

# The Banking Law Journal

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# Financial Promotion of Crypto Assets

*By James Tinworth and Jack Spence\**

*The United Kingdom has now brought “qualifying cryptoassets” into the regulatory ambit of the Financial Conduct Authority’s financial promotion regime. In this article, the authors explain the new rules, and advise cryptoasset businesses marketing to UK consumers, including firms based overseas, to get ready for the new regime.*

Until recently, the UK’s restriction on the marketing of financial services and products (the financial promotion restriction) did not apply to a number of digital assets. Certain types of cryptoasset (to use the UK regulators’ terminology) were caught by the previous financial promotion restriction.<sup>1</sup> However, the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2023 has now brought all “qualifying cryptoassets” into the regulatory ambit of the Financial Conduct Authority’s (FCA) financial promotion regime.

## BACKGROUND

The new rules took effect on October 8, 2023. Cryptoasset businesses marketing to UK consumers, including firms based overseas, must be compliant with this regime. Indeed, the FCA issued 146 alerts about Cryptoasset promotions on the first day of the new regime.<sup>2</sup>

Promotions that relate to qualifying cryptoassets that are not made using one of the permitted routes will be in breach of Section 21 of the Financial Services and Markets Act 2000 (FSMA), which is a criminal offence punishable by up to 2 years imprisonment.

It should be noted that the exemptions from the financial promotion restriction for “associations of high net worth or sophisticated investors” and for “sale of goods and supply of services” will not apply if the financial promotion relates to a qualifying cryptoasset.

A new temporary exemption has been introduced that will enable cryptoasset businesses registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the MLRs), who are not otherwise FCA authorized persons, to communicate

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<sup>1</sup> For instance, security tokens provide rights and obligations akin to shares, debt instruments or other securities, which are specified investments. This means that they are already caught by the existing financial promotion restriction.

<sup>2</sup> <https://www.fca.org.uk/publication/correspondence/letter-to-cryptoasset-firms-financial-promotions-regime.pdf>.

their own financial promotions in relation to qualifying cryptoassets. The intention is that, after the wider crypto regime is brought within the FCA's remit, this exemption will be removed, because cryptoasset businesses will need to be authorized by the FCA and will be able to communicate their own financial promotions without the need for this exemption.

### **“QUALIFYING CRYPTOASSETS”**

The new rules will apply to “qualifying cryptoassets.”

“Cryptoasset” means any cryptographically secured digital representation of value or contractual rights that (a) can be transferred, stored or traded electronically, and (b) uses technology supporting the recording or storage of data (which may include distributed ledger technology).

A “qualifying cryptoasset” is any cryptoasset which is (a) fungible; and (b) transferable.

The circumstances in which a cryptoasset is to be treated as “transferable” include where: (a) it confers transferable rights; or (b) a communication made in relation to the cryptoasset describes it as being transferable or conferring transferable rights.

A cryptoasset is not a “qualifying cryptoasset” if it is:

- (a) another controlled investment to which the financial promotion restriction applies;
- (b) electronic money;<sup>3</sup>
- (c) fiat currency;
- (d) digitally issued fiat currency; or
- (e) a cryptoasset that: (i) cannot be transferred or sold in exchange for money or other cryptoassets, except by way of redemption with the issuer; and (ii) can only be used in a limited way and meets one of the following conditions:
  - (aa) it allows the holder to acquire goods or services only from the issuer;
  - (ab) it is issued by a professional issuer and allows the holder to acquire goods or services only within a limited network of service providers which have direct commercial agreements with the issuer; or
  - (ac) it may be used only to acquire a very limited range of goods or services.

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<sup>3</sup> “Electronic money” has the meaning given by regulation 2(1) (interpretation) of the Electronic Money Regulations 2011(4).

“Qualifying cryptoassets” will be referred to as “Crypto Assets” in the remainder of this article, notwithstanding that some crypto assets (e.g. those that qualify as e-Money or regulated securities) fall outside of this definition).

## **NEW RULES FOR FCA AUTHORIZED FIRMS**

The FCA has also changed the rules that apply to the promotion of Crypto Assets by FCA authorized firms.

The FCA has also completed a separate consultation on guidance on how it approaches, and how authorized/registered firms comply with, its requirement that cryptoasset financial promotions must be fair, clear and not misleading. The FCA intends to publish fund guidance in the fall of 2023.

The FCA has categorized Crypto Assets as Restricted Mass Market Investments (RMMI), meaning that their marketing by FCA authorized firms to retail investors will be restricted. While the FCA accepted that there were a range of risk profiles in Crypto Assets, given the range of products out there, it remained of the view that Crypto Assets would likely only be suitable as a small part of a consumer’s diversified portfolio and should only be accessed when consumers understood the risks involved.

