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Regulatory Update

The U.K.'s New Cryptoasset Regime—the FCA Releases Its First Consultation Paper on Market Abuse and the Admissions and Disclosure Regime

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Introduction

The Financial Conduct Authority (FCA) has released its first publication (DP24/4) on its future rules for U.K. cryptoasset market participants. This discussion paper seeks input on the FCA's proposed rules for admissions and disclosures (A&D) and market abuse in cryptoassets (MARC).

DP24/4 is the first in a series of FCA publications expected over the next 12 months that will shape the functioning of the U.K.'s cryptoasset sector. Please see our previous alert here on the FCA's Crypto Roadmap and the additional topics the FCA will be consulting on.

The FCA is requesting feedback on the discussion paper by 14 March 2025. It is clear that the FCA is keen to engage with the industry via both written responses and meetings to ensure that it does not foot fault at a delicate time for the U.K. cryptoasset industry.

The developments in the U.K. come at a time when the sentiment towards the cryptoasset sector has improved in the United States and the EU's Markets in Cryptoassets Regulation has come into force. It appears that the U.K. does not want to be left behind in the race to regulate the cryptoasset sector.

In this Stay Current alert, we focus on the new admissions and disclosure requirements being consulted on. We will cover the market abuse rules in a second instalment.

Background

Cryptoasset businesses providing their services in the U.K. are currently subject to anti-money laundering registration, which mandates customer due diligence, transaction monitoring and screening. Separately, both offshore and U.K. cryptoasset businesses communicating to customers in the U.K. are also subject to the U.K.'s financial promotions rules, which mandates the display of certain 'front-end' disclosures and requires the imposition of 'back-end' customer frictions in onboarding journeys. The result is that U.K. cryptoasset businesses are not presently subject to full-blown financial services regulation.

Under the previous U.K. government, HM Treasury (HMT) had issued a Call for Evidence and Consultation and Response on the Future Financial Services Regulatory Regime for Cryptoassets (HMT Consultations). These proposals sought to align regulation for cryptoassets more closely with regulation applying to broader financial services markets.

Since the HMT Consultations in 2023, the U.K.'s cryptoasset industry has been waiting for substantive developments to provide it with direction and certainty. On 26 November 2024, the industry received its first communications on the proposed future regime from the FCA, when the FCA issued its Crypto Roadmap setting out the topics it will be consulting on over the next 12 months. As promised, the FCA has delivered the first of these topics in the discussion paper, which will introduce new admissions and disclosures requirements to cryptoasset businesses, as well as a market abuse regime.

As mentioned, we focus on the admissions and disclosures requirements in this alert, with a separate alert addressing the market abuse regime.

Overview and Summary

- HMT is expected to introduce legislation that will prohibit public offers of cryptoassets in the U.K., unless an exemption applies. These exemptions are expected to include offers of cryptoassets admitted to trading on a cryptoasset trading platform (the FCA uses the term "CATP", however, we will refer to such providers as "exchanges" in this alert) and those offered off-platform to certain persons such as qualified investors.

- For cryptoassets to be admitted to trading on an exchange, the A&D regime mandates issuers and offerors to make certain information available to ensure that investors are able to make informed decisions, much in the same manner as the prospectus regime that applies to traditional securities under the Public Offers and Admissions to Trading Regulations 2024 (POATRs). This reflects the U.K. government's intentions in the HMT Consultations. Given that some cryptoassets may not have identifiable issuers (i.e., Bitcoin), the person required to prepare the admission document may be the exchange itself.

- In addition to these disclosure obligations, the A&D regime introduces requirements on exchanges to conduct due diligence on issuers or offerors and their admission documents, which represents an uplift from existing token listing policies that many exchanges have typically implemented. This due diligence would need to be made public.

- U.K. exchanges will need to use their due diligence to determine whether to approve or reject the application for admission to trading. The FCA will set out outcomes-based criteria centred around consumer detriment, which exchanges will need to take into account in their decision-making.

- Admission documents will be available on the National Storage Mechanism (NSM).

Admission Documents and Disclosure

An admission document will need to comply with the 'necessary information test'. This test will be set out in statute, which has yet to be released. However, the FCA expects that the necessary information test will require, at a minimum, disclosures on:

- features, prospects and risks of the cryptoassets;
- rights and obligations attached to the cryptoassets (if any);
- an outline of the underlying technology (including protocol and consensus mechanism); and
- where applicable and available, details of the person seeking admission to trading on an exchange (which may, in certain scenarios, be the exchange itself).

As with the current prospectus rules for securities, the FCA will likely issue detailed disclosure rules in its rulebook. These rules could require further disclosures relating to the following types of matters:

- The governance mechanisms that may affect the cryptoasset;
- The operational and cyber resilience of the cryptoasset's underlying technology and exposure to risks of hacks, vulnerabilities and disruptions. This should account for both present and future threats in severe but plausible scenarios. Such risks should be identified and

documented, and any audits conducted, as well as both implemented and planned risk mitigation measures, should be disclosed;

- Financial information where relevant to the price of the cryptoasset, such as the value of assets controlled by an associated treasury or foundation (where applicable) and the cryptoasset's ownership concentration and options or lock-ups for holders including insiders and affiliates (in line with IOSCO's CDA recommendations);
- The cryptoasset's track record, including trading history and major events or technology changes affecting the cryptoasset; and
- The impact of the cryptoasset on sustainability related factors such as estimated annualised energy use and estimated annualised greenhouse gas emissions. Separately, where the cryptoasset makes claims to have particular sustainability credentials, the basis on which these claims are made and the evidence that supports the claims.

