

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL
PROMOTION) (AMENDMENT) ORDER 2023

2023 No. [XXXX]

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

- 2.1 This statutory instrument (“SI”) proposes to expand the scope of the financial promotion restriction in section 21 of the Financial Services and Markets Act 2000 (c.2008) (“FSMA”), by amending the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (2005/1529) (the “FPO”), to include financial promotions in respect of certain cryptoassets. The instrument, and relevant Financial Conduct Authority (“FCA”) rules, will provide for the regulation of in-scope cryptoasset financial promotions. This is aimed at improving consumers’ understanding of the risks associated with cryptoasset investments and ensuring that cryptoasset promotions are held to the same standards as for broader financial services.
- 2.2 This SI will seek to amend the FPO by creating a new controlled investment (defined as a “qualifying cryptoasset”), as well as amending relevant controlled activities to incorporate reference to qualifying cryptoassets. The SI will also apply and modify certain existing exemptions in the FPO to qualifying cryptoassets and create a temporary, limited exemption to the financial promotion restriction (imposed by section 21(1) of FSMA), for cryptoasset businesses (which are not authorised persons) on the FCA’s anti-money laundering register. The SI will provide for an implementation period of four months from the day after the SI is made before it comes into force. This period is intended to allow industry time to understand how the regime will be practically implemented, with the aim of ensuring compliance across the industry.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the whole of the United Kingdom.
- 4.2 The territorial application of this instrument is the whole of the United Kingdom.

5. European Convention on Human Rights

- 5.1 The Economic Secretary has made the following statement regarding Human Rights:
- “In my view the Financial Services and Markets Act 2000 (Financial Promotion) Amendment) Order 2023 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Section 21 of FSMA provides that a person, in the course of business, must not communicate an invitation or inducement to engage in investment activity, or claims management activity, unless (i) they are an authorised person (under Part 4A of FSMA), (ii) the content of the communication is approved by an authorised person, or (iii) an exemption applies. This is known as the financial promotion restriction. “Engaging in investment activity” is defined as entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity; or exercising any rights conferred by a controlled investment to acquire, dispose of, underwrite, or convert a controlled investment. The FPO specifies controlled activities and controlled investments and sets out a number of exemptions from the financial promotion restriction.
- 6.2 HM Treasury is using its powers under FSMA to make amendments to the FPO. In order to bring the promotion of certain cryptoassets into scope, this SI will add a definition of “qualifying cryptoasset” to the list of controlled investments in Part II of Schedule 1 to the FPO. It will also amend certain existing controlled activities, as set out in Part I of that Schedule, to include reference to qualifying cryptoassets.
- 6.3 Existing exemptions in the FPO will apply where relevant given their existing scope. HM Treasury will modify the Art. 51 (Association of high net worth or sophisticated investor) and Art 61. (Sale of goods and supply of services) exemptions to explicitly exclude qualifying cryptoassets. This is to ensure these exemptions cannot be used to avoid regulatory requirements in a way that was not intended.
- 6.4 The SI also introduces a temporary, limited exemption from the financial promotion restriction. The purpose of this exemption is to enable cryptoasset businesses registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (‘AML/CTF regulations’), who are not otherwise authorised persons, to communicate their own financial promotions in relation to qualifying cryptoassets. Registered cryptoasset businesses (“registered persons”) relying on this exemption will not be able to approve financial promotions for other businesses or to communicate their own financial promotions in relation to other controlled investments.
- 6.5 The exemption also extends to persons who communicate a non-real time financial promotion prepared by a registered person on that person’s behalf. This is to enable registered persons to place cryptoasset promotions for onward communication by a third party in such a way that ensures that the promotion complies with the applicable FCA rules and the registered person remains responsible for the way in which the promotion is communicated.
- 6.6 In order to ensure that registered persons and their promotions are subject to appropriate FCA oversight and enforcement, the SI applies a number of relevant FSMA provisions, some with modification and some without. This will ensure that the cryptoasset financial promotions of registered persons are subject to the same broad regulatory regime as those of authorised persons. When exercising its functions in respect of the provisions of FSMA applied by the SI in relation to registered persons and qualifying cryptoasset financial promotions made by them, the FCA will be carrying out functions under FSMA. As such, provisions of FSMA which relate to the FCA’s functions will apply in respect of registered persons (for example the FCA’s

fee-raising power and exemption from liability in damages, as set out at paragraphs 23 and 25 of Schedule 1ZA to FSMA respectively).

