

23 March 2022

Financial Conduct Authority  
12 Endeavour Square,  
London  
E20 1JN

To whom it may concern,

**Re: the FCA Consultation Paper on strengthening financial promotion rules for high-risk investments, including cryptoassets consultation**

Global Digital Finance ('GDF') supports efforts by global standard setters, national authorities and regulators to consult and work with the nascent global digital / virtual asset industry.

To that end, we are hereby providing input to the FCA Consultation Paper on strengthening financial promotion rules for high-risk investments, including cryptoassets consultation.

**About GDF**

GDF is a not-for-profit industry body that promotes the adoption of best practices for crypto and digital assets, and digital finance technologies through the development of conduct standards, in a shared engagement forum with market participants, policymakers and regulators.

Established in 2018, GDF has convened a broad range of industry participants, with 300+ global community members - including some of the most influential digital asset and token companies, academics and professional services firms supporting the industry. GDF is proud to include BitMex, Coinbase, DLA Piper, EQONEX Group, EY, Gate.io, Hogan Lovells, Huobi, the London Stock Exchange Group, Ownera, R3 and SDX as patron members.

The GDF Code of Conduct (the 'Code') is an industry-led initiative driving the creation of global best practices and sound governance policies. GDF is informed by close conversations with regulators and developed through open, inclusive working groups of industry participants, legal, regulatory and compliance experts, financial services incumbents and academia. The principles set out in the Code undergo multiple stages of community peer review and open public consultation prior to ratification.

The input to this response has been curated through a series of roundtables organised by GDF, convening a wide cross-section of the industry. GDF is grateful for all of its members who have taken part however, a special thanks goes to representatives from Clifford Chance, Coinbase, Elliptic, Hogan Lovells and Zumo who helped draft this response.

GDF implores the FCA to take time to consider our proposals. Given the severity of the concerns and the significant impact this will have on the UK cryptoasset industry, GDF is concerned that the FCA expects to finalise its rules by summer 2022, giving itself such a short timeframe to conduct detailed analysis.

As always, GDF remains at your disposal for any further questions or clarifications you may have and we would welcome a meeting with you to discuss these matters in more detail with our members.



Yours faithfully,

Lavan Thasarathakumar  
Director of Government and Regulatory Affairs, Global Digital Finance

- Response to Consultation -

**Q3: Should we ban inducements to invest e.g. refer a friend bonuses, for all ‘Restricted Mass Market Investments’ and ‘Non-Mass Market Investments’?**

As highlighted later in this response in Q25, cryptoassets should not fall within the scope of Restricted Mass Market Investments. Instead it should either be included in Readily Realisable Securities or put in a newly formed new category. Given the comparability to Readily Realisable Securities, where inducements are a legitimate form of promotion, cryptoassets should be allowed to continue to use inducements. It is a widely used marketing tool for investments and the similar risk profile, coupled with the proposed measures in place, ensures there are sufficient safeguards in place to ensure that investor protections are maintained.

**Q4: Should we introduce a personalised risk warning pop up for first time investors in ‘Restricted Mass Market Investments’ and ‘Non-Mass Market Investments’?**

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**Q5: Should we introduce a 24 hour cooling off period for first time investors in ‘Restricted Mass Market Investments’ and ‘Non-Mass Market Investments’?**

GDF considers that in its present drafting the requirements for direct offer financial promotions are quite onerous and need to be reworked to be suitable for cryptoassets.

The concept of Direct Offer Financial Promotions is slightly dated. It was a method that was designed to capture ways of promoting securities which would usually market through financial intermediaries and only in limited circumstances directly without intermediaries, for example ‘tear-off slips’ on prospectuses. It is these, rare circumstances where direct offer financial promotions of securities were taking place, that this measure was supposed to capture.

However, due to the breadth of this wording it is not clear how the definition will apply to cryptoassets for whom financial intermediaries are not very common. Without clarification of this, GDF considers it likely that many online advertisements will be caught. It seems with this, the FCA sees a two-tier system that applies more moderate rules to ‘normal’ financial promotions and much more restrictive ones to direct offer financial promotion rules. This rule may work well in the promotion of traditional securities, however will lead to unintended overregulation in the cryptoasset industry, when the same regulatory outcomes could have been met via different means. Due to the market structure and lack of financial intermediaries, most if not all marketing strategies are likely to involve direct offer financial promotions and will be subject to the more restrictive Direct Offer Financial Promotions Rules which do not line up with the typical consumer journey.

As such, measures such as the cooling off period and the personalised risk warnings, in their current state are not workable. For example, if a website is a Direct Offer and the user is a first time investor, a personalised risk warning is then supposed to be given and they are given a 24 hour cooling off period before there has been the opportunity to go through the flow of assessing the risk associated to the specific individuals.