The FCA considers that the benefit of requirements such as these would create flexibility for firms in determining the appropriate disclosures, as they would enable discretion based on the specifics of the cryptoasset in question. The alternative would be prescriptive rules that may enable consistency and certainty, but would also prohibit flexibility in a developing market.

Exchanges would assume the responsibility of setting and implementing their own more detailed requirements for the content of admission documents. Exchanges would need to review the cryptoassets' admissions documents (including those they had prepared themselves) during the admission process to ensure their requirements are met. As this approach could lead to a lack of consistency across the market, the FCA has said that it is keen to understand if standardised disclosures templates would be feasible.

Due Diligence

Exchanges will be required to conduct due diligence on offerors, issuers and persons seeking admission of cryptoassets (i.e., 'token projects') and the disclosures/admission documents.

Currently, many exchanges will maintain a token listing policy, which the FCA has mandated for cryptoasset business registrants under the MLRs via its webpage on Good and Poor Quality Cryptoasset Applications under the MLRs. However, without any regulatory detail, these policies can vary greatly from firm to firm creating inconsistency in the quality of due diligence conducted in the market.

The purpose of the due diligence exercise is to enable the exchange to make an informed decision of the potential risk and detriment to consumers, whilst also enabling it to establish with a "reasonable level of certainty" that the token project is legitimate and the disclosures are true and not misleading, as well as meeting the statutory necessary information test.

The FCA acknowledges that it may be difficult for exchanges to verify both token projects and the disclosures received from a token project. It is therefore proposing rules addressing what a "reasonable level of certainty" means.

The due diligence will cover certain elements that are already considered best practice in the industry. For instance, the FCA is proposing requiring due diligence to cover the cryptoasset's underlying technology (such as the distributed ledger technology used, or the use of smart contracts). This may require reviews of third-party code audits that have been conducted, including security audits of the underlying DLT, tests conducted on the code and conducted via test networks for the underlying DLT, and code audits on smart contract code.

Due diligence should also involve ensuring that the relevant risks of the cryptoasset are outlined appropriately in the admission documents.

The FCA also proposes that exchanges should conduct due diligence on the persons involved in the offer, as well as, where appropriate, on the token project members themselves. This due diligence should include reviewing those individuals' background, experience and involvement in current or prior token projects. It is to be seen how the FCA will implement this for founderless projects, such as Bitcoin.

A summary of the due diligence conducted by exchanges should also be disclosed in admission documents. This would include the due diligence scope and process, verifications that any claims are substantiated, and key findings about the cryptoasset, the issuer or other relevant persons—e.g., token project members. Exchanges would have some discretion in determining the information included in the summary.

Rejection of Admission to Trading

Given the large volume of cryptoassets that exchanges may seek to list and the potential for consumer detriment, the FCA is considering mandating exchanges to have processes for rejecting admission to trading. The FCA considers that a rejection process would ensure the robustness of due diligence whilst also mitigating instances of fraud, scams, money laundering and cryptoassets with significant technological vulnerabilities. The approach being considered by the FCA would align with its proposals for Public Offer Platforms.

These rules would be outcomes-based specifying a non-exhaustive list of factors focused on consumer detriment that, if satisfied, would require the exchange to reject the cryptoassets' admission. These factors may include material flaws in the design of the cryptoasset or its underlying technology.

National Storage Mechanism

The NSM will be familiar to participants/users in the securities space. It is a free-to-use online repository for regulated information required from issuers. The FCA is proposing that the NSM's capabilities can be leveraged to provide consumers with additional access to relevant information when investing in cryptoassets admitted to trading on an exchange.

As a result, the FCA is considering requiring exchanges to make sure that all admission documents produced for cryptoassets admitted to trading on their platform are filed on the NSM in a machine-readable format.

Liability

Statutory civil liability will apply to preparers of disclosure documents that, as stated above, may be the exchange itself. In general and in line with the standards applicable in the traditional securities market, the liability standard applied will be the 'negligence' standard as under section 90 and schedule 10 of the Financial Services and Markets Act 2000.

However, in order to encourage preparers of disclosures to include helpful and relevant forward-looking information in disclosures, the FCA notes HMT's intention to include a concept of 'protected forward-looking statements' (PFLS). This is a feature of the POATRs and reflects the position in section 90A and schedule 10A of FSMA, which provides that where a statement is a PFLS, the burden of proof lies with the consumer to establish that an issuer or offeror knew (or was reckless to the fact) that a PFLS was untrue or misleading.

The FCA expects HMT to delegate it the power to specify which types of statements should qualify as PFLS. These may include projections, intentions (e.g., regarding the cryptoasset's underlying technology) and opinions on future events or circumstances.

Next Steps

The FCA is requesting comments on the discussion paper by 14 March 2025. The FCA welcomes feedback from all participants in the cryptoasset sector, including international participants.

The FCA expects to release additional publications in Q1/Q2 of 2025, including:

- A discussion paper on trading platforms, intermediation, lending, staking and prudential considerations for cryptoasset exposures; and

- A consultation paper on stablecoins, custody and the introduction of a new prudential sourcebook.

Firms should keep abreast of these developments.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:


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