FINANCIAL CONDUCT AUTHORITY

Discussion Paper

DP25/1

Regulating Cryptoasset Activities

May 2025

How to respond

We are asking for comments on this Discussion Paper (DP) by **13 June 2025**.

You can send them to us using the form on our website.

Or in writing to:

Crypto Policy
Payments & Digital Assets Division
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email:
dp25-1@fca.org.uk

Disclaimer

We make all responses to formal consultations available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Chapter 1

Overview

Our approach

1.1 In 2023, HM Treasury (The Treasury) announced plans to legislate for a financial regulatory regime for cryptoassets. Currently our regulatory remit for cryptoassets is limited to the Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs), the financial promotions regime, and consumer protection legislation (including, the Consumer Rights Act 2015 and Consumer Protection from Unfair Trading Regulations 2008).

1.2 The Treasury outlined in November 2024 that the previous government's proposals to create new regulated activities for cryptoassets still stand. As set out in the draft Statutory Instrument (SI) for the Regulated Activities Order (RAO), this will bring the following activities within our regulatory remit: operating a cryptoasset trading platform, intermediation, cryptoasset lending and borrowing, staking and decentralised finance (DeFi).

1.3 This Discussion Paper (DP) sets out the outcomes we aim to achieve and the proposals we are seeking to implement. We are seeking feedback on these proposals and any alternatives that achieve the same outcomes.

1.4 The use of cryptoassets is becoming more popular amongst UK consumers. A recent survey we commissioned from YouGov shows that 93% of UK adults have heard of cryptoassets and 12% of UK adults (around 7 million adults) own cryptoassets. We want to develop a safe, competitive, and sustainable crypto sector in the UK that enables innovation and is underpinned by market integrity.

1.5 In November 2024, we published an indicative roadmap for developing and implementing the UK's crypto regime. Our approach is in line with our growth and international competitiveness objectives. We want to create the right environment for firms to grow and innovate. We will strike a balance to ensure consumers are protected and markets function well.

1.6 Unless stated, the language and terms we use in this DP reflect terms commonly used within the industry and are not legal terms or definitions in legislation or regulatory rules.

1.7 These proposals have been informed by extensive engagement with the crypto industry, consumers, traditional finance participants and input from Crypto Policy Roundtables held in April and May 2024. These proposals also reflect feedback from the 2023 Treasury Consultation.

1.8 We learn from and engage with international partners and regulators. Our developing framework is closely aligned with international standards. We play a leading role in International Organisation of Securities Commissions (IOSCO)'s crypto work and

work closely with the Financial Stability Board (FSB) and the Financial Action Task Force (FATF). We led the development of the IOSCO Crypto and Digital Assets (CDA) Recommendations (2023) and the implementation of those recommendations. We have also undertaken significant work to help develop international standards through the FSB and led its thematic peer review on global regulatory framework for cryptoasset activities.

Strategic outcomes

1.9 So far, we have:

- Published DP23/4 in November 2023, on developing our regime for fiat-backed stablecoins.
- Published DP24/4 in December 2024 outlining our proposed frameworks for admissions and disclosures (A&D) and market abuse regime for cryptoassets (MARC).

1.10 In addition to this:

- In Q2 2025, we will be publishing a Consultation Paper (CP), consulting on the proposed rules and guidance for issuing a qualifying stablecoin, safeguarding qualifying cryptoassets and specified investment cryptoassets. This will be published alongside a CP on the prudential framework for cryptoassets and prudential requirements for qualifying stablecoins and safeguarding.
- These activities will also be subject to wider conduct and firm standards, such as the Consumer Duty and rules within the Conduct of Business Sourcebook. We will consult on these standards in a CP on conduct and firm standards for RAO activities planned for Q3 2025.

1.11 By introducing rules to this new sector, we expect to have a positive impact on consumers and the market. In line with our new FCA strategy and strategic outcomes, we expect our regulation will bring the following benefits:

- **Consumer protection:** achieve an appropriate degree of protection for the public when dealing with crypto products and services.
- **Market integrity:** protect and enhance the integrity of the UK financial systems.
- **Effective competition:** support effective competition that delivers high quality offerings in the cryptoasset market.
- **International competitiveness and growth:** facilitate the international competitiveness of the economy of the UK and contribute to growth in the medium to long term, appropriately aligning with international standards.
- **Sustainable system:** achieve a sustainable system economically and financially.
- **Accessibility:** support access to appropriate financial products and services that meet consumer needs and offer fair value.

1.12 Costs of regulation may include:

- **Direct costs:** Once new requirements are part of our Handbook, firms are likely to need to make changes to comply with these requirements. These direct costs will affect firms offering cryptoasset services to UK consumers and will likely result in both one-off and ongoing costs. These may include: IT development, maintaining systems, staff training, communication, reporting and disclosure, and governance. Direct costs may also include changes to firms' business models.
- **Indirect costs:** Our proposed requirements would result in changes to the UK cryptoasset sector or market, which could in turn result in indirect impacts or costs. These could include higher prices, if firms pass on any incremental costs (associated with compliance or business model changes) they incur to consumers. There may also be higher barriers to entry as a result of our proposed requirements which could result in firm exit, or reduced competition in the sector.

Consumer duty considerations

1.13 In our CP on conduct and firm standards for RAO activities, which we are scheduled to publish in Q3 2025, we will consult on applying the Consumer Duty to the cryptoasset activities and services where they offer products to retail customers.

1.14 This DP proposes some additional requirements that would strengthen consumer protection. Throughout, we have considered where the Consumer Duty is sufficient to drive the outcomes we want to see in this market.

1.15 We welcome stakeholder views on whether some of the proposals in this DP are not warranted, because the Consumer Duty could drive the outcomes we want to see in this market. In answering questions throughout this DP, please clearly state where the Consumer Duty could achieve our outcomes and why that would be the case.

What this will mean for consumers

1.16 Aside from the MLRs, financial promotions regime, and consumer protection legislation, firms' cryptoasset activities are currently unregulated in the UK. At present, consumers who buy cryptoassets do not have regulatory protections and should be prepared to lose all their money.

1.17 The cryptoasset market is inherently volatile. This, combined with the lack of reliable basis for valuation of unbacked cryptoassets, means that even with our future regulatory regime in place, this market will remain high risk. Consumers should take this into account. Even when the future regime for cryptoassets is finalised, it will not offer the same degree of protection and market integrity as in traditional markets.

1.18 This is partly due to the structure of the cryptoasset market, particularly its cross-border, fragmented nature, the pseudonymity of wallets, the lack of an established financial market infrastructure for managing risks and settling trades and the lack of

a corporate 'issuer'. We will continue to pursue requirements that help consumers understand these risks before engaging in cryptoasset activities.

1.19 Given this context, we fully acknowledge the trade-offs of cryptoasset market regulation, and we are open to considering alternatives to our proposals.

Who should read this discussion paper

1.20 This DP will be of interest to a wide range of organisations and individuals that participate in the cryptoasset sector. This includes:

- firms or individuals that participate in, or support the services of, the proposed regulated activities in this DP
- finance services participants
- industry groups and trade bodies
- professional advisors and experts
- consumer groups and individual consumers
- policy makers and other regulatory bodies
- academics and think-tanks.

Equality and diversity considerations

1.21 Regulation of cryptoassets has the potential to attract a more diverse range of consumers, contributing to the growth of the sector. That said, this could mean a wider range of people, including those who are financially vulnerable, enter the market. Future regulation will seek to reduce information asymmetries, lower market abuse and increase consumer protection.

- A recent survey we commissioned from YouGov found that cryptoassets owners are more likely to be male, under 35 and more likely to have a higher-than-average household income.
- 20% of respondents who bought cryptoassets believed they had financial protection.
- 52% of current users and 31% of non-cryptoasset users indicated that they would be more likely to invest if the market was regulated, or if regulations provided financial protection against financial losses.

1.22 Overall, we do not envisage these proposals would adversely affect any of the groups with protected characteristics under the Equality Act 2010 which include: age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. We also believe that our proposals will not negatively impact financial inclusion.

1.23 We do not envisage our proposals will directly affect the digitally excluded population and older consumers who are less likely to invest in cryptoassets.

1.24 We expect cryptoassets consumers across all groups, not just a younger and higher income audience, will benefit from the protection of a regulatory regime for

cryptoassets. As we develop our regime, we will continue to consider if our work could affect the make-up of consumers in this market, or otherwise impact on equality and diversity. In the meantime, we welcome your input on this.

1.25 Overall, we do not consider our proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 (in Northern Ireland, the Equality Act is not enacted but other anti-discrimination legislation applies). We are aware that certain demographic segments are over-represented in cryptoasset ownership.

Next steps

1.26 We welcome feedback on the topics in this paper. See the questions we seek feedback on in Annex 3. Please provide your feedback by 13 June 2025.

1.27 We will consider the feedback we receive and will use it to determine next steps. We intend to publish a CP on any proposals outlined in this DP, if we propose to adopt them, as part of our final rules. We will draft appropriate new Handbook rules for consultation. Should issues arise that are beyond our powers, we will raise them with the Treasury and other stakeholders.

What you need to do

1.28 Please send us your responses via the form on our website or by email to dp25-1@fca.org.uk. If responding by e-mail, please indicate whether you wish your response to be treated as confidential and, separately, if you are content to be named as a respondent.

1.29 Following the publication of this DP, we are keen to continue engagement with market participants during the consultation period. Please make requests for meetings using the above email address.

Chapter 2

Cryptoasset Trading Platforms

Background and context

2.1 The Treasury's draft SI defines the new regulated activity of 'operating a qualifying cryptoasset trading platform' as:

[the operation of] 'a system which brings together or facilitates the bringing together of multiple third-party buying and selling interests in qualifying cryptoassets in a way that results in a contract for the exchange of qualifying cryptoassets for any of: (a) money (including electronic money); or (b) other qualifying cryptoassets.'

2.2 In this chapter, we refer to entities authorised as qualifying cryptoasset trading platforms as 'CATPs'. We refer to unauthorised ones in more generic ways, such as 'cryptoasset trading platforms' or 'exchanges'.

2.3 This chapter sets out our proposed policy for regulating CATPs. It has been informed by the current rules and obligations applied to trading venues in traditional financial markets. We have also considered the Treasury's 'Response to the consultation and call for evidence' (in particular Chapters 4, 5, and 6), as well as the IOSCO 'Policy Recommendations for CDA Markets'. In May 2024, we held policy roundtable discussions on cryptoasset trading platforms and intermediaries.

Risks and key harms associated with cryptoasset trading platform activities

2.4 Our proposals seek to reduce a number of risks:

Key risks to be addressed by location, incorporation, and authorisation requirements:

- Sale of unsuitable or illegal products and services to UK clients
- Inconsistent or unfair regulatory requirements between domestic and overseas firms
- Inability of UK investors to access or withdraw their invested assets
- Low levels of liquidity or poor price outcomes for UK investors

Key risks to be addressed by access, systems and controls, and trading and execution requirements:

- Disorderly, inefficient, illiquid markets
- Unreliable or unavailable trading systems
- Consumer harms from discriminatory trading practices or information asymmetries
- Consumer harms from unmanaged conflicts of interest

- CATP operators engaging in proprietary trading against their customers in a harmful way
- Losses or disorderly markets from settlement failures

Key risks to be addressed by transparency and reporting requirements:

- Inefficient, uncompetitive or unfair markets due to lack of transparency
- Market abuse due to non-existent or inconsistent monitoring capabilities

Desired Outcomes

2.5 Through our regulatory regime, we want to achieve the following outcomes:

Desired outcomes for location, incorporation and authorisation requirements:

- UK clients are served by authorised firms for regulated cryptoasset activities, unless specifically exempted.
- Authorised firms are structured in a way that enables us to adequately supervise the conduct of their UK business.
- UK investor access to global liquidity pools through authorised entities is permitted, where possible.
- Firms are encouraged to operate CATPs that comply with our rules and requirements in a way that encourages the sustainable growth of cryptoasset markets in the UK.

Desired outcomes for access, systems and controls, and trading and execution requirements:

- Investors access suitable products, consistent with their risk profile
- Investors can participate in liquid, efficient, fair, orderly and resilient markets, which are open and competitive.
- There is a clear understanding and allocation of responsibilities for investor protection and the promotion of clients' best interests.
- CATP customers get fair value outcomes as CATPs adequately address and manage their conflicts of interests.
- CATPs do not internalise, or take responsibility for, risk management activities with or between their clients.
- Transactions finalised over a CATP are settled in a timely and effective manner.

Desired outcomes for transparency and reporting requirements:

- All market participants can operate in fair, efficient and transparent markets.
- Executed transactions are adequately recorded, consistent with the relevant reporting requirements.

Summary of the key policy proposals

2.6 We summarise the key policy propositions discussed in the subsequent 5 sections:

- In general, an entity operating a trading platform for cryptoassets in the UK, or providing services to UK retail clients, will need to be authorised in the UK. We explore when offshore firms could provide trading services to UK clients through establishing a UK branch if the group also has an authorised UK subsidiary. We discuss the conditions for authorising a branch and how to allocate responsibilities and rules between the branch, the offshore CATP and the UK affiliate.
- CATPs should be subject to additional rules and obligations where there is retail access, algorithmic or automated trading and market making activity. For example, we consider whether CATPs should identify, and set up contractual arrangements with entities using market making strategies on their platforms.
- CATPs should operate trading systems according to non-discretionary rules. This means that the platform operator treats orders identically according to pre-determined rules. We discuss the risks and concerns from the interaction of principal dealing activities with the operation of a CATP in 3 possible cases: (i) the operator of the CATP dealing on own account on its own platform; (ii) the operator of the CATP dealing on own account off platform; (iii) a principal trading firm dealing on own account on a group affiliate CATP. We also discuss risks and possible options for executing orders finalised over a CATP on a matched-principal basis.
- CATPs should eliminate or, where this is not possible, manage their conflicts of interest. We think that CATPs should not be exposed to their clients' risks due to upstream or downstream activities. We discuss the extent to which CATPs can play a role in the issuance of cryptoassets and clearing and settlement. We discuss the various ways in which risks from potential conflicts of interests, or vertical integration, could be addressed.
- Provision of both pre-trade and post-trade transparency by CATPs. We ask whether there are preferred standards for the consistent recording of transaction data on-chain and off-chain, and how to address possible privacy concerns if there is direct retail participation.

Location, incorporation, and authorisation of CATPs

Background: authorisation requirements for operating a CATP

2.7 In line with the Treasury's approach, any entity operating a trading platform for cryptoassets in the UK, or providing services to UK clients, will generally need to be authorised in the UK. The Treasury legislation also clarifies that the current Overseas Person Exclusion (OPE) will not be extended to cryptoasset activities. However, we have considered and proposed alternative methods for enabling appropriate market access. The Treasury noted in their consultation that they may reassess this position once equivalence or recognition arrangements are in place with other jurisdictions.

2.8 In simple terms, whether a firm will have to be authorised will depend on the nature of its clients and whether these are dealing in a principal or agency capacity. If a firm operates a trading platform for cryptoassets in the UK, or is serving UK retail customers, it must be authorised as a CATP. On the other hand, a firm operating an offshore trading platform for cryptoassets that is only serving professional investors in the UK will not require authorisation. (See the draft Treasury SI for specific perimeter provisions.)

Authorisation of overseas firms operating CATPs via UK branches

2.9 Consistent with the Treasury consultation, we are committed to building a competitive and open financial system. International firms, including banking groups and market infrastructure operators are an established part of the UK's financial services landscape and help the UK maintain open and competitive markets.

2.10 In line with our approach to international firms, we recognise international firms have some choice on the legal form of their UK presence. For example, they can serve UK customers from an entity incorporated outside the UK through a UK branch. We refer to the UK establishment or physical presence of a non-UK entity as a UK 'branch'. Operating branches helps markets function well, while helping the UK maintain open and competitive markets.

2.11 However, international firms can present specific challenges, such as enhanced insolvency and resolution risks, risks of regulatory arbitrage, increased difficulties to detect or prevent risks, or enforce our rules and obligations on the overseas firm. So, when we consider a firm's application, we assess whether we can adequately supervise the conduct of its UK business and the level of supervisory cooperation with the firm's home state regulator, among other factors.

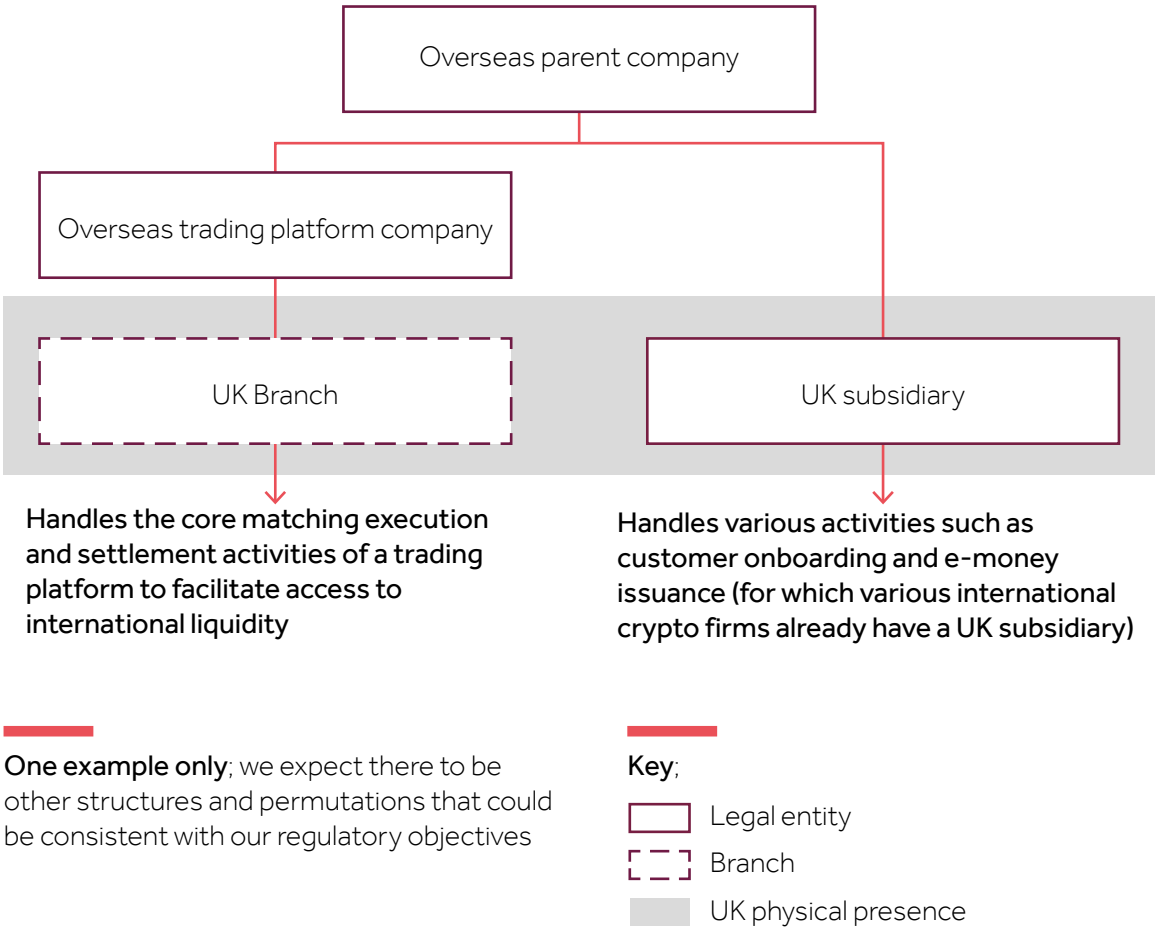
2.12 One approach could be to require all CATP activity to be operated by a UK legal entity. However, this could limit UK investors' access to international liquidity pools. It may also be disproportionate and misaligned with our secondary growth objective. An alternative approach would be to allow a CATP to operate through a branch of an authorised overseas firm. For firms serving retail customers, we think this is unlikely to meet our objectives due to risks of harm to these investors. Without any UK legal entity presence, it would be challenging to make sure our standards are being maintained. For cryptoasset activities, supervisory cooperation with overseas regulators is recent or very limited for several structural reasons.

