reasons including volatility, firm failure, comingling of funds, cyber-attacks and financial crime." We would suggest that there is similar volatility with traditional securities, especially those on the AIM market. It is not clear which firms the FCA has in mind with regard to firm failure in the cryptoasset industry, considering the significant number and size of cryptoasset exchanges, and we understand that there would be a greater insolvency risk with AIM firms than these cryptoasset exchanges.

Finally, the FCA states that "consumers may also not understand complex products offered to them. Poor-quality and misleading promotions can exacerbate these risks and lead to consumers buying investments that are outside their risk tolerance and which do not meet their needs." We would again state that while cryptoassets do have a degree of complexity, this is no more so than many AIM listed shares, or CFDs which are able to be marketed freely to retail customers (though CFDs must contain a risk warning).

We would also note that the proposal conflates distinct customer types involved in cryptoassets, namely consumers and businesses. Businesses that are not regulated are treated as retail under the proposal as they are not professional clients.

As it is not possible to be regulated for cryptoasset activity, it is not coherent to treat crypto the same as regulated instruments. There should be a different definition of "retail" with regard to cryptoassets to ensure that true retail customers are targeted by investor protection regimes, rather than bringing into scope those entities which do have expertise in the instruments, but due to the regulatory perimeter are not authorised.

In our view, the proposed categorisation and treatment of cryptoassets by the FCA is secondary in impact to the fundamental issue of including an unregulated asset in the financial promotion regime along with regulated assets, however the approach by the FCA compounds that issue. **We would also note that according to the FCA's research, the median holding in cryptoassets is £300, which is not particularly high. It would seem that the steps the FCA are taking are disproportionate to the risks.**

In our view, cryptoassets are more akin to Readily Realisable Securities, though if the FCA wishes to make a distinction, it makes sense to treat cryptoassets as a separate category, with different treatment to NRRS and P2P agreements. Further, cryptoassets themselves come in many different forms, with different risk profiles. The restrictions placed on cryptoassets should align with the risks that the FCA sets out and also take into account the safeguards of the ability to trade 24hours, liquidity of markets, and available information for investors the fact that it is more liquid. This would suggest:

- no ban on inducements (as is the case with RRS)
- no 24hr cooling-off for direct offer (as is the case with RRS)
- no restriction on the type of person that can invest

We would suggest including the other restrictions included by the FCA in relation to the RMMI, namely:

- An appropriateness test is carried out to ensure that the customer understands the risks
- Suitable risk warnings are included

2. **Should we introduce stronger risk warnings, as outlined in paragraphs 4.20 – 4.27, for all 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

We agree that a stronger risk warning for "Restricted Mass Market Investments" could be included. In our view, this should be a standard wording to be agreed with the FCA, which will ensure that each firm is compliant with the requirement while reducing the administrative burden of confirming that the risk warning is suitable. We do note that this would be a new approach for the FCA, but believe it could be beneficial.

We would also stress that the FCA must ensure that the same risk warnings are required across all assets that fall within "Restricted Mass Market Investments", not just crypto, so that there is a level playing field.

If risk warnings are to be required, the prominence requirements and prescribed information are acceptable, though again, the prescribed information should be the same across all assets that fall within "Restricted Mass Market Investments", not just crypto, so that there is a level playing field.

3. **Should we ban inducements to invest e.g. refer a friend bonuses, for all 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

To the extent that "Restricted Mass Market Investments" will include cryptoassets, our view is that this is an excessive requirement and could have an outsized impact on the cryptoasset industry.

The issue suggested in the Consultation relates to bad actors using inducements to invest, such as refer a friend bonuses and new joiner bonuses, to achieve rapid and exponential growth in fraudulent investment schemes that rely on the flow of money from new investors to fund existing investors' returns. We would note that such firms are not acting within scope of regulation in any event, so it is not clear that a ban on inducements would stop them from carrying out such practices.

However, many legitimate businesses do use this practice and it is generally accepted as a valid marketing tool. Trading accounts often have "refer a friend" schemes, and this is not generally cited as a problem for the industry. We also see it in other areas, such as insurance. It is a common feature, and it is not clear why the FCA believe that this is so detrimental.

