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HM Treasury Regulatory Framework for Approval of Financial Promotions (public consultation) - CryptoUK response

Dear Sir or Madam,

Introduction

The government is consulting on proposals to strengthen the Financial Conduct Authority's (FCA) ability to ensure the approval of financial promotions of unauthorised firms operates effectively.

CryptoUK (CUK) welcomes the opportunity to comment on the consultation together with Cryptoasset promotions twin consultation.

About CryptoUK

Crypto UK is the United Kingdom's (UK) trade body for the cryptoasset industry. We believe in the transformative potential of digital and crypto assets and the underlying blockchain technology. We promote accountable self-governance whilst advocating for fit-for-purpose legislation and regulatory frameworks for crypto and digital assets in the UK. We achieve our vision by establishing and fostering productive partnerships between digital and crypto asset industry participants with legislatures, policymakers, and regulatory agencies to educate and nurture an environment that fosters innovation, job creation and investment.

Below are the collective responses from our members to 3 questions posed by HM Treasury (HMT).

Consultation Questions: Proposals for Reform

> ***Option 1 –*** *Restrict approval of the financial promotions of unauthorised firms through the imposition of requirements by the FCA - GATEWAY*
>
> ***Option 2 –*** *Specify the approval of financial promotions communicated by unauthorised persons as a 'regulated activity' under FSMA - 55A ('Part 4A Permission to carry on regulated activities') of the Financial Services and Markets Act 2000 ('Application for permission' to carry on one, or more, regulated activities)*

1 Do you agree that a gateway should be established enabling the FCA to assess the suitability of a firm before it is permitted to approve the financial promotions of unauthorised persons?

Our members met over several weeks in a working group format to provide feedback that is representative of the cryptoasset industry, here in the UK.

Let us start by discussing the definition of a financial promotion. *"A financial promotion is a communication that contains an invitation or inducement to engage in a financial product or service"*. Many of the community felt that the products and services they are engaged in do not fall under the definition of a financial service. For the simple reason that certain cryptoassets are not regulated activities under FSMA or MiFID and so would fall outside the proposed gateway.

We appreciate it is HMT wish to bring cryptoassets into scope as a controlled activity in Part 1 of Schedule 1 to the FPO. Please refer to CUK response to the dual consultation on cryptoasset promotions, where we discuss certain exemptions and suggest alternative options.

Secondly, and of some significance to our members is a lack of clarity in regards to the definition of an authorised person, specifically for cryptoasset promotions. We have members that are authorised under FSMA and can carry out such activities as custody, advice and other broker dealer activities. We also have members with regulated persons under the senior managers regime, licensed to conduct specific regulated activities such as SMF17 Money Laundering Reporting Officer (MLRO) and SMF3 Executive Director.

We therefore request further clarity in regards to whether these regulated firms or persons qualify as authorised, under the proposals to approve promotions both for themselves and unapproved persons / firms.

Furthermore the consultation makes reference on occasion to the correct level or experience and knowledge of authorised firms signing off on promotions. We note that London Capital and Finance (LCF) mentioned in the consultation was an authorised firm. We see no information as to whether mini-bonds were mis-sold or that LCF failed in its level of expertise or due-diligence. Unfortunately the investigations findings are yet to be made public

Our members discussed this concept of expertise in the cryptoasset sector. This is a new technology that is highly technical. Therefore, we felt that generally the most appropriate persons to understand specific aspects of a promotion are crypto firms themselves. We further discussed the potential conflict of interest, where the smaller unauthorised firm only has the choice to use a larger, perhaps competitor firm to authorise their promotion. This would clearly not have the desired outcome especially if the promotion was timed to the launch of some proprietary product or service that could be of interest to the authorised competitor firm.

We hereby propose an alternative to the authorised firm. Similar but not an SRO the industry could form an institution or institutions that is fee based rather than member based, of which is qualified to understand cryptoassets and does not have a conflict with approving marketing campaigns. Something like the Advertising Standards Agency ASA, without any powers but specifically focussed on cryptoassets.

Our members accept that the mini-bonds losses were significant and that this requires action. However, our members felt that the size and therefore risk levels of the developing UK cryptoasset industry do not warrant being considered in the same light as traditional securities. Many of our members are small start ups with no revenues to date. All our members have applied for the new AML regime for the UK. This financial and resource burden together with the upcoming Economic Crime Levy[1] impact on UK business competitiveness.

Some members suggested that the current crypto AML regime could be extended to include additional controlled or non-controlled activities, such as promotions. For example, by using the senior managers regime in the same way for KYC using an MLRO (SMSF17), we felt a senior marketing employee could be the responsible expert in ensuring crypto promotions are fair and not misleading.

Finally section 4.9 mentions that the "*FCA's oversight of such approvals is, by necessity, **generally reactive**. It would **not be practicable** for firms to notify the FCA every time they approved a financial promotion or for the FCA to check all approved promotions before they were communicated"*.

CUK felt that the proposed gateway (option 1) is contrary to the statement in 4.9. We are aware that the FCA has to effectively manage its resources. Many members are facing delays in regards to their live KYC/AML licence applications, with a deadline fast approaching in January 2021. At this stage only 4 crypto firms have been authorised[2]. We therefore would like clarity as to how the FCA will, in a timely fashion approve all promotions across the financial sector. Can HMT release any quantitative data as to their forecast for expected numbers of promotions?

In summary CUK does not think a gateway should not be established. However, does believe that at this early stage in the development of the cryptoasset, industry the gateway as currently should not apply to crytoasset participants. Over-burdening smaller members of the community could have unintended consequences such firms moving off-shore and the proposal not achieving its aim for this sector.

[1] Economic Crime Levy Consultation
[2] FCA cryptoasset firm register

2 What are the risks and benefits of each of the two policy options put forward? Would there be any unintended consequences resulting from implementation?

Many of the risks for the crypto industry specifically are mentioned in question 1.

We also see great risk in the lack of quantitative data. We appreciate the mini-bond (LCF) miss-selling requires addressing. We ask the government to invest further time and resources in obtaining relevant quantitative data for cryptoassets. CUK championed the good work from the FCA in regards to their consumer research note[3] earlier this year. However, this has no mention of the levels of unclear and mis-leading promotions and whether it is proportionally correct to include cryptoassets in the propped gateway.

Our members discussed whether the research had been carried out solely on cryptoassets with no control element. It is like testing a new drug without using a placebo. Our members would like to see research which contrasts the results against other financial instruments which are able to be marketed and sold to retail investors. It would be interesting to see which ones investors think are the more risky, and if so, by how much they think they are more risky. We observe some of the conclusions are based on anecdotal evidence. We felt further work could be done considering the overarching impact to the evolution of the industry in the UK.

3 If the government was to proceed with one of the two policy options, which would be your preference and why?

CUK preference is for option 1. We feel that having financial promotions communicated by unauthorised persons become a regulated activity under FSMA, would be overly-burdensome for the crypto industry.

We again thank you for this opportunity to comment on the consultation and hope you find our response helpful. This is a new and technical area and we stand by ready to answer any further questions, and provide such further input as you may desire.

Yours faithfully,

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[3] FCA consumer research note