2.13 Figure 1 shows one potential example of a legal entity structure we believe would be compatible with our regulatory objectives. Here, an international crypto firm would have both a UK branch and a UK subsidiary, so:

- The UK authorised branch would handle functions which are central to a CATP's operation, so enabling UK investors' orders to interact with orders of overseas investors. This is one way in which UK investors would have access to superior price and execution outcomes.
- The UK subsidiary could handle certain other client-facing functions, like customer onboarding and e-money issuance, or other ancillary or complementary activities. Various international firms already have a UK subsidiary for these types of

activities. The presence of a subsidiary would also enable us to assess the conduct of the firm's overall UK activities more effectively.

Figure 1: An example of a legal entity structure that could meet our regulatory objectives



2.14 We think this is a reasonable alternative to the OPE and equivalence or recognition arrangements while international cooperation frameworks develop. As these frameworks and cooperation between regulators mature, we could rely more on overseas entities to carry out UK customer facing regulated activities.

2.15 We know there may be many other structures of arrangements which could meet our objectives. We remain open to other proposals that could strike an appropriate balance between ensuring sufficient oversight and regulatory control and maintaining competitiveness and market access.

2.16 As discussed in our approach to international firms, authorising a CATP operated through a branch of a non-UK firm creates greater potential regulatory risks. These risks can be caused by jurisdictional differences, or because it becomes more complicated for us to take specific action. So, our approach is to authorise such firms on a case-by-case basis. We will only give authorisation to operate a CATP through UK branches to an overseas firm if it can meet the fundamental threshold conditions and our general expectations. Additionally, a branch should only be authorised for non-UK firms, and

not as a gateway to operate a predominantly UK business from an overseas jurisdiction. Accordingly, CATPs with significant UK business will have to maintain the appropriate operations, permissions and authorisations in the UK. The factors we consider include:

- Whether the home regulator has a similar level of protections and regulatory requirements in place.
- The degree of cooperation with the home state regulator, including agreements and Memorandum of Understanding (MoU).
- Whether we can supervise the firm operating the CATP effectively through the UK branch (or the affiliated UK entity), including against the market abuse regime, and our ability to intervene effectively where appropriate.

2.17 As with our approach to offshore trading venues operating UK branches, we propose to apply a home/host approach. Home is the jurisdiction of incorporation and host is the location of the branch. We set out our expectation of how this would work in practice below.

- As the host jurisdiction for CATP branches, the requirements and obligations we propose to apply are:
  - Our CATP conduct rules and requirements, including relevant conduct of business (COBS) requirements.
  - Relevant reporting or monitoring requirements and obligations.
  - Conduct and firm standards that will apply generally to all regulated cryptoasset firms (including systems and controls, and Consumer Duty requirements) which will be set out in our CP later this year.
  - Admissions and Disclosures requirements and Market Abuse requirements (see DP24/4).
- We would expect the following requirements and obligations would remain the exclusive responsibility of the home regulator:
  - Prudential capital requirements.
  - Systems and controls for operating the trading system.
  - Relevant governance requirements for the overseas entity operating the CATP.

2.18 We believe this approach will maximise regulatory clarity, ensure compliance with CATP rules, and ensure fair competition among all CATPs providing services in the UK or to UK clients. This is also broadly consistent with our approach post-Brexit for MTF operators with a UK branch.

Access to CATPs and provision of trading services

2.19 In contrast to traditional trading venues that only provide access to authorised members, CATPs may be able to serve retail customers directly. This is a key feature of the existing cryptoasset market that we propose to retain where appropriate. We see benefits in lower costs of disintermediated models and in allowing clients to make their own decisions, provided all key risks are satisfactorily managed and addressed.

2.20 Direct retail access to CATPs raises various regulatory challenges. Rules and responsibilities that usually fall on authorised intermediaries may instead fall on the CATP operator to address the risks (see COBS 1.1.2R for how COBS currently applies in traditional financial markets). The UK client would still trade in its own name and be responsible for all its investment decisions.

2.21 In line with our current approach to international firms, we think that UK retail customers that are served by a CATP should always have a relationship with a UK legal entity. This is to ensure that UK retail customers can benefit from the higher level of supervision and oversight of a UK entity. However, the trading relationship between the firm and the customer could be more flexible to accommodate, for example, direct access to a branch or a model where the subsidiary allows seamless access into a branch.

Question 1: **What are the operational and practical challenges of applying the suggested trading, market abuse, and other requirements to authorised overseas firms operating branches in the UK? Are there alternative approaches that could equally mitigate the risks?**

Question 2: **What are the challenges and limitations of requiring the establishment of an affiliated legal entity for retail access to trading services by an overseas firm with a UK branch?**

Question 3: **What conditions should apply to the direct access of trading services of an overseas CATP with a UK branch?**

Systems and controls and participation in trading arrangements

Background

2.22 This section considers additional requirements where CATPs are admitting specific types of market participants:

- **Direct retail participants** – Retail customers trading in their own name on CATPs. This raises questions for regulators about the responsibilities on retail customers versus those who facilitate their access to the market.
- **Algorithmic traders** – Cryptoasset markets are characterised by the extensive use of automated software and bots (including by retail customers). These can be used cheaply and easily by day traders, unlike in traditional financial markets.
- **Market makers** – CATPs often rely on market makers to continuously quote buy and sell prices, using their own capital. Market making activities are often not transparent or performed by entities that are affiliated with the platform itself.

2.23 In traditional financial markets, entities providing Direct Electronic Access (DEA) capabilities to other clients, or dealing on own account through the use of market

making or algorithmic trading strategies, must meet specific rules and obligations (see MiFID RTS 6, MiFID RTS 8, and MAR 7A). Trading venues must also meet rules and requirements when granting access to these entities (for example, MAR 5.3A, MAR 5A.5, and REC 2.5). We have referred to these standards when designing these proposals.

CATP responsibilities and obligations for direct retail access

2.24 We want to make sure that it is always possible to identify the person responsible for placing an order to and executing a transaction on a CATP. This can become problematic when retail customers can directly access a CATP and participate in trading arrangements, as they may not be subject to regulatory requirements. One solution would be to require all such customers to be authorised members of the platform. However, this could undermine the attractiveness of direct retail access and affect how cryptoasset markets function.

2.25 As it may be inappropriate or impractical to put responsibilities and obligations on retail customers, we think that the CATP should take on various responsibilities on behalf of clients when they offer direct access to their trading systems. Indicatively, we suggest that CATPs should be required to:

- Disclose and clarify their own and their clients' respective responsibilities.
- Ensure that customers comply with the platform rules and relevant regulations (for example, not engaging in market manipulation).
- Monitor trading activity to identify infringements of rules.
- Set controls and limits for each type of customer profile.
- Be able to revoke access or participation rights, or to suspend a customer.

2.26 These requirements may be necessary to clearly identify responsibilities and make sure we can address risks to market integrity and ensure compliance with trading rules.

CATP responsibilities and obligations for algorithmic and automated trading

2.27 In traditional financial markets, trading venues must meet specific requirements for members using algorithmic trading and high-frequency trading (HFT) strategies. Algorithmic and HF traders also have to be authorised when carrying on activity in traditional financial markets. They need to be appropriately identified and cannot benefit from certain exemptions due to the risks they pose to orderly trading (see PERG 13 Q40).

2.28 Algorithmic trading and automated trading software are highly prevalent in cryptoasset markets, with popular bot providers reporting up to 1 million users. Retail investors can use a variety of trading software, or bots, that automatically place orders and determine trading strategies, with limited or no human intervention. Trading platforms also provide dedicated access capabilities for algorithmic trading or HFT.

2.29 We think that operating algorithmic or automated trading strategies and bots without proper controls and oversight may present threats to market integrity and orderly cryptoasset markets. Our proposals seek to manage these risks as far as possible.

One way of achieving this could be to adopt the rules and requirements which apply to authorised firms in traditional financial services (see MiFID RTS 6, MiFID RTS 8, and MAR 7A).

2.30 However, we know there are issues and challenges in this approach. Automated trading in cryptoasset markets can be operated by retail participants (who are not authorised persons and so not subject to the regulatory requirements that apply to authorised persons). There are also a growing number of software companies or bot developers that may offer a wide range of services and products to any investor (often for free or little cost). The use of bots may therefore be difficult to identify, monitor or influence.

2.31 For these reasons, we are considering whether we need to adopt a different and more pragmatic approach to the operation of algorithmic trading and automated trading software. We also want to understand the risks of not applying further requirements to CATPs to cover identifying, managing, or authorising algorithmic or automated trades. We want to understand the costs and challenges in implementing and effectively supervising and enforcing such requirements.

2.32 Whichever solution is preferred, CATPs will have requirements to ensure fair and non-discriminatory access to trading and ensure orderly markets. Conflicts of interests between providers of algorithmic or automated trading software and the CATP operator should be eliminated where possible, or adequately managed and disclosed where not possible.

CATP responsibilities and obligations for market making arrangements

2.33 In more traditional investment products such as cash equities, market makers play an important role by posting simultaneous buy and sell quotes on a continuous basis. Traditional trading venues have specific regulatory obligations in place with firms operating market making strategies. Additionally, due to their important role in providing liquidity and ensuring orderly markets, market makers in financial markets must be authorised and cannot benefit from certain exclusions available to persons dealing on own account (see PERG 13 Q40).

2.34 The concept of market making is currently not formalised in cryptoasset markets. Their precise role and share of trading volume is not fully clear and varies across different cryptoassets. In addition, retail traders can act as liquidity providers and potentially operate market making strategies.

2.35 We are concerned about the potential for practices that may undermine market integrity. These largely involve anti-competitive or collusive business practices between trading platforms and market makers. This may result in artificial inflation of trading volumes, unfair advantages for affiliated market makers or market manipulation.

2.36 Given the importance of market makers, it may be appropriate to impose further requirements on CATPs. These would require them to identify entities operating market making strategies on their platform, disclose potential legal, contractual, or commercial relationships and set up appropriate contractual agreements with them. These agreements may include terms and conditions of the market making scheme,

and the market makers' obligations when posting simultaneous two-way quotes over the platform for a specific liquidity pool. This would bring our rules in line with current requirements in financial markets. Alternatively, given the direct participation of natural persons and the increased complexities, it could be more appropriate and effective to limit these requirements to a subset of significant market makers for each CATP. However, this would require us to define a minimum threshold.

2.37 We welcome views from industry and the public on the best ways to address the risks from current market making practices in cryptoasset markets.

Question 4: **What, if any, additional responsibilities should we consider for CATPs, to address the risks from direct retail access?**

Question 5: **How can CATPs manage the risks from algorithmic and automated trading strategies?**

Question 6: **Do you agree that CATPs should have contractual agreements in place with legal entities operating market making strategies on their platforms? Are there alternative approaches that could equally mitigate the possible risks to market integrity?**

Trading and execution

Background

2.38 Cryptoasset trading services are provided by a variety of entities with different matching and execution protocols. Some cryptoasset exchanges combine discretionary and non-discretionary trading systems, as well as dealing activities and operating multilateral trading systems. Trading platforms often trade in principal capacity on and off platform with their clients but it can be unclear when they do so. These practices create a variety of regulatory concerns that should be addressed to make sure all relevant risks are adequately mitigated and managed.

2.39 This section discusses the ways orders can be matched and executed on the CATP. It also discusses the limited extent to which the firm operating the CATP, or group affiliates, can deal in principal capacity against the CATP's clients (on and off platform).

Discretionary trading practices

2.40 In a discretionary trading system, the operator exercises judgement on whether to place a client's order, and/or when and how to match and execute the order. In traditional financial markets, discretionary multilateral trading is reserved to largely illiquid non-equity instruments in inter-dealer markets (Organised Trading Facilities).

2.41 We intend to require all CATPs to operate non-discretionary trading systems. This means that the platform operator treats all orders identically, according to a consistent set of predetermined rules. The platform operator cannot use their judgement to match off orders against each other. This means it cannot decide if, when and how much of 2 or more orders it wants to match.

2.42 We think this is appropriate for the following reasons:

- **Consumer protection:** It ensures that all participants are treated fairly and are subject to the same, pre-defined rules, which are objective and non-discriminatory.
- **Business models:** Discretionary venues in financial markets are mainly used for manual or semi-manual trading protocols, such as voice or hybrid trading. Cryptoasset markets are fully digital and highly automated, open 24/7 and mainly operate order book systems. Our view is there are limited use cases for discretionary trading systems in crypto.
- **Market structure:** We think that cryptoasset markets will benefit from greater regulatory clarity and simplicity compared to traditional financial markets' trading rules and regulation, which evolved over several years, across a range of different products and instruments. As a result, we are not planning to define different authorisations for different platforms based on specific types or categories of cryptoassets admitted to trading.

2.43 Investors choose how they want to access the market. Under our proposals, investors who access the market directly would benefit from non-discretionary execution and be treated equally with all other market participants, including institutions. Various investor protection provisions may not be compatible with non-discretionary platforms (COBS 1.1.2R gives the current exemptions in traditional financial markets). For this reason, we may not expect CATPs to take all sufficient steps to obtain the best possible order execution results for clients, such as being subject to best execution requirements. Where investors access the CATP directly, the investors themselves would need to consider all prices and associated fees and costs to decide where best to execute their trade.

2.44 Alternatively, an investor could use an intermediary to access the market. In this case, the intermediary may be subject to additional investor protection rules and required to act in the investor's best interest, such as seeking best execution for the client. The intermediary is likely to charge commission or require compensation in other ways for this service. It would be up to the investors to determine which approach suits their needs best.

Operation of a CATP and ability to deal as principal

2.45 In simple terms, Matched Principal Trading (MPT) is a form of trading where a broker (middleman) stands between the buyer and seller as a central counterparty. The broker makes sure that the price and quantity is agreed on both sides before the trade is executed. The broker takes a fee rather than making money through the spread (difference between buy and sell price).

2.46 We see various risks from this practice when performed directly by operators of CATPs:

- Firstly, MPT may create conflicts of interest between the CATP operator and its clients. This is because it creates risks that the CATP may trade against their clients in a principal capacity. The firm operating the CATP may exploit the ability to trade on a matched-principal basis to take active market positions against clients on its own platform.
- Secondly, the ability to execute trades on a matched-principal basis exposes the CATP to some degree of credit risk. It also exposes the CATP to market risk if the counterparty defaults and another cannot be found immediately. This could both undermine CATPs' role as risk-neutral marketplaces, and lead to the failure of the CATP, substantially increasing the risk of disorderly markets.

2.47 For these reasons, we are concerned this practice may introduce risks to market integrity and consumer protection. It could also potentially undermine our intention to prohibit CATPs' operators from dealing in principal capacity against their own clients. Additionally, the benefits of operating MPT in cryptoasset markets are still unclear. We think that a CATP may achieve similar results through using a separate, affiliated entity to execute transactions finalised over the CATP on a matched-principal basis.

2.48 However, we know MPT is a common practice in cryptoasset markets. Exchanges often execute clients' transactions back-to-back, by standing between the 2 trading counterparties. Given MPT's relevance to the industry, we want to explore the benefits and risks of alternative regulatory options and would like to hear arguments about how the risks we outlined could be otherwise managed.

2.49 At present, CATPs engage in various principal dealing activities. The ability of the firm operating a CATP to deal as principal exposes the CATP to market and other risks which could create resiliency risks. Conflicts of interest may also undermine the fair and non-discretionary operation of markets. Finally, it may possibly lead to abusive or anti-competitive practices by the CATP operator. With the IOSCO CDA recommendations in mind, we want to discuss the following three policy propositions.

- First, in line with the standard approach in traditional financial markets, we do not think the CATP operator should be allowed to trade in principal capacity on its own platform under any circumstances. This would create unmanageable and unacceptable conflicts of interests between the CATP operator and its clients that would severely undermine market integrity and discourage investors from trading on that platform.
- Second, we are concerned about the risks of the CATP operator trading in principal capacity off platform, for trading activity not related to their CATP's operation. We think the CATP operator's ability to take market positions, including against the CATP's clients, presents significant risks of conflicts of interests and possible market manipulation. It also means the CATP can be exposed to market and product risks that may cause resiliency issues and undermine orderly markets.
- Finally, there could still be risks in allowing separate but affiliated principal trading firms, including market makers, to trade on the CATP. The non-discretionary nature of CATPs, together with appropriate transparency, disclosure and consumer protection requirements, reduce some of the risks emerging from firms dealing

in principal capacity on an affiliated platform. However, a CATP's group affiliate may still have some form of competitive advantage against the other trading counterparties, or be perceived to have this advantage. This may create risks of unfair markets and consumer harms for retail investors. These risks are particularly visible due to the potential conflicts of interests leading to illicit and illegal practices, such as wash trading and market manipulation.

2.50 We want to identify how we can best manage these risks. One part of the solution could be to require the principal trading entity to have either operational or legal separation from the firm operating the CATP, such as a different legal entity within the corporate group. For instance, the UK subsidiary in a branch-subsidiary model could be authorised to deal in principal capacity. Such separation between the CATP and the entity trading in principal capacity could help reduce the risks of conflicts and market risk. However, this would depend on the structure and degree of the separation. We also recognise that such separation can create costs and complexity for firms.