When taken with other obligations that firms have in relation to onboarding customers (which is also discussed at length elsewhere in the consultation), a potential customer will still have to demonstrate that an investment is suitable prior to being onboarded. If the customer meets all other requirements, we do not believe that it is relevant whether their friend receives a bonus from a cryptoasset firm should that customer ultimately trade.

We do not believe a full prohibition on inducements is sensible or commensurate with the risk of harm, however if there were to be a change to such inducements, we believe that this could be limited in certain ways. For example, there could be a limit on the value of any monetary inducement, or limits on the number of rewards that any individual customer can receive.

We would also note that there is a distinction between loyalty programs and initial rewards or bonuses, and we do not see that there is any merit in prohibiting the former based on the arguments found in the Consultation in relation to the latter.

4. **Should we introduce a personalised risk warning pop up for first time investors in 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

To the extent that "Restricted Mass Market Investments" will include cryptoassets, we do believe that the personalised risk warning could be a good opportunity to allow firms to educate investors, and provide them with more information.

5. **Should we introduce a 24-hour cooling off period for first time investors in 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

To the extent that "Restricted Mass Market Investments" will include cryptoassets, our view is that a 24-hour cooling off period, limited to first time purchases could be a positive introduction. This is on the basis that the cooling off period is implemented prior to any ability of the customer to trade, and so no will not be able to be used as a means of attempting to reverse a trade after it has been entered into. However, we would note that there is a risk that such a measure could also have the effect of driving customers offshore.

Further, if there was a cooling off period post-trade, this would have serious impacts on firms who would be required to hedge potential reversals should the price of an asset go down after a customer had entered into a trade and subsequently wished to unwind a trade.

We would suggest that any cooling-off period be incorporated into the onboarding process, delaying the ability to trade until the customer is onboarded.

6. **Should we change the investor declaration form for 'restricted', 'high net worth' and 'sophisticated' investors to introduce an 'evidence declaration' and simplify the declaration?**

To the extent that "Restricted Mass Market Investments" will include cryptoassets, we do not have an objection to this proposal, providing that it applies across all products within the 'RMMI' category.

7. **Should we make changes to our rules on appropriateness to ensure all investors in 'Restricted Mass Market Investments' must pass a robust assessment of their knowledge and experience?**

To the extent that "Restricted Mass Market Investments" will include cryptoassets, we believe that this would risk driving customers offshore, and there is a particular risk of retail customers being unfairly excluded.

We do not believe that the introduction of a knowledge and experience test is as simple as set out in the consultation, and would take considerable effort to implement. Further, it is not clear who would assess the effectiveness of any appropriateness test, as it is not clear whether it has been considered what constitutes sufficient knowledge and experience to invest in cryptoassets. For example, would an investor with a high level of technical computing knowledge be suitably sophisticated for crypto purposes despite lacking knowledge of traditional investing? Would the FCA consult on the questions that should be posed?

While we do not in principle object to the notion that an investor in crypto should be suitably knowledgeable, we do believe that in practice this will have potentially detrimental and unnecessarily restrictive consequences.

8. **Should we introduce record keeping requirements for firms to monitor the outcome of the consumer journey for 'Restricted Mass Market Investments' and 'Non Mass Market Investments'?**

No response.

9. **Do you agree with our proposed approach to implementation of our consumer journey proposals for investments already subject to our financial promotion rules?**

No response.

10. **Do you have any suggestions for how we can monitor the impact of our consumer journey proposals?**

No response.

11. **Do you agree with our proposed approach to implementation of our consumer journey proposals for cryptoassets?**

We agree that positive frictions should not apply to existing customers, and only to those engaging with firms for the first time.

As an industry, our members would like the FCA to provide more guidance on direct offer financial promotions, particularly with regard to website and app-based services. We note that the most recent guidance in this area is from 2009 in relation to spread-betting websites.

