CLIENT BRIEFING

TRAVERS SMITH

UK cryptoassets prudential proposals: unexpected gift or the nightmare before Christmas?

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To paraphrase Hemingway, the UK regime for regulating cryptoassets has taken shape in two ways: gradually, then suddenly. And so it was that after many months of waiting, on 16 December 2025, the UK FCA released an avalanche of consultation papers (**CPs**) containing its latest cryptoasset proposals, including CP25/42 on its proposed prudential regime for UK cryptoasset firms.

In many ways, the content of CP25/42 is not a massive surprise. As we explained in an earlier briefing, the FCA had already published a set of prudential proposals in CP25/15 in May 2025 which strongly suggested that it was envisaging a cryptoasset equivalent to the Investment Firms Prudential Regime (**IFPR**), which applies to most "traditional-finance" (**trad-fi**) UK investment firms. The latest proposals in CP25/42 are broadly a logical extension of that approach, filling in many of the gaps in relation to cryptoasset-related regulated activities which were not addressed in the first CP.

Nonetheless, even if the proposed framework was expected, the cryptoasset industry is likely to feel an initial sense of disappointment that its lobbying for a bespoke regime (rather than an IFPR Mark 2.0) has gone unheeded. Whatever the potential merits of an IFPR-like framework from an FCA supervisory perspective, for an emerging industry with many firms that are not currently subject to FCA authorisation requirements, implementing the latest proposals is likely to be a significant undertaking.

That being said, within the overall framework, the specific proposals are not *all* bad. There are some elements that suggest that the FCA has sought to be pragmatic in its approach, and for trad-fi investment firms that also undertake cryptoasset activities, broad alignment with IFPR may lead to greater operational simplicity. The absence of any proposed remuneration regime for employees of cryptoasset firms and of any rules requiring prudential consolidation within groups containing those firms will also undoubtedly be well-received.

On balance, though, while we think that it is probably hyperbolic to label the proposals as a nightmare, the framework taken as a whole is also unlikely to support policymakers' dreams of a UK cryptoasset revolution. While industry bodies representing trad-fi investment firms continue to lobby for dilution of the current IFPR rules on the basis that the regime is disproportionate and overly complex for simpler business models, replicating some of the same mistakes for cryptoasset firms would seem to be a missed opportunity. Still, there remains the possibility that the FCA could modify some of the proposals when it publishes its final rules, and firms have until **12 February 2026** to respond to the consultation.

In this briefing, we explain the key elements of the latest prudential proposals and their potential implications for firms undertaking cryptoasset-related activities.

1 What are the headline points for firms?

- The proposals confirm that the FCA is intending to implement an IFPR-like regime for cryptoasset firms. Complying with the proposed framework is likely to involve a very significant step up for businesses which are currently unregulated or which operate under lighter prudential frameworks (such as authorised payment institutions).
- The proposals will not apply to PRA-regulated entities. Their prudential requirements will continue to be set by the PRA's rules instead. However, where a PRA-regulated bank is required to set up a separate legal entity to act as a

stablecoin issuer in accordance with the PRA's supervisory expectations, that separate entity would become subject to the new proposed regime.

- The new regime largely mirrors the IFPR framework for UK trad-fi investment firms, but with some modifications.
- The FCA is not proposing to make UK cryptoasset firms subject to obligations to carry out a prudential consolidation of their wider groups. If this approach is maintained, this will be a significant win for the cryptoasset industry, although there are still some new requirements relating to membership of a group more broadly.
- The FCA is proposing that cryptoasset firms should be required to carry out an internal assessment of the adequacy of their financial resources (which is broadly similar to the IFPR ICARA process). This will not be welcomed by the industry, as this is time-consuming and onerous to implement and may result in the firm needing to hold additional regulatory capital and liquid assets above the minimum levels specified in the main rules.
- The FCA has now published the detailed "K-factors" that will be used to determine the regulatory capital requirements resulting from the various new regulated cryptoasset activities. We have summarised the proposed calculation rules in the Appendix to this briefing.
- The FCA is proposing that firms should publish certain annual disclosures about their regulatory capital and liquid asset resources and requirements, and about their relationship with their wider groups.
- The FCA consultation does not mention remuneration rules at all. At this juncture, it therefore appears that there are no proposals to subject employees in cryptoasset firms to detailed requirements about how they are paid. However, if a trad-fi MIFIDPRU investment firm also carries on cryptoasset activities, the firm would remain subject to the MIFIDPRU remuneration framework. This has the potential to influence some approaches to structuring activities between different entities within groups undertaking mixed business.

2 When would the proposals enter into force?

The FCA's draft rules do not contain a proposed application date. However, in practice, it seems likely that the rules would enter into force at the same time that the new UK cryptoassets regulated activities regime takes effect, which will occur on **25 October 2027**.

