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

Submitted by e-mail to: dp25-1@fca.org.uk

RE: FCA's Discussion Paper DP 25/1 – Regulating Cryptoasset Activities

CFA Institute¹ welcomes the opportunity to comment on the Financial Conduct Authority's (FCA) Discussion Paper DP 25/1 – Regulating Cryptoasset Activities (<https://www.fca.org.uk/publication/discussion/dp25-1.pdf>). We applaud the FCA for its proactive engagement and commitment to developing a comprehensive conduct regime for this evolving sector.

We are commenting on select aspects of the Discussion Paper.

Our submission reflects our interest in the promotion of capital market integrity, professionalism and investor protection, while balancing these imperatives with market dynamism and product innovation.

Executive Summary

CFA Institute has taken a keen interest in the development of digital finance and its policy implications. Our organization has released several pieces of research related to this new field affecting capital markets, since 2021. We have consistently advocated for regulatory clarification and international convergence. Below is a list and links to those various pieces which will be mentioned throughout the rest of this response, as appropriate.

- *Cryptoassets: The Guide to Bitcoin, Blockchain, and Cryptocurrency for Investment Professionals*. January 2021.
(<https://rpc.cfainstitute.org/research/foundation/2021/cryptoassets>)
- *Cryptoassets: Beyond the Hype – An Investment Management Perspective on the Development of Digital Finance*. January 2023.

¹ With offices in Charlottesville, VA; New York; Washington, DC; Hong Kong SAR; Mumbai; Beijing; Abu Dhabi; and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program. For more information, visit www.cfainstitute.org or follow us on [LinkedIn](#) and [X](#).

<https://rpc.cfainstitute.org/sites/default/files/-/media/documents/article/industry-research/crypto-beyond-the-hype.pdf>)

- *CFA Institute Global Survey on Central Bank Digital Currencies*. July 2023. (https://rpc.cfainstitute.org/sites/default/files/-/media/documents/survey/CBDC_Survey_Report_Online.pdf)
- *Valuation of Cryptoassets: A Guide for Investment Professionals*. November 2023. (<https://rpc.cfainstitute.org/sites/default/files/-/media/documents/article/industry-research/valuation-of-cryptoassets.pdf>)
- *An Investment Perspective on Tokenization — Part I: A Primer on the Use of Distributed Ledger Technology (DLT) to Tokenize Real-World and Financial Assets*. January 2025. (https://rpc.cfainstitute.org/sites/default/files/docs/research-reports/tokenization_part-i_online-1.pdf)
- *An Investment Perspective on Tokenization—Part II: Policy and Regulatory Implications*. May 2025. (https://rpc.cfainstitute.org/sites/default/files/docs/research-reports/bandi_tokenization_partii_online.pdf)

This letter specifically addresses proposals concerning:

- Overseas Cryptoasset Trading Platform (CATP) operations and UK presence
- Managing risks from direct retail access and automated trading strategies
- Discretionary trading practices on CATPs
- Principal dealing by CATP operators and affiliates
- Dealing in principal capacity off-platform
- Affiliated principal trading entities
- Cryptoasset lending and borrowing
- Restriction of the use of credit to purchase cryptoassets
- Decentralized Finance (DeFi)

Overseas Cryptoasset Trading Platform (CATP) operations and UK presence

While supporting international firms, effective mitigation of overseas CATP risks necessitates a strong UK legal entity presence to counter inherent jurisdictional and resolution risks. Direct retail access should be balanced with stringent conditions ensuring paramount investor protection and accountability in the UK.

Managing risks from direct retail access and automated trading strategies

CATPs should assume primary responsibility to manage risks incurred by retail and automated trading with robust controls and a comprehensive retail education framework, alongside contractual agreements for market makers.

Discretionary trading practices on CATPs

We only support mandatory non-discretionary trading for CATPs, with any rare exceptions requiring stringent safeguards and explicit investor consent.

Principal dealing by CATP operators and affiliates

We believe CATPs should operate as neutral venues and generally oppose principal dealing on their central order books. If such activities are allowed within the corporate group, they require legal and operational separation, strong governance, and significant capital for any affiliated entities.