2.51 We acknowledge that preventing group affiliates to trade on the CATP may reduce liquidity on the platform, which may affect client outcomes and increase the costs of operating global groups. So, we would like feedback to make sure that we can sufficiently address all the relevant risks emerging from firms dealing in principal capacity on an affiliated platform, while making sure that CATPs can operate liquid and efficient markets.

2.52 More generally, we want to better understand the current use of principal trading, including back-to-back or matched principal trading on the part of the CATP operator. Given the relevance of principal trading for the industry, we want to explore the benefits and risks of alternative regulatory options. The outcome we want is for firms to be able to show satisfactory governance arrangements and systems and controls to manage their risks and conflicts of interests between the 2 functions.

Question 7: **Is there a case for permitting discretionary trading practices for CATP operators? If so, how could the above risks be appropriately mitigated?**

Question 8: **Should firms operating a CATP be permitted to execute transactions on a matched-principal basis? If so, how could the above risks be appropriately mitigated?**

Question 9: **Have we properly identified the risks from the operator of a CATP also being able to deal in principal capacity off platform? What is your view on these risks and whether it should be permitted or restricted for an operator of a CATP? If permitted, how should those risks be mitigated?**

Question 10: **What are the risks from an entity affiliated with the CATP trading in principal capacity either on the CATP or off the CATP? What additional requirements are necessary to mitigate these risks?**

Pre-trade and post-trade considerations

Background

2.53 CATPs are involved at various stages of the typical trade life cycle. Among other things they may:

- Issue cryptoassets.
- Admit cryptoassets to trading, including their own, or cryptoassets they have a material interest in.
- Undertake brokerage activities, including acting as a principal trading firm.
- Provide access to their trading platform to clients, including retail customers.
- Hold clients' assets and perform reconciliation of their clients' positions internally.
- Perform the role of clearing houses and settlement entities: internalise and manage counterparties' credit and market risks, and settle trades finalised over their platform (often performing the role of 'settlement internalisers').

2.54 This section discusses how far a CATP should be able to: (i) merge primary and secondary markets' activities; (ii) internalise and manage counterparty credit risk; (iii) manage and address settlement risk.

Issuance of cryptoassets

2.55 Some exchanges admit cryptoassets for trading on their platform that they have a material interest in. Cryptoassets might be issued by the trading platform itself, by an affiliate entity of the group or by a partner with privileged commercial relationships.

2.56 This practice creates risks due to the conflicts of interests between the investors in the cryptoasset, the cryptoasset's issuers and the CATP admitting the token for trading. A CATP will have a significant economic interest in the success of the cryptoasset's issuance and trading. Risks may be greater when affiliated entities trading the token on the CATP may be incentivised to act on inside information or engage in wash trading. This may also stifle competition and disadvantage issuers of alternative tokens.

2.57 It may be problematic to simply prohibit CATPs from admitting cryptoassets issued by affiliated entities or cryptoassets that the firm operating the CATP has a financial interest in. These prohibitions could create unfair competitive conditions between different CATPs, or undermine the operations of certain service providers or even of the underlying blockchains. This is also true of tokens used to operate the consensus protocol of an underlying blockchain controlled or developed by the firm operating the CATP. These prohibitions could create unfair competition between different CATPs, or undermine the operations of certain service providers or even of the underlying blockchains.

2.58 We are considering whether we should require legal or functional separation between the firm operating a CATP and the issuer of the cryptoassets admitted to trading on the CATP. Legal separation may be justified to avoid credit and market risks exposures, address prudential risks from creating and issuing the cryptoasset, and conflicts of interests or uncompetitive practices against issuers. This would be in addition and independent from the necessary disclosure requirements as proposed (and to be consulted on) under the A&D regime (DP24/4).

Prefunding, counterparty credit risk, and parties' exposures

2.59 Exchanges currently use a variety of practices and strategies to manage and control market and counterparty credit risk. These include requiring prefunding or offering credit lines to some counterparties. We understand these practices are mainly implemented by exchanges to compensate for the lack of an established financial market infrastructure that can manage, and control for, risks of trading. By doing this, exchanges internalise some of the risk from counterparties trading on their platforms.

2.60 We think that CATPs should remain risk-neutral trading systems. We propose the best outcome would be for CATPs to have no counterparty or credit risk to clients or products. This ensures that price signals on CATPs are not distorted and do not internalise CATP-specific risk factors. It also increases transparency and reduces the risks of fragile or disorderly markets.

2.61 Under this model, a firm operating a CATPs would not be permitted to act as a clearing house and directly manage or internalise risk exposures between the counterparties that interact on their platform. It would also not be permitted to provide credit lines or make credit arrangements with their clients. This would also prevent CATPs from directly setting up lending arrangements with their clients or trading in a principal capacity against their clients.

2.62 However, we would still expect firms operating CATPs to have adequate arrangements in place to ensure that trades finalised on their platforms can be concluded. We see

advantages in allowing different ways of managing this risk. As a result, we do not intend to prescribe specific risk management protocols, such as explicitly requiring prefunding of orders, to manage settlement risks.

Settlement of transactions

2.63 Settlement is defined in financial markets (see 'Principles for Financial Market Infrastructures') as the 'irrevocable and unconditional transfer of an asset [...], or the discharge of an obligation [...] in accordance with the terms of the underlying contract.'

2.64 We note that the settlement process is quite different in cryptoasset markets. CATPS's do not have control of blockchains, and the Treasury does not intend to introduce regulation of blockchain protocols themselves. Additionally, concepts such as 'settlement finality' remain undefined for public permissionless blockchains. Through the Digital Security Sandbox (DSS) initiative with The Treasury and the Bank of England (BoE), we have temporarily modified the existing regime for securities settlement to include developing technologies such as Distributed Ledger Technology (DLT). We will consider lessons from this initiative that could apply in the cryptoasset market. The joint BoE and FCA policy statement gives further information about the DSS, including suggested timeframes.

2.65 Independent of the specific settlement and custody arrangements, we expect CATPs to have satisfactory arrangements for securing the timely and effective transfer of control over the cryptoassets traded on their platform. One option could be to allow CATPs to arrange or facilitate the settlement of transactions finalised on their platforms. In this case, we could place requirements and obligations over the relationships, communication and interactions with the entity responsible for settling trades. Alternatively, CATPs could internalise settlement practices. In this second case, we would need to define specific settlement obligations and requirements applicable to the CATP itself, which would now be directly responsible for settling trades finalised over its platform.

2.66 Alongside this, CATPs could be required to clearly inform their clients of their responsibilities for the settlement of the executed transactions, in line with requirements for traditional trading venues (see REC 2.8, MAR 5.4 and MAR 5A.6). We know the current models in the cryptoasset markets (where CATPs often internalise the settlement stage and take on settlement responsibilities) could create risks for the CATP or its clients if a counterparty cannot fulfil its settlement obligations. We would like views on these risks and how they could be mitigated.

2.67 Settlement requirements may also be connected to, or rely on, other existing FCA rules. One example is custody rules, defining the way an entity can maintain and reconcile its records and accounts both off-chain or on-chain (by signing and initiating blockchain transactions). This may avoid legal uncertainty or inconsistency between different regimes in case of separate rules for on-chain and off-chain settlement. We will consider conflicts of interest between different regulated activities, such as operating a CATP and cryptoasset custody, holistically. We will consider this fully in our later consultation paper. In addition to evaluating responses to this DP, we will also develop further work on this topic in coordination with other relevant stakeholders, such as the Law Commission, the Treasury, and the BoE.

Question 11: **What are the risks from admitting a cryptoasset to a CATP that has material direct or indirect interests in it? How should we address these?**

Question 12: **Are there important reasons why the same entity authorised to operate a CATP should also be able to provide credit lines or financial accommodations to the CATP's clients?**

Question 13: **Do you agree with our proposal to prevent CATPs from managing or internalising credit risks between counterparties trading on their platforms? If not, why not and how would you suggest the CATP manage these risks?**

Question 14: **How should we interpret or define settlement for the purpose of CATP settlement rules? Would these rules be specific to CATPs or should they be extended to other trading activities?**

Transparency and reporting requirements

Background

2.68 Market transparency is necessary to ensure market integrity. Greater transparency ensures efficient pricing and promotes fair markets and a level playing field for all firms providing trading services. This promotes greater consumer protection. However, transparency can be costly and have a negative impact on liquidity and therefore market function. We recognise transparency requirements need to balance these benefits and costs.

2.69 Currently, cryptoasset market data is often unreliable and inconsistent, and different markets have very different levels of transparency. This can undermine efficient pricing, create unlevel playing fields, and create incentives in favour of minor, or illiquid, trading desks that do not offer the same level of transparency.

2.70 We propose to introduce transparency and reporting requirements for CATPs to address these issues and enable better outcomes for consumers. However, there are various complications in applying transparency and reporting requirements to CATPs including:

- The lack of an industry-level data reporting infrastructure and established asset classes.
- The possible publication of clients' personal data and sensitive information.
- Potential duplication of information from platforms and intermediaries.
- Fragmented liquidity across a variety of trading and execution entities.

- The trade-offs from the costs of implementing additional transparency and data recording requirements on CATPs.
- The ability to finalise, report and record transactions both on-chain and off-chain.

Pre-trade and post-trade transparency requirements

2.71 We are proposing to subject CATPs to both pre-trade and post-trade transparency requirements. This means CATPs may be required to ensure public and non-discriminatory access to their order book data for pre-trade transparency, as well as historical data on executed transactions for post-trade transparency.

2.72 We suggest the following high-level propositions:

- In line with our approach to wholesale markets, data should be easily and widely accessible to users on a transparent, fair and reasonable basis.
- To ensure cryptoasset markets remain fair and transparent to all, CATPs must ensure public access to their pre- and post-trade market data to all investors. It is important that data is not made exclusively available only to the clients or members of a CATP. This ensures that any market participant can use and compare information from different execution venues.
- Where information is made public, it should not contain counterparty information. We are open to a calibrated delay to market wide publication of post-trade data to preserve the commercial interests of CATP and the counterparties to the trade. However, timely information is important to market function and the need to ensure direct access to CATPs in a fair and equal way. We therefore would welcome views on what this shortest delay could be.
- We are not proposing waivers for pre-trade transparency requirements, as it is likely to be too early to define specific liquidity thresholds for different assets.

Data format, clients' identification, and transaction records

2.73 In line with our position under MARC, we do not envision playing a central role in receiving or assessing STORs (as set out in paragraphs 3.59 and 3.68 of DP24/4). So, we suggest not requiring CATPs to systematically report transaction data to us. However, we suggest that CATPs (and intermediaries) should maintain records of their customers' transactions for 5 years (see paragraphs 3.65 and 3.68 of DP24/4) and be able to provide this information to us on request.

2.74 Unlike traditional financial markets – where only members of the trading venue (often acting as intermediaries) must meet transaction reporting requirements - cryptoasset markets allow direct retail access to the platform. For this reason, CATPs will need to maintain records of their clients' orders and transactions as there may not be an intermediary acting as the client's agent. This is in line with our suggested market abuse requirements.

2.75 Given the unique role CATPs play in cryptoasset markets, we identify two possible approaches:

- Impose record keeping requirements on both CATPs and intermediaries. We know this may generate possible risks of inconsistencies and duplications, or further inefficiencies and costs.
- Require CATPs to receive transaction records from intermediaries executing transactions on behalf of clients. CATPs will then keep and store them on their behalf. This may avoid the inefficiencies and costs of possible inconsistencies or duplications, but increase the operational costs of data transmission and possible risks of sensitive data leaks.

2.76 We know that cryptoasset markets introduce novel challenges in the privacy and the handling and recording of sensitive data, especially in data recording over public blockchains. Retail customers' transactions may need to be recorded by the entity providing access to the trading system using a personal identifier such as the National Insurance Number. This is consistent with traditional requirements over intermediaries. We welcome views on the best way to balance retail customers' participation with protecting their privacy and sensitive data.

Question 15: **Do you agree that CATPs should be subject to both pre-trade and post-trade transparency requirements? Are there any reasons we should consider pre-trade transparency waivers?**

Question 16: **Which challenges may emerge for transaction data requirements if there is direct retail participation?**

Question 17: **Are there preferred standards for recording transaction data?**

Question 18: **What opportunities and challenges do you see in trying to harmonise on-chain and off-chain transactions' recording and/or reporting?**

Chapter 3

Cryptoasset Intermediaries

Background and context

3.1 Intermediaries (including those dealing in qualifying cryptoassets as principal; dealing in qualifying cryptoassets as agent; and arranging deals in qualifying cryptoassets) play an important role in cryptoasset markets as they do in traditional finance, enabling markets to operate efficiently and catering for clients' diverse needs. Their function is separate and distinct from trading platform operators, even though many crypto firms currently perform both activities.

3.2 The risks from cryptoasset intermediation activities are similar in principle to those from intermediation in traditional financial markets. These risks of harm may be higher for retail customers than wholesale customers, as retail customers tend to be less knowledgeable and more vulnerable to information asymmetries. We consider these clients, as in traditional finance, should benefit from protections that are not necessary for wholesale clients.

3.3 The Treasury's 2023 consultation proposed to use rules for existing regulated intermediary activities as the basis of a regime for cryptoasset intermediation activities.

3.4 Intermediaries are not the main channel for buying cryptoassets, although a substantial percentage of UK crypto users use them. Popular intermediaries for UK crypto activity include large existing payment and brokerage firms. A recent survey we commissioned from YouGov found that 28% of crypto users have bought cryptoassets through these types of intermediaries.

3.5 The profile of those buying cryptoassets through intermediaries and those using a centralised exchange are very similar. Analysis of fees indicates intermediaries typically have higher costs for consumers than exchanges.

3.6 A broad range of intermediary business models have emerged since cryptoasset investing has become more widespread. Some of these intermediary firms focus on wholesale clients, while others target retail consumers.

3.7 Our proposed rules for intermediaries are in line with international frameworks (detailed below). This regime would strengthen the UK's reputation as a credible financial centre aligned with international standards.

Risks and key harms associated with intermediary activities

3.8 There are several interconnected risks, which can affect both retail and wholesale clients, which our proposals aim to mitigate:

- **Consumer understanding:** Some crypto intermediaries do not make it clear and prominent whether they are acting in a principal or agent capacity or as an arranger, or how they are different from a trading platform. Some brokers may design their consumer interface to look similar to a trading platform. Retail consumers may not be able to clearly distinguish between the different services available, particularly when firms within one group perform different activities. Information about execution policies and fees is not always clear. Clients may not be able to assess alternative services and make informed decisions as a result.
- **Client categorisation risks:** With traditional financial instruments, certain retail customers can apply to opt up to become elective professional clients. Following the opt up, they will lose a range of protections covering retail customers. If a similar regime is introduced for crypto, some firms may misuse it to encourage clients to inappropriately opt up to circumvent our rules.
- **Execution quality risks:** Firms executing orders for clients in crypto markets are not currently under any obligation to deliver good client outcomes. Clients, particularly less sophisticated ones, may unknowingly accept worse prices or unduly high costs when seeking to buy or sell cryptoassets. The firms may not be meeting the Consumer Duty, should it apply to them, as the price the customer pays is not reasonable compared to the overall benefits received.
- **Fragmented liquidity and pricing:** Prices of the same trading pair can vary considerably across platforms. There is often incomplete information on the market conditions and available prices, against which firms can demonstrate how well they have executed client orders.
- **Order handling risks:** Some firms may not have adequate procedures and arrangements to ensure the prompt, fair and expeditious execution of client orders. As a result, orders may be sequenced or aggregated in a way that disadvantages some clients.
- **Conflicts of interest risks:** Some firms carry out multiple activities, increasing the risks of conflicts of interest. For example, when a cryptoasset firm executing client orders also deals for its own account, the firm may be incentivised to prioritise its own positions and deliver worse execution outcomes for clients. Firms receiving payment for order flows may also be incentivised to route orders in a way that does not match clients' best interests.
- **Systems & controls:** Information from failed firms suggests they may not have appropriate systems and controls, or other effective governance and management procedures, including those to manage operational resilience risks. This leads to disruptions to trading and other services and damages consumer outcomes.
- **Opaque off platform transactions:** Currently, there is limited transparency about off-chain cryptoasset transactions executed outside trading platforms. This poses risks to consumers who may unknowingly pay higher prices or fees, and may also impact overall market liquidity.

Desired Outcomes

3.9 Through our regulatory regime, we aim to achieve the following outcomes:

- Facilitate UK investors' access (or exposure) to global crypto markets and liquidity pools through authorised entities.
- Make sure UK markets remain internationally competitive and that UK consumers have access to fair, orderly, transparent and liquid crypto markets.
- There should be fair and transparent conditions for trades executed for, or on behalf of, a client. Orders are executed in a way that serves the best interest of clients.
- Intermediaries ensure that the price a customer pays for a product is transparent and reasonable compared to the overall benefits the customer gets from the product.
- Firms will compete to provide best execution.
- Consumers will be effectively protected from unfair or abusive practices and benefit from better transparency.
- Intermediaries will manage conflicts of interest effectively.
- Support growth of the intermediary market in the UK through providing a clear and proportionate regulatory regime.

Summary of key policy proposals

3.10 We are considering rules to regulate the conduct of intermediaries in line with the principle of 'same risk, same regulatory outcome' wherever possible, taking into account the specific features of the crypto market. In designing our proposals, we have also considered differences between retail-facing businesses and wholesale-only businesses. We would like views on the following key proposals:

- Order handling and execution (aligned with IOSCO CDA Recommendation 4): We expect firms executing client orders to implement procedures to ensure prompt, fair and expeditious execution of client orders. We also propose to implement a set of best execution rules achieving similar regulatory outcomes to those under COBS 11.2A.
- Conflicts of interest during order execution (aligned with IOSCO CDA Recommendation 2): At a minimum, we expect functional separation between the principal trading and client order execution operations of firms. We also propose to specifically prohibit Payment for Order Flow (PFOF) for cryptoasset intermediaries.
- Pre-trade and post-trade transparency (broadly aligned with IOSCO CDA Recommendation 5): We are considering the necessity of pre-trade transparency requirements and the potential shape and form of post-trade transparency requirements relevant for some crypto intermediaries. We also seek views on potential exemptions/waivers/deferrals.
- Client categorisation: We are considering whether crypto-specific rules or guidance on retail customer opting up practices are needed.

Order handling and execution

Background

3.11 One of the key regulatory outcomes in the Treasury Consultation Response is that trades should be executed in a way that serves the best interest of the client. The Treasury proposed that intermediaries should take all reasonable steps to get the best possible result for the client when executing a client order. They should also make trading arrangements transparent to clients.