There are no proposed transitional provisions in the rules. This would mean that the new prudential requirements would apply in full immediately, rather than ramping up over a multi-year period (as occurred under IFPR). The industry may wish to push for a phase-in as part of its response to the consultation to allow newly regulated entities to build up their regulatory capital and liquid assets over a longer glide path.

However, as we explained in our briefing on the UK's final cryptoasset legislation, there will be a transitional framework under the cryptoassets regulated activities regime which has the effect that if a firm has applied for FCA authorisation to carry on cryptoasset-related activities and that application process is still in train, the changes to the UK's regulatory perimeter will not apply to that firm until its application is determined, subject to a longstop date of **25 October 2029**. In addition, the FCA will be able to direct that firms whose applications are still in train may be treated as exempt persons for the purposes of performing any pre-existing contracts that involve relevant cryptoassets. As the new prudential rules are tied to whether a firm has the relevant FCA regulatory permission to carry on cryptoasset-related activities, they would not apply to a firm that benefits from such transitional treatment until its application for authorisation is granted.

3 What is the territorial scope of the proposals?

The prudential rules for cryptoasset firms will be housed in two different FCA sourcebooks: COREPRU and CRYPTOPRU. Neither of those sourcebooks contains provisions dealing with the territorial application of the proposed new prudential rules, and the related definitions of a "COREPRU firm" and a "CRYPTOPRU firm" do not contain any inherent territorial limitation. This is a curious omission and it is unclear whether it is intentional, as the FCA does not discuss the issue of territoriality in the CP.

Although the new regulated activity of issuing a qualifying stablecoin (Article 9M RAO) can only be carried on from an establishment in the UK, the territorial scope of the other new cryptoasset-related activities is not clearly defined in the legislation. This would mean that in principle, it could be necessary for a third-country firm to be authorised to carry on the relevant activities where, despite the firm itself being based outside the UK, one or more of the cryptoasset activities is treated as being carried on in the UK. Even for the activity of issuing stablecoins, it is theoretically possible that a third-country firm could carry out the issuance from an authorised UK branch of a non-UK legal entity. In such circumstances, under the rules as currently drafted, the prudential rules would apply to the relevant authorised third-country firm.

This would be an unusual approach, as historically, the FCA has typically sought to avoid applying prudential requirements to non-UK entities in favour of relying on local regulators to ensure the financial stability of the firm. It is possible that the FCA has concluded that adopting this policy would not be viable in the case of cryptoasset firms, as there is no guarantee that they would be regulated at all in their home jurisdiction.

4 Do the proposals apply to UK banks or insurers?

No. The FCA's proposed prudential rules will apply only to firms which are authorised to carry on cryptoasset-related regulated activities, but which are not regulated by the PRA. This means that UK deposit-taking banks and insurers will not be subject to the relevant rules and neither will large investment banks which are subject to PRA supervision (i.e. PRA designated investment firms).

However, there may be FCA solo-regulated firms within larger banking groups which are carrying on regulated cryptoasset business and which would be subject to the new prudential rules. This may become common because in November 2023, the PRA sent a "Dear CEO" letter to UK deposit-taking banks stating that if such banks wished to issue regulated stablecoins to retail customers, this should be done in separate non-deposit-taking entities within their groups (rather than being issued directly by the deposit-taking bank). This means that to the extent that UK banking groups wish to carry on the new regulated activity of issuing qualifying stablecoins, they are likely to need to do this through an FCA authorised entity, which would need to comply with the FCA's proposed prudential rules.

5 Do the proposals apply on a group-wide basis?

Interestingly, the FCA is not proposing to introduce any requirements for firms to apply the new cryptoasset-related prudential rules on a consolidated basis. This will be a huge relief to the cryptoassets industry, as identifying consolidation groups and applying regulatory capital and liquidity requirements to consolidated group situations has proven technically demanding and onerous for other sectors in the past. The application of consolidated requirements can also interfere with group structuring and the use of debt financing by consolidation group members.

However, there are two important caveats to the position stated above:

CRYPTOASSET FIRMS FORMING PART OF MIFIDPRU INVESTMENT FIRM GROUPS

A cryptoasset firm that is included within a group that contains a trad-fi MIFIDPRU investment firm may still be included in the scope of a prudential consolidation group under the MIFIDPRU rules (and the FCA indicates that HM Treasury is expected to update the IFPR legislation to facilitate this).

This means where a cryptoasset firm is itself the parent entity of a MIFIDPRU consolidation group, it may nonetheless need to comply with consolidated MIFIDPRU-derived obligations. Where it otherwise forms part of the MIFIDPRU consolidation group but is not the parent, its activities may still end up contributing to the consolidated MIFIDPRU group capital and liquidity requirements – for example, due to its annual operating expenses driving an increase in the consolidated fixed overheads requirement.

This could lead to an uneven playing field or potential structural arbitrage between groups which contain a mix of trad-fi and cryptoasset investment business and those which contain only cryptoasset firms.