Dealing in principal capacity off-platform

The CATP operator itself should be prohibited from any principal trading activities, whether on or off-platform. If permitted by an affiliated legal entity, strict separation, information barriers, and heightened regulatory scrutiny are essential.

Affiliated principal trading entities

Significant risks from affiliated principal trading demand uncompromising legal and operational separation, robust information barriers, and intensive regulatory oversight to ensure a level playing field.

Cryptoasset lending and borrowing

We concur with the FCA's risk identification and urge additional focus on regulatory arbitrage and the systemic risk of excessive re-hypothecation. We support restricting retail access to these products in their current form.

Restriction of the use of credit to purchase cryptoassets

We support a direct restriction on using credit for non-qualifying cryptoassets to protect retail investors, complemented by point-of-transaction risk warnings, crypto-specific affordability assessments, and default transaction blocking mechanisms by payment processors.

Decentralized Finance (DeFi)

Embracing "same risk, same regulatory outcome" approach for DeFi, we propose additional measures such as targeted retail education, due diligence on identifiable protocols, and risk-calibrated access to mitigate DeFi's unique complexities.

Detailed Response

Set out below our detailed comments for consideration:

Overseas CATP operations and the imperative of UK presence

While the FCA's commitment to building a competitive and open financial system that includes international firms operating via UK branches is commendable, applying the full suite of UK trading, market abuse, and other conduct requirements to these entities presents the following operational and practical challenges:

- Jurisdictional complexity and regulatory arbitrage risk: differing home-country regulations create compliance ambiguities, potentially allowing firms to exploit gaps or minimum standards between jurisdictions.
- Data access, surveillance, and enforcement gaps: Core trading data and systems often reside overseas, hindering the FCA's ability to effectively detect market abuse, conduct surveillance, and enforce rules within the UK.
- Insolvency, resolution, and client asset protection: In the event of an overseas parent firm's failure, UK client assets will be subject to foreign insolvency laws, complicating recovery and resolution processes.
- Monitoring and ensuring genuinely established UK operations: Defining and continuously verifying what constitutes a "predominantly UK business" for branches is an ongoing supervisory challenge, risking a superficial UK presence.

Considering the inherent characteristics of cryptoassets, achieving effective mitigation without some form of strong UK legal entity presence for core functions remains difficult. The following approaches could serve as complements or, in limited circumstances, alternatives for specific, lower-risk scenarios:

- Strengthening international regulatory cooperation through agreements, including Memoranda of Understanding (MoUs) and information-sharing agreements at a systemic level. This would include agreements on data access, joint investigations, and cross-border enforcement assistance.
- Adopting a risk-based and proportional approach to branch authorisation, designed to facilitate market access while safeguarding market integrity. Such an approach would entail thorough assessments of a firm's internal controls, governance, and compliance track record. Limitations should also be placed on the types of cryptoassets they can offer, the trading mechanisms employed (e.g., no principal trading or complex derivatives), or the client segments they can serve (e.g., only professional investors, as suggested in paragraph 2.8). By narrowing the scope of permissible activities for branches, the FCA could reduce the complexity of oversight and the potential for consumer harm, aligning risk with the supervisory capacity.
- Enhancing data mirroring requirements and surveillance capabilities. Oversea firms operating UK branches should maintain a complete, real-time, auditable, and accessible mirror of all UK-related trading data and operational logs within the UK. It serves to strengthen the "host" regulator's hand.

Mandating an affiliated legal entity for retail access to trading services by an overseas firm with a UK branch, however, introduces challenges. These include

- Operational burden and cost, which could potentially disincentivise reputable global CATPs, potentially limiting market access and competition.
- Complexity and regulatory burdens for firms, when managing dual legal entities with overlapping obligations. An overly prescriptive structure might slow down innovation, hindering agile crypto-native firms from adapting to the UK market.
- Liquidity fragmentation, when a separate UK subsidiary for client-facing functions can introduce an additional layer of intermediation between the retail client and the global trading platform. It prevents direct interaction with global order books and potentially results in sub-optimal price formation for UK investors.