- 6.7 The SI applies and modifies those provisions of FSMA which have been identified as being of greatest importance to the effective operation of the exemption (including, for the avoidance of doubt, certain provisions which would apply in relation to registered persons in any event). Related provisions of FSMA which did not require modification (such as those in Parts 23, 27, 28 and 29) will also apply as relevant
- 6.8 Certain cryptoassets such as security tokens (which are already controlled investments for the purposes of the FPO) are already subject to the financial promotions regulatory regime. The purpose of this SI is to bring the majority of cryptoassets (e.g., exchange tokens such as Bitcoin) which are currently outside of the definition of controlled investment, within the scope of the financial promotion regime. The SI is not seeking to bring into scope non-fungible tokens (known as “NFTs”) as these have so far tended to be used in a way more akin to digital collectibles than financial investments.
- 6.9 This measure forms part of the Government’s wider staged approach to regulating the cryptoasset sector, alongside the consultation on future cryptoasset regulation, stablecoins legislation, and new powers and provisions included in the Financial Services and Markets Bill 2023. There are limited examples of undertakings in Parliament specifically relating to this instrument to date; however, the topic was raised by the Treasury Select Committee during the inquiry into the crypto-asset industry in January 2023.

7. Policy background

What is being done and why

- 7.1 The intervention is aimed at improving consumers’ understanding of the potential risks associated with cryptoasset purchases by raising standards of financial promotions through regulation and ensuring that the promotion of qualifying cryptoassets is held to the same standards as in broader financial services.
- 7.2 This SI is being made because of the risks posed to consumers (often retail investors) by misleading cryptoasset advertising, which often overstates the benefits and rarely warns of the risks involved. In 2018, the Cryptoasset Taskforce (consisting of HM Treasury, the Bank of England, and the FCA) published a report which found that misleading advertising and a lack of suitable information was a key consumer protection issue.¹ Since the report, the market has continued to evolve and FCA findings show cryptoasset ownership in the UK has risen while the understanding of risks involved has declined.²
- 7.3 Cryptoasset market instability continues to be a significant risk to consumers. The cryptoasset global market cap fell from a \$2.9 trillion record in November 2021 to under \$1 trillion in June 2022. There have been several high-profile failures of cryptoasset firms, for example in November 2022 FTX (a large cryptoasset exchange) filed for bankruptcy. The ongoing market volatility has attracted significant media and public interest, underscoring the need for effective regulation.

¹ Available at: <https://www.gov.uk/government/publications/cryptoassets-taskforce>

² Available at: <https://www.fca.org.uk/publications/research/research-note-cryptoasset-consumer-research-2021>

- 7.4 This evidence supports the case for regulatory intervention in the market to raise the standard of cryptoasset promotions by having them being subject to FCA oversight and enforcement.
- 7.5 Given developments in the cryptoasset sector during 2022, in February 2023 HM Treasury published a policy statement announcing certain further alterations to this SI.³
- 7.6 First, given recent volatility in cryptoasset markets, and the risks presented to consumers, the Government has reduced the implementation period for the measure – beginning on the day after the SI comes into effect from 6 months to 4 months.
- 7.7 Second, in response to industry feedback received since the January 2022 consultation response document was published, HM Treasury is also introducing a temporary, limited exemption. As set out above, this will enable cryptoasset businesses registered with the FCA under the AML/CTF regulations, who are not otherwise authorised persons, to communicate their own financial promotions in relation to qualifying cryptoassets. This approach seeks to balance the UK’s safe growth and innovation objectives with the consumer protection objective. This decision reflects the FCA’s rigorous process of assessing cryptoasset businesses for registration under the AML/CTF regulations, in line with international Financial Action Task Force (FATF) standards. The FCA will be empowered to subject businesses making use of this exemption to the same financial promotion rules as authorised persons when communicating cryptoasset promotions. The benefit of this exemption will also extend to persons who communicate non-real time financial promotions prepared by a registered person on that person’s behalf. The condition, in this case, that the promotion is prepared by the registered person ensures that in this scenario the promotion remains subject to rules made by the FCA.
- 7.8 The Government intends that this exemption will be temporary. The Government is preparing to bring stablecoins with propensity to be used for payment into the scope of regulation and is also consulting on its future regulatory approach to unbacked cryptoassets. The Government will review its approach to the exemption alongside the future regulatory approach to cryptoassets. Further information and context behind this decision is outlined in section 10.
- 7.9 HM Treasury believes that the proposed changes are needed now. Without this legislation, consumers in the UK are at risk from making ill-informed investments in volatile cryptoassets.