GROUP-RELATED RISKS AND DISCLOSURES

The proposed rules on the Own Risk Assessment (see below) will still require cryptoasset firms to consider the risks arising from their membership of a wider group and certain group-related public disclosure requirements will also apply. For these purposes, the FCA has decided not to set out detailed rules on identifying group membership for these purposes.

Instead, the proposed rules state that the concept of a "group" in this context has an "extended meaning" which goes beyond the usual FCA Glossary definition and also captures any entity to which the firm is linked by a "material level of shared ownership or control". Although this approach avoids the FCA needing to include detailed technical provisions around identifying group membership within its CRYPTOPRU rules, this does seem to be a particularly loose test, with no apparent guidance on how to interpret materiality in this context or what precisely is meant by the concepts of ownership or control.

On the one hand, this could offer some increased flexibility for firms in terms of where to draw the boundary of in-scope relationships; on the other, the resulting uncertainty could drive excessively conservative approaches to reduce regulatory risk and/or inconsistency across the industry. We suspect that if this approach survives into the final rules, the

FCA will almost inevitably end up publishing some form of supplementary guidance or commentary on this in the future, which would then limit firms' ability to apply flexible interpretations.

6 How would a cryptoasset firm's capital requirements be calculated?

A cryptoasset firm will need to hold regulatory capital that is at least equal to the **highest** of the following three requirements:

- The Permanent Minimum Capital Requirement;
- The Fixed Overheads Requirement; and
- The K-Factor Requirement.

This sets a minimum operating requirement, but firms will then also be required to undertake an internal analysis (termed the Overall Risk Assessment), which may result in them needing to hold further capital. We discuss this further in section 11 below.

7 What Permanent Minimum Capital Requirement will apply to cryptoasset firms?

The Permanent Minimum Capital Requirement (**PMR**) is a minimum level of regulatory capital that a firm must hold at the point at which it first becomes authorised and then continuously thereafter. In effect, this is a "floor" on the capital requirement which represents a minimum price of entry into the market for regulated services. In CP25/15, the FCA had proposed PMRs for the stablecoin issuance and cryptoasset safeguarding activities and the latest proposals in CP25/42 have now specified the relevant PMRs for the remaining CRYPTOPRU activities.

The proposed CRYPTOPRU PMRs are shown in the table below. Where a firm carries on more than one of the activities, the highest relevant PMR will apply. If the firm is also a MIFIDPRU investment firm, the PMR will be the higher of the CRYPTOPRU PMR and the MIFIDPRU PMR that is applicable to the firm.

Cryptoasset activity	RAO reference	Applicable PMR
Dealing in qualifying cryptoassets as principal	Article 9T RAO	£750,000
Issuing qualifying stablecoins	Article 9M RAO	£350,000
Safeguarding qualifying cryptoassets and relevant specified investment cryptoassets	Article 9N RAO	£150,000
Arranging qualifying cryptoasset staking	Article 9Z6 RAO	£150,000
Operating a qualifying cryptoasset trading platform	Article 9S RAO	£150,000
Dealing in qualifying cryptoassets as agent	Article 9W RAO	£75,000
Arranging deals in qualifying cryptoassets	Article 9Y RAO	£75,000

8 What is the Fixed Overheads Requirement?

The Fixed Overheads Requirement (**FOR**) is based on a firm's expenditure and is designed to act as a proxy minimum amount to reflect the funds that would be required to wind down the firm, if necessary. The rules governing the FOR that will apply to cryptoasset firms were originally published in CP25/15, but have been tweaked in CP25/42.

By way of a brief summary, the FOR is essentially calculated as a quarter of the firm's total expenditure in the preceding financial year, but adjusted to reflect certain allowable deductions. Those deductions are broadly intended to reflect items of expenditure which would not be mandatory, or which would otherwise become unnecessary, if the firm were in a wind-down situation. In CP25/42, the FCA has added certain additional permitted deductions, which now include:

- Fees and brokerage charges which are directly passed on to customers, or 80% of fees or brokerage charges which the firm incurs itself, but in either case, these must not include any fees which are necessary to maintain membership or meeting loss-sharing financial obligations to trading venues or central counterparties; and
- Losses from trading in financial instruments or qualifying cryptoassets.

In both cases, these seem designed to reflect the fact that trading volumes would be expected to fall during a wind-down scenario, such that including these expenses within the FOR would therefore result in an over-estimate of likely expenditure during that period.

As the FOR rules form part of the COREPRU sourcebook, in the future, it is expected that other types of FCA-regulated firms may become subject to the FOR when they are brought within the COREPRU framework.

In many trad-fi MIFIDPRU investment firms, the FOR is the "biting" requirement that determines the firm's minimum regulatory capital requirement. This is because the operating expenditure of such firms will often outweigh the impact of the K-factor calculation once large expenses such as employee salaries and rent are taken into account. This could become less common for cryptoasset firms, depending on the business and operating model that they adopt, as technology-driven solutions involving fewer staff and a reduced need for large business premises in expensive locations could result in smaller FORs.

