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Recent FCA Speeches Reveal Future Strategy Toward Regulation of Fintech and Digital Assets

May 9, 2023

Two recent speeches delivered by the UK's financial services regulator, the Financial Conduct Authority (FCA), shed light on how the FCA wants to be perceived when it comes to the regulation of fintech and digital assets markets. In this alert, we summarise the key talking points and expand upon what this means for the FCA's future strategy. Whilst the speeches underline that the FCA's primary concern is to protect consumers from potential harm, they also highlight how the FCA is keen to drive innovation in these markets and help the UK remain an attractive destination for financial technology investment.

Fintech regulation: FCA as innovator and incubator

In a speech given to TheCityUK, a private-sector membership body promoting the UK's financial and related professional services industry, on 26 April 2023 by Emily Shepperd, the FCA's chief operating officer and executive director of Authorisations, the underlying message was that the FCA wants to be seen as 'here to help'. When asked what regulators can do to make it easier for fintech firms to thrive, Shepperd noted that the temptation might be to 'rip up all the rules … [y]et one of the best things that a regulator can do to help innovators is to set firm foundations in place on which business can grow'. She described regulatory compliance as an essential ingredient to growth, noting that as fintech firms grow, they often find themselves moving toward more regulatory scrutiny and eventually, for example, applying for a banking licence. Shepperd also noted market integrity is protected through the FCA's authorisations gateway. Last year, the FCA turned away more firms than ever for not meeting the high standards required. Such high standards 'provide the solid foundations on which innovators can innovate and investors can invest – with confidence'.

Perhaps the most interesting remark made by Shepperd was her claim that the FCA is as much an innovator and incubator as it is a regulator. She noted that although the perception may be that the FCA are 'the fun extinguishers of financial services, forever saying "no" … behind the scenes, we are saying "yes" or at the very least "maybe". Or more frequently, "try again"'. This indicates a conciliatory approach that should encourage firms to engage in constructive dialogue with the FCA when their applications are rejected.

The FCA's Regulatory Sandbox

Shepperd was keen to highlight the FCA's sandboxes – in particular, its Regulatory Sandbox, where firms can test new ideas in a controlled environment and get access to regulatory expertise and a set of tools to facilitate testing. The FCA's Innovation Pathways also was mentioned, which assists firms with launching innovative products and services by helping them understand how regulation relates to their activities. To date, more than 830 firms have been supported through the Regulatory Sandbox and Innovation Pathways services.

Early and High Growth Oversight scheme and CryptoSprints

The next stage for newly authorised firms could be the FCA's Early and High Growth Oversight scheme, which works with firms immediately after authorisation to help them move from concept to reality, providing enhanced supervision for firms as they get used to their regulatory status. Shepperd noted that the FCA's public commitment to extend the scheme to 300 firms has now been met. Firms do not need to apply to be part of this scheme – the FCA will contact them directly if they're included.

Lastly, on crypto and emerging tech, Shepperd drew attention to the FCA's CryptoSprint events, which aim to increase the FCA's understanding of emerging cryptoasset market practices and seek views on an appropriate

regulatory regime. A notable focus has seen the FCA helping crypto companies make their fund flows more transparent and compliant with anti-money laundering legislation. The Treasury-led Financial Market Infrastructure, or FMI sandbox, is described as a rapidly evolving project that will test whether and how legislation needs to be amended to adapt to innovations, such as distributed ledger technology and tokenisation.

The speech ended with a reminder that the FCA's first objectives are to protect consumers from harm, maintain market integrity and promote competition. However, a new secondary objective is being introduced and embedded in the organisation: promoting growth among competitiveness. This is the ultimate aim of the above sandboxes, pathways, sprints and initiatives, with the FCA described as 'one cog in a bigger wheel that is trying to drive innovation forwards'.

Crypto risks and areas of future regulatory focus

In another speech delivered to TheCityUK on 25 April 2023, the FCA's Sarah Pritchard, executive director of Markets and executive director of International, acknowledged how investment in crypto has become mainstream and considered the challenges this poses for the regulator. She noted that in 2022, 42% of US institutional investors and 67% of European institutional investors held crypto. In addition, one in 10 individual consumers have owned crypto at some point. This growth in popularity has led to an increase in cryptocurrency crime, which reached an all-time high last year, with illicit addresses receiving $20.6 billion dollars in 2022, up from $18 billion in 2020. The number of reports to the FCA of cryptoasset scams went from 1,619 in 2019 to 6,372 in 2021.

Pritchard emphasised how the FCA's current remit over crypto is limited to applying crypto anti-money laundering and counterterrorism legislation, but this could be expanded in the future.

The UK's Money Laundering Regulations require UK-based cryptoasset exchanges and custodians to apply for registration with the FCA – with the FCA refusing nearly three-quarters of all applications. However, Pritchard noted that the FCA is committed to supporting firms in meeting the right standards, having registered 41 crypto firms of all sizes.

Crypto and financial promotions

In terms of future focus areas, the most tangible change will soon be in the regulation of crypto financial promotions, which will come under the FCA's remit once the relevant legislation is passed. Pritchard expects that crypto promotions will be treated on par with other high-risk investments, and failure to comply will be a criminal offence. Like other high-risk investments, consumers will be given a cooling off period to decide whether they want to invest. The new regulations will apply to all firms marketing cryptoassets to UK consumers, regardless of whether the firm is based overseas or what technology is used to make the promotion. Sanctions will range from taking down websites to issuing public warnings to enforcement action. Lastly, the government's consultation on providing the FCA with new powers over those conducting activities related to crypto that do not have origins in the UK but do provide services to UK consumers is described as 'unchartered territory and an area we will all explore together with interest'.

For further details, please refer to our March 2023 client alert on marketing of cryptoassets.

Summary: A shift in public perception?

Whilst both speeches maintain that the FCA's primary role is to protect consumers from harm, the speech by Shepperd, in particular, signifies a recognition by the FCA that it has an important part to play in driving innovation. Rather than being seen as the enemy of fintech firms, its sandboxes, schemes and sprints demonstrate that it is trying to seek input from industry and better understand the technologies – instead of refusing to authorise firms outright. It wants to be seen as a transparent regulator that will no longer hold the UK back but will instead solidify the UK's position as a leading fintech jurisdiction, serving as an innovator and incubator just as much as a regulator. At the same time, the FCA is alive to the growth in popularity of crypto investment and the new risks it poses for consumers, which the organisation will soon possess new powers to combat.

If you have any questions regarding the regulation of fintech and digital assets, or financial regulation generally,

please reach out to Cooley special counsel Yulia Makarova.

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