3.12 Significant client harms may arise during the order execution process. Clients may not understand that an intermediary may be directly selling to or buying from them and so may not act in their best interests. Clients also may not be able to monitor the outcomes of executions effectively. These considerations are relevant both to retail consumers and wholesale clients.

3.13 We plan to apply the Consumer Duty to cryptoasset intermediaries. This will require firms to act to deliver good outcomes for retail customers. In particular, the Duty requires firms to support their customers by helping them make informed decisions (Chapter 8 of FG22/5). As set out in our Roadmap, we plan to consult on the details of how the Consumer Duty applies to RAO cryptoasset activities in Q3 2025.

3.14 COBS 11.2A sets out rules that firms need to follow when executing client orders of financial instruments. In particular, a firm must take all sufficient steps to get the best possible results for its clients when executing orders. Firms are required to consider execution factors including price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of an order. Each firm should determine the relative importance of these different factors, taking into account the characteristics of the client and the order.

3.15 Many responses to the Treasury's consultation stated the concept of 'best execution' is difficult to define and apply for cryptoasset markets. This is due to the globalised and fragmented nature of execution venues and specific features of cryptoasset transactions, such as slippage in liquidity pools.

3.16 In response to the novel challenges of fragmented crypto markets and increased risks to consumers, we propose to introduce the following requirements. We will align them with relevant international approaches and recommendations.

Admission to trading requirements

3.17 The Treasury's consultation response highlighted the need to ensure that the A&D and MARC regimes are effectively triggered for cryptoassets bought and sold by UK investors. These regimes rely on regulatory trigger points that are controlled by authorised CATPs (instead of intermediaries). For example, to 'activate' these regimes, the cryptoasset has to be admitted (or seeking to admit) to trading on a UK authorised CATP.

3.18 Consequently, we are considering a requirement that any cryptoasset needs to be admitted to trading on at least 1 UK authorised CATP before any intermediary can deal in it or arrange deals for UK retail customers.

Order handling and best execution requirements

3.19 Consistent with COBS 11.3, we propose firms executing client orders should implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders.

3.20 We also propose that best execution rules achieving a similar set of regulatory outcomes to those under COBS 11.2A apply to cryptoasset intermediaries. Cryptoasset intermediaries should have established policies and procedures to execute orders for clients on the best available terms. They should be able to demonstrate to us how they are achieving this, on request.

3.21 When firms deal with retail customers, we think best execution is defined in terms of total consideration. Total consideration represents the price of the cryptoasset and the costs involved in execution. The costs considered must include all expenses incurred by the client which are directly related to the execution of the order. These can include execution venue fees, gas fees, settlement fees and any other fees paid to third parties involved in executing the order.

3.22 As with traditional finance requirements, the obligation to take all sufficient steps to get the best possible result for its clients should apply where a firm executes orders on clients' behalf. This includes dealing on own account with clients and firms' execution of orders on a matched principal basis.

3.23 We consider that best execution obligations should apply to all in-scope cryptoassets, whatever the ultimate execution venue. Firms should therefore gather relevant market data to check whether the OTC price offered for a client is fair and delivers on the best execution obligation.

3.24 We are considering applying best execution rules to some quote-driven crypto-markets. In this case, in-scope firms will not automatically comply with best execution requirements solely because a client has accepted a quote. For retail customers, we consider that best execution should always apply with regard to total consideration.

3.25 When providing quotes to clients, we propose that firms consider our relevant guidance for transactions in financial instruments. For example, we expect that firms price transactions transparently (based on benchmarks or other publicly available pricing data) to demonstrate they have given best execution.

3.26 We propose that firms may not be required to comply with best execution obligations when dealing with eligible counterparties (COBS 3.6 Eligible counterparties gives details of the current definitions). This is consistent with the traditional finance approach and justified by the different level of risk presented.

3.27 However, the price of the same trading pair can vary significantly across different execution venues. The fair market price for a cryptoasset at any moment may not be

obvious. So, we are considering providing additional guidance to firms that they need to check the prices for an order across at least 3 UK-authorised trading platforms. If fewer than 3 trading platforms in the UK can execute the order, firms should check the prices on all available platforms. We seek views below on the effectiveness and appropriateness of this guidance. This guidance would not replace the general best execution expectations.

3.28 The prices and liquidity available across different platforms can change quickly. We propose that firms should review, at least annually, their execution policies and order execution arrangements. We also propose that a firm should carry out a review whenever there is a material change that affects the firm's ability to obtain the best possible result on a consistent basis. As part of their ongoing monitoring, we propose that firms should assess if a material change has occurred (which could include a venue the firm relies on having suffered an outage) and consider adjusting their approach to meeting the overarching best execution requirement.

3.29 We expect to accommodate the branch solution discussed in the 2023 Treasury Consultation Response. This means that the order handling and execution rules proposed may be applied differently in a limited set of cases.

Execution venue requirements

3.30 Based on the location policy being introduced by the Treasury, we are considering requiring any firm executing orders for UK consumers to ensure these orders are ultimately executed only on UK authorised execution venues.

3.31 We know that regulatory regimes in many other jurisdictions are still evolving. We support the development of equivalence-type arrangements in the future. We will review our rules in the future if we need to flexibly respond to these developments.

Disclosure and record-keeping requirements

3.32 We are considering requiring firms to disclose their role(s) to clients before executing client orders, including whether they may act as a principal or agent for each order. We also propose requiring firms to disclose before executing client orders if these may be executed outside a trading platform, and explain the associated risks. This will enable clients to make more informed decisions based on their risk appetite.

3.33 Following the execution of a transaction on behalf of a client, we propose that firms tell the client where the order was executed. We are considering adapting the requirements in COBS 16A.3 for this purpose and welcome views on how these requirements should apply.

3.34 In line with our proposals on market abuse, we do not see a central FCA role in receiving and assessing Suspicious Transactions and Orders Reports (as set out in paragraph 3.59 of DP24/4). As a result, we do not plan to require intermediaries to systematically report transaction data to us. However, we think intermediaries should record and store the details of their clients' transactions for a certain period (5 years as proposed in the above DP) and make them available to us when requested.

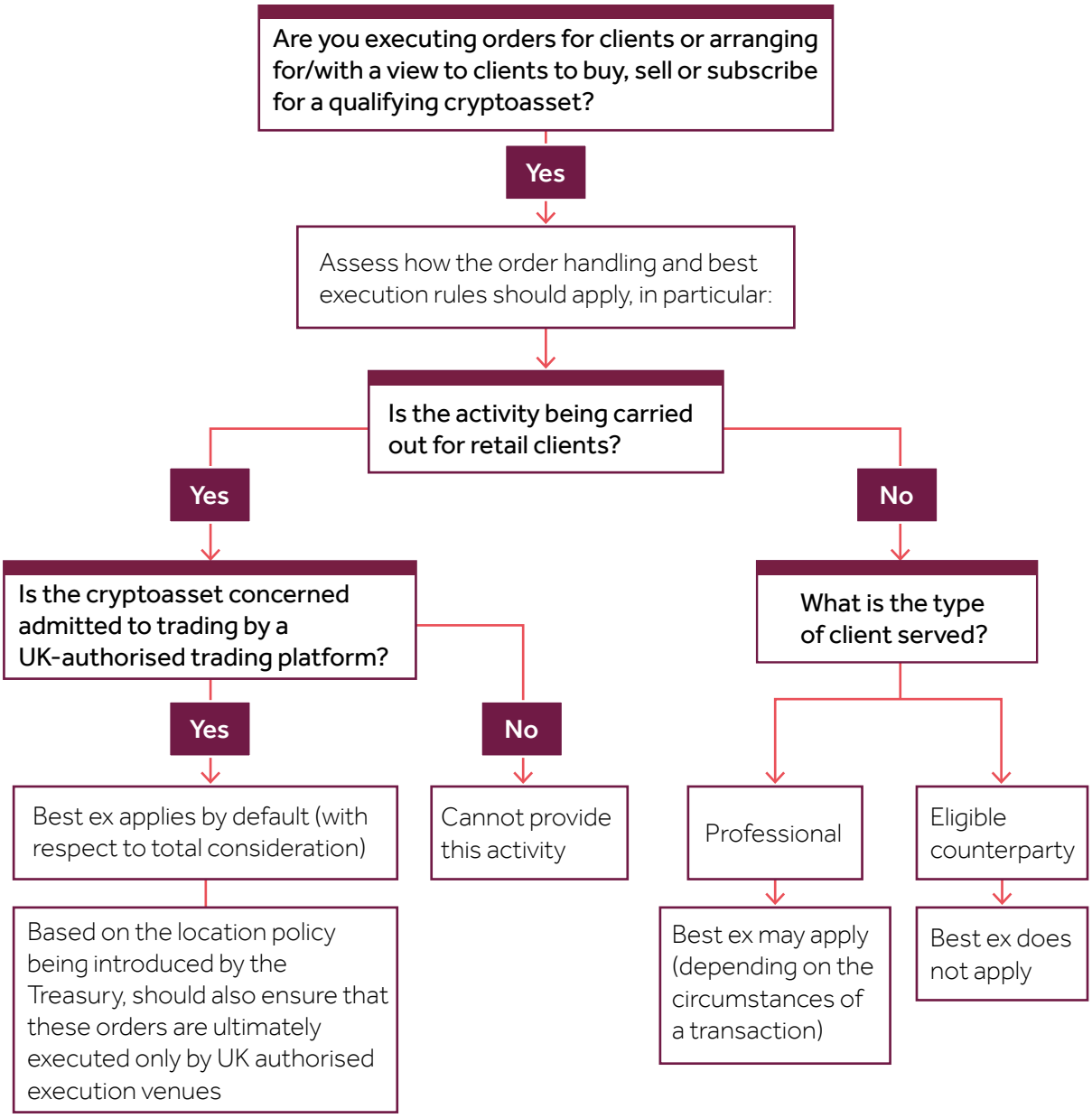
Additional considerations

3.35 Under the current traditional finance framework, when there is a specific instruction from clients, firms should generally execute the order in line with the instruction. However, for cryptoasset transactions, it is not clear whether clients have the necessary information to give such instructions and if the available options are clearly set out by firms. For example, there is a risk that some crypto firms may ask clients to choose a specific execution venue without ensuring that clients understand any potential impact on their order execution outcomes. Firms may also wrongly give the impression that giving instructions in a specific way is required for using their services. We are seeking to better understand the potential risks of harm related to specific client instructions.

3.36 We understand that an order can currently be executed on a range of different execution venues, such as trading platforms and OTC desks. These alternative ways of execution present different risk profiles. We want to better understand these risk profiles, and whether there may be circumstances that require further disclosures or restrictions.

3.37 Below we illustrate the main proposals of this section and when they would apply:

Figure 2: A summary of the main proposals of this section



Question 19: What practical challenges might firms face if they are required to comply with these order handling and best execution requirements? Are there any alternative approaches that would deliver the same or better order execution outcomes for retail and non-retail customers respectively? Please explain why they may be preferable.

Question 20: What benefits and risks do you see with the proposed guidance requiring firms to check the pricing for an order across at least 3 UK-authorised trading platforms (where available)?

Question 21: What benefits and risks do you see with the idea that best possible results should be determined in terms of the total consideration when firms deal with retail customers?

Question 22: Do you see any potential problems with the proposal to restrict intermediaries to offering regulated services for UK retail customers solely for cryptoassets admitted to trading on a UK authorised CATP?

Question 23: Are there any specific activities or types of transactions we should expressly carve out of our proposed order handling and best execution rules? If so, why?

Question 24: What risks arise when specific instructions (for example, specifying which execution venue to use) from retail customers are allowed to override certain best execution requirements? How can these be mitigated?

Conflicts of interest during order execution

Background and context

3.38 In line with the Treasury's target outcomes, we want to ensure those offering cryptoasset market intermediation services have effective controls and arrangements to manage conflicts of interest. These include conflicts from the different activities and services either they, or their affiliated entities, provide.

3.39 We already have rules on conflicts of interest that apply to traditional finance firms. In particular, SYSC 10 sets out the importance of investment firms identifying and preventing, or otherwise managing, conflicts of interest between, for example, the firm and its client, or individual clients. We are considering how these rules should apply to cryptoasset firms. Managing conflicts of interest is also one of our Principles for Business (Principle 8) which all authorised persons are required to follow.

3.40 Our general expectation is that firms will be required to show they are managing conflicts of interest appropriately within their specific business models as they seek authorisation and as part of ongoing supervision.

3.41 For intermediary business models, we discuss 2 main conflicts of interest here. This discussion is not exhaustive, and each firm needs to conduct its own analysis to understand and address the full range of potential conflicts of interest in its business.

Key conflicts associated with intermediary business models

Trading for own account while executing client orders

3.42 Conflicts may arise when a cryptoasset firm executing client orders, either as a principal or agent, also transacts on its own account in the same cryptoassets or closely related assets. The firm may be incentivised to prioritise its own positions and sequence the orders in a way that benefits its own trading outcomes.

3.43 We consider that at a minimum, functional separation, including separate governance structures, should be required between firms' principal trading and client order execution operations to reduce conflicts of interest.

3.44 We discuss conflicts of interest that specifically involve a firm operating a trading platform or an entity within the same group seeking to also deal for own account in Chapter 2 above.

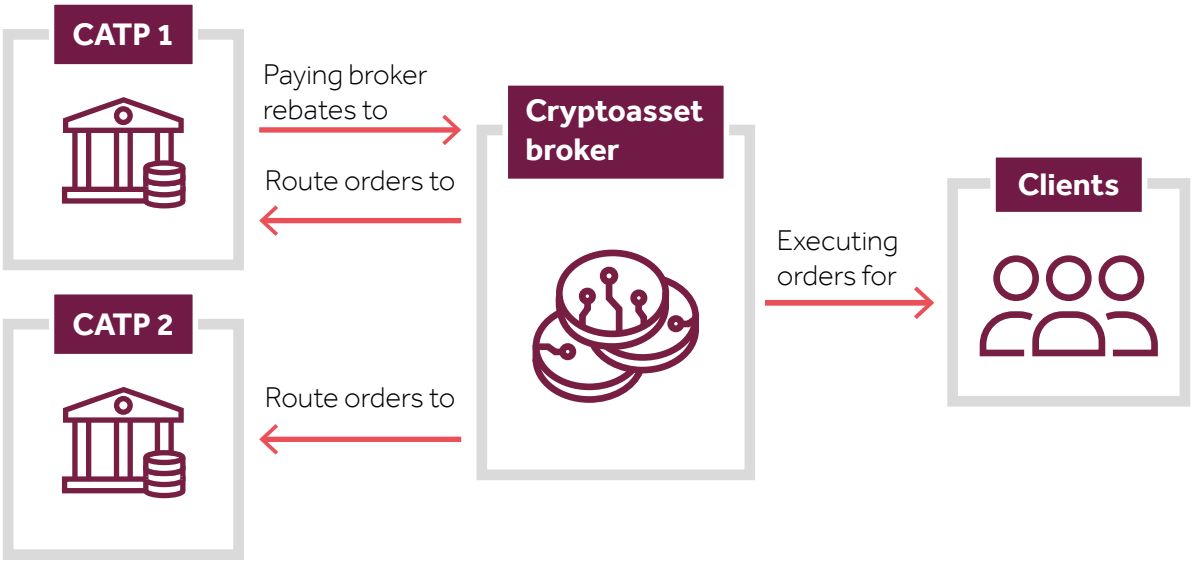
3.45 Separately, firms will also likely need to establish appropriate systems and controls to mitigate market abuse risks (please refer to para. 3.68 of the Discussion Paper on Admissions & Disclosures and Market Abuse for more details). This will further support the measures proposed here.

Payment for Order Flow

3.46 Conflicts may occur if a firm receives payment, remuneration or commission from third parties (including those to which it directs orders for execution) in relation to the execution of client orders. This is commonly referred to as Payment for Order Flow (PFOF).

3.47 A potential case of PFOF where we think there is a clear risk of client harm is shown below:

Figure 3: A potential case of PFOF



3.48 Unless the circumstances are exceptional, we consider PFOF in both crypto and traditional finance markets presents risks to effective management of conflicts of interest and inducements. It generates risks of consumer harm that individual firms may struggle to manage effectively.

3.49 We are also concerned that PFOF may encourage crypto intermediaries to build close relationships with certain CATPs and harm market competition. As a result, execution venues may downplay the role of price competitiveness, leading to worse prices for consumers in the long run.

3.50 We therefore intend to explicitly prohibit PFOF for cryptoasset intermediaries.

Question 25: **Are there circumstances under which legal separation should be required to address potential conflicts between executing own orders and client orders?**

Question 26: **Are there any other activities that may create conflicts of interest and risks to clients if performed by the same intermediary? How can these be managed?**

Pre- and post-trade transparency for intermediaries

Background

3.51 On the one hand, greater transparency contributes to price formation by improving the quality and timeliness of information for consumers and intermediaries. For firms making prices, accurate and timely information can enable them to quote prices more confidently, resulting in tighter spreads and higher liquidity. Greater transparency can also improve the confidence of other market participants, by providing better quality information to consumers and firms executing orders on their behalf.

3.52 On the other hand, any benefits of transparency need to be carefully balanced against costs to firms and potentially to liquidity.

3.53 There is currently very limited transparency for cryptoasset transactions, especially if outside of trading platforms. This lack of transparency will also increase if proprietary liquidity pools operating outside of trading platforms continue to grow in significance.

3.54 We consider that firms can act in the best interests of their clients by offering non-discriminatory pricing, taking into account the characteristics of a transaction such as size and complexity.

3.55 Separately, we have issued a policy statement on proposed changes to the bond and derivative transparency regime in the UK and another policy statement addressing this topic in the context of equity secondary markets. We have taken these into account when considering the policy options for crypto intermediaries.

3.56 There is no current UK transparency regime for crypto and there is a lack of important market infrastructures such as consolidated tapes. Operating such infrastructures will also involve additional costs and we will balance any proposal requiring new infrastructures against the expected benefits.

3.57 We will continue to consider the balance between the need to support market participants who supply liquidity and the potential costs to them of greater transparency. Additionally, we will consider the benefits from greater and timely transparency for the market as a whole in developing our proposals. We welcome feedback on how to best balance these considerations.

Transparency requirements

3.58 **Post-trade transparency:** We propose to require that cryptoasset intermediaries make the details of each transaction they executed as principal publicly available as close to real-time as is technically possible. This information would include the volume and price of those transactions and the time at which they were concluded.

3.59 **Pre-trade transparency:** We are considering whether to introduce some form of pre-trade transparency requirements and welcome views on what form market participants would find most useful. For example, these requirements may include requiring firms

executing client orders as principal to publish firm or indicative quotes, or quotes specific to a range of potential trade sizes.