9 What are K-factors and how will the K-Factor Requirement apply to cryptoasset business?

K-factors were an innovation of the original IFPR and are intended to be scalable capital requirements which are aligned to certain activities undertaken by firms or exposures that those firms have incurred.

In CP25/15, the FCA proposed the following two crypto-specific K-factors:

- **K-SII**, which is based on stablecoins in issuance and is aligned to the new regulated activity of issuing qualifying stablecoins (Article 9M RAO); and
- **K-QCS**, which is based on the value of relevant cryptoassets safeguarded and is aligned to the new regulated activity of safeguarding qualifying cryptoassets and relevant specified investment cryptoassets (Article 9N RAO).

In the latest CP, there are six new K-factors, divided between:

- Three "**activities-based**" measures, which essentially look at the volume of certain activities carried on by the firm. In simple terms, the more of these types of business that the firm undertakes, the higher the resulting capital requirements. The relevant volume-based measure is multiplied by a specified coefficient (expressed as a percentage) for each activity, which will determine the resulting requirement. Each of these measures is broadly intended to be a proxy for the operational risk arising from undertaking the relevant activity. The two K-factors proposed in CP25/15 (i.e. K-SII and K-QCS, described above) would also fall within this category; and
- Three "**exposure-based**" measures, which essentially look at market or default risk incurred by the firm in relation to transactions recorded in its trading book. These are not simple volume-based metrics because not all positions incurred by the firm will result in the same risks and some positions may offset each other. As a result, these measures tend to involve more complex calculations, but are relevant only to firms which incur risk in a principal capacity (rather than acting purely as agents for their clients). In practice, these firms would therefore normally need to be authorised to carry on the new activity of dealing as principal in qualifying cryptoassets (Article 9T RAO).

The K-factors are cumulative. Where a firm undertakes multiple different cryptoasset activities, or where a particular activity gives rise to multiple K-factors (which may be the case for firms that deal in cryptoassets as principal), the overall K-factor requirement is the sum of the requirement that arises from each applicable individual K-factor.

ACTIVITIES-BASED K-FACTORS

The three new activities-based K-factors are:

- **K-CCS**, which is based on the value of client cryptoassets staked and is aligned to the new regulated activity of qualifying cryptoasset staking (Article 9Z6 RAO);
- **K-CCO**, which is based on the value of orders in qualifying cryptoassets that a firm receives and transmits or executes in the name of clients. This broadly corresponds to the new regulated activities of dealing in qualifying cryptoassets as agent (Article 9W RAO) and arranging deals in qualifying cryptoassets (Article 9Y RAO). In the CP narrative, the FCA states that a firm which is operating a qualifying cryptoasset trading platform (Article 9S RAO) must include within K-CCO the value of any orders it handles in its capacity as operator of the platform, although it seems that this may not have been reflected in the wording of the draft rules themselves; and
- **K-CTF**, which is based on the value of orders in qualifying cryptoassets executed in the firm's own name, which broadly corresponds to the new regulated activity of dealing in qualifying cryptoassets as principal (Article 9T RAO).

EXPOSURE-BASED K-FACTORS

The three new exposure-based K-factors are:

- **K-NCP**, which is based on the value of qualifying cryptoassets that are recorded in the firm's trading book (which covers the firm's own proprietary positions, as well as positions it incurs that arise from servicing clients). This focuses on the firm's market risk exposure from its net positions;
- **K-CCD**, which is based on the risk of counterparty default incurred by the firm in connection with transactions in cryptoassets that are recorded in its trading book and which settle outside the standard spot settlement period; and
- **K-CON**, which is a measure of concentration risk incurred by the firm in connection with trading book transactions in qualifying cryptoassets.

In the Appendix to this briefing, we have included a table which contains more details on each of these K-factors.

10 What liquid assets requirements will apply to cryptoasset activities?

In CP25/15, the FCA proposed that the COREPRU rules should include a basic liquid assets requirement (**BLAR**) for cryptoasset firms. This is largely unchanged in CP25/42, except for the addition of guidance that the BLAR is only a *minimum* liquidity requirement and that the Overall Risk Assessment may require a firm to hold further liquid assets.

The BLAR is set at one third of the firm's FOR, plus 1.6% of the total amount of any guarantees provided to clients.

As the FOR is based on three months of a firm's non-discretionary expenditure, the BLAR is therefore effectively a requirement to hold at least one month's non-discretionary expenditure in liquid assets. The COREPRU rules specify the assets that can be counted as liquid assets for these purposes, which include:

- Coins and banknotes;
- Short-term deposits at UK authorised banks;
- Assets representing claims on, or which are guaranteed by, the UK government or the Bank of England (e.g. UK gilts or central bank money); and
- Units or shares in short-term MMFs.

These must be denominated in sterling, unless the firm incurs expenditure in another currency, in which case it may hold the relevant proportion of its liquid assets corresponding to such expenditure in eligible assets denominated in that other currency. In that case, any relevant short-term deposits may be held at non-UK banks and the assets may represent claims on the government or central bank of the relevant non-UK jurisdiction. The relevant liquid assets cannot belong to clients or be subject to any encumbrances.