It will make acquiring customers disproportionately difficult for cryptoassets without necessarily addressing the question of risk and what the industry can do to mitigate this. GDF proposes that the definition of Direct Offer Financial Promotions only applies to tailored and direct offers made to customers individually, and will not be improperly read to apply to a website or mobile app in its entirety or to basic functional steps such as a “buy/sell now” trading functionality. GDF members

are committed to delivering an investor protection and the community proposes that cryptoassets have the opportunity to implement the processes that have been outlined here such as the cooling off period and the personalised risk warning with a workable solution. GDF would be happy to convene a working group to work alongside the FCA on developing the technical standards for this.

GDF also welcome the measures that need to be implemented for client categorisation and appropriateness assessments.

Separately, on a technical level, GDF note that under the specific Direct Offer Financial Promotions Rules, the personalised risk warning is required before communicating the promotion. This in practice will be difficult to implement and reading the special rules for risk warning on websites, which states that the risk warning should be a pop up, suggests that the 'before' element of this requirement should be altered to 'when' i.e. simultaneously.

**Q14: Do you agree with the introduction of a competence and expertise rule to apply to all authorised firms when approving or communicating financial promotions?**

GDF has significant concerns around the competence and expertise rule and the detrimental impact this will have on the cryptoasset industry.

GDF notes that the Consultation is proposing much stricter rules regarding approving financial promotions, in particular, around the competence and expertise of authorised firms approving financial promotions:

*“Where the promotion is related to a regulated activity for which the firm has a Part 4A permission (e.g. dealing in investments), we would generally expect the firm to have met the C&E requirement by virtue of its regulated business.”*

As cryptoasset activities are not regulated activities, aside from the fact that cryptoasset firms themselves will not be able to approve their own promotions, it also means that they will have a very small number of (if any) firms who are able to approve their promotions due to this new high standard. This is acknowledged by the FCA who state that:

*“As cryptoassets currently sit outside the financial promotion regime, there is unlikely to be an existing population of s21 approver firms. We recognise that the population of authorised firms with sufficient competence and expertise to approve cryptoasset financial promotions is likely to be limited at first.”*

Considering this impact, GDF proposes that the transition period for this amendment to the financial promotion rules be increased to 18 months, with a review by HMT after 12 months to assess whether there is an appropriate market of authorised firms to approve cryptoasset financial promotions. The current proposal of 6 months by HMT and 3 months by the FCA is unworkable.

GDF notes that HMT state in their consultation response on a Regulatory Framework for Approval of Financial Promotions that it is intended for a restriction to be imposed on all authorised firms not to approve the financial promotions of unauthorised firms unless a variation of this restriction has been sought from, and granted by, the FCA (referred to as the Financial Promotion Requirement in the Response). This Financial Promotion Requirement will further reduce the population of potential approvers of financial promotions.

Whilst the rationale behind this decision is understood, there is a significant impact on the cryptoasset market, effectively stalling it.

As such, GDF proposes that HMT creates a new exemption under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “FPO”) for cryptoassets service providers (“CASPs”) who:

1. Are registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations (the “MLRs”); and
2. Follow the rules under the FPO.

This exemption would allow those CASPs, who are registered with the FCA under the MLRs and who follow the rules under the FPO to act as approvers of cryptoasset financial promotions. This would fulfil the policy aims of protecting consumers by ensuring responsible advertising (by bringing firms within the remit of the FPO) whilst allowing the market to continue to develop. This proposal would also prevent the need to amend the Regulated Activity Order, which in itself would create greater complications. GDF also proposes that the wording should be as such that this exemption would apply to both CASPs registered under the MLRs but also would cover CASPs under any future cryptoasset regime.

GDF also suggests that firms who have obtained an E-Money license that are also active in the cryptoasset space are recognised as authorised persons for the purpose of making and approving financial promotions with respect to cryptoassets.

Notwithstanding the proposed exemption stated above, cryptoasset firms cannot approve their own financial promotions but would be dependent on authorised firms to approve their financial promotions for them. GDF cannot identify a situation where the primary business is separated from the communications part of the business in any other part of the financial sector. This seems unfairly punitive on the cryptoasset industry and GDF questions the cost benefit analysis that the FCA has conducted on this. The assumptions made on costs to the industry are extremely conservative and does not take into consideration the competitive challenges the industry faces, especially when considering cryptoasset firms will have to pay a third party to approve its promotions.

Of particular concern is that firms who have already gone through a vetting process with the FCA to acquire an MLRs registration to carry on cryptoasset activities would effectively be prevented from marketing their own services to retail clients, but would also be unable to get authorised to carry on and promote their cryptoasset activities under the supervision of the FCA. This will have a stifling effect on the UK cryptoassets market and will put UK firms and those considering locating in the UK, at a competitive disadvantage compared to overseas competitors.

Taking into account the practical limitations of enforcing the UK financial promotions regime against overseas firms, this may also end up reducing consumer protection in the UK. Onshore regulated firms will be prevented from marketing services to UK customers, whilst offshore unregulated firms will continue, and likely increase, their marketing activities to UK customers from abroad.

