FCA
Financial Services Consumer Panel

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12 December 2025

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Dear FCA,

Financial Services Consumer Panel response to FCA CP25/28 – Progressing fund tokenisation

The Financial Services Consumer Panel[1] welcomes the opportunity to respond to the FCA's Consultation Paper on Progressing Fund Tokenisation (Chapter 5) and stresses the importance for a robust and future-proof framework for tokenised funds—one that ensures consumers are properly protected and that innovation does not come at the expense of consumer safeguards.

The Panel continues to emphasise that rules must evolve in line with emerging technologies, and that regulatory developments should prioritise consumer interests, particularly with regard to conflicts of interest, product suitability and the effectiveness of disclosures. The disclosures must be rigorously tested to ensure they do not create misleading impressions.

The Panel notes the significant opportunities that tokenisation may deliver—such as fractional ownership, instant access, lower costs, and more personalised investment options. Tokenisation has the potential to democratise access, enhance transparency, and foster competition. At the same time, the Panel recognises the associated risks, including increased complexity, speculative behaviour, cybersecurity vulnerabilities, and the potential for consumer misunderstanding. Concerns remain about adequate protection for vulnerable or less digitally confident consumers.

The Panel recognises that younger, digitally native investors are driving demand for accessible, transparent, and personalised tokenised products. Many make impulsive investment decisions, often influenced by trends and viral products. In tokenised funds, accessibility must be balanced with

[1] https://www.fca.org.uk/panels/consumer-panel

investor protection. Introducing structured friction[2]—such as cooling-off periods, suitability checks, and transparent dashboards—can help guard against impulsive, trend-driven decisions while preserving the benefits of innovation. The Panel notes that although features such as instant access, lower costs, and customisable portfolios are increasingly expected, these can also encourage speculative behaviour and overtrading.

The Panel broadly agrees with the FCA's proposed three phases of tokenisation (funds, assets, cash flows), however stresses that benefits and risks are not evenly distributed across these stages. A careful, phased approach—supported by enhanced consumer financial capability, greater transparency, and comprehensive safeguards—will be essential.

The Panel notes that composability (interoperable components across platforms) can improve efficiency but can also introduce contagion and cybersecurity risks. The Panel urges the FCA to consider that although tokenisation may broaden access to illiquid assets it does not make them inherently liquid, so clear disclosures about liquidity risks are vital.

The Panel agrees that the role of asset managers is evolving as orchestrators, stewards of digital identity, risk managers, and to some extent educators. It is certain that collaboration with technology firms and AI providers will become increasingly important.

The current funds framework must be adapted for digital tokens, with updated rules for risk assessment, valuation, custody, disclosure, and audit. Automation and real-time data will streamline processes, but strong consumer protections must remain. With that in mind, the FCA's role should also evolve to become more technology-informed, focusing on consumer outcomes, proactive risk monitoring, and prioritising transparency and financial capability.

Overall, the Panel commends the FCA's efforts to enhance consumer protection, market integrity, and international alignment in this rapidly evolving sector. We support the general direction of the proposals but emphasise the need for tailored, enforceable rules that reflect the unique risks and characteristics of tokenised funds. The Panel urges the FCA to remain open yet cautious, allowing innovation and experimentation while critically continuing to monitor risks, including systemic risks.

[2] Cooling-off periods before trades settles could include: giving investors time to reconsider. Requiring - risk acknowledgement prompts (e.g., "Are you aware this is a high-risk product?") before finalising purchases. Embedding suitability questionnaires to ensure investors understand the risks of tokenised products. Providing visual risk indicators, a traffic-light system, to make risks intuitive for investors. Deploying behavioural nudges and educational prompts.

The Panel continues to believe that the FCA's priorities for developing the tokenised funds framework should be guided by the potential benefits to consumers. These include reduced costs, a more navigable system, stronger safeguards against conflicts of interest, and improved access to accurate, timely information that enables better-informed decision-making.

The Panel's responses to the questions posed in the Consultation Paper for Chapter 5 are set out in Annex A below. The Panel appreciates the FCA's continued efforts in this area and looks forward to further engagement on these important topics.