It will be evident from the above list that stablecoins will not be eligible as liquid assets, which may be a disappointment to the cryptoasset industry.

Firms that are issuing qualifying stablecoins would also be subject to an additional "issuer liquid assets requirement" (**ILAR**), which is determined by reference to the backing asset pool for each relevant stablecoin.

11 What is the Overall Risk Assessment?

The FCA is proposing that all cryptoasset firms will need to implement an Overall Risk Assessment (**ORA**). As part of the ORA, the firm would have to operate appropriate systems and controls to allow it to identify, monitor and, where proportionate, reduce all risks which could result in material harm either from the ongoing operation of its business or from winding down the firm. Despite its name, the FCA rules are clear that the ORA is an *ongoing* process, not a static assessment, and firms are required to embed the ORA within their business model and strategic decision making.

This proposal would require firms to undertake a detailed internal analysis of whether the minimum own funds requirement and the BLAR are sufficient to cover the risks that arise from their businesses. The key elements of this framework are discussed below.

Trad-fi investment firms have historically found the equivalent MIFIDPRU requirements in this area to be very onerous to implement. The analysis is detailed and time-consuming, and it is common for firms to seek external professional advice to help develop and review the necessary assessments and control framework, which can result in significant expense.

The basic structure of the ORA is set out in COREPRU, although there are then supplementary crypto-specific requirements in CRYPTOPRU. This means that if the scope of COREPRU is widened in the future to include other FCA authorised firms, they will also become subject to key elements of these onerous obligations.

OVERALL FINANCIAL ADEQUACY RULE

Cryptoasset firms would be subject to the overall financial adequacy rule (**OFAR**), which is effectively the obligation to ensure that the firm maintains, at all times, sufficient regulatory capital and liquid assets for the business it undertakes. To determine the actual levels of regulatory capital and liquid assets that the OFAR requires, firms will need to implement the systems and carry out the assessments summarised below.

The overall level of regulatory capital that the firm determines it needs to hold cannot be lower than the minimum operating requirement summarised in section 6 above. Similarly, the overall level of liquid assets that the firm determines it must hold cannot be lower than the BLAR (or the sum of the BLAR and the ILAR, in the case of qualifying stablecoin issuers).

OWN FUNDS ASSESSMENT

The FCA is proposing that to comply with the OFAR, the firm will need to hold the higher of:

- The amount of regulatory capital that the firm requires at any given point in time to fund its ongoing business operations (taking into account any potential periods of financial stress in the business cycle); and
- The amount of regulatory capital that the firm needs to ensure that it can be wound down without causing material harm to its clients or counterparties, or to the wider markets.

The numbers that the firm generates for these purposes will need to be linked to, and justified by, the business assessment, stress testing and wind-down planning referenced below.

LIQUID ASSETS ASSESSMENT

The FCA is proposing that firms must:

- Assess the liquidity needs of their business over a rolling 90-day period; and
- Produce a reasonable estimate of the liquid assets that the firm would need to ensure it could be wound down without causing material harm to its clients or counterparties, or to the wider markets.

The firm will also need to assess its funding profile by producing a reasonable estimate of its liquidity needs over the next 12 months (taking into account the stress testing it carries out) and identifying the funding sources it has available during that period. It must then identify any funding gaps that may occur, and must ensure that it holds additional liquid assets to cover any funding gap that could occur within a forthcoming 90-day rolling period. In effect, this means that the firm will need to embed a dynamic forward-looking liquidity assessment into its systems and controls.

To comply with the OFAR, the firm would then need to hold at least the sum of the following:

- The BLAR;
- The ILAR (if the firm is a qualifying stablecoin issuer); and
- The higher of:
  - the amount of liquid assets that the firm needs to fund its ongoing business operations (taking into account the assessment above); or
  - the amount of liquid assets that the firm would need to be wound down without causing material harm.

Any liquid assets requirement that is in excess of the BLAR and ILAR can be held in a wider range of liquid assets than are eligible for the BLAR or ILAR (including, for example, in financial instruments such as shares, bonds, units in funds, etc.). However, those assets cannot include any asset which is issued by the firm or any of its affiliates (except that a firm can include short-term deposits with an affiliated bank). In addition, the firm must be satisfied that the asset is truly liquid, i.e. it can easily and promptly be converted into cash, even in stressed market conditions.

BASELINE RISK ASSESSMENT

When identifying the risks arising from their businesses, firms will need to consider risks which may cause material harm to the firm's clients or counterparties or to the markets in which the firm operates. This assessment must include all the firm's activities, including any unregulated activities that the firm carries on – i.e. this must be a holistic assessment of the firm's entire operations and is not limited only to cryptoasset activities.

