

Cryptoasset promotions

Consultation

Cryptoasset promotions Consultation



© Crown copyright 2020

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at: www.gov.uk/official-documents

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN 978-1-913635-49-7

PU2984

Contents

Chapter 1	Introduction	2
Chapter 2	Responding to this consultation	6
Chapter 3	Rationale for intervention	10
Chapter 4	The government's policy proposal	13
Chapter 5	Impact assessment	21

Chapter 1

Introduction

- 1.1 This consultation seeks views on a government proposal to bring the promotion of certain types of cryptoassets within scope of financial promotions regulation. The measure is intended to enhance consumer protection, while continuing to promote responsible innovation.
- 1.2 This document explains what this proposal means, sets out the reasons for making it and how it might be achieved, and seeks feedback on the proposal.
- 1.3 Separately, the government is also consulting on proposals to strengthen the Financial Conduct Authority's (FCA) ability to ensure the approval of financial promotions of unauthorised firms operates effectively **please look at the consultation page**. Further detail is given later in this chapter. That consultation should be read in conjunction with this consultation.

Responding to this consultation

- 1.4 As a consultation, this document is not a definitive statement of the government's intention. The government encourages constructive responses to this consultation from all parties. In particular, the government is seeking responses from firms that would be affected if the policy proposal outlined in this consultation were taken forward.
- 1.5 In each section of this consultation, questions highlight the areas where the government would most like to hear your views.
- 1.6 Full details about responding to this consultation are provided in Chapter 2. Please return your response by midnight on 25 October 2020, when this consultation closes. For further information about the process for responding to this consultation, please see Chapter 2.

The structure of this consultation

- 1.7 The remainder of Chapter 1 summarises recent Cryptoassets Taskforce actions on cryptoassets.
- 1.8 Chapter 2 sets out how to respond to this consultation.
- 1.9 Chapter 3 sets out the government's rationale for taking action, briefly summarising the options the government has considered.

- 1.10 Chapter 4 gives the government’s reasoning for proposing to focus regulatory attention on promotions specifically. It explains the detail of how this proposal might be achieved in law, providing draft legal text.
- 1.11 Chapter 5 begins to explore possible impacts on firms, and seeks views from industry participants as to the likely real-world impacts and costs.

Box 1.A: Defining cryptoassets

There is no single, widely-agreed definition of a cryptoasset. Broadly, a cryptoasset is a cryptographically secured digital representation of value or contractual rights that uses some type of distributed ledger technology (DLT) and can be transferred, stored or traded electronically. This is the approach taken to defining cryptoassets for the purposes of the UK’s Money Laundering and Terrorist Financing regulations, and is the basis of a definition developed below. Examples of cryptoassets include Bitcoin and Ethereum. The market is constantly evolving, with new and different cryptoassets being developed.

Recent Cryptoassets Taskforce actions

- 1.12 As a leading global financial centre, the UK is committed to fostering innovation, whilst maintaining the high standards of consumer protection, market integrity, and regulatory supervision for which its financial system is known.
- 1.13 It was for this purpose that the government set up the Cryptoassets Taskforce (the Taskforce) in March 2018, consisting of HM Treasury, the Financial Conduct Authority (FCA) and the Bank of England. It was tasked with exploring the potential impact of cryptoassets in the UK, including on consumers and businesses.
- 1.14 In October 2018, the Taskforce published a report, assessing the potential benefits of cryptoassets and the underlying distributed ledger technology (DLT), and stating that all three authorities would continue to support innovation.¹ However, the Taskforce also identified risks that cryptoassets pose to consumers and markets. The Taskforce concluded that the priority for the authorities should be to take actions to mitigate these risks.
- 1.15 The report proposed several steps to promote responsible innovation whilst ensuring the UK’s regulatory framework addressed the risks identified. Specifically, the three authorities committed to:

Authority	Activity	Addressing which risks	Status
HMT	Implementing one of the most comprehensive responses globally to the	Financial crime including money laundering and terrorist financing	Complete

¹ The Cryptoassets Taskforce final report (2018) examined the issue of financial stability but did not find evidence of serious risks. However, the Bank of England continues to monitor financial market developments to identify any emerging systemic risks.