3.60 We also propose that firms can determine the clients who get access to their quotes on the basis of their commercial policy, as long as this is done in an objective and non-discriminatory way.

Proportionality

3.61 These requirements aim to improve transparency but may negatively influence firms' decision to provide liquidity if they know other market participants can see their actions. Without appropriate waivers or deferrals, the new requirements may hinder liquidity provision and the execution of large orders.

3.62 Our proposal may capture cryptoassets with different market capitalisation and level of liquidity. The liquidity impact of any proposed requirements may be higher for some assets. For example, liquidity may be thin for newly issued or admitted cryptoassets. These assets are therefore less able to sustain meaningful transparency. We are open to suggestions on whether certain assets should be exempted from any future pre-trade transparency requirements or benefit from post-trade transparency deferrals. These suggestions should help us balance the benefits of increased transparency with the impact on liquidity appropriately.

3.63 For smaller firms, transparency requirements may be disproportionate to the risks. To promote effective competition and safeguard consumer choices, where those costs outweigh the benefits of the transparency, we may consider exemptions or reduced requirements for such firms.

Question 27: **What benefits does pre-trade transparency provide for different types of market participants and in what form will it be most useful for them? Please provide an analysis of the expected costs to firms for each option if available.**

Question 28: **What alternative solutions to the post-trade transparency requirements proposed above could mitigate the risks? Please provide an analysis of the expected costs to firms for each option if available.**

Question 29: **Do you believe that certain cryptoassets should be exempted from transparency requirements? If so, what would be the most appropriate exemption criteria which would best balance the benefits from transparency and costs to the firms?**

Question 30: **What would be the most appropriate exemption threshold to remain proportionate to the size of the firm while balancing the benefits from transparency and costs to the firms?**

Client categorisation

Background

3.64 In COBS 3, we set out obligations on traditional finance firms when categorising clients as either 'retail', 'professional' or 'eligible counterparty'. This existing client categorisation regime helps match protections for different types of clients with their varying levels of financial knowledge, experience and risk tolerance.

3.65 This existing regime in traditional finance allows retail customers to request to be 'opted up' to become elective professional clients.

3.66 The Consumer Duty Guidance (2.10) sets out that a firm that encourages a customer to seek a 'professional client' classification simply to avoid providing consumer protection would breach the Duty.

3.67 Firms carrying out MiFID business, or mixed business, must also meet the 'quantitative test'. This requires the firm to ensure the client satisfies 2 out of the 3 criteria in COBS 3.5.3R(2) when assessing an opt up request.

3.68 This can present risks of consumer harm as opted up retail customers lose a range of regulatory protections. These include client disclosures and restrictions in relation to higher risk products, such as Contracts for Difference (CfDs). The Consumer Duty and certain financial promotions rules are unlikely to apply to elective professional clients.

Additional rules or guidance

3.69 We are considering how the existing COBS client categorisation regime can apply in the crypto space. We seek views on whether crypto specific criteria or guidance on opting up practices can encourage more consistent approaches across firms and discourage poor practices.

3.70 We expect a firm will only accept a retail customer's request to opt up if it has undertaken an adequate assessment of the client's expertise, experience and knowledge against the expected cryptoasset trading activities. This assessment can be particularly challenging for crypto firms. New tokens and technologies are constantly emerging, with previous experiences becoming quickly outdated. New users' experience with cryptoassets may also be difficult to establish and evaluate.

3.71 As set out above, we propose to impose additional requirements on firms executing orders for retail customers. These requirements include that a cryptoasset needs to be admitted to trading on at least 1 UK authorised CATP before an intermediary can deal in it or arrange deals for UK retail customers. Firms also need to focus on total consideration when executing orders for retail customers. As a result, firms may execute orders from those retail customers that have opted up in a different way.

3.72 In considering the client opting up rules for spot cryptoassets, we are aware of the interactions with crypto derivatives and with other high risk investment products (such as CfDs and binary options).

3.73 We have also considered our recent Consultation Paper 24/24, which seeks feedback on whether the opt up rules could be improved in general.

3.74 We welcome views on how our existing client categorisation rules could apply and any areas where more specific rules or guidance would be appropriate.

Question 31: **What are the crypto-specific risks of opting retail customers up? How should these be managed and what additional guidance on how to assess the expertise, knowledge and experience of clients can we give firms to better mitigate risks of harm?**

Question 32: **What are the benefits of having quantitative thresholds when opting clients up? How should we determine any quantitative threshold? What alternative rules or guidance specific to crypto should we consider?**

Chapter 4

Cryptoasset Lending and Borrowing

Background and Context

4.1 Our assessment of the cryptoasset lending and borrowing sector identified various current business models. In this DP, we have broadly grouped these into two categories: 'cryptoasset lending' and 'cryptoasset borrowing'. Unless stated, the terminology in this chapter reflects terms commonly used within the industry, rather than formal definitions to be used in legislation or regulatory rules. For the purposes of this DP:

- Cryptoasset lending is an arrangement where a cryptoasset holder (the 'cryptoasset lender') transfers ownership of their assets to a third-party (the 'cryptoasset borrower'), typically a person, firm or platform. This transfer occurs under a contractual agreement which generally sets out the lender will receive a yield, or reward, and an equivalent value of the assets transferred will be returned to them at the end of the lending arrangement.
- Cryptoasset borrowing refers to an arrangement in which a person, firm, or platform (the 'cryptoasset borrower') receives a loan in cryptoassets or fiat from a third-party firm, platform or person (the 'cryptoasset lender') with an obligation for the cryptoasset borrower to pay back the loan and any associated fees or interest as per the contractual arrangement.

4.2 We understand the market is constantly evolving with new complex yield products e.g. yield farming. We view these as being based on the same fundamentals as the cryptoasset lending and borrowing models, but with differing features. The proposals set out in this chapter are intended to apply to the different variations of complex yield products, though we welcome feedback and evidence why they should be treated differently.

4.3 The global cryptoasset lending and borrowing market grew between 2017 and 2022, driven by leading cryptoasset lending platforms offering high-yield opportunities that appealed to retail consumers. However, this expansion was accompanied by inherent product and market risks, including market-wide inadequate risk and liquidity management. This was further compounded by poor practice such as firms issuing their own platform tokens, which they incentivised consumers to buy and hold, while manipulating the supply and price of the token.

4.4 When the crypto market experienced a downturn in 2022, these risks crystalised and exposed the sector's vulnerabilities, leading to the insolvency of some of the larger firms in this market. The lack of prudential controls and consumer protection regulations resulted in firms and consumers suffering widespread losses. For example, when Celsius Network LLC (Celsius) collapsed in 2022, it owed c. $4.7 billion to its creditors.

4.5 Since the market downturn, a number of firms have withdrawn their products from the market. Today, cryptoasset lending and borrowing represents a relatively small segment of the UK crypto market, particularly when compared to activities such as staking

and trading. A recent survey we commissioned from YouGov found that 9% of UK cryptoasset users reported participating in cryptoasset lending or borrowing within the 12 months before August 2024, fewer than the 27% who engaged in staking during the same period.

4.6 In 2023, the Treasury announced its commitment to bring cryptoasset lending and borrowing within our regulation. This was in recognition of the significant risks from these business models. The proposed regulatory framework, outlined in the draft RAO SI, captures operating a cryptoasset lending platform, cryptoasset lending and borrowing under the activities of 'cryptoasset dealing as principal' and 'arranging'. While the Treasury has not proposed to create a new 'operating a cryptoasset lending platform' RAO activity in legislation, we propose having specific rules for these business models given their risks and to ensure mitigation and effective oversight.

4.7 Despite the relatively low current demand for cryptoasset lending and borrowing from UK consumers, current business models present risks of significant harm, particularly to retail consumers. As markets evolve, there is also the potential that levels of demand could increase. So, we are using this DP to test our preliminary thinking for policy proposals, encourage feedback on them and explore any alternative policy approaches we should consider.

Risks and key harms from cryptoasset lending and borrowing

4.8 In their current form, cryptoasset lending and borrowing business models carry significant risks, including:

Common risks across cryptoasset lending and borrowing

- **Loss of Ownership:** To engage in cryptoasset lending or borrowing activities, consumers are required to transfer both legal and beneficial ownership of their cryptoassets – whether the assets being lent or those used as collateral to facilitate borrowing – to the service provider. If the firm becomes insolvent, consumers may be treated as unsecured creditors. Consumers do not always realise this when agreeing to the cryptoasset lending and borrowing terms.
- **Liquidity management:** Firms often hold high proportions of illiquid assets or insufficient funds on their balance sheets. Reinvesting and onward-lending assets also creates interconnected obligations, which has made it difficult for firms to meet liabilities in periods of stress.
- **Counterparty risk:** Counterparties are often unregulated, overseas or decentralised, who may have little to no risk management frameworks. This increases credit risk and liquidity risk for liabilities due on promised yields.
- **Lack of consumer understanding:** Retail customers are being offered complex and opaque products, with attractive returns/rates compared to traditional products. However, the risks involved are not always made transparent. As a result, many consumers do not fully grasp how the activity differs from other cryptoasset activities (such as staking) or traditional credit lines, especially where loans can appear to be received or repaid in fiat (e.g. linking cryptoasset loans to fiat credit cards). This can lead to consumers entering contracts they do not fully understand, and being vulnerable to unforeseen consequences or financial loss.

- **Conflict of interest with platform tokens:** Some platforms issue and promote their own platform tokens, which are often used within their cryptoasset lending and borrowing ecosystems. This practice introduces potential conflicts of interest as they can be used to drive artificial demand and price manipulation at the expense of good consumer outcomes.

Cryptoasset Lending Specific Risks

- **Speculative yield generation:** Yield generation in cryptoasset lending is speculative because the returns are not fixed, and consumers typically do not know exactly how their cryptoassets are being used to generate those returns. In contrast to securities lending, cryptoassets are typically on-lent to unregulated or decentralised parties who may have weak risk management and systems and controls, increasing the risk consumers may lose their assets.

Cryptoasset Borrowing Specific Risks

- **Margin Calls:** Due to the inherent volatility of cryptoassets, the value of collateral can fluctuate rapidly, making margin calls more likely. If the price of the collateral drops relative to the loan, the consumer will be required to add more collateral to maintain the agreed loan-to-value (LTV) ratio. If the consumer does not meet the margin call, the firm may liquidate part or all of the collateral to restore the LTV ratio. Consumers may not fully understand how margin calls work or the potential for loss, particularly in this volatile market. Additionally, in some cases, firms may automatically take assets from the consumer's wallet to meet the margin call, further increasing the risk of unintended loss.
- **Creditworthiness:** In contrast to traditional finance lending practices, cryptoasset borrowing firms typically do not assess the consumer's ability to afford the loan. Instead, they rely on the consumer's collateral as a guarantee against financial loss. Without a creditworthiness assessment, there is no evaluation of the consumer's broader financial situation, their capacity to meet repayment obligations or capacity for loss. This increases the risk of borrower default, leaving consumers, including vulnerable consumers, susceptible to financial instability.

Question 33: **Do you agree with our understanding of the risks from cryptoasset lending and borrowing as outlined above? Are there any additional risks we should consider?**

Regulatory approach

4.9 Given the potential risks to consumers from the current structure of cryptoasset lending and borrowing models, we do not consider these products to be suitable for retail consumers in their existing form. Market fluctuations in the value of cryptoassets can lead to consumers incurring substantial losses in a short space of time.

4.10 We are therefore proposing to restrict firms from offering these products to retail consumers in their current structure. However, we welcome feedback on this position.

4.11 In traditional finance, lending between institutions in wholesale markets is generally less regulated because these entities are considered capable of assessing and managing financial risks. We are proposing a similar approach to cryptoasset lending and borrowing as institutional clients are better equipped to understand the risks and complexities of the products. Accordingly, we do not propose restricting institutional access to cryptoasset lending and borrowing products. This includes where a lender is facilitating lending and borrowing between different institutional (non-retail) clients.

Question 34: **Do you agree with our current intention to restrict firms from offering access to retail consumers to cryptoasset lending and borrowing products? If not, please explain why.**

Potential Requirements

Background

4.12 As outlined above, our current proposal is to restrict firms from offering these products to retail consumers, though we recognise the market is evolving rapidly. Therefore, we are exploring whether the following proposals could effectively reduce the risk profile of these products to a point they could be appropriate for retail customers. We also welcome views on whether there any alternative, effective risk mitigation measures.

Summary of risk mitigating proposals

Cryptoasset Borrowing

- Requiring firms offering cryptoasset borrowing to retail consumers to comply with elements of the CONC sourcebook, such as the requirement to conduct creditworthiness assessments and provide appropriate forbearance to consumers in or approaching arrears or default.
- Requiring firms to seek express consent from retail consumers before topping up their collateral on their behalf.
- Limiting how much a cryptoasset borrowing firm can automatically top up a consumer's collateral over the duration of the loan.

Cryptoasset Lending and Borrowing

- Improve consumer understanding of cryptoasset lending and borrowing business models by requiring:
  - Express consent from consumers to firms before the contractual arrangement commences, stating they understand the risks and agree to transferring ownership of their assets to the firm.
  - Renewed express consent when there are significant changes to the initial contractual agreement.

  - Requiring an appropriateness assessment on consumers' knowledge and experience similar to those prescribed in the Conduct of Business Sourcebook.
  - A key features style document outlining features and risks of the product.

- Placing restrictions on firms' use of own Platform Tokens (PTs) for cryptoasset lending and borrowing where there is a conflict of interest. Specifically, for offering interest or reward payouts, offering fee reductions or other more favourable terms, being used as collateral and being used as the loaned asset.
- Restricting certain aspects of the cryptoasset lending and borrowing to only allow the use of qualifying stablecoins.

Risk mitigation proposals

Cryptoasset Borrowing

CONC requirements

4.13 In traditional finance, a firm that carries out credit-related regulated activities must comply with obligations in the Consumer Credit Sourcebook (CONC). We believe that in line with the principle of 'same risk, same regulatory outcome', cryptoasset borrowing firms should be held to the same standards where practicable and subject to regulation that ensures equivalent outcomes. We know cryptoasset firms currently require overcollateralisation of a loan as a security against the retail borrower defaulting. However, to ensure consistent regulatory standards and consumer protection, we want to understand if we could feasibly apply aspects of the CONC Sourcebook to this business model if we were to permit retail access to these products. In particular, we propose applying the requirements for creditworthiness assessments, arrears and forbearance.

4.14 **Creditworthiness Assessments:** In traditional finance, credit lenders must assess a consumer's creditworthiness before offering or significantly increasing credit under a regulated credit agreement. Creditworthiness involves credit risk (risk to the firm that the borrower will default) and affordability (risk to the borrower that they cannot afford to repay the debt). Requirements include gathering relevant financial information, such as income and expenditure. The obligation is on firms to make a reasonable assessment, not just of whether the customer will repay, but also of their ability to repay affordably and without this significantly affecting their wider financial situation.

4.15 **Arrears and Forbearance:** In accordance with CONC 7, if a borrower is in or approaching, arrears or in default on a regulated credit agreement then traditional finance credit lenders are required to provide timely, clear and understandable information. Lenders must treat that customer with appropriate forbearance and due consideration, taking into account the individual circumstances of the customer of which the firm is, or should be, aware. This may include actions such as reducing, waiving, or cancelling interest or charges, allowing deferment of payment of arrears in some circumstances or agreeing a sustainable repayment arrangement that gives the customer a reasonable period of time to repay.

Question 35: **Do you agree that applying creditworthiness, and arrears and forbearance rules (as outlined in CONC) can reduce the risk profile for retail consumers? Could these be practicably applied to existing business models? Are there are any suitable alternatives?**

Collateral

4.16 When taking out a cryptoasset loan, retail borrowers provide collateral to protect the cryptoasset firm from loss in case they default. However, the value of cryptoassets are typically highly volatile and can fluctuate significantly during the loan term. If the collateral's value drops below the agreed LTV ratio, the borrower may be required to add more cryptoassets to maintain the required level. In some business models we have seen, this top-up is done automatically by the cryptoasset borrowing firm. This process helps ensure the cryptoasset borrowing provider remains adequately secured against market downturns.

4.17 The inherent volatility of many cryptoassets amplifies the risks of needing to top-up the collateral beyond what a consumer can afford. Consumers may not understand the likelihood and complexity of margin calls and potential automatic collateral top-ups happening successively over a short period of time. This lack of understanding can lead to unexpected liquidations and financial losses.

4.18 We welcome feedback on whether we should impose the following restrictions on collateral top-ups:

- Requiring firms to seek express consent from consumers before the first use of automatic top ups. This would include explaining clearly and prominently the terms and implications of this, and seeking renewed express consent on any such contractual changes.
- Limiting how much a cryptoasset borrowing firm can automatically top up a consumer's collateral over the loan's duration.

Question 36: **Do you agree that the proposed restrictions for collateral top ups would reduce the risk profile for retail consumers? Are there are any suitable alternatives?**

Cryptoasset lending and borrowing

Consumer understanding

4.19 Retail consumers should be informed about, and understand the risks from cryptoasset lending and borrowing before entering into arrangements. If these products were to be offered to retail consumers, there may be a need for further measures to aid consumer understanding.

4.20 The Consumer Rights Act 2015 requires existing terms and conditions to be fair and clear. Our Financial Promotions rules and guidance also already require that promotions

must be clear, fair, and not misleading, and that firms must provide accurate information on the risks involved, ensuring that consumers can make informed decisions.

4.21 The application of the Consumer Duty would further aid consumer understanding. It would ensure firms have good practices that generally improve the clarity of their communications, including that key information is clear, visible and accessible.

4.22 However, we remained concerned with the complexity in these business models. As such, we propose that if these products were offered to retail customers, firms should provide a key features document or similar on the relevant product and the associated risks. In this, we would expect to see, as a minimum, information on the transfer of ownership of assets, fees, returns, interest rates, the risks of the product and loan length terms.

Express consent

4.23 We also propose requiring firms to get express consent from consumers before entering into any cryptoasset lending or borrowing contractual arrangement. This should state the consumer understands they are transferring ownership of their assets to the firm. Firms should also get renewed express consent if there are significant changes to the contractual arrangement such as extending the loan duration.

Appropriateness assessments

4.24 Appropriateness assessments are a key requirement under the financial promotion rules. However, there is currently no explicit rule requiring firms to undertake a further assessment after a consumer's initial purchase of cryptoassets. We have seen a mixed approach by firms. Some have not undertaken an appropriateness assessment when existing consumers with previously purchased cryptoassets want to enter cryptoasset lending and borrowing arrangements. To address this gap, we propose a requirement that firms conduct an appropriateness test before a consumer enters into any contractual agreement for cryptoasset lending or borrowing. This would include questions that test a retail consumer's understanding of the inherent features of lending and borrowing models. For example, the impact of transferring ownership of their assets to the firm, that yields are contractual promises and not guaranteed, and questions to test understanding of margin calls, interest rates and fees.