8. European Union Withdrawal and Future Relationship

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

- 9.1 This legislation does not consolidate any other legislation.

10. Consultation outcome

- 10.1 In July 2020, the Government published a consultation on a proposal to bring certain cryptoassets into the scope of the financial promotion regime. The January 2022

³ Available at: <https://www.gov.uk/government/consultations/cryptoasset-promotions>

consultation response document (see Government Website⁴), carefully considered 25 responses to the consultation from respondents including cryptoasset businesses, trade bodies, committees and members of the public. A brief summary of responses is set out below, with further detail available in the consultation response document.

- 10.2 There was broad support for the measure. Some stakeholders called for it to be accelerated, noting that poor marketing from irresponsible actors was damaging the credibility of the industry. Responses generally agreed with the proposed definition of qualifying cryptoassets, but several noted that further clarity would be required to ensure appropriate application of the regime. Some respondents felt this measure would be best implemented alongside a more comprehensive bespoke regulatory regime for cryptoassets; and several respondents questioned the rationale behind the intervention, citing the 2018 Cryptoasset Taskforce report as an outdated basis for assessing consumer risks.
- 10.3 Since the publication of its consultation, the Government's view is that risks to consumers have increased, as evidenced by several factors including rising ownership of cryptoassets. As is already the case with the application of the FPO, the Government and Parliament are responsible for setting the legal framework and scope of the regime, while firm rules and guidance will be determined by the FCA.
- 10.4 Additionally, since HM Treasury issued its consultation response and the FCA consulted on its planned detailed rules, HM Treasury received further feedback on potential unintended consequences. The original proposals would have had the effect that firms would need to be authorised to communicate or approve financial promotions relating to qualifying cryptoassets (or otherwise limit the communication of such promotions to fall within the scope of one or more exemptions in the FPO). As most cryptoasset firms are not authorised by the FCA, they would not be able to communicate or approve their own financial promotions. In the anticipated absence of suitable third party authorised persons willing and able to approve cryptoasset firms' promotions, cryptoasset businesses and other stakeholders highlighted that the measures as originally proposed would significantly restrict, or amount to an effective marketing ban on, cryptoasset promotions.
- 10.5 In its response, the Government did acknowledge this risk, but considered it justified in order to protect consumers from significant risks. However, a complete marketing ban on high quality cryptoasset financial promotions was not the intended outcome of the legislation. Therefore, HM Treasury is introducing a limited, temporary exemption from the financial promotion restriction in s.21 FSMA for cryptoasset businesses registered with the FCA under the AML/CTF regulations. The decision to include this exemption was not consulted on because a consultation would have significantly set back the timeline for implementing this SI. Given the evident significant and growing risks to consumers in the cryptoasset market, the Government announced this decision and a clear rationale in a policy statement on 1 February.
- 10.6 Lastly, the consultation response confirmed that Government would provide for a six-month implementation period, after the SI is made, for this measure. Recent market turmoil and growing consumer risks and harms means that there is a robust rationale for the intended change to a 4-month implementation period without further consultation. This was also communicated in the February 2023 policy statement.

⁴ Available at: <https://www.gov.uk/government/consultations/cryptoasset-promotions>