While acknowledging these limitations, the benefits for investor protection derived from clear UK legal accountability are paramount. We therefore advocate for solutions that carefully balance robust oversight with market dynamism, and we commend the FCA's openness to considering other compatible structural arrangements.

Last but not least, while we acknowledge that direct retail access to CATPs offers benefits like reduced costs and increased client autonomy, for an overseas CATP with a UK branch to provide direct access to trading services, particularly to retail consumers, a stringent set of conditions should apply. Drawing upon the FCA's stated concerns and objectives, we may propose the following conditions:

I. Consumer protection and product governance

- Risk warnings: Clear, prominent, and easily comprehensible information on cryptoasset risks and the direct access model, explicitly addressing the absence of intermediary advice.
- Suitability test: Thorough due diligence and assessments to ensure retail clients comprehend the complex nature and inherent risks of the products.
- Complaints and dispute resolution: Accessible, efficient, UK-based procedures for complaints handling, including access to the Financial Ombudsman Service (FOS) for UK retail clients.

II. Platform and asset safeguarding

- Segregation of client assets: Rules governing the segregation of client cryptoassets from the CATP's own assets, enforced and audited, to safeguard investor in the event of insolvency.
- Operational resilience and cybersecurity: Robust frameworks, subject to UK supervisory scrutiny, that address the resilience of custody solutions and ensure the continuous delivery of platform services.

III. Accountability and oversight

- Accountability and best execution obligations: The UK branch (or affiliated subsidiary) is accountable for upholding ethical conduct in all services to UK retail clients. Policies and procedures in place to ensure optimal execution of retail orders.

- Market abuse surveillance and controls: Systems in place to detect and prevent market abuse across trading activities.
- Periodic reporting and data sharing: Information disclosure to the FCA on trading, client data, and incidents.

These conditions are essential to balance direct market access benefits with investor protection in a high-risk asset class.

Managing risks from direct retail access and automated trading strategies

The widespread presence of individual retail investors and the proliferation of automated trading strategies on CATPs presents unique regulatory complexities. Unlike traditional financial markets where participants operate under specific authorizations, retail cryptoasset users and widely accessible trading software largely operate with insufficient oversight, thereby challenging the clear assignment of responsibility for order placement and execution. Therefore, it is imperative that CATPs assume appropriate responsibilities when offering direct access to their trading systems, as individual retail customers generally lack the extensive knowledge or resources needed to comply with complex trading system regulations.

We support the requirements proposed in the Discussion Paper, and we suggest the FCA consider implementing a risk and product education framework. CATPs should be required to establish comprehensive and easily accessible educational initiatives. These resources should go beyond static risk warnings, aiming to enhance investor comprehension of cryptoasset risks, trading mechanics, and platform-specific functionalities. The goal is to empower retail investors with the knowledge to make informed decisions, rather than simply presenting disclaimers.

Regarding algorithmic and automated trading strategies, we support the FCA's assessment that algorithmic and automated trading strategies, particularly when operating without proper controls and oversight, pose significant threats to the integrity and orderliness of cryptoasset markets. We concur with the aim of managing these risks and protecting market integrity, by way of a pragmatic and fit-for-purpose approach distinct from the wholesale adoption of existing MiFID RTS 6, MiFID RTS 8, and MAR 7A frameworks.

Given these complexities, we believe that CATPs are primarily responsible for managing these risks. Essentially, those providing direct access to trading systems should be the ones ensuring a level playing field and market stability. Set out below some recommendations:

- Implement pre-trade controls that screen orders from algorithmic systems before they hit the market.
- Enhance real-time market surveillance of trading activity to detect suspicious or disruptive algorithmic behavior.
- Enforce algorithmic testing and certification regimes before an algorithmic trading system is allowed to operate on the platform.
- Implement kill switches and emergency measures to mitigate the impact of runaway algorithms or extreme volatility.
- Ensure clear disclosure and conflict of interest management to enhance transparency, especially concerning platform-affiliated or preferred algorithmic liquidity providers.

- Strengthen client due diligence processes and onboarding for algorithmic users, and implement contractual clauses that hold users accountable for their bot's behavior and compliance failures.