Yours sincerely,

Chris Pond

Chair, Financial Services Consumer Panel

Chapter 5: Supporting future tokenised models- now – COB Wednesday 26 November

Tomorrow's investor: changing consumer demands

23 How are changing investor habits and expectations influencing the design of tokenised products?

Changing investor habits and expectations, particularly among younger, digitally native consumers,[34] are driving tokenised product design towards greater accessibility, transparency and personalisation. The growing popularity of trading apps and ETFs reflect a desire for liquidity and control, prompting firms to design products that mirror these features.

According to FCA's Dec 2024 research,

- A quarter of young investors admit they make investment decisions impulsively to keep up with current trends.
- £550 is the average spend on hyped investment products.
- 66% of 18-40 year-old investors spend less than 24 hours deciding on an investment, and 14% finalise their decision in under an hour.
- When asked more generally about any viral items they had purchased within the last year, crypto was fourth in the list (27%), just behind air fryers (42%), which topped the list, followed by smart watches (32%) and energy drinks (32%).

With investors increasingly demanding instant access, lower costs, and the ability to customise their portfolios, firms are using DLT and composability to develop products that enable fractional ownership, faster settlement and interoperable portfolios.

The Panel would like to highlight that these developments may also present potential risks relating to investor understanding, risk comprehension, speculative behaviour and broader systemic risk.

- Fractional ownership, 24/7 accessibility and enhanced personalisation, can lead to consumers favouring tokenised assets for short term gains over long-term stability, potentially leading to speculative behaviour.

[3] https://www.fca.org.uk/financial-lives/financial-lives-2024
[4] FCA finds two-thirds of young investors take less than 24 hours to make investment decisions | FCA

- Lower barriers to entry, gamified interfaces, transparency, traceability and autonomy can blur the boundaries between responsible investment and speculation, particularly in the absence of consumer education and adequate consumer oversight and it may well lead to overtrading.
- Instant trading, on-chain liquidity, composability and interoperability may heighten systemic risks and cybersecurity vulnerabilities.
- Volatility, unclear consumer rights and opaque valuations could undermine consumer trust.

The Panel therefore urges the FCA to prioritise clarity, consumer education, and transparency regarding the underlying risks of tokenised assets, ensuring that innovation advances in a manner consistent with consumer protection and market integrity.

While the FCA is not directly responsible for delivering financial education, it does have a crucial role in promoting financial capability and ensuring consumer understanding. The FCA should therefore prioritise consumer transparency and financial capability, making sure that consumers are equipped to understand the risks and features of tokenised products. This means the FCA must focus on clear communication, effective disclosures, and supporting consumers in making informed decisions, rather than taking on the role of an educator itself. However, the Panel notes that consumer education and disclosure is not necessarily always sufficient on its own. Accordingly, the Panel believes the FCA needs to be alerted to the limitations of transparency as a method of consumer protection, and be prepared to introduce additional measures where needed.

Three Stages to Progress Tokenisation

24 Do you agree with the three phases described? Are these developments industry is looking to pursue?

The Panel broadly agrees with the three phases, tokenisation of funds, assets and cash flows that many firms are actively exploring. From a consumer perspective, however, the benefits and risks are unevenly distributed across these stages.

Phase 1 (tokenised funds) delivers operational efficiencies for firms and benefits will only be tangible for consumers if costs savings are transparently passed on to consumers through lower fees and enhanced services. Currently, there is no assurance that these savings will be passed on to consumers through lower fees and improved services.

Phased 2 (tokenised assets) offer great personalisation, accessibility direct ownership but can also increase consumer exposure to complexity, custody risks and speculative behaviour.

- Direct custody in digital wallets introduces consumer responsibility for security and key management, areas where retail consumers often lack experience.
- Smart contracts managing "micromodel portfolios" may not be easily understandable for less financially able consumers.

Without clear consumer education, this phase could inadvertently increase consumer risk even as it democratises access.

Phase 3 (tokenised cash flows) is very promising offering consumer hyper personalisation in theory allowing consumers to personalise their tokens based on their financial goals (e.g. a certain retirement income, mortgage offsetting). This stage could potentially overwhelm unfamiliar retail investors with products that are difficult to value or understand.

The Panel therefore supports a phased progression, provided that each stage is accompanied by consumer testing, consumer education, consumer transparency and protection.

25 What processes within the fund and investment management lifecycle do firms want to begin to make 'composable'?

Composability offers clear operational benefits allowing interoperable components across products, processes and platforms, allowing consumers to get cheaper, faster and interoperable investment services across platforms and service providers.

