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Consultation on cryptoasset promotions
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Dear Sir or Madam

HMT cryptoasset promotions consultation (the "Consultation")

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

The Committee welcomes the opportunity to respond to the Consultation. This letter sets out the Committee's responses to the questions posed.

Question 1 - Do you have any comments on the proposed definition of qualifying cryptoassets?

We note that a definition of cryptoasset is already now included in article 14A(3)(a) of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the "**MLRs**") and a definition of "*unregulated transferable cryptoasset*" will be included in the FCA Handbook glossary from 28 October 2020 by virtue of the FCA's Policy Statement PS 20/10. Whilst the definition in the MLRs is considerably wider, the definition of unregulated transferable cryptoasset and the "*qualifying cryptoasset*" definition proposed in paragraph 4.17 of the consultation are very similar to, but slightly distinct from, one another. Whilst it is likely that many assets either will fall

within or outside both definitions, having two different definitions will, in the absence of a clear policy intention for the differences, lead to considerable confusion and uncertainty for consumers, promoters and also regulators in enforcing the different regimes. Similarly, given the slight difference between the final words in the MLR definition ("*and can be transferred, stored or traded electronically*") and the initial words in paragraph (b) of the definition in the consultation ("*is transferable or confers transferable rights*") there may be uncertainty as to whether there is a practical difference or firms, regulators or courts seeking to interpret these provisions alongside one another.

We also note that it is HM Treasury's intention to consult on the UK's broader regulatory approach to cryptoassets. When that consultation takes place, we are concerned that yet another definition may be advanced that would either add further confusion or necessitate a further change to the financial promotions regime. In the absence of a clear and urgent need to implement a regime to regulate cryptoasset financial promotions in isolation from that broader review, we believe that greater certainty and clarity would be gained by implementing any changes to the financial promotions regime at the same time as any changes to the regulatory perimeter, rather than addressing them in a consecutive manner.

Question 3 – In your view, which of the controlled activities in Part 1 of Schedule 1 to the FPO correspond most closely to the activities undertaken by firms in the cryptoasset space? Which firms are undertaking these, and what services are they providing in particular?

Please see our response to question 4 below.

Question 4 - Do you agree that the list of controlled activities under the FPO given at paragraph 4.29, [of the consultation document], 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?

Until the responses to the impact assessment questionnaire (which forms Chapter 5 of the consultation) are published, it is difficult to comment on whether the controlled activities identified in paragraph 4.29 of the consultation the most appropriate. Nonetheless, we agree that the activities identified in paragraph 4.29 do appear to be those most likely to capture the types of activity to which the consultation relates.

It is possible that the activity of safeguarding and administering investments could also be one that is performed by firms operating in this space however we do not consider it appropriate to include them within these legislative changes. The MLRs already include the activities of a "*custodian wallet provider*" which has a very different definition to that set out in paragraph 6 of Schedule 1 to the FPO. Any decision to include such wallet providers within the scope of FSMA would be better addressed as part of the broader perimeter review. Including it through an interim adjustment based solely on the FPO Schedule 1 definition would lead to confusion between the FPO regime, that set out under the MLRs, and the e-money regime (given that we anticipate that many businesses which would be operating custodian wallet services may also be e-money providers).

Question 5 - In your view, would the activities described at paragraph 4.31, [of the consultation], fall within scope of the FPO if the controlled activities under the FPO (particularly those at paragraph 4.29) 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 4.29 above)?

We agree with the consultation that the promotion of such activities would be brought within the scope of the financial promotion restriction in these changes were made. It is however not possible

to comment on what the consequences of such changes are (whether intentional or otherwise) until the text of the proposed legislation is made available.

We are not aware of any other important activities that pose similar risks. However, as we have already stated above, to the extent any such activities are identified (whether by the impact assessment or otherwise), we consider that this is better addressed as part of the broader review into the scope of the UK's regulatory perimeter.

Question 6 - Do you have any other comments on the proposed treatment of controlled activities?