We also appreciate the FCA's focus on formalizing the role of market makers in cryptoasset markets and their potential impact on market integrity. Therefore, we agree that CATPs should have contractual agreements in place with legal entities operating market-making strategies on their platforms. This provides a clear framework for accountability, and a formal legal basis to address issues such as non-continuous quoting or the withdrawal of liquidity without notice. A contractual agreement also helps define expected ethical conduct and brings the cryptoasset market making more in line with current expectations in traditional financial markets.

Last but not least, we acknowledge the FCA's consideration of the costs and challenges in enforcing such requirements, and the need to balance product innovation and development with market integrity. While setting contractual agreements and rules akin to traditional financial markets is a logical starting point, their effectiveness will be maximized when integrated within a broader framework of proportionality.

Discretionary trading practices on CATPs

We support the FCA's proposal to mandate non-discretionary trading systems for all CATPs. The rationale provided for prioritizing consumer protection, given the highly automated nature of cryptoasset markets, and promoting regulatory clarity, is paramount.

Considering the inherent characteristics of cryptoasset markets, we believe there is a very limited, if any, practical case for broadly permitting discretionary trading practices for CATP operators in the UK cryptoasset market. However, if a highly specific and narrowly defined use case for discretionary trading were to emerge, potentially for extremely illiquid or bespoke over-the-counter like transactions that genuinely cannot be accommodated by an automated order book, then any such permission would necessitate exceptionally stringent mitigation measures to address the inherent risks. See below:

- **Strictly defined scope:** Any discretionary permission must be confined to specific, highly illiquid cryptoasset instruments or transaction types where automated execution is demonstrably unfeasible. It must not apply to commonly traded assets or standard order-book functionality.
- **Investor protection and consent:** Discretionary services should be exclusively offered to sophisticated or professional investors who can fully comprehend and accept the associated risks. Explicit, informed consent must be obtained, clearly detailing how discretion will be exercised, the potential for conflicts of interest, and the absence of best execution obligations that might apply to an intermediary.
- **Transparency and disclosure:** The discretionary process must be transparent. This includes disclosure of pricing methodologies, fees or compensation derived, and detailed post-trade reporting that justifies the discretionary execution decisions.
- **Conflict of interest management:** Given the high risk of conflicts when an operator exercises judgment (as highlighted by concerns regarding principal trading), policies

and procedures for conflict identification, management, and disclosure would be paramount. This might also involve information barriers and independent oversight.

- **Audit trails and regulatory reporting:** Every discretionary decision and execution should be logged, with comprehensive audit trails available for regulatory review. Enhanced, periodic reporting on such activities would be essential for continuous oversight.
- **Accountability and liability:** Clear lines of accountability must be established, holding the CATP operator responsible for market integrity breaches or consumer detriment arising from discretionary actions.

Without such a high bar for permission and an equally rigorous set of mitigation measures, the risks to fairness, transparency, and market integrity would likely outweigh any perceived benefits of allowing discretionary trading practices for CATP operators.

Principal dealing by CATP operators and affiliates

We commend the FCA's assessment of the significant risks associated with firms operating a CATP executing Matched Principal Trading (MPT) or engaging in other principal dealing activities. Our view is that CATP should not be permitted to execute transactions on a matched-principal basis, particularly for client orders submitted to the CATP's central order book. This position is rooted in the fundamental principle that a trading venue should operate as a neutral, non-discretionary system connecting multiple third-party buying and selling interests.

However, acknowledging that MPT is a common practice within the cryptoasset industry, and understanding the FCA's openness to explore alternative regulatory options and how risks could be managed, we believe the key lies in stringent structural and operational separation for any entity performing principal dealing functions within the same corporate group as a CATP.

If, under specific and tightly regulated conditions, MPT were to be permitted, the following measures are recommended:

- **Operational and legal separation:** The most critical mitigation is to require the entity engaging in matched-principal trading (or any principal dealing) to have complete operational and legal separation from the firm operating the CATP. This would involve a distinct legal entity within the corporate group – with separate management, personnel, and internal systems – addressing the conflicts of interest and resiliency risks identified.
- **Governance, controls, and disclosure:** Sophisticated governance arrangements and internal controls should be implemented. This includes clear information barriers to prevent the sharing of commercially sensitive client or order book data from the CATP to the principal trading entity. Furthermore, clients engaging with the principal trading entity should be provided explicit, clear, and prominent disclosure about its relationship with the CATP, how conflicts of interest are managed, and how their orders are executed. This is vital to ensure transparency for clients, particularly retail investors.
- **Capital requirements:** The principal trading entity must be subject to capital requirements commensurate with the market and credit risks it assumes, ensuring its

resilience and preventing potential contagion to the CATP or broader market if it faces financial distress.