	use of cryptoassets for illicit activity.		
FCA	Consulting on a potential prohibition of the sale to retail consumers of derivatives referencing certain types of cryptoassets (for example, exchange tokens), including contracts for difference (CFDs), options, futures and transferable securities.	Consumer protection risks	Complete
FCA	Consulting on guidance clarifying which cryptoassets fall into the existing regulatory perimeter to provide clarity for industry.	Consumer and firm understanding of the regulatory perimeter	Complete
HMT	Consulting on whether the regulatory perimeter under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (RAO) requires extension in relation to cryptoassets that have comparable features to specified investments but currently fall outside the perimeter.	Consumer protection / market integrity risks	See below regarding commitments at Budget 2020

1.16 This consultation, and the further commitment to consult on the UK's approach to cryptoasset regulation more broadly at the 2020 Budget derive from the fourth of the above commitments.

Wider work underway

1.17 This section briefly summarises wider government work currently underway in relation to cryptoassets.

1.18 One of the Taskforce's main areas of focus has been on so-called stablecoins, a subset of cryptoassets that have received widespread attention during 2019. Stablecoins seek to stabilise their value in relation to another asset (such as a given fiat currency) or set of assets (such as a basket of fiat currencies).

1.19 In coordination with the FCA and Bank of England via the Cryptoassets Taskforce, and through global forums including the G7 and G20, HM Treasury continues to monitor the challenges and potential benefits posed by stablecoins, including those for retail or wholesale use.

- 1.20 In its October report, the G7 Working Group on Stablecoins said that no global stablecoin project should begin operation until the legal, regulatory and oversight challenges and risks outlined in the report – including risks or impacts to financial stability, market integrity and monetary policy – are adequately addressed.²
- 1.21 HM Treasury will continue to work closely with the FCA and the Bank of England through the Cryptoassets Taskforce to consider the risks and opportunities arising from stablecoins and, in particular, those with the potential to be globally or systemically significant. It should be noted that HM Treasury expects that the majority of stablecoin designs would be captured by the proposal laid out below or under the regime in its current form.
- 1.22 HMT is also working with the FCA, the Bank of England and the Payment Systems Regulator (PSR) on a review of the payments landscape, looking at major trends including the rise of digital payments, changes to the UK's payments infrastructure and new technologies and business models. The review will ask what actions need to be taken by government, regulators and industry to support a more innovative and resilient payments system and ensure the UK payments sector remains world leading.
- 1.23 Separately, the government is consulting on proposals to strengthen the FCA's ability to ensure the approval of financial promotions of unauthorised firms operates effectively. In that consultation, the government proposes to establish a regulatory 'gateway', which a firm must pass through before it is able to approve the financial promotions of unauthorised firms. Any firm wishing to approve the financial promotions of unauthorised firms would first need to obtain the consent of the FCA. These proposals apply to the regime overall, and this consultation considers whether to bring cryptoassets within scope of that regime.
- 1.24 Finally, HM Treasury and the Bank of England are undertaking analytical work to evaluate the risks and opportunities involved in the creation of a UK central bank digital currency. The government welcomes the Bank of England's important work with overseas central banks to share valuable experience related to central bank digital currencies. The UK is taking a leading role in exploring this topic, and the wide-ranging opportunities and challenges it could bring.

² G7 Working Group on Stablecoins (2019), *Investigating the impact of global stablecoins*.

Chapter 2

Responding to this consultation

2.1 Email responses should be sent to crypto.finproms@hmtreasury.gov.uk.

2.2 Written responses should be sent to:

Consultation on cryptoasset promotions
Cryptoassets branch
Payments and FinTech (1 Blue)
Financial Services Group
1 Horse Guards Road
SW1A 2HQ
London

2.3 The closing date for responses is midnight on 25 October 2020, when this consultation closes.

2.4 You can respond using the form attached on the GOV.UK page for this consultation, or in a document format of your choosing.