As we discuss in more detail in response to question 9, we are concerned that by adopting a restriction on financial promotions without a corresponding change to the regulatory perimeter, there is considerable scope for confusion for both unregulated and regulated firms on the activities that they can (and cannot) perform, and for the broader regulatory implications of them doing so. In particular, by only making these changes through the schedule to the FPO, there are likely to be significant difficulties caused for the FCA in adopting their rulebook to accommodate this change that would give rise to a disproportionate effect when considered against delaying the implementation of these provisions until such time as the broader perimeter review has been concluded (this is discussed further in response to question 9 below).

Question 9 - Do you agree with the government's assessment of alternative policy options?

We appreciate that there is a desire for consumer protection with regard to the promotion by some persons of unregulated cryptoassets. However, we do not consider that the proposed approach will sufficiently achieve the objectives set out in paragraph 3.5 of the consultation. That paragraph sets out three areas of focus – with consumer protection sitting alongside market integrity and financial crime. The financial crime objective has already been addressed by the changes to the MLRs implementing the Fifth Money Laundering Directive, whilst the market integrity objective remains unaddressed by either this consultation or the MLR changes. Given that work in reviewing the broader regulatory perimeter has already seemingly commenced, we consider that it would be preferable to delay making these changes to the financial promotions regime until that broader review is complete and the changes can be made in the round. This would also help to reduce the risk of inadvertently causing confusion and giving rise to regulatory uncertainties in the proposed scope of the regime.

It is not clear from the consultation whether it is intended that authorised firms would be permitted to issue or approve financial promotions relating to the unregulated cryptoassets that would be brought within the scope of the financial promotion restriction. We appreciate that the FCA has made a clear policy statement with regard to prohibiting the promotion and distribution of investment products (such as CFDs) that reference cryptoassets to retail clients, but it is not clear whether such an approach would be extended to these unregulated cryptoassets themselves. Without knowing the intentions of government and the FCA in this regard, or seeing the text of the proposed legislation, it is difficult to comment in detail on the proposals set out in this consultation and their likely impact. However we have identified a number of areas where there is likely to be confusion or anomalous results. For example, if it was intended that an authorised firm could issue or approve communications relating to such assets, it is not clear how the provisions of Chapter 4 of the FCA's Conduct of Business Sourcebook would apply, since many of the provisions are reliant on the firm conducting designated business (which it would not be). We anticipate that the FCA would be required to make substantive and far-reaching changes to numerous provisions of its Handbook to accommodate a change that may be superseded in relatively short order were the broader perimeter regime to take place as is anticipated.

Similarly, if a business that was currently producing, distributing or otherwise trading in these types of cryptoassets wished to continue to market their services, it would not be possible for them to obtain a Part 4A licence from the FCA unless they also began performing services that were within

the scope of the regulatory perimeter. This would then give an unfair competitive advantage to those firms that were already performing regulated activities, at least until such time as the broader perimeter review took place and potentially allowed those other firms to obtain a licence under an expanded perimeter.

Given our concerns about the risk of overlapping or conflicting definitions and terminology, we would suggest that a sunset clause be included in any legislation that was passed to give effect to this narrower financial promotion regime review, such that the legislation was required to be revisited as part of that subsequent review.

Question 10 - Do you have any views on the government's proposal not to provide for a transitional period?

As we have mentioned above, it is not clear whether it is the government's or the FCA's intention to allow authorised firms to issue promotions for these types of cryptoassets and to approve communications for unauthorised persons to issue such promotions. If it is the intention that authorised firms will be permitted to issue and approve communications in such products, a transitional period should be included to allow persons operating in the cryptoassets space without a current authorisation to apply to become authorised persons. A related question then arises as to how a person operating in the unregulated cryptoasset space could become and authorised person if these changes were to go ahead in advance of the broader perimeter review. If a firm wished only to issue financial promotions and otherwise conduct activities in relation to such unregulated cryptoassets it would not be possible for them to apply for a Part 4A licence since they would not be performing any regulated activities. This would give a competitive disadvantage to those persons who perform activities solely in respect of unregulated cryptoassets compared to firms that are already authorised to perform currently regulated activities and who are also involved in the promotion of unregulated cryptoassets.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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