The firm must then assess whether there are remaining risks of material harm after taking into account any mitigants it has put in place. If there is residual risk, the firm will need to consider whether it needs to hold additional regulatory capital or liquid assets to cover that risk. This analysis is often not straightforward and necessarily involves a significant degree of judgement, particularly in relation to risks where there may not be large amounts of data.

BUSINESS ASSESSMENT, STRESS TESTING AND WIND-DOWN AND RECOVERY PLANNING

As part of their ORA, cryptoasset firms would have to:

- Have a clearly defined business model and strategy and a clearly articulated risk appetite that is consistent with that strategy;
- Identify material risks of misalignment between the firm's business model and the interests of its clients and the financial markets, and assess whether those risks have been appropriately mitigated;
- Comply with the OFAR and carry out prospective assessments of whether it will have sufficient financial resources to continue to meet the OFAR in the future, allowing for any planned growth; and
- Carry out stress testing using severe but plausible stresses to assess whether the firm would still have sufficient financial resources to comply with the OFAR in a stressed scenario.

As part of the above requirements, firms would need to:

- Identify levels of regulatory capital and liquid assets which, if reached, would indicate that the firm may be at risk of breaching the OFAR, and specify potential recovery actions the firm would take in those situations; and
- Develop a wind-down plan to identify the necessary steps and resources needed to wind down the firm and any risks of material harm that might result, with appropriate mitigants.

GROUP-RELATED RISKS

Where the firm forms part of a wider group, it must identify, monitor and where appropriate, mitigate any risks arising from its membership of that group, such as where it has direct financial exposures to other group members or is reliant on other group entities to generate its revenue or provide its services. It must also consider potential reputational risk issues.

REVIEWING AND DOCUMENTING THE OVERALL RISK ASSESSMENT

The firm's governing body must review the adequacy of its ORA at least every 12 months. It will also need to carry out an ad hoc review if there is a material change in the firm's business (such as a major acquisition or restructuring, for example).

The FCA also emphasises that senior managers within the firm are responsible for contributing to the analysis required by the ORA in relation to the business areas that fall within their remit.

The firm will need to ensure that the analysis undertaken as part of any review is properly documented and must retain the relevant records for at least three years.

12 What are the proposed public disclosure requirements?

The FCA is proposing that cryptoasset firms should publish certain disclosures on at least an annual basis. Broadly, these would cover the following areas:

- A concise statement of the risks associated with the firm's business strategy which may result in material harm. This statement must be approved by the firm's governing body.
- A summary of the strategies and processes that the firm uses to manage any identified risks.
- A breakdown of the composition of the firm's regulatory capital, with a reconciliation back to the firm's audited financial statements (although this does not apply if the firm is not required to publish financial statements).
- A description of the main features of any regulatory capital instruments issued by the firm.
- A breakdown of the regulatory capital requirements that apply to the firm, split between its PMR, its FOR and its K-factor requirement, with a disaggregation of some of the individual constituent K-factor components.
- The overall level of regulatory capital and liquid assets that the firm has determined it needs to comply with the OFAR.

- Information on the firm's wider group, including the direct and indirect financial exposures it has to other group members and information on the financial position of its ultimate parent undertaking.

The publication date will be aligned to the date that the firm publishes its annual financial statements or, if it is not required to publish annual financial statements, the date on which it submits its Companies Act 2006 confirmation statement to Companies House.

The disclosures must be easily accessible and free to obtain and be presented in a way which is easy to understand. The FCA generally expects that they will be published on a firm's website, but this is not required if such publication would cause the firm to breach the law of another jurisdiction to which it is subject.

In the narrative to CP25/42, the FCA indicates that the aim of the disclosure requirements is to "support market discipline" by effectively submitting the firm's regulated business to public scrutiny by customers, counterparties and regulators. In practice, experience from the equivalent "Pillar 3" disclosure regimes for UK and EU banks, and similar public disclosure requirements for MIFIDPRU firms, suggests that customers and counterparties rarely read the relevant documents, although regulators and financial journalists have traditionally engaged with them somewhat more. Although firms typically do not welcome increased disclosure requirements, one potential upside would be the ability to benchmark quantitative conclusions about the OFAR with similar firms in the sector, allowing a firm to ascertain whether it is an outlier or not.

13 Next steps

The proposals in CP25/42 are detailed, technical provisions that are based upon (but are not identical to) the FCA's MIFIDPRU rules introduced under IFPR. Travers Smith has extensive experience of advising on the IFPR framework and we helped a range of firms implement the new regulatory capital and liquidity requirements when that regime was introduced. This includes helping firms to develop the MIFIDPRU equivalent of the Overall Risk Assessment. We will also be working closely with industry associations to analyse the FCA's latest proposals for cryptoasset firms and to assist with responding to the consultation.

If you would like to discuss how any of the FCA's latest proposals may affect your organisation or if you have any questions in relation to any of the content in this briefing, please get in touch with your usual Travers Smith contact or any of the individuals named below.