HM Treasury Consultations - Processing of Personal Data

2.5 This notice sets out how HM Treasury will use your personal data for the purposes of this Cryptoasset promotions consultation, and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

Your data (Data Subject Categories)

2.6 The personal information relates to you as either a member of the public, parliamentarians, and representatives of organisations or companies.

The data we collect (Data Categories)

2.7 Information may include your name, address, email address, job title, and employer of the correspondent, as well as your opinions. It is possible that you will volunteer additional identifying information about themselves or third parties.

Legal basis of processing

2.8 The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental

policies or proposals or obtaining opinion data in order to develop good effective government policies.

Special categories data

- 2.9 Any of the categories of special category data may be processed if such data is volunteered by the respondent.

Legal basis for processing special category data

- 2.10 Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.
- 2.11 This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Purpose

- 2.12 The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

Who we share your responses with

- 2.13 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).
- 2.14 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.
- 2.15 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.
- 2.16 Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.
- 2.17 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: <https://www.gov.uk/government/organisations>.

- 2.18 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.

- 2.19 Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

YOUR RIGHTS

- 2.20 You have the right to request information about how your personal data are processed and to request a copy of that personal data.
- 2.21 You have the right to request that any inaccuracies in your personal data are rectified without delay.
- 2.22 You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- 2.23 You have the right, in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted.
- 2.24 You have the right to object to the processing of your personal data where it is processed for direct marketing purposes.
- 2.25 You have the right to data portability, which allows your data to be copied or transferred from one IT environment to another.

How to submit a Data Subject Access Request (DSAR)

- 2.26 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit
G11 Orange
1 Horse Guards Road
London
SW1A 2HQ
dsar@hmtreasury.gov.uk

Complaints

- 2.27 If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk.
- 2.28 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office

Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

2.29 Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

CONTACT DETAILS

2.30 The data controller for any personal data collected as part of this consultation is HM Treasury, the contact details for which are:

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
London
020 7270 5000
public.enquiries@hmtreasury.gov.uk

2.31 The contact details for HM Treasury's Data Protection Officer (DPO) are:

The Data Protection Officer
Corporate Governance and Risk Assurance Team
Area 2/15
1 Horse Guards Road
London
SW1A 2HQ
London
privacy@hmtreasury.gov.uk

Chapter 3

Rationale for intervention

- 3.1 This chapter summarises the current scope of the regulatory framework relevant to cryptoassets and explains the government’s rationale for making a regulatory intervention.

Cryptoassets in the regulatory framework

- 3.2 Detailed guidance on the regulatory perimeter can be found on the FCA’s website and in its 2019 guidance.¹
- 3.3 In the Cryptoassets Taskforce report, the government had proposed a taxonomy of cryptoassets comprising “exchange tokens”, “security tokens” and “utility tokens”. Respondents to the FCA’s Consultation on Perimeter Guidance commented that the distinction, used in the Cryptoassets Taskforce’s report of 2018, between “exchange token” and “utility token” categories was sometimes unclear. For this reason, in their following Policy Statement the FCA folded the Exchange and Utility token categories together into “unregulated cryptoassets”, referring to all tokens that are not security tokens or e-money tokens. This terminology is used through the rest of this consultation.
- 3.4 It is the government’s assessment that many of these unregulated cryptoassets expose consumers to unacceptable levels of risk.
- 3.5 Specifically, the Taskforce identified the following three areas of risk as a priority for the authorities to take action:
- **consumer protection:** cryptoassets pose a range of substantial risks to consumers. This includes the risk of consumers purchasing unsuitable products without having access to adequate information, the risk of consumers being exposed to fraudulent activity, and risks arising from the immaturity or failings of market infrastructures and services
 - **market integrity:** the cryptoasset market is still in a relatively early phase of development. As a result, many of its participants are unsophisticated, operational controls are immature, and there are large information asymmetries. This creates openings for market abuse and manipulation. There is anecdotal evidence of “pump and dump” schemes, in which organisers synchronise purchases of a chosen cryptoasset to inflate its price, generate interest from other investors, and then offload their cryptoassets for a profit

¹ <https://www.fca.org.uk/firms/cryptoassets> and <https://www.fca.org.uk/publication/policy/ps19-22.pdf>.