11. Guidance

- 11.1 The Government will not be issuing further guidance relating to this measure. The FCA intends to amend its perimeter guidance for authorised and registered firms.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities, or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 The effect of the planned approach would be that the FCA would become the regulator and supervisor of qualifying cryptoasset promotions. Once the regime is in force there will be four routes to legally communicating a financial promotion for qualifying cryptoassets: i) the promotion is communicated by an authorised person; ii) the content of the promotion is approved by an authorised person for the purposes of section 21 of FSMA; iii) the promotion is communicated by, or on behalf of, a registered person; iv) the promotion otherwise complies with the conditions of an exemption in the FPO.
- 12.4 The FCA will be provided with rule making, supervision and enforcement powers to enable it to have effective oversight of cryptoasset promotions. This will ensure that the FCA is able to apply financial promotions rules to cryptoasset promotions communicated by or on behalf of registered persons and to take action where such promotions fail to comply.
- 12.5 A full impact assessment has not been produced for this instrument as no, or no significant, impact on the private, voluntary or public sector is foreseen. A de minimis assessment concluded that the Equivalent Annual Net Direct Cost to Business (EANDCB) per year would fall beneath the £5 million threshold for impact. The de minimis impact assessment is published alongside the instrument and this Explanatory Memorandum at www.legislation.gov.uk.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 13.3 In absolute terms, the impact on small businesses is expected to be in line with the impact on larger businesses. However, the proposed measures may have a greater impact on small and micro businesses relative to larger businesses. This is because the costs of becoming authorised, AML/CTF registered or finding a section 21 approver are likely to be relatively constant regardless of the size of the business.
- 13.4 The Government does not have an estimate of the number of small or micro businesses in the UK that are liable to be affected by this measure. This arises from a number of factors:
- Extremely limited data about the size and composition of the cryptoasset market in the UK and globally. Exceptions such as the Cambridge Centre for Alternative Finance's research offer indicative figures, but these estimates cannot be extrapolated with any accuracy to provide helpful UK figures and are complicated by the below factors.

- Cryptoasset businesses are global in nature, and a business's domicile is not necessarily indicative of the location where the majority of the business's activity is undertaken or where economic value is located.
 - Detailed breakdowns of industry composition in the UK do not exist, including a breakdown that would approximate to the set of businesses which would be affected.
- 13.5 The Government has considered possible mitigating options that support this category of businesses. However, the Government has decided against them on the basis of the reasons given below:
- Exemptions or tiered requirements for small or micro businesses: this option was rejected because the risks to consumers from substandard promotions arise equally from businesses regardless of size.
 - Tailored support to small businesses to assist them in understanding the requirements: this option was rejected on the basis that information about the impact of the regulatory changes will be available to all market participants equally. The FCA has consulted on its rules, a process that small and larger businesses were able to contribute to equally; and when these rules are published, these and guidance relating to them will be available to market participants equally. The FCA also conducted extensive stakeholder engagement as part of consulting on its rules.
- 13.6 The Government has taken on board a key point of feedback on the need for an implementation period made by industry, including by smaller businesses, and has adapted the proposal accordingly.
- 13.7 Additionally, Government has taken on board industry feedback on the risk that an insufficient number of FSMA authorised persons willing and able to approve cryptoasset promotions would emerge. HM Treasury has therefore introduced an exemption which will exempt businesses from the requirement to have their promotions approved by an authorised person provided that the issuing business is registered with the FCA under its AML/CTF regime. This exemption will support small and large businesses.
- 14. Monitoring & review**
- 14.1 HM Treasury will monitor the measure on an ongoing basis, including in the context of any future cryptoasset regulatory initiatives. Further, the FCA will be responsible for implementing this measure and will continue to monitor its implementation and efficacy.
- 14.2 Additionally, HM Treasury intends to introduce further cryptoasset regulatory initiatives – such as those set out in the 2023 future financial services regulatory regime for cryptoassets consultation and call for evidence; and the 2022 response to the consultation and call for evidence for the UK's regulatory approach to cryptoassets, stablecoins, and distributed ledger technology in financial markets – which will ensure ongoing analysis as the government keep the interaction of cryptoasset regulatory measures under continual review.
- 14.3 The SI does not include a statutory review clause. In line with the requirements of the Small Business, Enterprise and Employment Act 2015 Andrew Griffith MP has made the following statement:

- 14.4 The instrument does not include a statutory review clause given that wider ongoing cryptoasset regulation is underway and under constant monitoring and consideration. The anticipated annualised net impact on business is expected to be lower than £5m net. The Cryptoasset Taskforce will continue to monitor the effectiveness of this, and any broader regulation introduced and consider appropriate further actions as needed.

15. Contact

- 15.1 Taliesin Renouf at HM Treasury, tal.renouf@hmtreasury.gov.uk, can be contacted with any queries regarding the instrument.
- 15.2 Laura Mountford, Deputy Director for Payments and Fintech, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Andrew Griffith, MP, the Economic Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.