There is a concern among members that the customer journey proposals may create an uneven playing field between UK firms and their competitors, with a resulting negative impact on competition and innovation.

We suggest that the frictions should be applicable to investments over a particular size. Noting that the median holding in cryptoassets is £300, this suggests that transactions sizes are generally very small. We would propose a de minimis threshold of £1000, under which

no frictions would be required. This would allow low value trading that is low risk to customers, while picking up those people who are risking more.

12. **Do you agree with our proposed changes to COBS 4.5 to clarify the obligation regarding the name of the s21 approver?**

Yes, subject to our general comments on the proposed s. 21 approval regime.

13. **Do you agree with our proposal for s21 approvers to ensure that approved promotions include the date of approval in the financial promotion?**

Yes.

14. **Do you agree with the introduction of a competence and expertise rule to apply to all authorised firms when approving or communicating financial promotions?**

As discussed in our introduction to this response, the key issue that will impact cryptoasset firms is that due to HM Treasury's response to their consultation only authorised firms will be able to approve financial promotions in relation to cryptoassets, despite cryptoassets not being regulated and so vanishingly few cryptoasset firms are authorised.

This proposal by the FCA compounds that, by requiring that authorised firms that approve financial promotions in relation to cryptoassets must have suitable competence and expertise to do so. It is not clear which authorised firms the FCA believes will have suitable competence and expertise to approve financial promotions in relation to cryptoassets given that it is not necessary to be authorised to carry out activities in relation to cryptoassets and so few, if any, firms will have expertise in relation to those cryptoasset activities which they may wish to approve. We would also request that the FCA makes it clear what it sees as suitable competence and expertise to approve such promotions, something which it is yet to do. This would of course have a huge bearing as to how this proposal would impact the industry.

Of the 32 firms on the FCA's Cryptoasset Register, there are only three (Archax Ltd, eToro (UK) Ltd, and Crypto Facilities Ltd) that have Part 4A authorisation. It is not clear on what basis the FCA believes that these firms would approve financial promotions for their competitors. This proposal is wholly anti-competitive, giving certain firms a huge advantage over those that are not authorised, and we note the FCA has a statutory duty to promote competition.

Further, we do not believe that it is generally market practice for authorised firms to approve the promotions of unauthorised firms in any event, save for those in a principal/appointed representative relationship. It is unclear, even if there were many authorised firms with the relevant expertise, if any would approve the financial promotions of unauthorised firms. If they were to do so, we expect the costs to be extremely high, and will again lead to a lack of competition and innovation in the sector as firms unable to bear those costs are driven out.

We appreciate that the issue is fundamentally one for HMT, however as noted, the FCA appears to seek to compound that issue by increasing the difficulty for those firms who may be able to approve financial promotions relating to cryptoassets from doing so.

These proposed changes have the potential to cause serious damage to the cryptoasset industry, and with it the jobs the industry creates. They appear at odds with the stated aims of the government and FCA of supporting innovation and the FinTech sector more broadly. The proposal is not one that is being considered anywhere else internationally.

We do not agree that this competence and expertise requirement should be brought in as it impacts cryptoasset promotions in a disproportionate fashion. Should the FCA persist with this, it should seriously consider a delay in implementation to allow firms to develop the required competence and expertise. This is especially important considering the consultation still outstanding regarding bringing stablecoins within scope of financial regulation. Should this happen, there will be more firms who could have the relevant competence and expertise to approve financial promotions.

Other potential mitigating actions that could be taken include:

- Remove the competence and expertise element from the approval of cryptoasset promotions altogether, but instead introduce a responsibility on the authorised person to ensure technical accuracy of the promotion;

- Introduce a 12-18 month transitional period, or a period of supervisory forbearance.

Whatever outcome, we would suggest that a review of the impact of the legislation be carried out within a short timeframe by an independent third party, though we expect this to be too late to remedy any issues that arise from this proposal.

15. **Do you agree with the proposed approach to firms assessing competence and expertise?**

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16. **Do you agree with our guidance to firms on the competence and expertise requirement?**

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17. **Do you agree with our proposal for a new ongoing monitoring requirement for s21 approvers?**

Yes.