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APPENDIX
PROPOSED CRYPTOASSET K-FACTORS

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
K-SII (Stablecoins in issuance)	Issuing qualifying stablecoins (Article 9M RAO)	• Calculated on first business day of each month • Arithmetic mean of stablecoins in issuance at the end of each business day over previous 9 months, excluding most recent 3 months • Foreign currency amounts must be converted into the firm's functional currency on a particular business day at an appropriate market rate	2%	Proposed in CP25/15 and essentially unchanged in CP25/42.
K-QCS (Qualifying cryptoassets safeguarded)	Safeguarding qualifying cryptoassets and relevant specified investment cryptoassets (Article 9N RAO)	• Calculated on first business day of each month • Arithmetic mean of qualifying cryptoassets and relevant specified investment cryptoassets being safeguarded at the end of each business day over previous 9 months, excluding most recent 3 months • Values must include any relevant cryptoassets in relation to which the firm has delegated safeguarding to a third party <u>and</u> any relevant cryptoassets for which the firm has been delegated responsibility for safeguarding by a third party • Foreign currency amounts must be converted into the firm's functional currency on a particular business day at an appropriate market rate • If the firm is also a MIFIDPRU investment firm, this excludes any specified investment cryptoassets that the firm safeguards which are included within K-ASA (Assets safeguarded and administered) under the MIFIDPRU rules	0.04%	Originally proposed in CP25/15, but widened in CP25/42 to include relevant specified investment cryptoassets, which tracks the amendments to what is now Article 9N RAO made by HM Treasury in its final legislation.
K-CCS (Client cryptoassets staked)	Qualifying cryptoasset staking (Article 9Z6 RAO)	• Includes qualifying cryptoassets in respect of which the firm makes staking arrangements on behalf of another person (whether as principal or as agent) • Calculated on first business day of each month	0.04%	In CP 25/42, the FCA states that although not all cryptoassets used for qualifying staking will participate in blockchain validation (e.g. because the assets are held in a queue),

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
		• Arithmetic mean of total value of client cryptoassets staked at the end of each business day over the previous 9 months, excluding the most recent 3 months • Excludes any qualifying cryptoassets already included in K-QCS (see above), but in that case, the firm must consider whether the staking activity gives rise to any risks which would require additional financial resources under the firm's Own Risk Assessment • Includes any client cryptoassets staked where the firm has appointed a third party to carry out arranging the qualified cryptoasset staking and the firm assumed responsibility to the client for staking (i.e. effectively, where the firm delegates staking to a third party) • Also includes any relevant cryptoassets in relation to which a third party has appointed the firm to carry out arranging qualifying cryptoasset staking (i.e. effectively, where a third party delegates staking to the firm) • Foreign currency amounts must be converted into the firm's functional currency on a particular business day at an appropriate market rate		the firm should also include any cryptoassets that are in the process of being staked or unstaked as part of the qualifying cryptoasset activity.
K-CCO (Cryptoasset client orders)	Dealing in qualifying cryptoassets as agent (Article 9W RAO) Arranging deals in qualifying cryptoassets (Article 9Y RAO) Operating a qualifying cryptoasset trading platform (Article 9S RAO)	• Covers reception and transmission of orders in qualifying cryptoassets and execution of client orders in qualifying cryptoassets • The FCA states that this is also intended to cover orders handled by the operator of a cryptoasset trading platform, although this is not clear from the drafting of the relevant technical rules in CRYPTOPRU • Excludes any orders executed in the firm's own name (even if ultimately on behalf of a client) – these are captured within K-CTF instead (see below) • Excludes any arrangements which relate solely to introducing a person to an authorised person to carry on a regulated activity • Excludes any arrangements which do not, or would not, bring about the transaction to which the arrangements relate	0.1%	The proposed K-CCO rules refer to "reception and transmission" of orders relating to the purchase or sale of a qualifying cryptoasset, but this is not a defined term. Unlike for trad-fi investment orders which fall within the UK MiFID regime, there is no separate legislative concept of reception and transmission in relation to cryptoassets. It appears that the exclusions for introductions to

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
		• Calculated on first business day of each month • Arithmetic mean of total value of client cryptoasset orders at the end of each business day over the previous 9 months, excluding the most recent 3 months • Calculated as the absolute value of each buy and sell order (i.e. buys and sells are <u>not</u> netted off) by reference to the amount paid or received (but may exclude any embedded transaction costs, such as gas fees) • Where the firm is receiving and transmitting the order, there are additional rules to determine the relevant order price in relation to orders with limit prices or with no specified price • Foreign currency amounts must be converted into the firm's functional currency on a particular business day at an appropriate market rate		authorised persons and for arrangements which would not bring about a transaction are intended to give some shape to this undefined concept, essentially by trying to limit in-scope orders to those in relation to which the firm carries on the Article 9Y(1) RAO arranging (bringing about) transactions in cryptoassets.
K-CTF (Cryptoasset trading flow)	Dealing in qualifying cryptoassets as principal (Article 9T RAO)	• Covers orders in cryptoassets executed in the firm's own name (which may include orders that ultimately benefit a client, but which the firm executes as principal rather than agent) • Calculated on first business day of each month • Arithmetic mean of total value of relevant cryptoassets orders at the end of each business day over the previous 9 months, excluding the most recent 3 months • Calculated as the absolute value of each buy and sell order (i.e. buys and sells are not netted off) by reference to the amount paid or received • Foreign currency amounts must be converted into the firm's functional currency on a particular business day at an appropriate market rate	0.1%	