- Prohibiting preferential treatment: The CATP must operate on a non-discriminatory basis, ensuring that an affiliated principal trading firm receives no competitive advantage regarding access, latency, or information compared to other market participants.
- Regulatory oversight: Given the heightened risks, regulatory oversight of such separated principal trading entities and their interactions with affiliated CATPs would need to be intensive, including regular reporting, audit capabilities, and the power to intervene.

While permitting affiliated principal trading may offer benefits such as increased liquidity, market integrity and consumer protection must remain paramount. Therefore, any flexibility in this area must be accompanied by an uncompromising commitment to the outlined mitigation measures, ensuring that the benefits outweigh the demonstrably high risks.

Dealing in principal capacity off-platform

We share the FCA's concerns that significant risks are presented when the operator of a CATP is also able to deal in a principal capacity off-platform, even for trading activity not directly related to the CATP's operation. The concerns identified regarding conflicts of interest, potential for market manipulation, and the exposure of the CATP to market and product risks are properly and comprehensively identified.

Our view is that allowing the CATP operator itself to conduct principal trading activities, even off-platform, creates substantial, unmanageable risks and warrants careful consideration. The operator's unique position at the core of market functioning, with privileged insight into order flow and participant behavior, inherently gives rise to conflicts of interest that are difficult to mitigate effectively, regardless of whether the principal trading occurs on or off the specific platform. Such activity could undermine investor trust and market integrity. The potential for resource drain, reputational damage, and financial contagion back to the CATP itself also poses material resiliency concerns. Therefore, we believe that the CATP operator itself should be prohibited from engaging in any principal trading capacity, whether on or off its platform. This aligns with the FCA's strong policy proposition for on-platform trading, and we argue the same rationale extends to off-platform activities by the operator.

However, if, under a highly restricted framework, any form of principal trading is to be permitted within the broader corporate group (i.e., by a separate, distinct legal entity affiliated with the CATP, rather than the CATP operator directly), the following measures are recommended:

- Legal and operational separation (Details explained previously. See “Principal dealing by CATP operators and affiliates”)
- Information Barriers (Details explained previously. See “Principal dealing by CATP operators and affiliates”)
- Conflict of interest policies and independent oversight (Details explained previously. See “Principal dealing by CATP operators and affiliates”)

- Regulatory scrutiny and reporting: Both the CATP operator and the principal trading affiliate must be subject to heightened regulatory scrutiny. This would involve granular, regular reporting on all principal trading activities, financial exposures, and the effectiveness of internal controls and information barriers. Regulators reserve full audit rights to verify compliance.
- Capitalization and risk management: The principal trading entity must be adequately capitalized to absorb market and credit risks independently, preventing any potential contagion to the CATP or adverse impact on market stability. Its risk management framework should be robust and subject to compliance and regulatory review.
- Transparency of affiliation: Should such affiliated principal trading entities also participate on the CATP itself, their affiliation must be clearly and prominently disclosed to all other market participants.

While acknowledging that such rigorous separation creates operational costs and complexity, these measures are indispensable. The inherent risks of conflicts of interest and market disruption stemming from principal trading, even off-platform, by entities affiliated with a CATP operator are too significant to permit without uncompromising safeguards that uphold market integrity and investor protection.

Affiliated principal trading entities

We agree with the FCA's identification of the significant risks arising from an entity affiliated with a CATP trading in a principal capacity, whether directly on the CATP or in broader off-platform activities. As articulated in the Discussion Paper, these risks are substantial and directly threaten market integrity and consumer protection.

