

CLIENT ALERT

UK financial promotion regime extended to marketing of cryptoassets to UK consumers

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Introduction and background

The FCA's objective is to ensure that UK consumers only invest in cryptoassets if they understand the risks involved and are prepared to lose the money invested. The FCA is concerned that cryptoasset advertising is often targeted at retail investors and there have been several cases where the adverts were misleading, where adverts offered high rates of return with no evidence as to how the rates of return could be achieved. Investors have incurred significant losses, for example, in relation to complex products such as the algorithmic stablecoin project Terra/Luna. Such investors are generally not subject to protection from the Financial Service Compensation Scheme or the Financial Ombudsman Service if something goes wrong. The FCA wants to ensure that consumers are not pressured, misled or inappropriately incentivised to invest.

Accordingly, from 8 October 2023, the UK financial promotion regime will apply to all firms marketing cryptoassets to UK consumers, regardless of whether the firm is based in or outside the UK and regardless of what technology is used to make the promotion. A financial promotion can apply to a wide range of communications including its website, mobile apps, social media posts and online advertising.

The FCA published on 8 June 2023 the near final rules that will apply in a Policy Statement (PS23/6) to give firms time to prepare for compliance with this regime. Further changes are not expected to what has been published and the rules are expected to take effect on that basis from 8 October 2023. A Guidance Consultation (GC23/1) which provides further clarity on the standards expected to ensure that financial promotions are fair, clear and not misleading was also published and will be finalised this Autumn.

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The FCA will consider the new rules a success if it results in fewer consumers investing in cryptoassets who have a low risk tolerance or who are vulnerable. The FCA expects fewer firms that are not authorised or registered with the FCA will promote cryptoassets to UK consumers.

The New Rules

The new rules will require that any communication which invites or induces a person in the UK to buy or sell “qualifying cryptoassets” will be within the scope of the regime and referred to subsequently in this briefing as cryptoassets for ease.

A qualifying cryptoasset is broadly “*any cryptographically secured digital representation of value or contractual right that is transferable and fungible*”. It does not include electronic money, investments (such as securities, funds and derivatives and security tokens), fiat currency, including fiat currency issued in digital form and NFTs.

Under the new rules there will be 4 routes to legally promoting cryptoassets to UK consumers:

- The promotion is communicated by a firm authorised by the FCA
- The communication is made by an unauthorised person (such as non-UK firms) but is approved by a UK authorised firm
- The communication is made by a cryptoasset business registered under the UK Money Laundering Regulations; or
- The promotion is made in compliance with an exemption to the UK’s financial promotion rules.

Note that for firms authorised only under the Electronic Money Regulations or the Payment Services Regulations, they are not considered as “authorised persons” for this purpose. In relation to promotions for cryptoassets which are available to UK consumers, it is unlikely that there will be an applicable exemption available, including exemptions for high net worth individuals and self-certified sophisticated investors that are otherwise available for certain types of investments.

The FCA will apply a consistent approach to the rules relating to the promotion of other high-risk investments to UK consumers, specifically the rules that apply to “Restricted Mass Market Investments” (“RMMI”s). Broadly, RMMIs include investments such as unlisted shares and bonds and P2P agreements. RMMIs can be marketed to UK retail investors, subject to certain restrictions.

In addition to the overarching requirement that a financial promotion be fair, clear and not misleading, there will be restrictions on the promotions including clear risk warnings, banning incentives to invest, positive frictions (such as a cooling-off period), client categorisation requirements and appropriateness assessments. The FCA considers such restrictions appropriate given recent high-profile failures of firms operating in the cryptoasset market.

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In responses to consultation on the rules, some respondents argued for a more differentiated approach to take account of the different risk profiles of different types of cryptoasset, however the FCA has determined to apply the same rules to all types.

Risk Warnings

To ensure that consumers understand the risks involved, specific prescribed risk warnings must be included within the financial promotion together with a risk summary which can be adjusted to reflect the specifics of the cryptoasset being promoted.

Banning incentives to invest

A benefit that is not intrinsic to the cryptoasset, or exclusively bound up with its function or business model, and which is used as an incentive to motivate a consumer to buy that cryptoasset - such as the offer of “free” additional cryptoassets, is not allowed.

Additional requirements for Direct Offer Financial Promotions

Additional requirements apply to “Direct Offer Financial Promotions” (“**DOFP**”). A DOFP is a financial promotion that contains: (a) *an offer by a firm or another person to enter into a “controlled agreement” with any person who responds to the communication, or (b) an invitation to any person who responds to the communication to make an offer to the firm or another person to enter into a “controlled agreement”*. This would include a promotion with a “buy now” button or anything that promotes an investment and contains a mechanism which enables a consumer to place their money in that investment is likely to be a DOFP.

For first-time investors with a specific firm, a cooling-off period of 24 hours will apply to enable investors to consider whether the investment is appropriate for them. This period can be included as part of the onboarding process of a customer. In addition, the DOFP is to include a personalised risk warning pop-up for first time customers.

Before a DOFP can be made, the consumer must be categorised as either a High Net Worth, Certified Sophisticated or Restricted Investors and receive statements from the investor in a prescribed form for the applicable category and the firm must assess the proposed cryptoasset as appropriate to the consumer, including an assessment of the client’s knowledge and experience of this type of product. This can also be conducted as part of the firm’s onboarding.

If a firm breaches the rules, the FCA has a number of options as to the actions it can take, including requesting firms to take down websites that are in breach, placing firms on a warning list and placing restrictions on firms to prevent harmful promotions and other enforcement action. Unauthorised firms that communicate financial promotions in breach of the rules is a criminal offence punishable by unlimited fines and/or up to 2 years in jail.

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Next steps

All firms marketing cryptoassets to UK consumers, including those outside the UK will need to prepare for this regime and consider which of the 4 routes referred to above they will use to lawfully communicate the promotion. UK authorised firms which intend to approve cryptoasset communications must notify the FCA of their intention to do so and ensure they have the appropriate competence and expertise to do so. Such firms will also be mindful of the FCA's proposals subject to future legislation which will require authorised firms to pass through a regulatory gateway before they can approve financial promotions. This will clearly increase the cost and burden to firms of marketing cryptoassets to consumers in the UK. Authorised firms may be unwilling to approve communications to be made by unauthorised firms given the obligations imposed on firms approving financial promotions in addition to having to take into account the new Consumer Duty which firms must comply with from 31 July 2023. The Consumer Duty includes additional rules requiring authorised firms to act to deliver good outcomes for retail customers, including in relation to the price and value of products, consumer understanding and availability of consumer support.

The FCA states that the rules are not intended to prevent consumers from buying or selling these types of investments but to protect consumers by ensuring they understand the risks.

If you have any questions regarding this client alert, please contact the following attorney or the Willkie attorney with whom you regularly work.

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