- **financial crime:** cryptoassets can be used to facilitate money laundering, terrorist finance and other illicit activity. The third National Risk Assessment, outlined in the government's 2019 Economic Crime Plan, will be using the latest information at the government's disposal to consider the threat of money laundering and terrorist financing from cryptoassets further

3.6 Further detail on the risks identified can be found in the Cryptoassets Taskforce report.

Rationale for intervention

3.7 In its discussion of the above risks, the Taskforce's final report identified misleading advertising and a lack of suitable information as a key consumer protection issue in cryptoasset markets.

3.8 In particular, the report noted that advertising regarding cryptoassets, which is often targeted at retail investors, is not typically fair or clear and can be misleading.

3.9 In the report's words: *'Adverts often overstate benefits and rarely warn of volatility risks, the fact consumers can both grow and lose their investment, and the lack of regulation. There are also examples of regulated firms marketing cryptoasset products without clarifying that this part of their business is not regulated'*.

3.10 Since the report was published, further consumer research commissioned by the FCA in 2020 has highlighted a number of relevant conclusions:²

- the research findings highlight a statistically significant increase from 3% in the 2019 FCA Consumer Research to 5.35% this year in those who hold or held cryptoassets. This represents an increase of 2.35 percentage points, from approximately 1.5 million people to 2.6 million people
- 45% of all current and previous unregulated cryptoasset owners sampled said that they had seen a related advert; of those who had seen a related advert, 35% said it made their purchase more likely
- a further 14% said it made them curious about cryptoassets, 46% said it did not change their attitude, and only 5% said it discouraged them from buying cryptoassets
- those who displayed relatively less knowledge of cryptoassets and had incorrect assumptions around the regulatory protections for cryptoassets were more likely to be influenced by advertisements (e.g. could not accurately define them, or overestimated the level of protections they would have in purchasing cryptoassets)
- those that were influenced by advertising, were more likely to subsequently regret the purchase

² The FCA's research can be found at: <https://www.fca.org.uk/publication/research/research-note-cryptoasset-consumer-research-2020.pdf>

- conversely, those who purchased lower amounts, saw it as a 'gamble that could make or lose money' and intend to hold them for longer time periods, were less likely to be influenced in this way
- a minority (11%) of current and past cryptoasset owners incorrectly believed that their holdings received regulatory protections. Though a minority, extrapolation from the representative sample suggests this figure represents c. 300,000 people
- a minority (17%) of current and past cryptoasset owners reported having had a negative experience in relation to buying or owning cryptoassets, amounting to c. 450,000 owners. These tended to be regarding fees on exchanges, transaction times, cryptoassets being stolen, and fluctuation in the value of cryptoassets.
- The changing profile of cryptoasset holders shows a higher number of older users engaging in these high risk investments

3.11 These factors underscore the importance of promotions being candid about the risks involved in purchasing cryptoassets. In the government's view these factors together contribute to the basis for intervention in this market.

Chapter 4

The government's policy proposal

- 4.1 Having set out the rationale for intervention above, this chapter outlines the government's proposed policy response to the above considerations.
- 4.2 The government proposes to expand the perimeter of the financial promotions regime in order to enhance consumer protection while the government continues to consider its approach to the broader challenges of cryptoasset regulation. This would ensure that cryptoasset promotions are held to the same high standards for fairness, clarity and accuracy that apply to the traditional financial services industry.
- 4.3 This section expands on the government's proposed measures, beginning by explaining how the financial promotions regime applies to mainstream financial services promotions today.