The Panels urges the FCA to consider that composability may also introduce the contagion risks across platforms, cybersecurity risks of interconnected systems and blur accountability when products and technologies are intertwined.

26 How does 'composability' impact the liquidity profile of assets we currently think of as less liquid or illiquid?

While tokenisation and composability can broaden retail investor access to traditionally illiquid assets, such as real estate or infrastructure, by enabling tokenised income streams, this does not inherently transform the underlying assets into liquid ones. Consequently, retail investors remain vulnerable to liquidity traps, particularly during periods of market stress when such assets may be frozen. The Panel therefore strongly recommends that the FCA mandate clear and prominent disclosure of the risks and limitations associated with investing in illiquid assets. Consumer testing is important to ensure consumers clearly understand the liquidity risks of such products.

27 How might the tokenised portfolio management vision enhance consumer outcomes?

Tokenised portfolio management can improve accessibility, efficiency and personalisation, enabling consumers to align their investments to their financial goals. These benefits can only be realised if consumers can clearly understand and trust the products offered. The Panel urges the FCA to prioritise financial capability, product clarity and transparency around tokenised investments. Regulation must evolve to ensure innovation safeguards consumer interests and protection.

Changing role of asset managers

28 Do you foresee any other major changes to the role of asset managers or other market participants in a tokenised flows 'end-state'? What are the opportunities and risks?

The role of asset managers will expand. Asset managers will increasingly operate in a digital-first environment, where tokenised assets and stablecoins become core components of financial infrastructure. This will require adapting to new technologies and integrating digital assets into traditional portfolios.

Beyond traditional portfolio management, they will need to operate as:

- Digital service orchestrators, integrating DLT, digital custodians, identity providers, and data platforms.
- Stewards of digital identity, ensuring accurate and secure use of decentralised identifiers and wallet-based profiles.
- Risk managers across new domains, including smart-contract resilience, cybersecurity, and the reliability of underlying technological systems.
- Educators and interpreters, helping consumers navigate complex, programmable financial products. As consumers become more interested in tokenised funds, asset managers will act as guides,

helping clients transition from traditional finance to digital finance, explaining new products, and managing the risks associated with tokenised assets.

Asset managers will also need to work more closely with technology firms, AI providers, and data specialists to leverage automation, analytics, and secure digital identities.

Opportunities

For consumers, tokenisation of funds:

- should democratise access to investment options, including low-minimum holdings and potentially more digitally inclusive product design;
- should increase investment choice and competition;
- may enable more personalised portfolios that reflect an individual's financial needs;
- should improve transparency, allowing consumers to observe holdings and valuations in real time.

For asset managers:

- the rise of tokenised money market funds and other digital instruments will allow asset managers to offer new products with features such as instant settlement, fractional ownership, and potentially broader access for retail investors. Tokenised funds may also create new sources of income for asset managers;
- tokenisation will improve transparency (real-time tracking of assets and flows) and operational efficiency (faster settlement, reduced costs), changing how asset managers monitor and report on portfolios.

Risks

For consumers, tokenised funds introduce new risks such as:

- Complexity and digital exclusion: vulnerable consumers and those who are less digitally confident may struggle to understand these products or may be less comfortable interacting with them;
- Privacy risks: tokens and wallet-linked digital identities may expose consumers to increased data visibility and profiling;

- Unclear accountability for losses if smart contracts fail;

- Behavioural risks, as frictionless trading may encourage frequent switching or panic selling;

- Opaque fees, where platform or execution fees may be difficult for consumers to understand.

For asset managers, tokenised funds likely risks include:

- increased reliance on digital infrastructure, exposing firms to risks such as hacking, system failures, and vulnerabilities in cryptographic protocols;

- evolving and fragmented regulation across jurisdictions, creating compliance challenges and limiting cross-border activity;

- potential systemic risks if rapid growth in tokenised assets or stablecoins leads to large-scale redemptions or failures;

- market-structure changes, where disintermediation enables non-bank or asset managers (e.g. Klarna entering the stablecoin market)[5] and technology firms to enter the market, potentially reducing the influence of traditional asset managers;

- an increased need to ensure clients understand the risks and mechanics of tokenised products in order to maintain trust and avoid reputational damage.

