IRSG
INTERNATIONAL REGULATORY STRATEGY GROUP

International Regulatory Strategy Group (IRSG)

RESPONSE TO FINANCIAL CONDUCT AUTHORITY DISCUSSION PAPER (DP25/1): REGULATING CRYPTOASSETS

Introduction

The International Regulatory Strategy Group (IRSG) is a joint venture between TheCityUK and the City of London Corporation. Its remit is to provide a cross-sectoral voice to shape the development of a globally coherent regulatory framework that will facilitate open and competitive cross-border financial services. We welcome the opportunity to respond to the Financial Conduct Authority (FCA) Discussion Paper (DP25/1): 'Regulating Cryptoasset Activities'.

This discussion paper (DP) marks a pivotal moment in shaping the regulatory direction and framework governing cryptoasset markets in the UK. Overall, we welcome steps to develop a clear and proportionate regulatory framework for cryptoasset activities that supports a flourishing digital assets industry in the UK and global leadership in financial innovation. We recognise the FCA's intent to provide greater clarity and consumer protection, while enabling market access and innovation. However, we ask that the FCA considers the points below, which require clarification and refinement, to ensure an effective, proportionate and internationally competitive regime.

We wish to thank Clifford Chance LLP for their support in drafting this response.

In summary:

- **Clarity on the intentions and outcomes**: Some aspects of this DP require greater clarity, in particular, the proposals for authorising overseas cryptoasset trading platforms serving UK retail clients via branches. A clearly defined regulatory perimeter is vital to avoid unnecessary complexity for firms and ensure an effective and competitive regime.
- **Alignment with existing regime**: Where appropriate, the regulatory approach to cryptoassets should reflect the established principles and permissions that apply to traditional financial instruments. While recognising the unique characteristics of cryptoassets, the regime should avoid imposing requirements that go beyond what is expected for traditional assets, unless justified by specific risks, thereby promoting fairness, legal clarity, and operational continuity across markets.
- **Minimising disruptions to existing cryptoasset activities**: While some of the FCA's proposals are legally sound and accepted in traditional markets, the FCA must ensure that future rules reflect current cryptoasset market practice and carefully consider any unintended consequences or undue disruption that new rules may present in practice due to the unique nature of cryptoassets markets.
- **A balanced and proportionate regulatory approach**: The FCA must ensure that the future UK regulatory regime for cryptoasset activities is proportionate, risk-sensitive, and outcomes-focused, recognising the diverse nature of firms and business models in the sector. The framework should be designed to deliver appropriate consumer protections and uphold market integrity, while avoiding the imposition of undue burdens or disproportionate liability

on either the customers or firms. This is vital to support UK-based innovation and avoid driving future activity overseas.

- **International alignment and competitiveness**: The FCA must establish a regulatory framework that recognises the decentralised nature of the cryptoasset market, where activities often flow across multiple jurisdictions. The FCA should avoid creating excessively stringent rules that could disadvantage UK-based market participants compared to those operating under international standards. Where possible, pursuing international interoperability will prevent market fragmentation and reduce the risk of regulatory arbitrage, fostering a unified and efficient regulatory environment that helps the UK maintain its competitive edge in the international crypto market. As divergent international approaches emerge, the UK must position itself as a central hub that holds liquidity in a diverse range of robust cryptoassets issued worldwide.

Points for consideration

<u>Cryptoasset Trading Platforms</u>

Authorisation models & regulatory framework

The FCA's proposals concerning the authorisation of cryptoasset trading platforms serving UK retail clients via branches require further clarity. While the DP strongly pushes against the notion of non-UK firms operating “a predominantly UK business from an overseas jurisdiction” and advocates a subsidiary and branch model, it keeps the door open for an alternative. While the FCA appears open to arrangements involving a UK branch operating alongside a local broker, it remains unclear why a cryptoasset service provider would opt for dual authorisation and what commercial rationale might be behind this decision. It is also uncertain whether compliance obligations for such branches will be clearly codified or determined on a case-by-case basis. According to the proposed changes to the financial services perimeter and accompanying policy note, the policy intention is that overseas firms that do not service UK authorised firms would not trigger authorisation requirements. As such, it would be open to UK authorised firms to intermediate access to their global trading venues, without having to establish a branch.