Understanding the financial promotions regime

- 4.4 Financial promotions play an important role in the financial decisions made by individuals. Consumers are influenced by both the substance and presentation of promotions, which can have a significant impact on whether they decide to engage with a particular financial service provider or take out a particular financial product. The financial promotions regulatory regime – which consists of legislative restrictions set by Government, as well as more specific FCA rules for firms – seeks to ensure consumers are provided with clear and accurate information that enables them to take decisions which are appropriate for their individual circumstances.
- 4.5 The scope of the financial promotions regulatory regime is broad. It applies to promotions communicated by firms authorised to carry on regulated financial services activities, and to promotions of certain unregulated investment activities communicated by unauthorised firms. The Financial Services and Markets Act 2000 (FSMA), which sits at the centre of the UK legislative framework for financial services, sets out how the financial promotions regime applies to both regulated and unregulated activities.
- 4.6 Section 19 of FSMA sets out the 'general prohibition'. This provides that no person may carry on a regulated financial services activity in the UK unless they are authorised or exempt. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) specifies the financial services activities which are subject to regulation. In order to undertake a regulated activity, a firm must generally be authorised by the FCA or, in the case of banks, credit unions and certain insurers and investment firms, by the Prudential Regulation Authority (PRA). Authorised firms are referred to as authorised persons in FSMA.

- 4.7 Section 21 of FSMA contains the financial promotion restriction. This restriction is broad in scope and provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity or claims management activity. This includes invitations or inducements to engage in certain activities which are not regulated for the purposes of the general prohibition. For example, a person may not necessarily carry on a regulated activity requiring authorisation in issuing bonds but the marketing of the bonds is likely to be subject to the financial promotion restriction. The financial promotion restriction does not apply if:
- the communication is made by an authorised person, or
 - the content of the communication is approved by an authorised person, or
 - the financial promotion otherwise meets the conditions of an exemption within the Financial Services and Markets Act 2000 (Financial Promotion) Order (FPO) 2005¹
- 4.8 The effect of the financial promotion restriction is that an unauthorised person must have its financial promotions approved by an authorised person before they are communicated (unless an exemption applies). Communicating a financial promotion in breach of section 21 is a criminal offence on the part of the unauthorised person under section 25 of FSMA. As noted in Chapter 1, in a separate consultation, the government is proposing changes which would require authorised firms to obtain a specific permission from the FCA before undertaking approvals of financial promotions of unauthorised firms [\[ADD LINK WHEN LIVE\]](#). This could be designed in a way to ensure that only authorised firms with the relevant expertise are able to approve the promotion of a particular product type.
- 4.9 If the FCA finds that an approved financial promotion breaches its rules, the FCA will usually engage with the authorised firm that approved the promotion to request that the promotion is changed or withdrawn. If the FCA is not satisfied with the response of the authorised firm, it has a broad power under section 137S of FSMA to direct the firm to address the breach, which may include directing the firm to withdraw its approval of the promotion. The FCA can also open an investigation which can lead to enforcement action (such as a financial penalty) if serious misconduct is discovered.
- 4.10 Currently, security tokens that fall within the regulatory perimeter of the RAO are captured by the FPO as “controlled investments”, and e-money tokens are regulated separately under Electronic Money Regulations 2011 (the E-Money Regulations). Promotion of either is subject to the financial promotions regime. Unregulated cryptoassets are not subject to similar regulation.

¹ S.I. 2005/1529. The FPO 2005 includes a number of exemptions from the financial promotion restriction. These enable unauthorised persons to communicate financial promotions in certain circumstances, including to defined groups or individual investors, without requiring approval. Financial promotions which are communicated within the scope of the exemptions are not subject to FCA rules.

- 4.11 Schedule 1 to the FPO sets out a list of controlled investments and controlled activities (see below). A person will be engaging in investment activity for the purposes of section 21 of FSMA if they:
- enter, or offer to enter, into an agreement the making or performance of which by either party constitutes a controlled activity, or
 - exercise any rights conferred by a controlled investment to acquire, dispose of, underwrite, or convert a controlled investment
- 4.12 Controlled investments under the FPO currently include, for example, government and public securities, options and futures.
- 4.13 The list of controlled activities includes, for example, dealing in securities and contractually based investments, arranging deals in investments and managing investments.
- 4.14 In order to bring the relevant activities into scope, the government proposes to include certain unregulated cryptoassets in the list of controlled investments, and to amend a number of the current controlled activities.