The primary risks we identify are:

- Information leakage and unfair advantage: An affiliate trading on the CATP can gain preferential and direct access to sensitive data such as order book, real-time pricing, and potentially insights into aggregated client order flow. Even with "firewalls", this proximity and shared technological infrastructure can lead to the affiliate having an informational edge over other market participants. This advantage can be leveraged to front-run orders or manipulate prices on the CATP or in external markets, to the detriment of clients and the broader market. Furthermore, affiliates may benefit from strategic insights, product development plans, or knowledge of system vulnerabilities gleaned from their relationship with the CATP operator.
- Market manipulation and distorted market quality: The close relationship between a CATP and an affiliated entity increases the risk of manipulative trading practices. For example, the affiliate could engage in "wash trading" or "spoofing" on the CATP to create artificial volume or price signals, which it then exploits for profit on the CATP itself or through off-platform trading. Furthermore, an affiliated entity could also strategically place orders to influence prices, knowing the platform might execute client orders based on these manipulated prices. This activity, not solely driven by genuine market demand, can distort price formation and liquidity, potentially creating a false

sense of market depth or activity. There's also a risk that the CATP might favour its affiliate's orders, even within rules-based matching processes.

- Resilience and contagion risks: Financial distress or significant losses within an affiliated trading entity, even if legally separate, could negatively impact the reputation, operational capacity, or even the financial stability of the core CATP due to shared branding, resources, or interdependent systems. This interconnectedness creates a systemic risk. Last but not least, even with robust controls, the perception that a CATP's affiliate is actively trading on the platform or leveraging its relationship will undermine market participants' trust in the venue's impartiality and fairness. This erosion of trust is particularly critical for the crypto market seeking to establish greater legitimacy and investor confidence.

Given the significant concerns and potential risks involved, the standard for allowing an entity affiliated with the CATP trading in principal capacity must be high, requiring stringent and continuously auditable requirements beyond conflict-of-interest management. These measures should aim to achieve a regulatory outcome equivalent to a neutral venue, as follows:

- Legal and operational separation (Details explained previously. See “Principal dealing by CATP operators and affiliates”)
- Information Barriers (Details explained previously. See “Principal dealing by CATP operators and affiliates”)
- Conflict of interest policies and independent oversight (Details explained previously. See “Principal dealing by CATP operators and affiliates”)
- Clear public disclosure of affiliation (Details explained previously. See “Dealing in principal capacity off-platform”)
- Regulatory scrutiny and reporting (Details explained previously. See “Dealing in principal capacity off-platform”)
- Capitalization and risk management (Details explained previously. See “Dealing in principal capacity off-platform”)

Considering the inherent risks created by the overarching corporate relationship, the proposed mitigation measures aim to create a level playing field, ensuring that the benefits of affiliated liquidity provision can be realized without compromising the foundational principles of fair and orderly markets.

Cryptoasset lending and borrowing

We commend the FCA’s thorough work in identifying and understanding the inherent risks in cryptoasset lending and borrowing, and we largely concur with their findings. The categorization of these risks into common, lending-specific, and borrowing-specific areas creates a strong foundation for future regulatory actions.

To further strengthen this framework, we propose an additional focus on regulatory arbitrage, also known as jurisdictional risk. While the FCA acknowledges counterparty risk from overseas entities, we believe it is crucial to specifically consider instances where firms intentionally

structure their operations to circumvent the UK's regulatory perimeter. This can expose UK consumers to entities operating under weaker or non-existent regulatory regimes. The borderless nature of cryptoassets significantly heightens this risk, making it imperative to address how firms might exploit jurisdictional differences to evade regulatory oversight.

With reference to paragraph 4.8, we suggest the FCA also consider the systemic risk of excessive re-hypothecation. This practice extends beyond simple onward-lending, involving the multi-layered pledging of the same cryptoassets initially provided as collateral. This creates opaque and highly leveraged "collateral chains" that dramatically amplify contagion risk across the ecosystem. This practice also challenges consumers to accurately trace their assets or comprehend their true exposure, potentially leading to irreversible losses if any party in the chain defaults.