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
K-NCP (Net cryptoasset position)	This is an exposure-based (rather than activities-based) metric, but as it applies only to a firm's trading book, in practice, it will be relevant to firms dealing in qualifying cryptoassets as principal (Article 9T RAO)	• Covers positions in qualifying cryptoassets that are recorded in the firm's trading book • The trading book includes the firm's own proprietary positions and positions in the firm's own name arising from client servicing • A "position" covers any qualifying cryptoasset owned by the firm beneficially, or which it has an existing contractual right to receive in the future or (in the case of a short position) which it has an existing contractual obligation to deliver in the future • Broadly, the rules require the firm to calculate each cryptoasset net position in the trading book (i.e. by offsetting long and short positions in identical cryptoassets) and then multiplying the resulting net position by a position risk adjustment, which reflects the nature of the cryptoasset according to its liquidity and volatility • Excludes any positions in qualifying stablecoins which comply with the backing asset requirements in CASS 16 • Where the firm is also a MIFIDPRU firm, excludes positions in financial instruments, foreign exchange or commodities which are subject to the MIFIDPRU K-NPR (net position risk) or K-CMG (clearing margin given) requirements, unless the firm is seeking to net those against another cryptoasset under the K-NCP rules instead	N/A – this is an exposure-based measure	In the narrative in CP 25/42, the FCA states that it generally expects all cryptoasset positions held on a firm's balance sheet to be trading book positions.
K-CCD (Cryptoasset counterparty default)	This is an exposure-based (rather than activities-based) metric, but as it applies only to a firm's trading book, in practice, it will be relevant to firms dealing in qualifying cryptoassets as principal (Article 9T RAO)	• Covers transactions in qualifying cryptoassets which are recorded in the firm's trading book and which expose the firm to the risk of counterparty default that extends beyond the "standard spot settlement period" (which the FCA defines in this context as the period which is generally accepted in the market as the standard delivery period for a spot transaction in a given qualifying cryptoasset) • This includes (but is not limited to) trading book transactions which involve lending qualifying cryptoassets to a counterparty	N/A – this is an exposure-based measure	In many cryptoasset transactions, it will presumably be the case that the standard settlement period is extremely fast, as blockchain-based settlement may occur very quickly. However, in nascent cryptoasset markets, it is unclear whether there will

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
		• Broadly, the rules require the firm to calculate an exposure value by calculating the replacement cost of the transaction less the value of collateral received from the counterparty • The replacement cost is based on the market value of the cryptoasset, but must be increased by a specified volatility adjustment, which depends on the nature of the asset • The value of any collateral received is decreased by a specified volatility adjustment (i.e. effectively, subject to a haircut), which depends on the nature of the asset • The exposure value is then multiplied by a counterparty risk factor, which varies depending on the type of counterparty (and which has the effect that the requirements for transactions with retail customers are significantly increased) • Where the firm is also a MIFIDPRU firm, excludes transactions or contracts which are subject to the MIFIDPRU K-TCD (trading counterparty default) requirement		necessarily be an accepted "standard" settlement period in the same way as exists for many trad-fi financial instruments today.
K-CON (Concentration risk)	This is an exposure-based (rather than activities-based) metric, but as it applies only to a firm's trading book, in practice, it will be relevant to firms dealing in qualifying cryptoassets as principal (Article 9T RAO)	• Covers transactions in qualifying cryptoassets which are recorded in a firm's trading book • Broadly, the rules require the firm to identify all trading book transactions in qualifying cryptoassets and financial instruments with a client or group of connected clients • The transaction must include any positive excess of long positions over short positions in financial instruments or qualifying cryptoassets with the relevant client, as well as the exposure value of any transactions subject to either K-CCD (see above) or the MIFIDPRU K-TCD requirement • There is a "soft limit" of 25% of the firm's own funds (although this is increased to the lower of £150 million or 100% of the firm's own funds if the counterparty is a	N/A – this is an exposure-based measure	

Cryptoasset K-factor	Corresponding regulated activities	Basis of calculation	Coefficient	Notes
		UK MiFID investment firm or bank, a CRYPTOPRU firm, or a third-country investment firm or bank subject to prudential requirements that are comparable to those in the UK) • Where the exposure to a client or group of connected clients exceeds the firm's soft limit, the K-CON requirement is triggered and the firm will need to hold additional regulatory capital in relation to the excess amount • The calculation of the regulatory capital required is based on how long the excess exposure has persisted and the size of the excess		