The government's approach to controlled investments

- 4.15 This section explains how the government proposes to define relevant cryptoassets as controlled investments.
- 4.16 By adding unregulated cryptoassets to the list of controlled investments in Part 2 of Schedule 1 to the FPO, the financial promotion restriction would apply to any inducement or invitation to exercise any rights conferred by unregulated cryptoassets to acquire, dispose of, underwrite or convert the same (by virtue of section 21 of FSMA).
- 4.17 Our proposed definition of the unregulated cryptoassets to be covered by the FPO as controlled investments is:

"qualifying cryptoasset" means any cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and which —

(a) is fungible;

(b) is transferable or confers transferable rights, or is promoted as being transferable or as conferring transferable rights;

(c) is not any other controlled investment as described in this Part;

(d) is not electronic money within the meaning given in the Electronic Money Regulations 2011; and

(e) is not currency issued by a central bank or other public authority."

- 4.18 This excludes cryptoassets that are security tokens and which are already specified investments under the RAO. These will already be "controlled investments" under the FPO, and so limb (c) of the definition carves them out of the definition of "qualifying cryptoasset".

- 4.19 Limb (d) carves out e-money tokens, which already fall to be regulated under the Electronic Money Regulations.
- 4.20 The majority of stablecoins would either already be in scope of the FPO, as security tokens or e-money tokens, or would be caught under this new category of controlled investment.
- 4.21 Applying the financial promotions regime to too broad an array of cryptoasset activity could stifle innovation without a proportionate benefit to consumer protection.
- 4.22 Therefore, the government's proposed definition includes only those cryptoassets that are both fungible and transferable (i.e. both characteristics are required).
- 4.23 The concept of fungibility refers to an asset being freely replaceable by another of a similar nature or kind; some assets, such as fiat currency, are interchangeable. Any £5 note can be exchanged for another £5 note, as they are considered to be functionally equivalent. An asset that is interchangeable in this manner would be considered "fungible". A painting would be an example of an asset that is not interchangeable in this manner, and which would therefore be considered non-fungible.
- 4.24 In the government's estimation, these are the two critical features – fungibility and transferability – that make a cryptoasset significantly more likely to give rise to consumer protection concerns. Fungibility and transferability are core characteristics of money, as well as of a range of widely-used, regulated products, from stocks to bonds.
- 4.25 When consumers buy tokens with these characteristics, they are liable to buy them with similar expectations that consumers tend to have when purchasing regulated financial services. For example, because they are fungible and transferrable, consumers may expect them to hold a stable value, or rise in value, and they may expect that markets will be sufficiently deep and liquid to allow them to sell their holdings easily and quickly. The fact that this is generally not in fact the case in cryptoasset markets gives rise to risk.
- 4.26 Carving out non-fungible tokens excludes digital collectibles, such as Cryptokitties, which are traded as "non-fungible tokens" on the Ethereum blockchain.² The value of these products is perceived to be attributable to each token's unique characteristics and the utility it gives the token holder. Whilst such tokens can be accumulated speculatively, as high-risk purchases, or even used as a means of exchange, they are not readily interchangeable and the relative value of one token in relation to another, each being unique, is hard or impossible to predict. This limits the extent to which these tokens can be bought with the expectations described above (3.25), substantially reducing consumer risk. Therefore, bringing these products into financial services regulation would not be an appropriate treatment.
- 4.27 The exclusion of cryptoassets that are "not transferable" nor which "confer transferable rights" would exclude cryptoassets used within a closed system

² Where players "breed", collect, and sell token virtual cats.

where only redemption via the issuer, rather than transfer to other users, is possible. For example, were a supermarket customer loyalty scheme to exist on a DLT system, with the tokens analogous to loyalty points, the government has accepted that these would fall out of scope of regulation. These tokens would not be freely transferable outside the system. This limits the extent to which these tokens can be bought with the expectations described above (3.25), substantially reducing consumer risk. Therefore, it is appropriate to exclude them from the regime.

Q1: Do you have any comments on the proposed definition of qualifying cryptoassets?

Q2. Do you agree that the correct tokens have been excluded from scope under this proposal?