18. **Do you agree with our guidance on ongoing monitoring for s21 approvers?**

Yes.

19. **Do you agree with our proposal to require s21 approvers to obtain attestations of no material change from clients?**

Yes.

20. **Do you agree with our proposal to extend conflicts of interest requirements to s21 approvers?**

As discussed in our introduction to this response, the key issue that will impact cryptoasset firms is that due to HM Treasury's response to their consultation only authorised firms will be able to approve financial promotions in relation to cryptoassets, despite cryptoassets not being regulated and so vanishingly few cryptoasset firms are authorised.

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Further, we do not believe that it is generally market practice for authorised firms to approve the promotions of unauthorised firms in any event, save for those in a principal/appointed representative relationship. It is unclear, even if there were many authorised firms with the relevant expertise, if any would approve the financial promotions of unauthorised firms. If they were to do so, we expect the costs to be extremely high, and will again lead to a lack of competition and innovation in the sector as firms unable to bear those costs are driven out.

While we appreciate that the FCA has clearly considered that there are risks of anti-competitive behaviour, we do not believe that extending the conflicts of interest requirements goes anywhere near far enough to mitigate the fallout from the proposal more broadly.

21. **Do you agree that s21 approvers of 'Restricted Mass Market Investments' should take reasonable steps to ensure that the relevant processes for appropriateness tests comply with our rules on an ongoing basis?**

No response.

22. **Do you agree with our expectations on what reasonable steps may look like when complying with the appropriateness test?**

No response.

23. **Do you agree with our proposed guidance to firms on conducting appropriateness tests?**

As discussed in our introduction to this response, the key issue that will impact cryptoasset firms is that due to HM Treasury's response to their consultation only authorised firms will be able to approve financial promotions in relation to cryptoassets, despite cryptoassets not being regulated and so vanishingly few cryptoasset firms are authorised.

This proposal by the FCA compounds that, by requiring that authorised firms that approve financial promotions in relation to cryptoassets must have processes in place to assess appropriateness. It is not clear which authorised firms the FCA believes will have suitable

processes in place to assess this in relation to cryptoassets given that it is not necessary to be authorised to carry out activities in relation to cryptoassets and so few, if any, firms will have expertise in relation to those cryptoasset activities which they may wish to approve.

Of the 32 firms on the FCA's Cryptoasset Register, there are only three (Archax Ltd, eToro (UK) Ltd, and Crypto Facilities Ltd) that have Part 4A authorisation. It is not clear on what basis the FCA believes that these firms would approve financial promotions for their competitors. This proposal is wholly anti-competitive, giving certain firms a huge advantage over those that are not authorised, and we note the FCA has a statutory duty to promote competition.

Further, we do not believe that it is generally market practice for authorised firms to approve the promotions of unauthorised firms in any event, save for those in a principal/appointed representative relationship. It is unclear, even if there were many authorised firms with the relevant expertise, if any would approve the financial promotions of unauthorised firms. If they were to do so, we expect the costs to be extremely high, and will again lead to a lack of competition and innovation in the sector as firms unable to bear those costs are driven out.

We appreciate that the issue is fundamentally one for HMT, however as noted, the FCA appears to seek to compound that issue by increasing the difficulty for those firms who may be able to approve financial promotions relating to cryptoassets from doing so.

These proposed changes have the potential to cause serious damage to the cryptoasset industry, and with it the jobs the industry creates. They appear at odds with the stated aims of the government and FCA of supporting innovation and the FinTech sector more broadly. The proposal is not one that is being considered anywhere else internationally.

24. **Do you agree with our proposed guidance for firms approving financial promotions for 'Non Mass Market Investments'?**

No response.