Changing regulations

29 How might market integrity and financial stability risks evolve in the future tokenised portfolio management model?

Tokenisation brings clear benefits in transparency and operational efficiency, but also introduces new risks to market integrity and financial stability.

Evolving Risks

Consumers may perceive tokenised funds as risk-free when they are not.

[5] Klarna Group plc - Klarna Launches KlarnaUSD as Stablecoin Transactions Hit $27 Trillion Annually

Errors in wallet-based identity systems and the loss of keys could lock consumers out of assets or prevent access to redress.

Increased reliance on digital infrastructure and tokenisation exposes markets to new risks, such as hacking, cryptographic failures, and operational outages. A breach or failure in the underlying technology could undermine trust and trigger rapid outflows or market disruptions.

Instant settlement and interoperability may facilitate rapid, large-scale redemptions, especially in tokenised money-market instruments or stablecoins. As tokenised assets and stablecoins grow, the risk of large-scale, rapid redemptions (akin to a "run" on a stablecoin) increases. This could have knock-on effects on underlying assets (e.g., US Treasuries) and broader financial stability, especially if the market capitalisation of these instruments becomes significant.

Tokenisation can improve transparency, allowing real-time monitoring of positions and flows. However, too much transparency[6], or poorly interpreted data, could trigger panic if market participants react to perceived risks before they are fully understood.

Different jurisdictions may adopt varying regulatory approaches, leading to inconsistencies and potential regulatory arbitrage. This could undermine market integrity if some regions become havens for less robust practices. Divergent international rules could weaken market integrity and create incentives for activities to migrate to less-regulated jurisdictions.

The entry of non-bank and technology firms into asset management and market infrastructure could challenge traditional oversight and risk management frameworks, potentially introducing new vulnerabilities or reducing the effectiveness of existing safeguards.

The complexity and novelty of tokenised products may make it easier for bad actors to create fraudulent or misleading instruments increasing the risk of scams and loss of investor confidence.

Cross-border tokens may make recovery of consumer assets more difficult in distress.

Risk Mitigation

Prioritising consumer transparency and financial capability ensures consumers are equipped to understand the risks and features of

[6] With tokenisation everyone sees every movement immediately, people might jump to conclusions too quickly. For example, if a large investor suddenly sells, others might panic and sell too — even if there's no real problem.

tokenised products. Clear communication, labelling (e.g. not risk free) and effective disclosures are important measures supporting consumers to make informed decisions.

Real-time data and automation can improve risk detection and response, allowing for more dynamic and proactive supervision for asset manager and the FCA.

Robust recovery mechanisms, standardised identity frameworks and clear consumer redress mechanisms and dispute resolution channels, help protect consumers from errors in wallet-based identity systems and loss of keys.

Smart contracts can embed compliance and risk controls directly into transactions (programmable rules, allow-lists, automated suitability checks), can potentially reduce operational errors and improve market discipline.

Cybersecurity standards, regular penetration testing and independent audits of cryptographic protocols as well as insurance schemes for operation losses, can protect consumers from cryptographic and operational failures.

Liquidity buffers, redemption gates/limits during extreme volatility and transparency on reserve composition can reassure the market during volatile markets.

International coordination and mutual agreements will help harmonise standards on capital, disclosure and custody.

Cross-jurisdictional legal frameworks for asset recovery, international dispute resolution mechanisms, and standardised consumer protection rules across borders will help safeguard consumers' assets.

Licensing regime tailored for tech entrants through joint supervisory frameworks between financial and tech regulators can help with the challenging oversight of tech related entrants.

30 What areas of the current funds framework will need to be recreated in the future vision? What areas could be simplified across different parts of the Handbook?

<u>Areas the current funds framework will need to be recreated</u>

Consumer protection, transparency, and trust will remain essential. Traditional controls around diversification, eligible assets, and liquidity need to be adapted to ensure consumers are placed only into flows appropriate to their needs and circumstances, particularly as tokenised models scale to mass retail.

Frameworks for risk assessment, monitoring, and reporting will need to be adapted to address new risks associated with tokenisation (e.g., technology failures, cyber threats, and systemic risks from rapid flows).

Rules for valuing assets and safeguarding client holdings will need to be updated for digital tokens, including standards for smart-contract security and digital custody solutions.