The government's approach to controlled activities

- 4.28 This section explains how the government has approached tailoring the relevant controlled activities.
- 4.29 The controlled activities that the government considers most relevant are:
- dealing in securities and contractually based investments
 - arranging deals in investments
 - managing investments
 - advising on investments
 - agreeing to carry on specified kinds of activity
- 4.30 The government therefore intends to amend these controlled activities so that they incorporate activities in relation to the buying, selling, subscribing for or underwriting of qualifying cryptoassets (the proposed definition of which is set out above).
- 4.31 The government has also examined whether the list of controlled activities needs to be amended to capture activities that may be unique to cryptoassets and pose a risk to consumers. The government's survey of cryptoasset activities identified the following:
- cryptoasset exchanges (where customers can buy, sell or exchange cryptoassets for fiat currency or other cryptoassets), cryptoasset ATMs (where customers can exchange cryptoassets into cash and vice versa)
 - airdrops (a distribution mechanism for delivering tokens, sometimes/often for free)
- 4.32 The government considers that these activities would already be covered by the current set of controlled activities as set out above in paragraph (3.29) as applied to qualifying cryptoassets to the extent that they facilitate the acquisition, disposal, underwriting or conversion of qualifying cryptoassets. The government therefore does not consider it necessary to amend the list of controlled activities any further than as proposed above. It is the government's view that activities that facilitate the purchase of cryptoassets would be in scope of those controlled activities; other activities in relation to

cryptoassets do not pose a serious consumer harm risk, and where possible the government aims to avoid unnecessary or disproportionate amendments to the regulatory perimeter. The government will however continue to monitor developments in this space.

Q3: In your view, which of the controlled activities in Part 1 of Schedule 1 to the FPO correspond most closely to activities undertaken by firms in the cryptoasset space? Which firms are undertaking these, and what services are they providing in particular?

Q4: Do you agree that the list of controlled activities under the FPO given at paragraph [3.29](#), above, best captures the activities undertaken by firms in the cryptoasset space which facilitate the buying, selling, subscribing for and underwriting of cryptoassets and whose activities are most associated with the risks this consultation seeks to mitigate? Do you agree that the government is therefore proposing to amend the correct set of controlled activities under the FPO?

Q5: In your view, would the activities described at paragraph [3.31](#), above, fall within scope of the FPO if the controlled activities under the FPO (particularly those at paragraph [3.29](#)) were amended to apply to cryptoassets? Are there other important activities undertaken by cryptoasset firms that pose similar risks in relation to the purchase of cryptoasset that are unlikely to be captured by the controlled activities the government proposes to amend (paragraph [3.29](#) above)?

Q6: Do you have any other comments on the proposed treatment of controlled activities?

The government's approach to exemptions

- 4.33** Parts IV-VI of the FPO contain numerous exemptions to the financial promotions restriction. For example, these allow potential investors to initiate inquiries, engage in follow-up communications, and exempt communications to institutional and sophisticated investors.
- 4.34** The government considers that exemptions for qualifying cryptoassets should generally be consistent with the approach taken to exemptions for other controlled investments.
- 4.35** The government examined the possibility that various exemptions could be combined to allow cryptoasset "white papers" for initial coin offerings (ICOs) to be distributed indirectly to vulnerable consumers without approval. ICOs are a form of fundraising involving the issuance of a new cryptoasset. The Cryptoassets Taskforce final report concluded that there was a risk that ICOs could be used for fraudulent purposes, and that white papers often contain misleading information. However, it was judged a low probability that the exemptions could be combined for this purpose, and that therefore regulatory amendments specifically to address this risk would be disproportionate.
- 4.36** Finally, the government proposes to add a new exemption to the FPO. The government wishes to ensure that vendors merely offering to accept cryptoassets in exchange for their goods or services, and buyers merely offering cryptoassets to pay for goods or services, in the same manner as they would accept pound sterling payments, are not captured under the

regime. Therefore, the government proposes to add the following exemption to the FPO:

- 4.37 “The financial promotion restriction does not apply to any communication which merely states that a person is willing to accept or to offer qualifying cryptoassets in consideration for the supply of goods or services.”

Q7: Do you have any views on the government’s proposed treatment of exemptions?