Having said that, we agree with the FCA's current intention to restrict firms from offering access for retail consumers to cryptoasset lending and borrowing products in their present form. Our position stems from the acute and multifaceted risks so clearly outlined in the Discussion Paper, coupled with the proven susceptibility of retail consumers to substantial losses. This approach is further reinforced by the FCA's proposed distinction for institutional clients, who are acknowledged as being better equipped to understand and manage these complex financial risks.

We recognize and appreciate the FCA's focus on understanding and regulating cryptoasset lending and borrowing. For more detailed information on this topic, we invite you to refer to our previous publication, [*"Cryptoassets: Beyond the Hype – An Investment Management Perspective on the Development of Digital Finance."*](#)

Restriction of use of credit to purchase cryptoassets

We align with the FCA's discerning analysis regarding the risks associated with utilising credit facilities for the purchase of cryptoassets. Our view is that the proposed restriction represents a protective regulatory intervention for retail consumers against the potential harms arising from speculative investment compounded by debt.

While acknowledging the FCA's receptiveness to alternative approaches, we lean towards the view that no single alternative measure is likely to offer the same robust level of protection as a direct restriction on using credit for non-qualifying cryptoassets.

Should a total prohibition not be universally applied, or to fortify a nuanced regulatory approach, the following measures could be considered:

- **Point-of-Transaction risk warnings:** Implement unavoidable, highly visible risk warnings at the precise moment a consumer initiates a cryptoasset purchase using credit. These warnings should depict the magnified risks of debt in conjunction with extreme asset volatility, including clear examples of potential rapid and complete capital loss. While crucial for transparency, reliance solely on disclosures often proves insufficient to deter determined or vulnerable individuals, necessitating complementary point-of-transaction risk warnings.

- **Crypto-specific affordability and suitability assessments:** If any credit facility were to be permitted for cryptoasset purchases (beyond highly regulated stablecoins), the onus should fall on credit providers to conduct stringent affordability and suitability assessments. These evaluations should also transcend conventional credit checks, explicitly assessing a consumer's capacity to absorb substantial, potentially total, losses on a volatile asset while concurrently servicing debt obligations.
- **Transaction blocking mechanisms:** Default blocking of transactions identified as cryptoasset purchases to be established by credit card networks and payment processors at the merchant Category code level. This barrier would require an explicit, highly regulated opt-in process, thereby creating a significant procedural friction point.
- **Cooling-off periods for credit-funded purchases:** Implementing cooling-off periods between a consumer's decision to use credit for a cryptoasset purchase and the actual execution of that transaction. This "circuit breaker" should allow for reconsideration, particularly in cases of impulsive decision-making or susceptibility to market hype.

Decentralised Finance (DeFi)

We commend the FCA's focus on Decentralised Finance (DeFi) in this Discussion Paper and agree with the fundamental principle that "all cryptoasset activities, whatever their underlying technology, infrastructure or governance which pose the same risks as centralised services should have the same regulatory outcomes" (paragraph 7.5). This "same risk, same regulatory outcome" approach is essential for minimising regulatory arbitrage, promoting an equitable market, and safeguarding consumers within the evolving cryptoasset landscape.

Regarding the FCA's proposed approaches, we consider them to be broadly appropriate, particularly the commitment to issue guidance to support understanding. Such outcomes-focused guidance will be indispensable for firms to properly understand and interpret their regulatory obligations, especially in identifying the "clear controlling person(s)" responsible for bringing activities within the regulatory perimeter.

Below, we highlight a few emerging industry practices that support DeFi participants' compliance with the proposed requirements:

1. **"Permissioned" DeFi frameworks and identity solutions:** While DeFi often emphasizes permissionless access, a growing trend involves "permissioned" DeFi protocols or "walled gardens", seeking to introduce access controls and identity verification. The examples of "permissioned" DeFi protocols include integrating Know Your Customer (KYC) and Anti-Money Laundering (AML) checks up front by whitelisting participants. To many financial institutions, the core motivation for permissioned DeFi is to bridge the gap between the efficiency and innovation of decentralized finance and the regulatory requirements of traditional finance, offering a way to selectively control participation and ensure compliance.
2. **Smart contract assurance mechanisms:** Continuous and robust third-party auditing of smart contracts are becoming more sophisticated. It typically involves a combination of manual code review, automated tooling and testing, and documentation review. The outcome of an audit is usually a detailed report outlining identified vulnerabilities, their

severity, and recommendations for remediation. Smart contract audits can facilitate building secure and reliable DeFi protocols.