Question 37: **Do you consider the above measures would be proportionate and effective in ensuring that retail consumers would have sufficient knowledge and understanding to access to cryptoasset lending and borrowing products?**

Platform Tokens

4.25 Platform Tokens are cryptoassets issued and potentially burned by cryptoasset firms themselves, thereby giving them control over the token's price. For cryptoasset lending and borrowing, platforms enable these tokens to be used as both a means for yield and collateral, offering better rates to those who use their native token in comparison

to other cryptoassets. However, this introduces a potential conflict of interest, as the platform itself plays a role in driving demand for its native token. By offering favourable terms for cryptoasset borrowing and lending with their token, as well as controlling supply, platforms may contribute to artificial price inflation or market manipulation.

4.26 Celsius Network's Platform Token is an example of this risk materialising. Before its bankruptcy, Celsius was able to control the supply, demand, and valuation of their own crypto token 'CEL' which it heavily promoted. This allowed them to limit supply to create scarcity which falsely drove-up consumer demand and caused consumers to buy up Celsius' own token from wallets they did not think could be associated with them, further limiting supply, and driving up the price. Alongside this, Celsius made the interest rates on the cryptoasset lending and borrowing platform more favourable for CEL. This dual control allowed Celsius to pay inflated yield rates back to original lenders while misleading investors into believing its value was based on real market forces.

4.27 Given previous firm failures involving platform tokens and associated risks, we want to understand if restricting the use of platform tokens for cryptoasset lending and borrowing products could reduce conflicts of interest, and so give consumers greater protection.

Question 38: **What benefits do platform tokens provide to consumers?**

Question 39: **How can conflicts of interest be managed for platform tokens to reduce the risk profile for retail consumers?**

Use of qualifying stablecoins

4.28 It is our assessment that the use of qualifying stablecoins as defined in the Treasury's draft SI and issued by a part iv authorised stablecoin issuer, can reduce price volatility and risk to retail consumers for both the cryptoasset lending and borrowing models. For example, under the cryptoasset borrowing model, we assess that using a qualifying stablecoin as collateral would significantly reduce the likelihood of a margin call occurring. Under the cryptoasset lending model, we perceive that lending in qualifying stablecoin and receiving qualifying stablecoin as the reward, would likely stabilise interest rate rewards for retail consumers and provide increased confidence in the market.

4.29 Therefore, we want to gather views on whether it is appropriate to provide an exemption to restricting retail access to these products where the model only allows them to:(i) lend qualifying stablecoins and, (ii) borrow where the collateral is a qualifying stablecoin. We welcome feedback on this.

Question 40: **Do you consider that if we are to restrict retail access to cryptoasset lending and borrowing, an exemption for qualifying stablecoins for specific uses within the cryptoasset lending and borrowing models would be proportionate and effective in reducing the level of risk for retail consumers?**

Chapter 5

Restricting the use of credit to purchase cryptoassets

Background

5.1 According to the most recent Financial Lives 2024 survey, 84% of UK adults (around 46 million people) held at least one credit or loan product or had done so at some point in the previous 12 months. This high percentage reflects the widespread use of credit amongst UK adults and the importance of credit to their financial and personal wellbeing.

5.2 Buying cryptoassets with credit is becoming more popular amongst consumers. A recent survey we commissioned from YouGov found that those who said they paid for cryptoassets with a credit card or existing credit facility, has more than doubled from 6% in August 2022 to 14% in August 2024. However, using credit to buy cryptoassets is risky, due to their inherent volatility. Fluctuations in cryptoassets' value can significantly and rapidly change the value of a consumer's holdings.

5.3 We are concerned that consumers buying cryptoassets with credit may take on unsustainable debt, particularly if the value of their cryptoasset drops and they were relying on its value to repay.

5.4 The potential for impulsive crypto purchases can also increase the risk of over-indebtedness. Credit also usually carries interest charges and fees, which can increase if the balance is not repaid. Failure to repay could also result in the consumer's credit score being downgraded, which can affect their ability to get both loans and lower interest rates in the future.

5.5 While a number of high-profile payment firms have voluntarily restricted consumers from buying cryptoassets with their credit cards, some cryptoasset firms continue to promote the ability for consumers to buy these assets using credit.

Proposal

5.6 So, we are exploring whether it would be appropriate to restrict firms from accepting credit as a means for consumers to buy cryptoassets. We are considering a range of restrictions, including restricting the use of credit cards to directly buy cryptoassets, and using a credit line provided by an e-money firm to do so.

5.7 Our initial expectation is that qualifying stablecoins issued by an FCA authorised stablecoin issuer would be exempt from potential restrictions, and firms would not be restricted from offering credit options for the purchase of these qualifying stablecoins.

5.8 We know any form of restriction will have an impact on both firms and consumers. So we are seeking views and further evidence to help us understand the implications and feasibility of imposing restrictions on the use of credit to buy cryptoassets on both firms and consumers.

Question 41: **Would restrictions on the use of credit facilities to purchase cryptoassets be effective in reducing the risk of harm to consumers, particularly those vulnerable? Are there alternative approaches that could equally mitigate the risks?**

Chapter 6

Staking

Background and Context

6.1 The industry generally uses the term staking to describe the process where cryptoassets are used and locked for blockchain validation. Participants typically 'stake' a given amount of their cryptoassets (locking them down on a smart contract or alternative software solution) for a period of time. As an incentive for doing so and ensuring smooth operation of this validation process (on proof-of-stake blockchains), participants are offered financial rewards, in the form of cryptoassets, or returns (such as reduction in staking fees). Participants who manipulate the validation process risk losing their staked cryptoassets.

6.2 Rates and distribution of rewards are typically defined by the blockchain consensus rules and directly managed by the consensus protocol which is pre-programmed. However, the validators and other intermediaries involved can choose the amount they take from this reward as commission.

6.3 The minimum amount of cryptoassets which needs to be locked down, or staked, can be prohibitively high for staking participants. Firms have started offering opportunities to retail consumers to pool together cryptoassets to meet the minimum staking requirements. Increasingly, firms market this to retail consumers as an opportunity to generate yield.

6.4 Retail consumers' participation in staking is on the rise, both globally and in the UK. A recent survey we commissioned from YouGov shows that 27% of adults who own cryptoassets in the UK have engaged in staking.

6.5 Following the amendments to the The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, which came into force on 31 January 2025, staking arrangements do not amount to collective investment schemes. As outlined in the draft RAO SI, the Treasury will bring cryptoasset staking activity (where there is intermediation) into our regulation.

Risks and desired outcomes

Staking Risks

6.6 There are a number of risks specific to the staking process and current business models which our proposals look to address:

Technological risks:

- **Slashing** is a financial penalty applied to the cryptoassets that have been locked up for staking, resulting in consumers' loss of their cryptoassets. These penalties apply when a validator fails to meet certain pre-defined requirements or acts in a way that negatively affects the blockchain. Our analysis has shown that slashing is a very low probability risk to date.
- **Third-party risks:** Depending on the business models, cryptoasset staking firms may use third-party providers to run the validator nodes or provide the software for doing so. Some third parties may also have a role in distributing rewards, with these third parties receiving the rewards first before onward distribution. Reliance on third parties could also increase any inherent technological risks.

Consumer understanding risks:

- Staking is often marketed to retail consumers as a way to generate returns. However, consumers may not fully understand the blockchain validation process and its technology, including the availability, access, and amount of rewards or returns, as well as potential fees and penalties. This risks consumers making uninformed decisions.
- Retail consumers may not be fully aware that different staking periods on different blockchains will mean a different, potentially longer, period of cryptoassets being locked up. Various staking mechanisms and procedures could potentially involve delays or a pause of reward pay-out, commission and fees. Consumers could end up making decisions without a clear understanding of the risks and implications for their returns.
- Retail consumers may not be fully aware that they may be unable to access their staked cryptoassets, or that these could be subject to increased price volatility while they are locked up.

Safeguarding risks:

- Inadequate segregation between the staked consumer's cryptoassets and other consumers' cryptoassets risks all consumers' cryptoassets being inadequately ringfenced in the case of insolvency or hacking.
- Inadequate record-keeping of staked cryptoassets risks shortfalls, delayed recovery of cryptoassets during firm failure and/or inaccuracies in calculating rewards or penalties.
- Inadequate or incorrect reconciliations leading to misalignment with reported figures on both staked cryptoassets and expected rewards or penalties. This risks either a shortfall or excess of client cryptoassets being safeguarded by firms.

Desired outcomes

6.7 Through our regulatory regime, we are aiming to achieve the following outcomes:

- Retail consumers will be better protected from the risks of asset losses caused by technological and counterparty risks, and will benefit from products operating in a technologically resilient environment.

- Retail consumers will have a better understanding of the risks involved in staking and product transparency, making appropriate and informed decisions that match their risk profile.
- The UK cryptoasset staking market will be fair, orderly, and transparent through consistent standards. This will reduce the risk of fraud, malpractice or improperly managed staked cryptoassets, including managing safeguarding risks.
- Supporting growth of the staking market in the UK through providing a clear regulatory regime and requirements that encourage sustainable growth of staking as an activity.

Summary of key policy proposals

6.8 Building on our existing financial promotions regime and in addition to the conduct and firm standards for cryptoasset firms generally, we welcome views on the following proposals for regulated cryptoasset staking firms. In designing our proposals, we seek to ensure an appropriate degree of consumer protection while harnessing the benefits of staking.

Key proposals to address technological risks in cryptoasset staking:

- Firms will be liable for financial losses suffered by retail consumers where the firm has inadequately assessed its technological and operational resilience, including third-party dependencies.
- Firms will be required to implement robust arrangements as part of our prudential requirements to ensure they hold sufficient capital to absorb such losses, such as those caused by slashing.

Key proposals to address lack of consumer understanding:

- Firms must get retail consumers' explicit consent on the amount of staked cryptoassets, conditions for payment, repayment, return of cryptoassets and fee-charging arrangements, before the firm stakes their cryptoassets.
- Firms must give retail consumers key information on staking products and the associated risks in a key features document.

Key proposals to address safeguarding risks:

- Firms will need to maintain separate wallets for consumers' staked cryptoassets, distinct from the firm's and other consumers' cryptoassets.
- Firms will need to maintain accurate records of staked cryptoassets at all times.
- Firms will need to conduct regular reconciliations of staked cryptoassets.

Technological resilience and third-party dependency

6.9 As outlined in paragraph 6.6 above, staking presents inherent technological, cyber and third-party risks. Our wider conduct and firm standards, which will apply when regulated cryptoasset activities are brought into our regulatory regime, will help address these risks by applying operational resilience and prudential requirements for firms engaged in all new regulated cryptoasset activities, including staking.

6.10 We will set out our operational resilience framework (SYSC 15A) in more detail in our forthcoming CP on conduct and firm standards for RAO activities. Under this framework, we would expect regulated staking firms, and all other firms undertaking new regulated cryptoasset activities, to manage operational and technological risks. Firms will need to have a comprehensive understanding and mapping of the people, processes, technology, facilities and information needed to deliver each of their important business functions and support resilient provision of third-party services, such as though scenario testing.

6.11 Firms with more robust financial resources should generally be more resilient in absorbing and recovering from losses, such as those caused by the actions of third-party software providers involved in the staking process. Our prudential requirements will consider the potential risk of harm from a firm's ongoing operations to ensure firms have robust arrangements in place to recover from losses. We will discuss the details of the upcoming cryptoasset prudential requirements in our forthcoming CP on issuing a qualifying stablecoin, safeguarding qualifying cryptoassets and specified investment cryptoassets.

6.12 Retail consumers' losses may occur as a result of the actions of third-party technological providers, such as the malicious actions or poor operational practice of node validator operators resulting in slashing. In such cases, we do not think retail consumers should bear the consequences of such failures, over which they have no control. This principle is common practice among some cryptoasset staking platforms who offer 'slashing insurance'.

Technological resilience and third-party requirements

6.13 We propose that firms are required to absorb and reinstate in full retail consumers' losses caused by third party failure. This is because retail consumers generally lack the understanding or the resources to consider risk mitigation strategies for various staking business models and firms' third-party providers.

6.14 To reduce the likelihood of this risk, firms should also ensure that they have adequately assessed their technological and operational resilience, including third-party providers, just as with all newly regulated cryptoasset activities. As with other new cryptoasset activities, we do not propose to extend accountability to the firms to include incidents that happen outside of their control, such as blockchain disruptions.

Question 42: **Do you agree that firms should absorb retail consumers' losses from firms' preventable operational and technological failures? If not, please explain why? Are there any alternative proposals we should consider?**

Question 43: **Do you agree that we should also rely on the operational resilience framework in regulating staking, including the requirements on accountability?**

Consumer Understanding

Background

6.15 Staking has been increasingly marketed to retail consumers as a way to earn yield and generate returns. However, firms have not clearly explained and disclosed the technological process and corresponding risks involved. We propose that, in addition to the current financial promotions requirements, retail consumers should have access to clear, comprehensive, and accurate information on the staking process before their participation.

Transparency on cryptoasset staking and ownership status

6.16 At present, firms often promote staking to retail consumers as 'earn' or 'yield' products, without explaining the underlying staking process or implications for the staked cryptoassets. Often, these promotions do not differ significantly from other yield generating activities such as cryptoasset lending. This could lead to confusion for retail consumers. We will consider whether our current financial promotion rules will need to be strengthened further to help improve these promotion practices, as part of the forthcoming CP on conduct and firm standards for RAO activities.

6.17 More importantly, firms have not fully disclosed to retail consumers whether there is a transfer of ownership of cryptoassets during the staking process, or how this may differ depending on the selected staking model. For example, for liquid staking models, it is unclear if all firms are duly disclosing that retail customers may not keep ownership of their underlying cryptoassets when they are staked, or that the ownership is transferred to the firm.

6.18 Additionally, we know of instances where consumers' cryptoassets held by firms have been staked without consumers' consent or awareness. In this situation, the firm stakes the cryptoassets to earn a reward without distributing any of this reward to the consumer. We want to stop this happening and ensure consumers are aware, and consent to, their cryptoassets being staked.

6.19 Our proposed regulatory approach aims to ensure that retail consumers are fully aware of, and understand, the risks of staking and the product features of their selected staking model as part of the contract before staking their cryptoassets. In addition to disclosure rules applying to all new cryptoasset regulated activities, we propose a range

of specific measures in this DP. These include requiring firms to make clear, full, and proper disclosure of product risks and features, requiring firms to get retail consumers' consent before staking, and strengthening retail consumers' knowledge of the staking process and products and how these processes affect their cryptoassets.

Commission received from staking

6.20 Validation incurs operational costs which are collected by validators as commission. The rate of commission will vary depending on the blockchain and the validator's terms. In addition to the validation commission rate, staking platforms also charge fees. The commission and fee structure may vary depending on the blockchain and may not always be presented clearly to retail consumers.

6.21 Our proposed regulatory approach aims to prevent this opaque commission and fee structure by improving product transparency and retail consumers' understanding of key product features, as outlined below.

Time taken to receive staked cryptoasset or rewards

6.22 The process of unstaking (withdrawing) cryptoassets from the staking process is not instantaneous. It may take anywhere from hours to days depending on the blockchain protocol. The 'unstaking period' is the duration required by the blockchain protocol for staked cryptoassets to become liquid and available for withdrawal after initiating the unstaking process. Beyond this period, cryptoasset staking firms may apply additional processing time between the consumer's instruction and when they get their cryptoassets back. This processing time will vary depending on the firm and during this time cryptoassets are locked and cannot be transferred or traded.

6.23 The time period until newly staked cryptoassets start earning a reward may also vary depending on the blockchain, as does the rewards payout interval when rewards are paid back to a consumer.

6.24 While their cryptoassets are locked up, consumers may face delays in accessing their funds. This delay, amplified by market volatility, could introduce added liquidity risks to consumers who's staked cryptoasset could lose value in a short period of time. Retail consumers do not always know or fully understand that they cannot immediately unstake their cryptoassets at any time or even during market events. They are also often unaware that there are different duration or types of delays due to the various terms different firms or blockchains use when referring to time taken to receive staked cryptoassets/rewards.

6.25 By requiring firms to seek retail consumers' consent and disclose product features, as explained in paragraph 6.28 below, our proposed approach aims to ensure that retail consumers fully understand both the terminology and potential liquidity delays that they may face in staking. Where firms offer retail consumers the ability to unstake their cryptoassets while they are locked up on the blockchain, this may present a liquidity risk to firms rather than consumers.

Technological and third-party dependency risk

6.26 As outlined above, there are certain technological and third-party dependency risks in staking as an activity. Firms should make retail consumers aware of these, through our proposal of introducing a key features document, explained in paragraph 6.28. This document should explain that these are risks associated with the staking process that can happen due to the (in)action of third parties and the subsequent implications on the payment or return of cryptoassets to consumers.

Consumer Understanding Requirements

6.27 Our proposed regulatory approach aims to manage the risks of retail consumer understanding, while being proportionate to the risks of staking. Beyond the staking specific requirements below, regulated cryptoasset staking firms will also be subject to conduct and firm standards requirements across their services to be published in the forthcoming CP on conduct and firm standards for RAO activities. This will include the Consumer Duty, where firms must give customers timely information and support to ensure they make properly-informed decisions, as well as compliance with Financial Promotions rules. In this section, we cover the additional requirements we propose would apply to regulated staking firms.

6.28 We are looking to gather views on the following proposals:

- As part of agreeing to staking, retail consumers must sign a declaration to give express consent for their cryptoassets to be staked. This should cover: (a) the type, amount, and value of cryptoassets that the firm will stake on a consumer's behalf; (b) the payment / repayment / return of cryptoassets after the staking process; and (c) the fees that will be charged.
- Firms should give retail consumers a key features document before consenting to stake. As a minimum, this should state:
  - The fees and commission the retail consumer will be charged, including where these vary by blockchain.
  - Any unstaking delay or processing delay a retail consumer may face in getting their cryptoassets back or the time period until newly staked cryptoassets start earning a reward. These terms should be clearly defined in the key features document.
  - Any delay between staking assets and earning a reward or being paid this reward following unstaking.
- Whether there is a transfer of beneficial and/or legal ownership of cryptoassets to the firm (or any other person or entity) during the staking process. Or, whether the firm remains holding those cryptoassets on behalf of a client, and in what capacity, including whether these cryptoassets are being held on trust.
- That there may be risks to staked cryptoassets in the event of hacking, slashing or other technological failure. This includes situations where firms will absorb and reinstate in full consumer losses arising from third-party events and where a consumer may face these losses.

