

25 October 2020

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



Dear Sir or Madam,

## Consultation on Cryptoasset Promotions

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In October 2018, the U.K.'s Cryptoassets Taskforce, comprising representatives from HM Treasury, the Financial Conduct Authority ("FCA") and the Bank of England, published a report (the "**Cryptoassets Taskforce Report**") assessing the potential benefits and risks arising from cryptoassets.<sup>1</sup> One of the risks identified in the Cryptoassets Taskforce Report was the possibility of misleading advertising and a lack of suitable information in cryptoasset markets. HM Government has proposed that the perimeter of the financial promotions regime is expanded to ensure that cryptoasset promotions are compelled to meet the same standards for fairness, clarity and accuracy that apply to the traditional financial services industry (the "**Cryptoasset Promotions Proposal**"). It has published a consultation on this proposal (the "**Cryptoasset Promotions Consultation**")

The Financial Services and Markets Act 2000 ("**FSMA**") provides the financial promotions regime in the U.K. Section 19 of FSMA sets out the general prohibition which provides that no person may carry on a regulated financial services activity in the U.K. unless they are "authorized" or exempt from the authorization regime. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "**RAO**") specifies the financial services activities that are subject to regulation.<sup>2</sup> Section 21 of FSMA contains the financial promotion restriction, which provides that an unauthorised person must not "communicate an invitation or inducement to engage in investment activity or claims management activity". The restriction does not apply if the communication is made or its content is approved by an authorised person, or if the financial promotion otherwise meets other conditions set out in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**FPO**"). The Cryptoasset Promotions Proposal, if adopted, will add cryptoassets to the list of controlled investments in Part 2 of Schedule 1 to the FPO and, as a result, the restriction in section 21 of FSMA will apply to unregulated cryptoassets.<sup>3</sup>

For this purpose, the Cryptoasset Promotions Proposal sets out the following definition of a "qualifying cryptoasset":

A "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;

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- 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.

Question 1 of the Consultation asks for feedback on the proposed definition. The FMLC would like to draw attention to concerns with regards the definition.

Terms such as “fungible” and “transferable” may not offer the specificity and certainty required to determine which cryptoassets fall within the proposed regime. “Fungibility”, in a financial services context, has traditionally referred to the interchangeability of an asset with another asset of the same type or with other goods. In a FinTech context, “fungibility” has a more specific and technical meaning.<sup>4</sup> Correlatively, a non-fungible token (“NFT”)—a special type of cryptographic token which represents something unique—has come to be understood to refer, most often, to crypto-collectible trading card games. The FMLC is aware, however, that token standards developed for this purpose are being used to create custom wallets that can hold fungible tokens (“FTs”) which can be traded and then wholly destroyed to claim their contents. Such products would arguably fall outside the proposed Cryptoassets Promotions regime.

Regardless of whether the token standard being used is one established for FTs, many cryptoassets are distinguishable by their issue date or registration number. In some cases, a greater value may be attached to “markers” of this kind. There is also no certainty that a non-fungible cryptoasset will remain non-fungible—or, indeed, that a fungible cryptoasset will retain that characteristic. It might be important for authorities to consider the probability that a cryptoasset’s fungibility may shift over time and consider how the proposed definition will apply in those circumstances.

In relation to a cryptoasset’s “transferability”, in particular, it may be important to note that there is not one uniform method by which cryptoassets are created and transferred. For example, the transfer of cryptoassets may not be analogous to the transfer of, say, shares or money. Some cryptoassets are transferred by novation. It is not clear whether such cryptoassets will fall within the definition.

More specificity in relation to the meaning of the terms used in the definition would be helpful. Perhaps it would be more helpful were HM Treasury to focus on specific types of cryptoassets, their function and effect rather than to define the category as a whole, which may not bring into scope all appropriate types of cryptoassets and may give rise to opportunity for arbitrage. It may be easier to focus, for example, on asset-referenced tokens. This is the approach proposed by the European Commission in its Digital Finance Framework Package, published on 24 September 2020.<sup>5</sup>

The FMLC’s second observation relates more generally to attempts being made around the world to define cryptoassets for the purposes of regulation. A first attempt at defining cryptoassets was made by the E.U. in Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the “**Fifth Money Laundering Directive**” or “**5MLD**”).<sup>6</sup> This definition has been transposed into U.K. law. Section 14A of the Money Laundering,

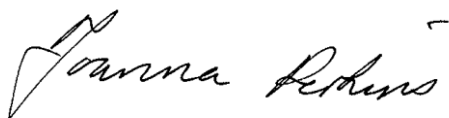
Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, as amended, provides that a “cryptoasset” is

a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically.