3. On-chain analytics and transaction monitoring tools: Advanced analytics tools are enabling improved tracing of funds and identification of suspicious activities on public blockchains, even in pseudonymized environments. This aids in AML compliance for firms operating at the identifiable points of interaction with DeFi.

In addition, we recommend the following measures to mitigate the risks posed by DeFi services to retail consumers:

1. Risk disclosure and targeted education: Provide retail consumers with clear, concise, and prominent risk warnings specific to DeFi services. This goes beyond generic crypto warnings to explain the unique complexities of smart contracts, impermanent loss, oracle risks, governance vulnerabilities, and the absence of traditional recourse mechanisms. Educational initiatives should aim to improve consumer understanding of DeFi mechanics and inherent risks.
2. Due diligence and continuous monitoring: For any DeFi service where a "clear controlling person" is identified within the DeFi protocol, stringent due diligence should be implemented. This includes assessing the underlying smart contract security, governance structures, operational resilience, and the clarity of terms and conditions, aiming to address the "lack of identifiable entity" and "vulnerabilities in code" risks (highlighted in paragraph 7.7-7.8). This also involves ongoing monitoring of smart contract health, incident response plans for code vulnerabilities, and clear procedures for safeguarding client assets against technical exploits.
3. Risk-calibrated access and product suitability: Limit retail consumers access to highly complex, volatile, or experimental DeFi products, especially those with unproven track records or extreme yield promises. A risk-based approach ensures that retail consumers are only exposed to DeFi services that are relatively more established and understood.
4. Complaint handling and accessible redress: Ensure clear and accessible channels for consumer inquiries and complaints, even if the underlying DeFi protocol has no such mechanism. This includes transparent policies on how issues (e.g., redemption difficulties) are addressed, regardless of the decentralised nature of the underlying service.

In conclusion, while DeFi's dynamic nature and the diverse decentralisation spectrum present unique challenges, the FCA's outcomes-focused approach, coupled with industry guidance, appears well-positioned to cultivate a safer and more transparent environment. The evolution of industry practices, particularly in areas involving identifiable entities, further reinforces the feasibility of achieving compliance and enhancing investor protection within this innovative sector.

Concluding Remarks

We appreciate the FCA's continued leadership in developing a robust and comprehensive regulatory framework for the evolving cryptoasset landscape. The Discussion Paper DP 25/1 marks a significant step towards achieving regulatory clarity and safeguarding market integrity.

Given the rising cryptoasset ownership among UK investors and the inherent risks associated with these assets, the comments we have provided across some of the key areas are rooted in our commitment to fostering investor protection and market integrity. We believe that a balanced and holistic approach — one that leverages international cooperation and convergence, embraces technological innovation, and establishes stringent yet proportionate safeguards — will be of crucial importance. This approach will ensure the UK remains at the forefront of financial innovation, while building a secure and trustworthy cryptoasset sector for all market participants.

On the topic of decentralised finance and virtual assets, we have recently published two comprehensive reports: "[An Investment Perspective on Tokenization — Part I: A Primer on the Use of Distributed Ledger Technology \(DLT\) to Tokenize Real-World and Financial Assets](#)" and "[An Investment Perspective on Tokenization—Part II: Policy and Regulatory Implications](#)." We invite you to refer to these for detailed analysis and recommendations.

We encourage open communication and collaboration between regulators and market participants to ensure a seamless implementation of the proposed measures, including any necessary adjustments arising from this Discussion Paper.

Thank you for your consideration of our views and perspectives. CFA Institute looks forward to continued engagement with the FCA as these critical policies are shaped and implemented. Should you have any questions or require further elaboration of our views, please contact Mr. Olivier Fines, Head of Advocacy and Policy Research at CFA Institute, at olivier.fines@cfainstitute.org.

Sincerely,



Olivier Fines, CFA

Head of Advocacy and Policy Research

CFA Institute



Phoebe Chan

Research Specialist, Capital Markets Policy,
EMEA Advocacy

CFA Institute