The rules and processes for disclosure, reporting, and audit will need to be updated to fit a world where information is available instantly and in new formats, ensuring that transparency is maintained and investor protection is not compromised.

In a tokenised, real-time environment:

- Investors, as well as the FCA, could have access to real-time data on fund holdings, transactions, and valuations, rather than waiting for periodic reports.
- Smart contracts could automatically generate and share required disclosures, reducing manual intervention and the risk of errors.
- Auditors may be required to verify the integrity of code (smart contracts) and the security of digital custody solutions, not just financial statements.
- There will be a need for new data standards to ensure that real-time data is accurate, comparable, and meaningful across different platforms and products.

Real-time data availability requires:

- simplified, standardised disclosures suitable for non-expert retail consumers;
- clear explanations of product features and conditions.

Rules on compensation must reflect scenarios where:

- smart contracts fail;
- tokens malfunction;
- issuers and/or digital custodians become insolvent;
- cross-border tokens fall outside UK jurisdiction.

Cross-border regulatory structures will need to be recreated to address the unique features of tokenised assets, including cross-border transactions, multijurisdictional compliance, and the involvement of tech firms, decentralised platforms, and other entrants that may play a key role in the market. The regulatory framework may need to expand to cover these participants.

The FCA may need new tools and expertise to monitor and supervise in real time and to respond to emerging risks. As assets and transactions can be programmed with rules governing who can own them and when they can be traded, the FCA will need expertise in programmability to ensure that the rules embedded in platforms will deliver the desired investor protections and outcomes.

Areas that could be simplified

- Settlement and reconciliation could be simplified, as tokenisation enables instant or near-instant settlement, reducing the need for complex post-trade processes and manual reconciliations.
- Tokenisation may reduce the need for complex fund structures, enabling more direct and transparent investment options.
- Automation through smart contracts can streamline fund administration, compliance checks, and income distribution, reducing paperwork and manual intervention.
- Digital identity and programmable compliance can simplify investor onboarding, KYC/AML checks, and cross-border access to funds.

With the above in mind, certain rules that exist to manage manual processes (e.g., settlement cycles, reconciliation, paper-based disclosures) could be simplified to reflect the nature of tokenised funds.

Overall, the framework should retain strong consumer protections while reducing rules that exist purely to compensate for manual or legacy processes. The future tokenised-funds framework will need to ensure core investor protections, risk management, and regulatory oversight for the digital era. Simplified operational processes and automation could lead to a more efficient, transparent, and accessible investment environment, with a more streamlined Handbook that retains a focus on outcomes and investor protection.

31 What areas of the Handbook, or wider rules and legislation, do we need to reconsider to support the growth of the proposed tokenisation models?

The FCA rightly identifies that current portfolio management rules under COBS may not provide adequate protection when extended to a mass-retail audience. The absence of prescriptive rules on diversification, liquidity, and eligible assets could expose consumers to unsuitable portfolios and increased volatility. The Panel supports a review of portfolio management rules to ensure scalability and proportionality, and believes that rules will need to reflect continuous product suitability and provide clear guidance on vulnerable consumers using digital systems.

The FCA may also need to set standards for wallet-based identity verification, data minimisation, and privacy-preserving digital identities. Legislation may need updating to clarify the enforceability of smart-contract terms, including liability for coding errors and responsibility for token failures or incorrect flows.

The Handbook may also need to consider cross-border issues, rules for interoperability and portability of tokens, and consistency with global DLT standards. The FCA will also need to clarify the role of digital custodians, including their obligations and the segregation of on-chain and off-chain assets.

The FCA may need to simplify disclosures to prevent information overload for consumers, introducing standardised wording for key disclosures. FSCS and redress schemes may also need to be clarified—specifically, when they apply and how consumers will be compensated when things go wrong.

32 What should the FCA's role look like in this future vision?

It is clear that tokenisation will reshape the way asset management works today from a product based model to a more service based ecosystem of multiple products, where technology replaces traditional intermediaries.

The FCA's future role should evolve from a purely rules-based and outcome-based regulator towards a more technology informed regulator that ensures:

- Consumers outcomes are consistent across digital and traditional - models.
- Risks across Digital and traditional models are proactively monitored.
- Consumer protection, transparency and financial capability is prioritised