25. **Do you agree with our proposal to apply the financial promotion regime to cryptoassets and classify them as 'Restricted Mass Market Investments'?**

AS we stated at question 1, it is not clear why the FCA proposes to include cryptoassets in the same category as NRRS and P2P agreements. Both of those are characterised by a lack of liquidity, with the FCA saying at paragraph 3.5 of the CP "the common feature of NRRS and P2P investments is that consumers may not have frequent opportunities to sell these investments on a secondary market that offers continuous trading." In our view, cryptoassets are in many ways the exact opposite of this. Most major cryptoassets traded on an exchange have a good level of liquidity and low bid/offer spreads, and furthermore have 24-hour trading that even traditional equity markets cannot compete with.

Further, the Consultation Paper states that consumers who buy NRRS and P2P agreements are typically investing in companies or individuals about whom limited public information may be available. Conversely, in the case of cryptoassets there is usually a white paper that sets out the initial offering of what the cryptoassets' features are, as well as a lot more in terms of engagement from the issuer with the public than you would see with NRRS.

We also note that the CP singles out the cryptoasset industry as one where "consumers may suffer sudden, large and unexpected losses from these investments for reasons including volatility, firm failure, comingling of funds, cyber-attacks and financial crime." We would suggest that there is similar volatility with traditional securities, especially those on

the AIM market. It is not clear which firms the FCA has in mind with regard to firm failure in the cryptoasset industry, considering the significant number and size of cryptoasset exchanges, and we understand that there would be a greater insolvency risk with AIM firms than these cryptoasset exchanges.

Finally, the FCA states that "consumers may also not understand complex products offered to them. Poor-quality and misleading promotions can exacerbate these risks and lead to consumers buying investments that are outside their risk tolerance and which do not meet their needs." We would again state that while cryptoassets do have a degree of complexity, this is no more so than many AIM listed shares, or CFDs which are able to be marketed freely to retail customers (though CFDs must contain a risk warning).

We would also note that the proposal conflates distinct customer types involved in cryptoassets, namely consumers and businesses. Businesses that are not regulated are treated as retail under the proposal as they are not professional clients.

As it is not possible to be regulated for cryptoasset activity, it is not coherent to treat crypto the same as regulated instruments. There should be a different definition of “retail” with regard to cryptoassets to ensure that true retail customers are targeted by investor protection regimes, rather than bringing into scope those entities which do have expertise in the instruments, but due to the regulatory perimeter are not authorised.

In our view, the proposed categorisation and treatment of cryptoassets by the FCA is secondary in impact to the fundamental issue of including an unregulated asset in the financial promotion regime along with regulated assets, however the approach by the FCA compounds that issue. We would also note that according to the FCA’s research, the median holding in cryptoassets is £300, which is not particularly high. It would seem that the steps the FCA are taking are disproportionate to the risks.

In our view, cryptoassets are more akin to Readily Realisable Securities, though if the FCA wishes to make a distinction, it makes sense to treat cryptoassets as a separate category, with different treatment to NRRS and P2P agreements. Further, cryptoassets themselves come in many different forms, with different risk profiles. The restrictions placed on cryptoassets should align with the risks that the FCA sets out and also take into account the safeguards of the ability to trade 24hours, liquidity of markets, and available information for investors the fact that it is more liquid. This would suggest:

- no ban on inducements (as is the case with RRS)
- no 24hr cooling-off for direct offer (as is the case with RRS)
- no restriction on the type of person that can invest

We would suggest including the other restrictions included by the FCA in relation to the RMMI, namely:

- An appropriateness test is carried out to ensure that the customer understands the risks
- Suitable risk warnings are included

26. **Do you agree with our proposed approach to exemptions for cryptoassets?**

We would draw the FCA's attention to the difference in treatment between cryptoassets and the other Restricted Mass Market Investments.

Under the FPO, exemptions are available for high-net worth and self-certified investors for unlisted shares. This means that the COBS exemptions that the FCA suggests would apply to RMMI would not bite on such instruments if they have already benefited from the FPO exemption.

These exemptions are not proposed to be available to cryptoassets under the HMT consultation, though it is not clear why this difference in treatment should exist. As a result of this, we do not believe that the FCA's proposals provide any meaningful relief. Nevertheless, we welcome any exemptions that the FCA proposes to minimise the impact of the marketing restrictions that are being proposed.

Yours faithfully,

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