



Client Alert: **Marketing Cryptoassets to Consumers in the UK**

29 June 2023

Introduction

The U.K.'s Financial Conduct Authority (“**FCA**”) will introduce new rules later this year for those marketing cryptoassets to U.K. consumers. The new “near final” rules include a “cooling-off” period for first-time consumers and will bring “qualifying cryptoassets” into the scope of the FCA’s “financial promotion regime.”

Under section 21 of the Financial Services and Markets Act 2000, a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless authorised to do so by the FCA or the communication is approved by a person authorised to do so (known as the “financial promotion restriction”). Breach of the financial promotion restriction is a criminal offence (with the possibility of unlimited fines and/or imprisonment) and any agreement resulting from such promotion may be unenforceable.

The new requirements will cover financial promotions for all firms aimed at U.K. consumers, regardless of where the promoter is based (i.e. also covering firms outside the U.K. targeting U.K. consumers) or what technology is used.

Which cryptoassets are affected by the new rules?

For these purposes a “qualifying cryptoasset” is any cryptographically secured digital representation of value or contractual rights that is transferable and fungible but does not include e-money (as defined), nor an existing controlled investment. Those assets excluded from these new rules are:

- those already specified to be “controlled investments” under the financial promotions rules (e.g. shares, units in collective investment schemes, options and futures);
- electronic money;
- fiat currency;
- fiat currency in digital form;
- cryptoassets that cannot be transferred or sold in exchange for money or other cryptoassets except by way of redemption by the issuer; and
- cryptoassets issued by a professional issuer and which allow the acquisition of goods from a limited network of service providers which have direct commercial agreements with the issuer.

Why is this relevant to cryptocurrency entrepreneurs seeking to do business in the UK?

The definition of “qualifying cryptoassets” to be covered by the new rules, detailed more particularly below, is very broad and captures both more-decentralised systems, such as Bitcoin and Ethereum, as well as more centralised systems with central issuers such as issuers of garden-variety cryptocurrency ICOs. Non-fungible products such as art NFTs are likely not captured by the regulation although whether a particular product is or is not affected by the incoming rules is a fact-driven analysis that will require specific advice.

Additionally, by placing such a wide range of cryptoassets under the existing financial promotion regime, described more particularly below, the FCA will likely capture a much broader range of communications than investment prospectuses,

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tube and radio advertisements and pitch decks. For example, it is common practice in the cryptocurrency industry to sponsor in-person events like meetups and hackathons, and to have employees and founders present at conferences or join podcasts as guests.

Anyone engaging in seemingly innocuous and hitherto entirely normal cryptocurrency promotion activities in the course of business, where these communications might be seen by a U.K. consumer, will, going forward, need to exercise extreme caution and ensure that they and their organization adheres to the new rules strictly. Although the U.K. has not, thus far, taken the course the U.S. has (i.e. forcing cryptocurrency companies to register their tokens as securities), with these new rules, the U.K. is effectively creating a disclosure regime which will regulate the conduct of any person who markets cryptocurrencies to U.K. consumers in much the same manner as the U.K. regulates the promotion of securities.

Legal promotions of cryptoassets

There will be four routes to legally promote qualifying cryptoassets to U.K. consumers:

- (1) the communication is made by an FCA-authorised firm;
- (2) the communication is approved by an authorised firm that has passed through regulatory gateway legislation (which is currently with Parliament);
- (3) the communication is made by or on behalf of a cryptoasset business that is registered with the FCA (under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017) but which is not otherwise authorised by the FCA; or
- (4) the communication falls under an exemption in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (“FPO”). Note that existing FPO exemptions for promotions to high-net-worth individuals and self-certified sophisticated investors will not apply to cryptoassets, and the U.K. government is also carving out exemptions for associations of high-net-worth or sophisticated investors and promotions in association with the sale of goods and supply of services, unless an exemption applies under the FSMA (Financial Promotion) Order 2005 (“FPO”).

Firms outside the UK

Cryptoasset businesses outside the U.K. are likely to be most impacted by these changes to the law.

Communications originating outside of the United Kingdom will be caught by the financial promotion rules if they are “capable of having an effect in the United Kingdom.”

Of the four legal options to promote cryptoassets set out above, options 1. and 3. above are unavailable if the overseas firm does not have a U.K. presence and option 4. will generally be unavailable if you want to market to retail consumers. Option 2. may also be a challenge because the pool of potential approvers is likely to be very small given that approvers need appropriate product expertise as well as specific permission from the FCA.

Exemptions

There will be a new exemption to permit crypto exchanges and crypto custodians (e.g., wallet providers) that are registered with the FCA under the Money Laundering Regulations 2017 to promote their own services without the approval of a fully FCA-authorised firm. Those relying on this exemption won't be able to approve financial promotions or to communicate their own financial promotions in relation to other controlled investments. It also won't allow them to approve financial promotions for other businesses.

Unlike the other types of financial promotion, there is no exemption from the cryptoasset restriction for promotions to high-net worth individuals and self-certificated sophisticated investors. Promotions of cryptoassets to associations of high-net-worth or sophisticated and in respect of the sale of goods and supply of services will also not be available.

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Risk Warnings and Summaries

The new rules include requirements for risk warnings, including wording, prominence, and a link to a risk summary. How prominent the warnings need to be will be dictated by the form of marketing – for example, digital promotions should not require consumers to take any further steps in order to see the full risk summary after they have clicked on the hyperlink in the risk warning. The FCA have suggested the following form of risk warning:

“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. Take 2 mins to learn more.”

In addition to the above language, a personalised warning for first-time investors must also be given, before communicating any promotion of a cryptoasset. The FCA have proposed the following warning:

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

In each of the above two cases, the ‘Take 2 min to learn more’ statement must link to a product-specific risk summary.

There must be a minimum 24-hour cooling-off period for first-time investors. Such 24-hour period commences when the customer asks to view the Direct Offer Financial Promotion (“**DOFP**”) – a defined term which is likely to capture almost all financial promotions. A firm would be prevented from making a DOFP unless the customer has reconfirmed their request to proceed after the end of the cooling-off period.

Firms will now also need to conduct adequate due diligence on those persons to whom they are marketing and ensure their promotions are fair, clear, and not misleading.

Other Restrictions

1. Incentives to invest, such as “refer a friend” and new joiner bonuses, are now prohibited.
2. There must be a “cooling off” period of 24 hours between the consumer receiving a direct offer financial promotion and the consumer being able to invest.
3. There are new requirements for personalised risk warning pop-ups.
4. Appropriateness rules for promotions are now more robust, so consumers’ knowledge and experience are thoroughly vetted.

To help firms understand the incoming standards, the FCA has released draft guidance on cryptoasset promotions. The guidance focuses on the core requirement for financial promotions to be fair, clear and not misleading. It also considers specific scenarios such as staking arrangements, stablecoins and cryptoassets with complex yield models.

Compliance

If you operate in this sector you will need to ensure you are compliant before 8 October 2023. This will include ensuring that:

1. your marketing communications are compliant;
2. your website is compliant, including possible changes to your process for onboarding new consumer clients to allow them the requisite 24-hour cooling-off period;
3. your social media strategy and apps are compliant when discussing or promoting their products via such channels; and
4. you record relevant metrics setting out how you have classified your clients and how you have ensured that only appropriate communications were made.

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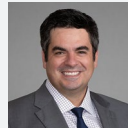
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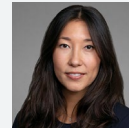
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