The following requirements, which are designed to ensure that investors are aware of the risks of investing in Crypto Assets, will therefore need to be met, in order for FCA authorized firms, including those firms operating under the interim exemption for firms registered under the MLRs, to market Crypto Assets to retail investors in the UK.

### **1) A Risk Warning and Risk Summary Must Be Included in A Financial Promotion for A Crypto Asset**

A risk warning, featuring prominently in a financial promotion, and inviting a consumer to access and review a risk summary setting out the risks relating to the risks of a particular investment, must be included with a financial promotion for a Crypto Asset.

*“Don’t invest unless you’re prepared to lose all the money you invest. This is a high-risk investment and you are unlikely to be protected if something goes wrong.”*

Where the financial promotion is, or is to be, communicated by way of a website, mobile application or other digital medium, the risk warning must also include a link in the form of the text: Take 2 mins to learn more, which, when activated, delivers the specified risk summary in a pop-up box (or equivalent) relating to the type of investment. Where the financial promotion is communicated other than by way of a website, mobile application or other digital medium,



the specified risk summary must be provided in a durable medium.

## 2) Incentives to Invest are Banned

Incentives to invest, such as “*refer a friend*” schemes, are not permitted, on the basis that they can unduly influence a consumer’s behavior. While benefits that are intrinsically bound in the Crypto Asset itself (such as the right to vote in a Decentralised Autonomous Organisation (DAO)) would not be considered to be an “*incentive*,” the FCA has clarified that the offering of additional “*free*” Crypto Assets would be likely to constitute an incentive. Additionally, the “*shareholder benefit*” exemption, whereby a product or service is provided by the issuer would fall outside of the scope of this ban, will not apply to Crypto Assets.

In respect of NFTs or other Crypto Assets which entitle the holder to an “*airdrop*” (where a new crypto asset is distributed, typically to holders of another qualifying asset, in order to promote an upcoming release) it may therefore be challenging to promote such assets under the FCA regime.

## 3) First Condition for DOFPs: A Cooling Off Period Before Being Able to Invest

A first-time consumer must be required to wait at least 24 hours between making an initial request to receive a DOFP relating to a Crypto Asset and being presented with a Direct Offer Financial Promotion (DOFP – an offer which also contains a means by which the consumer can request to actually invest, or specifies how to make such a request). This time period can run in parallel with the other onboarding steps, such as KYC checks and investor categorization, (see point 5 below) and is only required for the first investment made by the consumer.

## 4) Second Condition for DOFPs: A Personalized Risk Warning for First Time Investors

Before being presented with a DOFP for a Crypto Asset, a consumer will need to be presented with a personalized warning, to be displayed prominently (e.g. in a popup online) saying:

“[Client name], *this is a high-risk investment. How would you feel if you lost the money you’re about to invest? Take 2 mins to learn more.*”

Where the DOFP is, or is to be, communicated by way of a website, mobile application or other digital medium, the risk warning must also include a link in the form of the text: Take 2 mins to learn more, which,

when activated, delivers the specified risk summary in a pop-up box (or equivalent) relating to the type of investment. Where the DOFP is communicated other than by way of a website, mobile application or other digital medium, the specified risk summary must be provided in a durable medium.

#### **5) Third Condition for DOFPs: The Need to Categorize Clients Prior to A DOFP**

Before a DOFP relating to a Crypto Asset can be made to a consumer the consumer must be categorized as a Restricted, High-Net Worth or Certified Sophisticated investor. Unlike for other RMMIs, the Self- certified Sophisticated investor category is not available in respect of Crypto Assets.

#### **6) Fourth Condition for DOFPs: The Need to Consider The Appropriateness of The Crypto Asset**

Before processing a response to a DOFP (i.e. processing the order for the Crypto Asset), a firm must consider whether the particular Crypto Asset is suitable for the consumer, including assessing whether the consumer has sufficient knowledge and experience to understand the risks of the Crypto Asset they are purchasing. This will typically be determined by the consumer completing a “test.”

The FCA discourages the use of binary yes or no questions in this test, and requires a 24 hour waiting period before a test can be retaken after two failed attempts. Firms should attempt to ensure that questions are not repeated in subsequent tests, so that consumers cannot “game” the test, and firms should not inform consumers of the answers which had caused them to fail the test.

Even if a particular Crypto Asset has been deemed to be appropriate for a consumer, the firm should consider whether any subsequent Crypto Asset is sufficiently different in its characteristics and risk profile so as to require a further appropriateness assessment.

#### **7) The Need to Keep Records**

Firms promoting Crypto Assets must retain metrics relating to client categorization and the appropriateness assessments.