There is also currently a lack of clarity around how prudential supervision will work for overseas firms operating in the UK through a branch. The DP explicitly states in the home/host section that prudential capital requirements, systems and controls for operating the trading system, and relevant governance requirements for the overseas entity would remain the exclusive responsibility of the home regulator. However, it remains unclear whether this responsibility will rest with the firm’s home country regulator or if firms will need to agree bespoke arrangements with the FCA. The FCA should also indicate when it expects to publish a list of “home regulators” with comparable levels of protection and regulatory standards to support this approach.

The FCA appears to suggest that firms should assume they are subject to the full set of UK prudential rules and then justify why certain rules may not apply afterwards. This creates uncertainty for firms and risks unnecessary complexity, as they may end up designing their operations around requirements that ultimately are not relevant or appropriate.

Proprietary trading & legal separation

The FCA's proposal to prohibit proprietary trading by Cryptoasset Trading Platform (CTP) operators off platform, and to prevent affiliated entities from trading on the same venues mark a significant departure from established practice in traditional markets, where multilateral trading facility (MTF), operators would be allowed to trade as principal off venue and where affiliates may participate under appropriate governance and control arrangements.

In addition, while the principles underpinning conflict management are sound, the application in crypto markets requires nuance, given the unique nature of these markets. It is unclear whether requiring legal separation offers any material benefit beyond what can already be achieved through strong internal conflict of interest management, including operational and informational barriers. These existing information barriers and governance structures may be sufficient without requiring legal separation, while mandating structural separation may push firms offshore and reduce UK oversight. Therefore, this approach risks imposing disproportionate restrictions on cryptoasset business models, potentially undermining market efficiency without delivering a clear corresponding regulatory gain.

It is also important that the FCA consider international standards, such as those set by the International Organisation of Securities Commissions (IOSCO), to ensure consistency and reduce regulatory arbitrage.

Settlement process

While the FCA recognises that settlement in cryptoasset markets differs from traditional securities markets, its proposals do not fully reflect current market practice. In most cases, the settlement mechanism for CATPs takes place off-chain through internal ledgering within exchanges, often using omnibus wallets, with on-chain settlement typically reserved for larger transactions to minimise gas fees. This distinction must be acknowledged explicitly and aligned with HM Treasury's (HMT) draft Statutory Instrument (SI), which remains unclear on key concepts such as transferability and fungibility. Greater clarity on the range of settlement models and their corresponding regulatory treatment is essential to ensure proportional and practicable implementation.

Market abuse and reporting standards

We support the introduction of market abuse reporting requirements as a necessary step towards enhancing transparency and integrity within cryptoasset markets. However, it is important that, where plausible, these requirements are harmonised with international standards and regulatory approaches to ensure interoperability across key jurisdictions, such as the EU's Markets in Crypto-Assets Regulation (MiCAR).

More generally, we believe that it is important for the emerging UK regime to align in a way which is broadly equivalent to the evolving United States regulatory landscape for digital assets under the GENIUS Act and the CLARITY Act. It is also important to avoid the overly prescriptive approach of MICAR or anything which would require market participants in jurisdictions with broadly equivalent regulatory regimes to bear significant additional regulatory burdens when seeking UK market access (and vice versa). As divergent international approaches emerge, the UK must position itself as a central hub that holds liquidity in a diverse range of robust cryptoassets issued worldwide. Failure to pursue such alignment risks undermining UK competitiveness, as firms may face conflicting and burdensome requirements across different markets, or lead to regulatory arbitrage.

Flexibility should be maintained to accommodate different market infrastructures and existing reporting formats, recognising the diversity of firms operating in this space. The FCA should also avoid introducing overly prescriptive or idiosyncratic obligations that risk conflicting with established international frameworks or resulting in duplicative reporting, which could create unnecessary burdens without a corresponding regulatory benefit. This is highly important given that duplication and its resultant costs can significantly impact operational efficiency and competitiveness, particularly for firms operating across multiple jurisdictions.