The FCA has also suggested a definition of “unregulated transferable cryptoassets” in relation to its policy on the sale to retail clients of investment products that reference cryptoassets.<sup>7</sup> The definition will be inserted into the FCA’s Handbook and will come into force on 28 October 2020.<sup>8</sup> While the FMLC is certainly in favour of clear regulation in respect of cryptoassets, it would encourage authorities to consider the uncertainty which might be caused by a proliferation of sometimes-conflicting or overlapping definitions.<sup>9</sup>

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

A handwritten signature in black ink that reads "Joanna Perkins". The signature is written in a cursive style with a large initial 'J' and a small flourish at the end.

Joanna Perkins  
FMLC Chief Executive<sup>10</sup>

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<sup>1</sup> HM Government, *Policy paper: Cryptoassets Taskforce: Final Report*, (October 2018), available at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752070/cryptoassets\\_taskforce\\_final\\_report\\_final\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf)

<sup>2</sup> 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”).

<sup>3</sup> The Cryptoassets Taskforce Report also suggested that cryptoassets be categorised as: (1) exchange tokens, which are used as a means of exchange or for investment; (2) security tokens, which provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits; and (3) utility tokens, which can be redeemed for access to a specific product or service, typically provided using a DLT platform.<sup>3</sup> In a July 2019, Policy Statement, the FCA added a new category—that of “E-money tokens”—and combined the exchange and utility token categories to create a new category—“unregulated cryptoassets”—which would refer to all tokens that are not security tokens or e-money tokens.<sup>3</sup> Under existing regulation, security tokens falling within the regulatory perimeter 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.

<sup>4</sup> For example, the Legal Statement published by the U.K. Jurisdiction Taskforce in November 2019 examined the characteristics of cryptoassets and noted that the very premise of blockchain technology is that cryptoassets are, in essence, unique. “Fungibility”, as associated with securities, is a characteristic of deliberate legal design. On the contrary, cryptoassets are for the large part not legal creations by design and therefore most will lack this characteristic. In cases where cryptoassets are treated as identical to each other and interchangeable, it is by virtue of consensus between network users. See: U.K. Jurisdiction Taskforce of the LawTech Delivery Panel, Legal statement on cryptoassets and smart contracts (November 2019), available at: [https://35z8e83m1ih83drye280o9d1-wpengine.netdna-ssl.com/wp-content/uploads/2019/11/6.6056\\_JO\\_Cryptocurrencies\\_Statement\\_FINAL\\_WEB\\_111119-1.pdf](https://35z8e83m1ih83drye280o9d1-wpengine.netdna-ssl.com/wp-content/uploads/2019/11/6.6056_JO_Cryptocurrencies_Statement_FINAL_WEB_111119-1.pdf)

The FMLC has also examined this in 2016. FMLC, *Virtual Currencies* (June 2016), available at: [http://fmlc.org/wp-content/uploads/2018/03/virtual\\_currencies\\_paper\\_-\\_edited\\_january\\_2017.pdf](http://fmlc.org/wp-content/uploads/2018/03/virtual_currencies_paper_-_edited_january_2017.pdf)

<sup>5</sup> European Commission, Communication: Digital Finance Package (24 September 2020), available: [https://ec.europa.eu/info/publications/200924-digital-finance-proposals\\_en](https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en). This formed the basis for the first draft of a Regulation on Markets in Cryptoassets (“MiCA”), published by the European Commission last month.

<sup>6</sup> The FMLC has commented on both the Directive and its transposition in the U.K. to draw attention to unintended and unhelpful consequences arising from the limitations included in that definition. See: FMLC, *Report: Exchange Tokens* (23 October 2019), available at: <http://fmlc.org/report-exchange-tokens-23-october-2019/> and FMLC, *Letter to HM Treasury on 5MLD and Cryptoassets* (30 July 2019), available at: <http://fmlc.org/letter-to-hm-treasury-on-5mld-and-cryptoassets-30-july-2019/>.

<sup>7</sup> FCA, Policy Statement 20/10: Prohibiting the sale to retail clients of investment products that reference cryptoassets (PS20/10), (6 October 2020), available at: <https://www.fca.org.uk/publication/policy/ps20-10.pdf>

<sup>8</sup> An “unregulated transferable cryptoasset” is

a cryptographically secured digital representation of value or contractual rights that uses distributed ledger technology and which:

- a) is capable of being traded on or transferred through a platform or other forum;
- b) is not limited to being transferred to its issuer in exchange for a good or service, or to an operator of a network that facilitates its exchange for a good or service;
- c) is not electronic money;
- d) is not a specified investment;
- e) is not a representation of ownership or other property right in a commodity; and
- f) is not money issued by a central bank.

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<sup>9</sup> In addition, the draft MiCA published by the European Commission provides definitions on what constitutes a cryptoasset as well as various token sub-categories. The U.K. will withdraw from the E.U. before MiCA will come into force and so it will not be automatically implemented in the U.K.

<sup>10</sup> The FMLC is grateful to Etay Katz (Allen & Overy LLP) for reviewing this letter.