Question 44: **Do you agree that firms should have to get express consent from retail consumers, covering both the value of consumer's cryptoassets to be staked and the type of cryptoassets the firm will stake, with each cryptoasset staked by the consumer requiring its own consent?**

Question 45: **Do you agree that firms should provide a key features document as outlined above to retail consumers? If not, please explain why? What other means should be used to communicate the key features and risks of staking to consumers?**

Question 46: **Are there any alternative proposals we should consider to minimise the risks of retail consumers' lack of understanding leading to them making uninformed decisions?**

Safeguarding

Background

6.29 Cryptoasset staking firms generally safeguard consumers' cryptoassets throughout the staking process. When the firm safeguards these on behalf of consumers during the staking process we propose introducing specific safeguarding requirements to address the associated risks. A forthcoming CP will consult on the wider safeguarding regime for qualifying cryptoassets and specified investment cryptoassets. However, we propose additional safeguarding requirements specifically for staked cryptoassets.

Requirements for the safeguarding of staked cryptoassets

Segregation of staked cryptoassets from other client cryptoassets

6.30 Currently, staked cryptoassets may be pooled with other custodied client cryptoassets in an omnibus wallet. The forthcoming CP on conduct and firm standards for RAO activities will detail the proposed segregation requirements of custodians segregating consumers' cryptoassets from their own by recording ownership and wallet labelling. In addition, we propose that regulated cryptoasset staking firms must segregate staked cryptoassets from other consumers' cryptoassets, as well as from the firm's own cryptoassets, and hold consumers' assets in a separate wallet.

6.31 We seek views on whether it is operationally viable to segregate a single consumer's staked cryptoassets into a single wallet for each staking product. There may be other approaches to prevent co-mingling of cryptoassets on top of our proposed requirements on record-keeping and reconciliation.

6.32 This proposal aims to protect consumer cryptoassets should a wallet containing staked cryptoassets be hacked. In such cases, a segregated wallet would mean the consumer would only lose their staked cryptoassets, rather than all of them. This proposal also aims to improve practice by managing any conflicts of interest and supporting accurate record keeping (discussed further below).

Question 47: **Do you agree that regulated staking firms should be required to segregate staked client cryptoassets from other clients' cryptoassets? If not, why not? What would be the viable means to segregate clients' assets operationally?**

Record-keeping

6.33 As set out in DP23/4, we believe that accurate books and records are essential to ensure a firm holds the correct amount of cryptoassets for a consumer. This will enable proper governance and management of the distribution of cryptoassets, reduce opportunities for misuse or fraud and allow for quicker distribution if a firm fails. Building on this, we propose that regulated cryptoasset staking firms must maintain accurate records of cryptoassets staked, including who the cryptoasset is being staked on behalf of, and expected rewards, as well as custody records of consumers' original cryptoassets.

6.34 This proposal reflects our view that if a firm does not accurately record the cryptoassets staked and the specific allocations to validators, this can create shortfalls, delay recovery and distribution of cryptoassets following firm failure, and lead to inaccuracies in calculating rewards or penalties.

Question 48: **Do you agree that regulated staking firms should be required to maintain accurate records of staked cryptoassets? If not, please explain why?**

Reconciliations

6.35 Reconciliations are checks firms undertake by comparing different sets of records to ensure their accuracy and identify and resolve any discrepancies. Reconciliations help firms check they are safeguarding the right amount of custody cryptoassets for the right clients, to protect them from the risk of a shortfall or excess, and that they are segregating clients' cryptoassets from their own at all times.

6.36 In addition to the general requirements for safeguarding, we propose that regulated staking firms must conduct regular reconciliations of staked cryptoassets. They must ensure alignment with reported figures on both staking and expected rewards or penalties. The frequency of reconciliations will be covered in the forthcoming CP on safeguarding qualifying cryptoassets and specified investment cryptoassets.

Question 49: **Do you agree that regulated staking firms should conduct regular reconciliations of staked cryptoassets? If not, please explain why? If so, what would be the appropriate frequency?**

Chapter 7

Decentralised Finance (DeFi)

Background and context

7.1 The industry term 'decentralised finance' (DeFi) is commonly used to market a range of financial services with a high degree of automation. They do not necessarily involve traditional financial or cryptoasset intermediaries. The degree of automation or decentralisation amongst current DeFi services varies on a sliding scale, rather than in a binary centralised-decentralised way.

7.2 Most of these services offer similar cryptoasset services as 'centralised' cryptoasset firms, as discussed in Chapters 2 to 6. UK consumers, both retail and institutional, have shown an increased interest in these DeFi services in recent years. Nevertheless, in terms of volume and amount these activities remain a small portion of the entire cryptoasset market. This is in line with the findings of a recent survey we commissioned from YouGov which found only 11% of the reported UK consumers who hold cryptoassets used decentralised exchanges to buy them, against 69% through centralised exchanges.

7.3 At present, certain activities relating to DeFi already need to consider whether they fall within the scope of existing regulations, such as the financial promotions regime (see paragraph 4.29 of the Treasury's consultation response on the financial promotions regime).

7.4 In line with the Treasury's intention in the published draft RAO SI, DeFi activities are not covered by the regime where they are truly decentralised. When DeFi involves the proposed regulated activities, and where there is a clear controlling person(s) carrying on an activity, then these activities will be covered by the regime, for example, services that involve an identifiable intermediary or entity that has control over business operations and product features.

7.5 All cryptoasset activities, whatever their underlying technology, infrastructure or governance which pose the same risks as centralised services should have the same regulatory outcomes. It is the substance of the activity firms are carrying out, not the technological mechanism through which it is provided, that determines whether it falls within our regulation.

7.6 We want to create an equitable regulatory environment that safeguards consumers in the UK's evolving cryptoasset market. It is fundamental that our new regime should include a framework that ensures entities providing regulated activities, including those commonly referred to as decentralised, have consistent regulation, supervision, and enforcement.

7.7 Current business models in the decentralised space share many of the risks and key harms identified in previous chapters. The higher degree of automation, the reliance on smart contracts, and the vulnerabilities in the code, could potentially increase operational resilience risks.

7.8 In addition, there may not currently always be an easily identifiable entity to oversee operations, resolve issues, or respond to consumers' enquiries such as on terms and conditions or redemption difficulties in an efficient and timely way.

7.9 Consumers often do not fully understand the complexities of DeFi mechanics, including risks involving loss of assets and liquidity, risks from the reliance on certain parties for governance changes and how these could increase the potential for financial harm.

Desired outcomes and proposed approaches

7.10 Within the regulatory perimeter the Treasury sets, we will ensure fairness and consistency by ensuring all market participants must meet the same set of outcomes-focused rules for the same activities. This will minimise the risk of regulatory arbitrage and protect consumers. **To achieve the same regulatory outcomes for the same activity, we propose that the same set of requirements outlined in previous chapters 2-6 will apply to those DeFi as outlined in paragraph 7.4.**

7.11 To build a well-functioning market for cryptoassets, including DeFi, it is essential that firms clearly understand their regulatory obligations. **To help firms understand their obligations, we intend to introduce guidance.**

7.12 We recognise that DeFi is dynamic. We will collaborate closely with stakeholders to understand the types of guidance firms need to help them understand their regulatory obligations. **Following this DP's publication, we will host a stakeholder forum to foster open dialogue and get valuable insights from experts and market participants.**

7.13 Specifically, we invite feedback on how to assess the degree of centralisation and decentralisation, how decentralised features interact with the regulatory perimeter, and the emerging industry practices that could support the implementation of the proposed regulatory obligations.

7.14 We want to understand any practical technical constraints to achieving compliance, and potential solutions. We will use the feedback from this forum to inform our upcoming updates to the guidance and Handbook, as well as other possible new guidance to help implement the proposed requirements.

Question 50: **Do you consider the proposed approaches are right, including the use of guidance to support understanding? What are the effective or emerging industry practices which support DeFi participants complying with the proposed requirements in this DP? What specific measures have you implemented to mitigate the risks posed by DeFi services to retail consumers?**

Chapter 8

Conclusion

8.1 This DP sets out our current thinking on how to regulate cryptoasset trading platforms, cryptoasset intermediatieries, cryptoasset lending and borrowing, the use of credit to buy cryptoassets, staking and DeFi. It covers both retail and wholesale aspects of the regime. As set out at the start of this DP, the majority of cryptoassets will remain high-risk, speculative investments and consumers should be prepared to lose all their money if they buy them. We welcome feedback on our approach to regulating these activities and whether there is a need for greater, or less, regulatory intervention in this market.

8.2 Our aim is to achieve an appropriate degree of consumer protection, enhance market integrity, support effective competition whilst facilitating international competitiveness and encouraging growth as far as reasonably possible. We welcome feedback as to whether the policy proposals achieve an appropriate level.

8.3 We welcome feedback on the impact of our policy proposals on current business models, domestic and international market participants, and the market, including any relevant costs. We also welcome suggestions on any other relevant market developments that we have not considered or unintended consequences on our proposals.

8.4 Following publication of this DP, we will engage with a wide range of stakeholders in roundtable discussions as well as individual meetings. We will consider the responses received to prepare new Handbook rules, or whether there are other aspects of our existing rules that may need changing, for consultation.

Question 51: **We consider these potential additional costs to firms and consumers in the context of the potential benefits of our proposed approach, set out earlier in Chapter 1. In your view, what are the costs of these different approaches? Can you provide both quantitative and qualitative input on this.**

Question 52: **Do you agree with our assessment of the type of costs (both direct and indirect) and benefits from our proposals? Are there other types of costs and benefits we should consider?**

Question 53: **How do you see our proposed approach to regulating these activities affecting competition in the UK cryptoasset market?**

Question 54: **Are there any additional opportunities, including for growth, we could realise through a different approach to regulating these activities?**

Annex 1

ESG considerations

We have considered the environmental, social and governance (ESG) implications of our proposals and our duty under ss. 1B(5) and 3B(1)(c) of FSMA 2000 to have regard to contributing towards the Secretary of State achieving compliance with the net-zero emissions target under section 1 of the Climate Change Act 2008 (UK net zero emissions target) and environmental targets under s. 5 of the Environment Act 2021.

Overall, we do not consider that the proposals within this DP are relevant to contributing to those targets. However, we recognise the impact cryptoassets can have on energy consumption and greenhouse gas emissions and have proposed disclosure requirements in our DP24/4 accordingly. We will also further explore any ESG implications for RAO authorised firms in our forthcoming CP on conduct and firm standards for RAO activities.

In Chapter 6 we outline how staking, as a validation method, is a less environmentally harmful consensus mechanism compared to proof-of-work consensus mechanisms. By bringing staking within the regulatory perimeter, it has potential to reduce the environmental footprint of blockchain validation. We will keep ESG considerations under review during the feedback period.

Annex 2

Business models

Chapter 2: Cryptoasset trading platforms

Cryptoasset exchanges are often part of global diversified groups with multiple legal entities performing various activities across jurisdictions. These activities - including trading, dealing, custody and provision of credit - are often bundled together by larger cryptoasset exchanges, which is known as 'vertical integration'. By doing so, they can serve as a single point of access to cryptoasset markets (see the recent IOSCO CDA recommendations for a fuller description of this issue as well as recommendations for regulators which we have taken into consideration in this DP).

The central role of cryptoasset exchanges is to provide a digital marketplace for cryptoassets, where buyers and sellers can interact. To carry out this function they operate multiple 'liquidity pools' (where buy or sell orders can be interacted, matched and filled against other orders). Like in foreign exchange markets, there are separate liquidity pools for different trading pairs. A trading pair can be between a traditional currency, referred to here as a "fiat" currency, and a cryptoasset (for example GBP-BTC). This is often used for onboarding and offboarding clients. A trading pair can also be between two cryptoassets (for example BTC-ETH). The largest exchanges may operate thousands of trading pairs across hundreds of different cryptoassets and many fiat currencies. This enables customers to conveniently exchange between different assets without multiple transactions.

International cryptoasset exchanges usually run these liquidity pools on global, centralised platforms, often making use of global settlement wallets. In simplified terms, this means that a UK customer's buy order can be centrally matched and settled with sell orders from customers globally. The advantage of this is that a UK investor is likely to face better pricing and order book depth because there are more sell orders for the asset. However, this may present challenges for local authorities due to limited regulatory oversight and control over the global platform. To cater for differences in needs across different types of customers, some cryptoasset exchanges focus on professional and institutional investors. These firms may offer more advanced trading functionalities, very fast ('low latency') execution and custody services which may be more suited to institutional customers. Other cryptoasset exchanges focus on retail investors, typically with a more basic offering, but more convenient and user-friendly applications and interfaces. The largest exchanges typically cater for both customer segments with differentiated offerings.

Chapter 3: Cryptoasset Intermediaries

There are three main intermediary activities that the Treasury intends to define: (1) dealing in qualifying cryptoassets as principal, (2) dealing in qualifying cryptoassets as agent, and (3) arranging deals in qualifying cryptoassets.

Some firms only provide one of the three activities, while other business models involve a combination. We expect firms' business models will continue to evolve in this area.

We discuss several common business models below. These are non-exhaustive and are examples which we discuss in this chapter.

Certain cryptoasset lending and borrowing arrangements will also be captured under activities (1) and (3) above. Their business models are further discussed in the section below.

Retail brokers

Retail brokers act on behalf of consumers when executing their orders, often making technical decisions on how an order should be executed. In traditional finance, a broker often acts as an intermediary between a consumer and a securities exchange, because retail investors in most cases cannot trade directly on regulated markets. Even though consumers can access trading platforms directly to buy/sell cryptoassets, some retail brokers play a role in executing orders for clients. They manage and execute transactions for clients by routing orders to a range of execution venues. This can facilitate price discovery and transactions across different platforms.

Brokers can also provide an extra layer of screening when selecting execution venues. They can provide user-friendly interfaces, and a "one-stop shop" for consumers that may wish to have all their brokerage needs and potentially other services such as payments and foreign exchange in the same place.

Consumers using a brokerage service may end up paying more in fees compared to using cryptoasset trading platforms directly. The convenience and potentially improved user experience that they provide, are balanced against these additional costs.

Wholesale brokers

Wholesale brokers, on the other hand, generally focus on serving large institutions such as banks, asset managers and hedge funds. They allow more streamlined access to crypto markets by these institutions.

Similar to the activities performed by retail brokers for retail consumers, wholesale brokers can provide increased connectivity and broader liquidity access to wholesale market participants. They allow clients to connect to a range of trading platforms, OTC desks and other service providers. Clients can benefit from a consolidated platform and integrated services.

Wholesale brokers typically charge fees based on the level of services provided or the volume of transactions processed. They may also provide a range of additional services such as financing, credit provision, custody, or research. Some firms with broader service offerings are set up as prime brokers, which typically involve multiple separate activities.

Principal trading firms

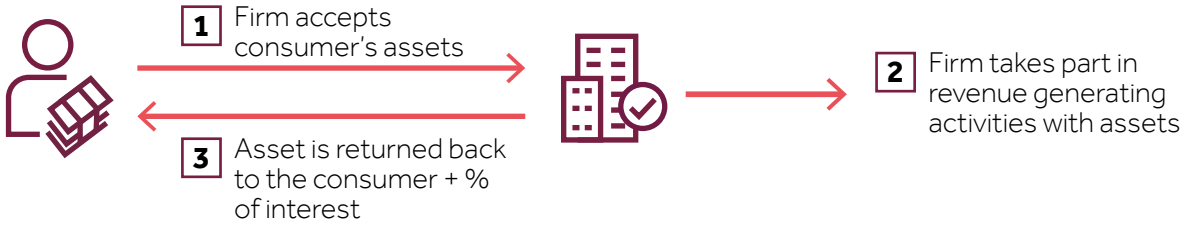
Principal trading firms (PTFs) act as direct counterparties to client transactions. PTFs enter into transactions using own capital and profit from the transactions directly, for example through the spreads between buy and sell prices. They may not charge fees in the way that brokers do.

Principal trading firms can enhance the liquidity available on a market. They quote prices and hold themselves out as willing to buy and/or sell a particular asset at that price. They can also improve the execution speed and minimise the market impact of large orders. They help clients to keep their identities confidential to the wider market.

Firms commonly referred to as market makers operating in crypto markets are also a type of PTF. They actively make markets by quoting both buy and sell prices for specific assets and may operate across a range of different platforms.

Chapter 4: Cryptoasset lending and borrowing

Figure 4: Cryptoasset lending model



Cryptoasset lending is a contractual arrangement where the holder transfers their assets to a third party eg a firm, in return for a promised yield. Firms offering cryptoasset lending products often vary the yield or rewards promised to consumers based on factors such as:

- The cryptoasset lent (eg, platform tokens, stablecoins).
- The volume of assets lent.
- The duration of the lending arrangement.

During the cryptoasset lending process, the cryptoasset lender relinquishes ownership and all associated rights of their cryptoasset to the firm. This grants the firm full discretion over the assets, allowing them to engage in yield-generating activities to maximise returns and the firms revenue. The returns offered to clients are directly tied to how the firm utilises assets. To generate yield, firms employ various strategies, which may include:

- Lending the assets to other retail or wholesale clients.
- Staking the assets.
- Participating in decentralised finance (DeFi) activities, such as providing liquidity to decentralised exchanges (DEXs) or other yield generating ventures.

Cryptoasset lending lacks a direct equivalent in traditional finance but is similar to: (i) securities lending as both involve the full transfer of ownership from the consumer to the firm, allowing the firm to utilise the assets for various purposes and (ii) speculative mini-bonds as both depend on the yield-generating activities of entities that consumer cannot directly monitor. Consumers have little or no awareness of how firms are using assets to generate revenue and the counterparties that are involved in the lending process.

