

Article Information

Authors: Michael Bacina, Tom Skevington

Service: Blockchain, FinTech

Sector: Financial Services

UK Treasury proposes plan to protect retail investors from digital asset promotions

The UK government is consulting on proposals to significantly expand the perimeter of its financial promotions regulations to explicitly include digital asset promotion.

The [Financial Conduct Authority's \(FCA\)](#) and broader UK Cryptoasset Taskforce has expressed a view that cryptoasset promotions should be held to the same high standards for that apply to the traditional financial services industry. This is a significant propose shift in approach for the UK, and one that will be watched closely.

The rationale for the proposal originally comes from the [UK Cryptoassets Taskforce final report](#), published in October 2018. The report included a finding that digital asset advertising is often targeted at retail investors, but is typically unclear and can be misleading. The report went on to find that:

"[a]dverts often overstate benefits and rarely warn of volatility risks, the fact consumers can both grow and lose their investment, and the lack of regulation"

Since the publication of the October 2018 report, the FCA has commissioned further research which highlighted the following key conclusions:

1. a statistically significant increase from 3% in the 2019 FCA Consumer Research to 5.35% this year in those who hold or held digital assets. This represents an increase of 2.35 percentage points, from approximately 1.5 million people to 2.6 million people;
2. a minority (17%) of current and past digital asset owners reported having had a negative experience in relation to buying or owning digital assets, amounting to approximately 450,000 owners; and
3. The changing profile of digital asset holders shows a higher number of older users.

The consumer protection risk identified in the October 2018 report, as well as the findings above, have informed the UK government's view that market intervention is necessary.

The consultation report confirms that:

"Currently, security tokens that fall within the regulatory perimeter of the [Financial Services and Markets Act 2000 (Regulated Activities) Order 2001] RAO are captured by the [Financial Services and Markets Act 2000 (Financial Promotion) Order (2005)] FPO as "controlled investments", and e-money tokens are regulated separately under Electronic Money Regulations 2011 (the EMoney Regulations). Promotion of either is subject to the financial promotions regime. Unregulated cryptoassets are not subject to similar regulation."

However, the consultation proposes adding a new definition of "qualifying cryptoasset" under the FPO, making digital assets subject to the same promotion restrictions as conventional financial products.

The proposed definition of "qualifying cryptoasset" is remarkably broad:

“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.”

This may be contrasted with the definition of digital currency under the Australian [GST Act](#) which defines digital currency as:

“units of value that: (a) are designed to be fungible; and (b) can be provided as consideration for a supply; and (c) are generally available to members of the public without any substantial restrictions on their use as consideration; and (d) are not denominated in any country’s currency; and (e) do not have a value that depends on, or is derived from, the value of anything else; and (f) do not give an entitlement to receive, or to direct the supply of, a particular thing or things, unless the entitlement is incidental to: (i) holding the digital units of value; or (ii) using the digital units of value as consideration; but does not include: (g) money; or (h) a thing that, if supplied, would be a financial supply for a reason other than being a supply of one or more digital units of value to which paragraphs (a) to (f) apply”

or the definition of digital currency under the [Anti-Money Laundering and Counter Terrorism Financing Act](#):

“digital currency means: a) a digital representation of value that: (i) functions as a medium of exchange, a store of economic value, or a unit of account; and (ii) is not issued by or under the authority of a government body; and (iii) is interchangeable with money (including through the crediting of an account) and may be used as consideration for the supply of goods or services; and (iv) is generally available to members of the public without any restriction on its use as consideration; or (b) a means of exchange or digital process or crediting declared to be digital currency by the AML/CTF Rules; but does not include any right or thing that [AUSTRAC exclude as digital currency].”

While the consultation recognises that *“applying the financial promotions regime to too broad an array of cryptoasset activity could stifle innovation without a proportionate benefit to consumer protection”*, this definition seems likely to capture almost all digital assets other than non-fungible collectible tokens, such as CryptoKitties or Neds Horses. For example a loyalty point which is managed via a cryptotoken would fall within this definition.

The consultation goes on to suggest that:

“When consumers buy tokens with these characteristics [fungibility and transferability], they are liable to buy them with similar expectations that consumers tend to have when purchasing regulated financial services”

While the report suggests that the proposed definition would *“exclude cryptoassets used within a closed system”*, such as a hypothetical supermarket customer loyalty scheme on a DLT system, with tokens analogous to loyalty points, much will turn on any final wording in a legislative instrument.

The focus on regulation of promotion and marketing conduct rather than the underlying offering is similar to ASIC’s predominant focus in Australia in preventing misleading and deceptive conduct in relation to digital asset products and offerings.

In ASIC’s [INFO 225](#), ASIC has emphasised that conduct that may be misleading or deceptive to consumers can include:

1. stating or conveying the impression that the ICO or digital assets offered are not a financial product if that is not the case;
2. stating or conveying the impression that a digital asset trading platform does not quote or trade financial products if that is not the case;
3. using social media to generate the appearance of a greater level of public interest in an ICO or digital asset;
4. undertaking or arranging for a group to engage in trading strategies to generate the appearance of a greater level of buying and selling activity for an ICO or digital asset;

5. failing to disclose adequate information about the ICO or digital asset; or
6. suggesting that the ICO or digital asset is a regulated product or the regulator has approved the ICO or digital asset if that is not the case.

ASIC has more recently been [targeting responsible entities of managed investment schemes](#) over concerns that funds were providing inadequate information or were not accurately and clearly presenting key features of their investment products. In particular:

1. *Unbalanced comparisons* – comparisons focusing on one aspect of a fund (e.g. higher returns), without providing a fair and balanced indication of key differences and risks;
2. *Safety and stability representations* – promoting the funds as having little or no risk of capital loss, despite the fund's underlying assets being subject to considerable risk and market volatility; and
3. *Withdrawal representations* – giving the impression to consumers that it is easy to withdraw funds on short notice, where the liquidity of the fund assets does not support this claim.

As more digital asset providers and DAO's expand into regulated offerings, considering whether their marketing and promotion efforts go beyond providing information and into encouraging FOMO will become increasingly important. Sound legal advice will continue to be critical.

Submissions remain open for the consultation until 25 October 2020 and may be emailed to crypto.finproms@hmtreasury.gov.uk.