Consideration of other options

- 4.38 The government considered alternative options for addressing the consumer protection risks outlined at the outset of this document.
- 4.39 The government considered expanding the scope of the RAO to designate these assets as ‘specified investments’. This would require a firm to become an authorised person in order to carry out a range of cryptoasset activities (such as dealing in cryptoassets) – not just cryptoasset *promotions*. By becoming authorised the firm would be subject to FCA regulation and supervision when carrying out those activities. Further analysis is required to determine whether this is an appropriate and proportionate action. HM Treasury committed at Budget in March 2020 to consult on the UK’s broader regulatory approach to cryptoassets, including stablecoins, later in 2020. This option has not been ruled out ahead of that consultation. However, at present and pending further analysis of the market to fully assess its distinctive and still-evolving technological features and risks, the government is not pursuing this option at this time.
- 4.40 The government also considered whether to develop an approach based on industry self-regulation. Such an approach might involve firms using industry-drafted ‘codes of conduct’ or ‘best practice’ standards, potentially with the involvement of industry-created organisations providing oversight or independent standard-setting and accreditation of firms. However, the government’s view is that this approach would be inconsistent with the government’s approach to similar potential risks arising in the context of financial service promotions for mainstream financial services.
- 4.41 The government also considered whether to retain the status quo unchanged, using other regulatory bodies and consumer protection laws to address the issue outlined above. However, the government concluded that the status quo presents unacceptable risk to consumers. Further, it was considered that the financial regulatory framework and the FCA were most appropriate for addressing the problem, given the similarities – including in functions and risks – between cryptoassets and the range of products and activities currently regulated and supervised by the FCA.
- 4.42 As noted above, the government continues to consider broader regulatory measures to address other risks arising from the buying and selling of cryptoassets. The government has committed in the 2020 Budget to consult on broader regulatory treatment of cryptoassets later in 2020.

Q8: Do you agree with the government's assessment of the risks in the cryptoasset market, as summarised above and as outlined in detail in the Cryptoassets Taskforce report?

Q9: Do you agree with the government's assessment of alternative policy options?

Commencement date

4.43 The government does not propose to introduce a transitional period before the amendments to the FPO comes into force. The government expects that firms would have sufficient time to adjust their practices to comply during the lead time prior to the Statutory Instrument coming into force.

Q10: Do you have any views on the government's proposal not to provide for a transitional period?

Territoriality

4.44 The government does not propose to adjust the FPO's territorial scope, which currently applies to all firms in the UK and overseas which issue promotions to UK customers.

Q11: Do you have any views on the proposed approach to territoriality.

Q12: Do you have any additional comments to make on the proposed approach?

Chapter 5

Impact assessment

- 5.1 The government is seeking information from respondents about the impacts this policy would have on cryptoasset firms and users of cryptoassets, as well as broader impacts.
- 5.2 The below questions seek to draw out data points that the government thinks would be of most value in assessing the impact of the policy proposal above. Should the government take this policy proposal forward after consultation, having a detailed picture of the probable impacts would be vital.
- 5.3 The government would welcome your views across the below questions.

Impact assessment questions

#	Question
13	Promotion costs / challenges <ul style="list-style-type: none">a) How many promotions annually would you estimate that your firm would need to have signed off by a firm authorised under FSMA?b) Do you have an estimate of the costs of (or qualitative assessment of the challenges involved in) redesigning promotions to make them compliant with the law?c) Do you have an estimate of the costs of (or qualitative assessment of the challenges involved in) having promotions signed off by a firm authorised under FSMA?
14	Comparative impacts on firms <ul style="list-style-type: none">a) Do you anticipate that the proposed measure would impact some firms more than others? E.g. do some firms rely more heavily than others on promotions?
15	Market sizing and overall firm impacts <ul style="list-style-type: none">a) Do you have an estimate of the number of firms that would be affected by this measure?b) Do you have estimates of the value of the cryptoasset market in the UK?c) Do you have estimates as to the annual turnover and/or profits of the average firm that would be affected by this measure?

16	Consequences for UK market a) Do you have any views as to the impact that the above policy proposal, if introduced, would have on the cryptoasset market in the UK?
----	---