Cryptoasset intermediaries

Order handling and best execution requirements

The FCA introduces obligations akin to those placed on traditional financial intermediaries under MIFID, including: order handling and execution standards; best execution requirements across multiple venues; and a clear separation between principal and client trading. These concepts are well-established and effective across traditional securities, and efforts to align with existing requirements are positive. However, we are concerned that, in practice, these would raise challenges when applied across the cryptoassets market.

In particular, the requirement for firms to check the price for a cryptoasset against at least 3 UK-authorised trading platforms (3.27) would be problematic. Larger cryptoasset exchanges have their own ecosystems and price benchmarks and typically do not check other venues' pricing before generating their own prices. This could encourage price arbitrage, undermining price discovery and potentially exposing investors to increased volatility and systemic risk. It is also unclear whether traditional metrics of best execution can be applied effectively for the cryptoassets market. For example, we question whether the rigid separation of functions would be feasible for smaller crypto firms. The FCA should consider proportionality and provide examples or safe harbours to avoid regulatory overreach.

Client categorisation

We support proposals to categorise and allow clients to ‘opt up’ to elective professional client status. This would align with the existing regime (financial promotions and MIFID), while also reflecting existing practice in crypto markets. To facilitate investor protection without unnecessary friction, we encourage the FCA to ensure that formalising this status can be done as easily as possible by existing firms, and to incorporate feedback from industry in response to the FCA's CP24/24, which include enhancements to the existing framework to allow for greater flexibility and to ensure that the approach is more reflective of clients' capabilities.

Cryptoasset lending and borrowing

We note that the FCA is proposing to prohibit firms from offering cryptoasset lending and borrowing products to retail customers. We would advocate for this to be a more nuanced prohibition, where certain margin products and securities lending may be available to more sophisticated customers, and where the firm can demonstrate that it can manage the resulting risks. More generally, we would welcome an exception for qualifying stablecoins, given these assets do not carry the same price volatility and associated risks to customers as unbacked cryptoassets.

The FCA's exploration of mitigation measures to make these products suitable for retail in the future is a positive signal of an agile regulatory approach that would allow the UK regime to remain competitive as the global cryptoassets landscape continues to evolve. However, the proposal to apply certain elements of the Consumer Credit sourcebook (CONC)—such as requirements for creditworthiness assessments and forbearance for borrowers in arrears should be applied only to in respect of less sophisticated retail clients and may not be necessary for more qualified investors even when they are individuals.

We are aware that the consumer credit requirements currently only apply in respect of individuals and sole traders. However, it is important to emphasise that in respect of wholesale markets, lending and borrowing in cryptoassets markets are currently dominated by institutional participants, and so are often collateralised. Therefore, applying any consumer credit-style regime/retail-focused regulations to this market segment would be misaligned with current market practices and misrepresent the nature of cryptoasset borrowing risks. Requiring creditworthiness assessments would also introduce significant friction and cost, which would hinder institutional innovation where such assessments may be disproportionate given sophisticated risk management capabilities.

We acknowledge that from a retail perspective, the UK's recent push for enhanced consumer protections, including similar creditworthiness requirements introduced under the Consumer Credit Act (CCA) for Buy Now Pay Later (BNPL) products, demonstrates regulatory appetite for such safeguards where consumer harm risks are elevated. Therefore, a risk-based approach should distinguish between retail and professional participants. For retail consumers, appropriate creditworthiness assessments may align with broader UK consumer protection objectives and institutional responsibility frameworks, with potentially greater flexibility provided for high net worth individuals (NHWIs). For professional participants, existing safeguards within lending platforms and institutional risk management frameworks should be recognised as providing adequate protection without imposing unnecessary regulatory burden. This tiered approach would ensure consumer protection while maintaining institutional innovation.

Crucially, overly burdensome requirements that exceed approaches taken by other jurisdictions risk driving both retail and institutional participants to offshore, unregulated providers, ultimately undermining the UK's regulatory objectives and market competitiveness.

Financial Services Compensation Scheme

While we support the development of a shared regulatory framework, we believe further clarity is needed regarding the potential role of the existing Financial Services Compensation Scheme (FSCS) in relation to cryptoasset activities. The current DP and HMT's draft SI do not reference FSCS coverage in this context, and the FCA's policy position remains unclear. As such, our broader support for extending the regulatory perimeter to encompass cryptoassets will depend, in part, on the approach taken to the FSCS. We would be concerned by any framework that resulted in traditional investment firms bearing the cost of failures in the cryptoasset sector through the FSCS levy. To maintain fairness and proportionality across sectors, we encourage the FCA to provide assurance that any future compensation arrangements are appropriately ringfenced and risk-sensitive.

Restricting the use of credit to purchase cryptoassets

We understand that a restriction on using credit for retail customers to purchase cryptoassets would help establish a level playing field between decentralised finance (DeFi) and traditional finance (TradFi), and welcome the proposed exception for the purchase of these qualifying stablecoins. However, we ask that the FCA make the following considerations.

The restriction on using credit to purchase cryptoassets may be appropriate for some retail consumers to avoid the buildup of unsustainable debt. However, a blanket ban may prove overly restrictive and stifle the market. Sophisticated retail customers, or NHWIs who currently use credit to fund staking activities would lose this option, reducing their flexibility and potentially excluding or deterring them from participation. Given that it is accepted that some customers should be allowed to be 'opted up', the FCA should similarly consider potential carve-outs or exceptions from this restriction for these experienced customers, NHWI who have sufficient financial assets to absorb potential losses, or institutional participants.

Imposing such a restriction would also mark a significant shift from the traditional financial markets, where using credit to purchase regulated investments is typically permitted, and restrictions rely on risk disclosures and suitability checks rather than outright prohibitions. The FCA should align with the financial promotion framework to ensure consistent treatment and uphold the principle of technology neutrality.

The FCA must avoid creating perverse outcomes where consumers are incentivised to access offshore credit lines for the same purpose. A proportionate, risk-based framework would better align with international practice and reduce regulatory displacement.

Staking

Heightened disclosure obligations.

While we welcome the FCA's intention to increase transparency for retail customers and provide strong consumer protections, we are concerned that these new requirements would create undue friction for retail customers. Obtaining explicit, informed consent from retail customers for each staking arrangement would create more complex and time-consuming steps for the customer, who would be required to review and understand detailed key documents before participating in staking. The cumulative effect of these requirements—more paperwork, more disclosures, explicit consents, and stricter asset segregation—could also slow down the process, making it less appealing, especially for retail users seeking direct, rapid access to staking services. This may encourage retail participants to look overseas, ultimately harming UK competitiveness.

Equal treatment of all retail customers

While earlier in the DP, the FCA maintains the importance of carrying 'client categorisation' across into the cryptoassets regime (see above), the new proposals for staking would require all retail customers, regardless of their sophistication or credit standing. This risks alienating more capable users and creating unnecessary frictions. We would recommend a differentiated approach for NHWIs, and individuals who have opted-up as sophisticated investors.

Custodian liability for staked assets

While consumer protection is paramount in any future regime, some risks associated with staking, such as validator slashing or protocol bugs, are inherent to distributed ledger technology (DLT) networks and are not under the custodian's direct control. Holding custodians fully liable for these risks would be excessive. This may deter firms from entering or remaining in the UK staking market, reducing market access and liquidity, and harming UK competition and innovation. This could also result in fewer choices and higher costs for UK consumers, potentially pushing activity offshore to less-regulated jurisdictions. The FCA must ensure proportionality in these requirements to ensure that regulatory measures are calibrated to the actual risks presented, avoiding unintended consequences that could harm both consumer choice and the UK's position as a competitive financial centre.

Regarding safeguarding approaches, we would encourage the regulators to avoid setting specific technology-based solutions (such as separate wallets), but to take an outcomes-based approach such as requiring firms to ensure that they are able to identify the assets owned by individual customers. This would allow firms to adapt to improvements in technology and practice over time.

Decentralised Finance

The lack of a clear regulatory position both in the Regulated Activities Order (RAO) and in FCA rules in respect of the application of regulation on DeFi has a chilling effect on market development. We strongly advocate for HMT and/or the FCA to clarify either that truly decentralised services are not in scope of regulation or that the FCA will take a technology-neutral approach and apply its rules to DeFi solutions. The FCA should clarify when and how DeFi arrangements fall within the regulatory perimeter.

Thank you for considering this submission.

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