GDF proposes that HMT brings the financial promotions obligations for cryptoassets within the remit of the bespoke regime for cryptoassets that GDF called for in its consultation response to the HMT Consultation and Call for Evidence on UK Regulatory Approach to Cryptoassets and Stablecoins.

Rather than attempting to broaden the scope of existing legislation, stifling the market and attracting unintended consequences, a new bespoke regime should be implemented. This regime would include obligations for how cryptoasset promotions should be communicated and more generally would provide clarity on how cryptoasset firms should conduct themselves and how regulators should supervise them. CASPs would be able to approve their own promotions and this would provide a more cost effective regime whilst maintaining the same regulatory outcomes. This clarity in approach would attract cryptoasset firms to domicile in the UK, delivering the jobs and growth the sector can bring whilst maintaining high standards of investor protection.

**Q25: Do you agree with our proposal to apply the financial promotion regime to cryptoassets and classify them as ‘Restricted Mass Market Investments’?**

GDF does not consider the classification of cryptoassets as Restricted Mass Market Investments as accurate. This classification generalises cryptoassets and treats them all the same regardless of attributes, information or liquidity. GDF considers that there are more parallels with readily realisable securities than there are with peer-to-peer arrangements and non-readily realisable securities.

The FCA suggests that instruments in the restricted mass market investments category do not have the liquidity, access to continuous trading and access to market information that readily realisable securities do.

GDF addresses this point by highlighting that cryptoassets do meet these criteria and in fact surpasses this at times. In terms of liquidity, the majority of major cryptoassets are traded on an exchange that has a good level of liquidity with a low bid / offer spread. In terms of continuous trading, cryptoasset markets trade 24hours, which is incomparable to traditional equities markets or packaged projects. Finally, in terms of market information, there is typically a white paper that sets out the information of what the cryptoasset is offering. Further to this, common practice in cryptoassets is that the issuer provides information on an ongoing basis of the developments of the cryptoasset on their website / twitter feed.

GDF is concerned with a number of points raised in the introductory section of applying our financial promotion rules to cryptoassets, which gives the rationale for the introduction of these new rules.

*"The cryptoasset market is generally unregulated, so consumers are unlikely to be protected if something goes wrong. We have repeatedly warned consumers they should be prepared to lose all their money when investing in cryptoassets."*

The GDF community has repeatedly called for regulatory clarity, which we acknowledge will help improve the standards of the industry. In fact, in lieu of this our members attest to a code of conduct as to how they will conduct business. The second point of this statement points towards the FCA warnings for the loss of money. This is the case with any investment and applies to traditional securities in particular AIM traded shares. Does the FCA have any empirical evidence that investors lose more money on cryptoassets than trading in AIM listed shares?

*"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."*

Reiterating the point above, the risks of volatility apply to AIM traded shares. However, a loss is not a loss until it is crystallised. Therefore, whilst the market may have dropped, it only impacts the

retail customer should they sell. GDF asks the FCA what evidence they have collected to come to this decision and the extent to which investors have made profits versus the levels of actual loss realised by retail consumers. GDF would then like to understand how these figures stand up against AIM traded shares.

Addressing the aspect of firm failure, GDF considers that again it is more likely for investors to lose all their money by investing in companies whose shares are AIM traded. AIM listed companies are more likely to go insolvent than it is for an investor in cryptoassets to lose all their money due to a failure of a cryptoasset issuer. It is unclear through what evidence that the FCA have obtained their concern for firm failure as the significant number of cryptoasset exchanges and the sheer size of them indicates otherwise.

*"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."*

GDF agrees that there is a level of complexity to some cryptoassets, but again drawing a parallel to newly listed AIM shares, where there is a comparable level of complexity. Regarding the point on the quality of promotions, GDF members are not against investor protections standards which would improve the quality of promotions but want to highlight that this is a sector that is not regulated at this stage and similar results may have occurred should an assessment have been conducted before traditional financial services were regulated. Therefore, this in and of itself should not place it in a riskier category.

It is for these reasons that GDF considers that cryptoassets should be considered as Readily Realisable Security.

GDF warns against trying to separate out different types of cryptoassets and trying to put those with certain characteristics such as a certain level of liquidity in one category and others in a separate one. This would create huge levels of complexity and instead if the FCA does not consider it appropriate to put all cryptoassets into Readily Realisable Securities, then it should create a new category.

The additional category can address the concerns that the FCA has but not be disproportionately punitive. The category would include:

- no ban on inducements (aligned with RRS);
- no 24hr cooling-off for direct offer (aligned with RRS);
- no restriction on the type of person that can invest but there would be an appropriate test to ensure that they understand risks (aligned with RRS); and
- then the remaining requirements for Restricted Mass Market Investments i.e. The warnings and the appropriateness test.

This better addresses the FCA's concerns and mitigates against the risks it sets out. These measures also take into account the safeguards that come with the cryptoasset sector such as the ability to trade 24 hours, the liquidity of the markets and the availability of information for investors.