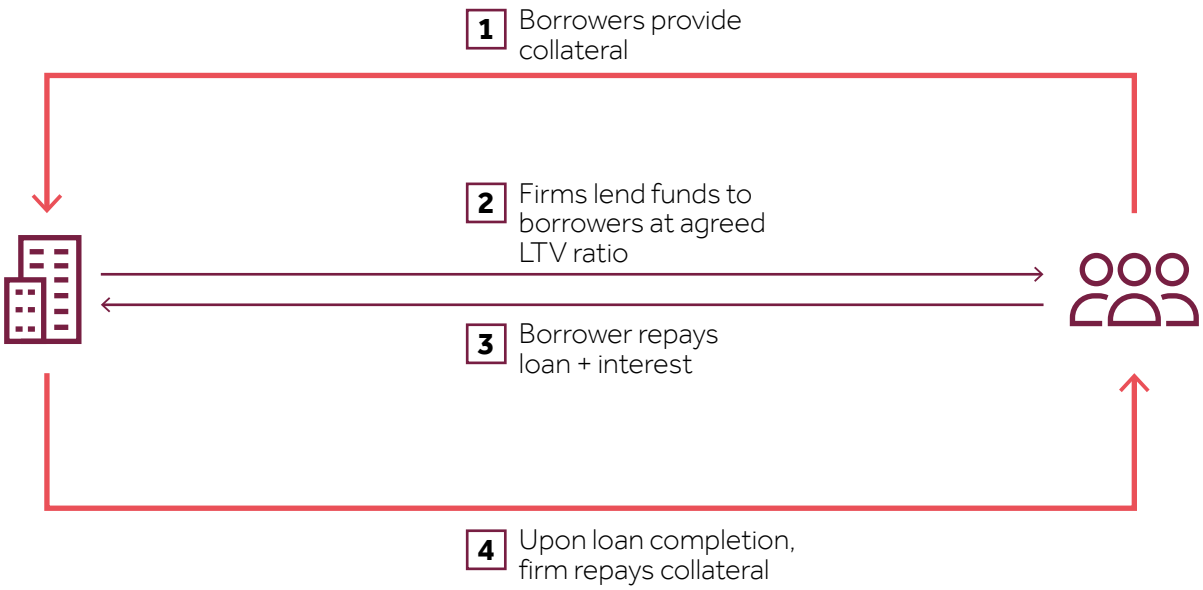
Consumers typically participate in cryptoasset lending to:

- **Earn interest on existing assets** – consumers seek to earn a return on their cryptoassets by 'lending' them.
- **Favourable interest rates** – rates offered for cryptoasset lending are often higher than rates in traditional finance or staking.

Cryptoasset borrowing

Cryptoasset borrowing is a contractual loan arrangement where a cryptoasset holder 'the lender' lends cryptoassets to a third-party 'the borrower' for an agreed time period. When a consumer 'the borrower' enters into a loan arrangement with the lender, there is a requirement to provide collateral – often in the form of cryptoassets – to secure the loan. There is generally a contractual requirement that the collateral must be overcollateralised, meaning the value of the collateral must exceed the value of the loan, which acts as a guarantee for the firm if the loan cannot be repaid.

Figure 5: Collateralised cryptoasset borrowing model



Firms structure their business model in this way as a means of managing the credit risk. However, this structure does not adequately take into account the borrowers' creditworthiness ie their ability to afford and repay the loan and the impact on their wider financial situation if they were to default on the loan and lose their collateral.

The majority of cryptoasset borrowing platforms accept a variety of cryptoassets as collateral, but most prefer those with the highest liquidity, such as Bitcoin, Ethereum. Additionally, some platforms also accept stablecoins or their own Platform Token (PT) issued by their own platform or related entities, as collateral for loans.

Depending on the product arrangements, cryptoasset borrowing may also in some cases fall within the existing consumer credit perimeter. We would remind firms that section 19 FSMA provides that no person may carry on a regulated activity in the UK, or purport to do so, unless they are either an authorised person or exempt person. Firms should consider if they are conducting regulated activities in consumer credit and if so should be authorised to do so as under section 23 FSMA. It is a criminal offence to contravene the general prohibition.

The cryptoasset borrowing process for retail consumers follows these key steps:

- **Collateral Submission:** Consumers transfer their cryptoassets to the firm. Firms hold assets of the equivalent value in a wallet which holds them as security.
- **Loan Disbursement:** The firm provides the loaned asset (crypto) at a pre-agreed Loan-To-Value (LTV) ratio. Typically, the LTV is set at around 70-80% but can vary depending on factors such as the type of cryptoassets loaned, the collateral provided by the retail consumer and the length of the loan.
- **Loan Lifecycle:** Loan lengths vary and are set out in the firm's terms and conditions. Typically, borrowers have the ability to repay their loan, and thus end the loan's lifecycle, at any time during the agreed-upon loan period. Upon repayment of the loan the collateral is returned to the consumer.
- However, during the loan's lifecycle, if the value of the collateral depreciates, the LTV ratio increases. At a predefined threshold – set above the loan amount to ensure the collateral sufficiently covers the loan – the firm issues a margin call. The borrower is then required to either repay a portion of the loan or provide additional collateral. If the borrower fails to take action, by neither repaying the loan nor adding more collateral, the firm will begin the process of liquidating the collateral to cover the loan.

Retail consumers participate in cryptoasset borrowing to:

- **Access liquidity without selling cryptoasset holdings** – cryptoasset loans can provide borrowers with access to other cryptoassets without having to sell or trade their current cryptoasset holdings.
- **Arbitrage** – some cryptoasset borrowers will seek to exploit price differences across different cryptoasset exchanges to make a profit.

Chapter 6: Cryptoasset Staking

While staking participants could directly manage their own validator node and interact with the blockchain (commonly referred as solo staking by the industry), we only focus on those business models that the Treasury seeks to regulate:

Delegated staking

In delegated staking, firms offer arrangements where consumers delegate the operation of validation node to a third-party service provider commonly referred to as 'validators'. Validators are typically responsible for validating transactions and producing blocks on the blockchain, thereby generating rewards. Consumers who stake their cryptoassets under this arrangement are able to participate in the staking process and earn rewards without having to manage the technical aspects of running a node themselves. The validators handle the operation and maintenance of the node, while consumers benefit from the staking rewards generated by the validator's activities.

Dedicated staking

A firm can both safeguard consumers' cryptoassets and operate a dedicated validator node(s) on behalf of a single customer. A custodian in this model may outsource the operation of validators to a staking as a service provider. There is no mixing of client cryptoassets, pooling or other consolidation based on the models we have seen so far.

Pooled custodial staking

Staking operates and functions differently on different blockchains. Different blockchains have different thresholds of 'staked' cryptoassets or mechanisms of validation process. For example, staking on Ethereum requires 'locking up' a minimum amount of cryptoassets to participate as a validator. To allow participation, firms offer services allowing individuals to pool their cryptoassets to meet the minimum staking requirements. Control of the cryptoassets' private keys is required to perform pooling. Proceeds from staking may be paid to members of the pool as a ratio of their share of the staked cryptoassets, minus any fees being charged by the pooling provider.

Liquid staking

While liquid staking shares some of the similar features of the above business models (for example pooling or delegation), it differs from those business models in terms of the distribution of rewards and the added arrangement where consumers could use the value of underlying staked assets for other investment purposes. Consumers will receive another type of cryptoasset, commonly referred as 'liquid staking tokens', which represent a claim on the value of the underlying staked assets; and can use or invest these separate cryptoassets during the staking process. Meanwhile, firms will continue with the staking process using consumers' original cryptoassets. Staking rewards are passed to consumers in the form of liquid staking tokens.

Chapter 7: DeFi

Based on our latest research on global market activities, market participants promote or offer DeFi services including all of those captured in the RAO SI as outlined in chapters 2-6 and in this Annex.

Across these proposed RAO activities, staking is becoming increasingly popular in the decentralised space in terms of trading value, followed by cryptoasset lending and borrowing. Trading platform, dealing, and arranging activities involve the highest number of protocols. Retail consumers' involvement continues to account for a relatively small amount comparing to the entire cryptoasset ecosystem.

Annex 3

List of Questions

Chapter 2 – Cryptoasset Trading Platforms

Question 1: What are the operational and practical challenges of applying the suggested trading, market abuse, and other requirements to authorised overseas firms operating branches in the UK? Are there alternative approaches that could equally mitigate the risks?

Question 2: What are the challenges and limitations of requiring the establishment of an affiliated legal entity for retail access to trading services by an overseas firm with a UK branch?

Question 3: What conditions should apply to the direct access of trading services of an overseas CATP with a UK branch?

Question 4: What, if any, additional responsibilities should we consider for CATPs, to address the risks from direct retail access?

Question 5: How can CATPs manage the risks from algorithmic and automated trading strategies?

Question 6: Do you agree that CATPs should have contractual agreements in place with legal entities operating market making strategies on their platforms? Are there alternative approaches that could equally mitigate the possible risks to market integrity?

Question 7: Is there a case for permitting discretionary trading practices for CATP operators? If so, how could the above risks be appropriately mitigated?

Question 8: Should firms operating a CATP be permitted to execute transactions on a matched-principal basis? If so, how could the above risks be appropriately mitigated?

Question 9: Have we properly identified the risks from the operator of a CATP also being able to deal in principal capacity off -platform? What is your view on these risks and whether it should be permitted or restricted for an operator of a CATP? If permitted, how should those risks be mitigated?

Question 10: What are the risks from an entity affiliated with the CATP trading in principal capacity either on the CATP or off the CATP? What additional requirements are necessary to mitigate these risks?

Question 11: What are the risks from admitting a cryptoasset to a CATP that has material direct or indirect interests in it? How should we address these?

Question 12: Are there important reasons why the same entity authorised to operate a CATP should also be able to provide credit lines or financial accommodations to the CATP's clients?

Question 13: Do you agree with our proposal to prevent CATPs from managing or internalising credit risks between counterparties trading on their platforms? If not, why not and how would you suggest the CATP manage these risks?

Question 14: How should we interpret or define settlement for the purpose of CATP settlement rules? Would these rules be specific to CATPs or should they be extended to other trading activities?

Question 15: Do you agree that CATPs should be subject to both pre-trade and post-trade transparency requirements? Are there any reasons we should consider pre-trade transparency waivers?

Question 16: Which challenges may emerge for transaction data requirements if there is direct retail participation?

Question 17: Are there preferred standards for recording transaction data?

Question 18: What opportunities and challenges do you see in trying to harmonise on-chain and off-chain transactions' recording and/or reporting?

Chapter 3 – Cryptoasset Intermediaries

Question 19: What practical challenges might firms face if they are required to comply with these order handling and best execution requirements? Are there any alternative approaches that would deliver the same or better order execution outcomes for retail and non-retail customers respectively? Please explain why they may be preferable.

Question 20: What benefits and risks do you see with the proposed guidance requiring firms to check the pricing for an order across at least 3 UK-authorised trading platforms (where available)?

Question 21: What benefits and risks do you see with the idea that best possible results should be determined in terms of the total consideration when firms deal with retail customers?

Question 22: Do you see any potential problems with the proposal to restrict intermediaries to offering regulated services for UK retail customers solely for cryptoassets admitted to trading on a UK authorised CATP?

Question 23: Are there any specific activities or types of transactions we should expressly carve out of our proposed order handling and best execution rules? If so, why?

Question 24: What risks arise when specific instructions (for example, specifying which execution venue to use) from retail customers are allowed to override certain best execution requirements? How can these be mitigated?

Question 25: Are there circumstances under which legal separation should be required to address potential conflicts between executing own orders and client orders?

Question 26: Are there any other activities that may create conflicts of interest and risks to clients if performed by the same intermediary? How can these be managed?

Question 27: What benefits does pre-trade transparency provide for different types of market participants and in what form will it be most useful for them? Please provide an analysis of the expected costs to firms for each option if available.

Question 28: What alternative solutions to the post-trade transparency requirements proposed above could mitigate the risks? Please provide an analysis of the expected costs to firms for each option if available.

Question 29: Do you believe that certain cryptoassets should be exempted from transparency requirements? If so, what would be the most appropriate exemption criteria which would best balance the benefits from transparency and costs to the firms?

Question 30: What would be the most appropriate exemption threshold to remain proportionate to the size of the firm while balancing the benefits from transparency and costs to the firms?

Question 31: What are the crypto-specific risks of opting retail customers up? How should these be managed and what additional guidance on how to assess the expertise, knowledge and experience of clients can we give firms to better mitigate risks of harm?

Question 32: What are the benefits of having quantitative thresholds when opting clients up? How should we determine any quantitative threshold? What alternative rules or guidance specific to crypto should we consider?

Chapter 4 – Cryptoasset lending and borrowing

Question 33: Do you agree with our understanding of the risks from cryptoasset lending and borrowing as outlined above? Are there any additional risks we should consider?

Question 34: Do you agree with our current intention to restrict firms from offering access to retail consumers to cryptoasset lending and borrowing products? If not, please explain why.

Question 35: Do you agree that applying creditworthiness, and arrears and forbearance rules (as outlined in CONC) can reduce the risk profile for retail consumers? Could these be practicably applied to existing business models? Are there are any suitable alternatives?

Question 36: Do you agree that the proposed restrictions for collateral top ups would reduce the risk profile for retail consumers? Are there are any suitable alternatives?

Question 37: Do you consider the above measures would be proportionate and effective in ensuring that retail consumers would have sufficient knowledge and understanding to access to cryptoasset lending and borrowing products?

Question 38: What benefits do platform tokens provide to consumers?

Question 39: How can conflicts of interest be managed for platform tokens to reduce the risk profile for retail consumers?

Question 40: Do you consider that if we are to restrict retail access to cryptoasset lending and borrowing, an exemption for qualifying stablecoins for specific uses within the cryptoasset lending and borrowing models would be proportionate and effective in reducing the level of risk for retail consumers?

Chapter 5 – Restrictions on the use of credit to purchase cryptoassets

Question 41: Do you consider that implementing restrictions on the use of credit facilities to purchase cryptoassets would be effective in reducing the risk of harm to consumers, particularly those who could be considered vulnerable? Are there alternative approaches that could equally mitigate the risks?

Chapter 6 – Staking

Question 42: Do you agree that firms should absorb retail consumers' losses from firms' preventable operational and technological failures? If not, please explain why? Are there any alternative proposals we should consider?

Question 43: Do you agree that we should also rely on the operational resilience framework in regulating staking, including the requirements on accountability?

Question 44: Do you agree that firms should have to get express consent from retail consumers, covering both the value of consumer's cryptoassets to be staked and the type of cryptoassets the firm will stake, with each cryptoasset staked by the consumer requiring its own consent?

Question 45: Do you agree that firms should provide a key features document as outlined above to retail consumers? If not, please explain why? What other means should be used to communicate the key features and risks of staking to consumers?

Question 46: Are there any alternative proposals we should consider to minimise the risks of retail consumers' lack of understanding leading to them making uninformed decisions?

Question 47: Do you agree that regulated staking firms should be required to segregate staked client cryptoassets from other clients' cryptoassets? If not, why not? What would be the viable means to segregate clients' assets operationally?

Question 48: Do you agree that regulated staking firms should be required to maintain accurate records of staked cryptoassets? If not, please explain why?

Question 49: Do you agree that regulated staking firms should conduct regular reconciliations of staked cryptoassets? If not, please explain why? If so, what would be the appropriate frequency?

Chapter 7 – DeFi

Question 50: Do you consider the proposed approaches are right, including the use of guidance to support understanding? What are the effective or emerging industry practices which support DeFi participants complying with the proposed requirements in this DP? What specific measures have you implemented to mitigate the risks posed by DeFi services to retail consumers?

Conclusion

Question 51: We consider these potential additional costs to firms and consumers in the context of the potential benefits of our proposed approach, set out earlier in Chapter 1. In your view, what are the costs of these different approaches? Can you provide both quantitative and qualitative input on this.

Question 52: Do you agree with our assessment of the type of costs (both direct and indirect) and benefits from our proposals? Are there other types of costs and benefits we should consider?

Question 53: How do you see our proposed approach to regulating these activities affecting competition in the UK cryptoasset market?

Question 54: Are there any additional opportunities, including for growth, we could realise through a different approach to regulating these activities?

Annex 4

Glossary

Unless linked back to an existing FCA definition or rule, terms used in this DP reflect common industry terms and are not legal terms or definitions in legislation or regulatory rules

Term	Definition
Arrears	Defined in the Consumer Credit sourcebook under CONC 7.3
Blockchain	A method of recording and distributing data. Data, such as transaction records, is generally recorded in a form of distributed ledger and organised into 'blocks', that are linked or grouped to form an auditable 'chain' of transactions.
Creditworthiness	Defined in the Consumer Credit sourcebook under CONC 5.2
Distributed Ledger Technology (DLT)	DLT refers to the protocols and supporting infrastructure that allow computers in different locations to propose and validate transactions and update records in a synchronised way across a network.
Execution venues	These include CATPs, intermediaries and other liquidity providers or overseas entities that perform a similar function to the function performed by any of the above
Forbearance	Defined in the Consumer Credit sourcebook under CONC 7.3
Inside Information	Defined in the Market Abuse Regulation under MAR Article 7
Multi-lateral Trading Facility (MTF)	An investment firm or market operator that operates a multilateral system in accordance with non-discretionary rules (based on the current FCA definition)
Market making activities	The activities of posting firm, simultaneous two-way quotes, with the result of providing liquidity on a regular and ongoing basis to the market (based on FCA Handbook)

Term	Definition
Payment for Order Flow (PFOF)	Refers to a situation where a firm receives payment, renumeration or commission from third parties (including those to which it directs orders for execution) in relation to the execution of client orders
Platform tokens	Cryptoassets issued cryptoasset firms themselves.
Smart contracts	Programmes stored on a blockchain that offer blockchains functionality to run self-executing code to automatically enforce pre-specified terms when certain conditions are met.
Slashing	A financial penalty applied to the cryptoassets that have been locked up for staking, resulting in consumers' loss of their cryptoassets. These penalties apply when a validator fails to meet certain pre-defined requirements or acts in a way that negatively affects the blockchain.
Wallet	A device or service that stores users public and private keys allowing them to interact with various blockchains and allows them to send and receive cryptoassets.

Annex 5

Abbreviations used in this document

Acronym	Description
A&D	Admissions and Disclosures
CDA	Crypto and Digital Asset
CP	Consultation Paper
CATP	Cryptoasset Trading Platform
CfD	Contract for Difference
COBS	Conduct of Business Sourcebook
DAOs	Decentralised Autonomous Organisations
DEA	Direct Electronic Access
DeFi	Decentralised Finance
DLT	Distributed Ledger Technology
DP	Discussion Paper
ESMA	European Securities and Markets Authority
EU	European Union
FCA	Financial Conduct Authority
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act
HFT	High-frequency trading
IOSCO	International Organisation of Securities Commissions
KYC	Know Your Customer
LTV	Loan-To-Value
MARC	Market Abuse Regime for Cryptoassets

Acronym	Description
MLRs	The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
MTF	Multi-lateral Trading Facility
NSM	National Storage Mechanism
OTC	Over the counter
PERG	Perimeter Guidance Manual
PFOF	Payment for Order Flow
PoS	Proof-of-Stake
Principle Trading Firms	PTF
PT	Platform Token
RAO SI	Regulated Activities Order Statutory Instrument
RegTech	Regulatory Technology

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12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk