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Response to FCA consultation on a prudential regime for cryptoasset firms (CP25/42)

Coinbase Global, Inc. (together with its UK subsidiary CB Payments Ltd. and its other subsidiaries, **Coinbase**) appreciates the opportunity to respond to CP 25/42 (**the Consultation Paper**) published by the Financial Conduct Authority (**FCA**).

Coinbase is a trusted service provider of crypto trading, custody, and infrastructure. Founded in 2012 and publicly listed in the United States, we offer a secure and user-friendly interface for millions of verified retail and institutional investors globally. We are committed to building an open financial system and are doing so with the strongest regulatory compliance and security protocols available.

A proportionate prudential framework will support a regime appropriate for the crypto sector that encourages a competitive and resilient market, with clear standards for firms and protections for consumers. To be successful in this aim, the UK must be a location where cryptoasset firms are able to do business and provide high quality products and services to UK customers, rather than driving activity offshore. In this response we have set out areas of the proposals that merit revision to deliver this goal while protecting consumers and market integrity.

We welcome the opportunity for continued engagement, and stand ready to assist the FCA as it designs its regime and prepares for implementation.

Yours sincerely,

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Introduction

We appreciate the opportunity to respond to this Consultation Paper, and we are grateful for the ability to do so alongside the proposals in CP25/40 and CP25/41. A well-balanced prudential regime should focus on providing firms with an adequate buffer against operational, asset, business model, and wind-down risk, while recognising other mitigants in place for these risks including conduct requirements and the opportunities afforded by blockchain technology.

We welcome some of the pragmatic steps the FCA has taken in some areas of the prudential regime. In particular:

- **We support the proportionate approach taken to considering group risk as part of the Overall Risk Assessment.**

This provides firms with the ability to apply risk-sensitive prudential tools in line with a holistic assessment of their group, rather than forcing a rigid application of capital requirements on a consolidated basis.

- **The ability to carry out a single risk assessment for mixed MIFID and crypto businesses will avoid duplication and lead to better risk management.**

The own risk assessment (**ORA**) process is a significant undertaking for firms. For mixed businesses the ICARA under MIFIDPRU and ORA under CRYPTOPRU serve the same purpose, and would be duplicative if carried out separately. A single, coordinated risk assessment to comply with both regimes will reduce firm burden and allow for a more streamlined, holistic assessment across business lines.

- **The FCA's capital requirements have recognised the high safety profile of qualifying stablecoins, but should extend this beyond UK-issued stablecoins.**

By considering where UK-issued qualifying stablecoins should be treated differently when calculating own funds requirements, for instance on position risk, the FCA has recognised their status as money-like instruments with safeguards to protect their stability. While we support this differentiation, the FCA has not extended this recognition to overseas qualifying stablecoins issued under equivalent regulatory regimes. To ensure the regime is risk-reflective, the FCA should revisit this position given stablecoins fully-backed by HQLA and regulated for their issuance do not bring an analogous risk profile to unbacked cryptoassets.

Beyond these positive aspects, in key areas we believe revision is required to ensure that the final regime aligns with the FCA's commitment to further the UK's growth and international competitiveness.

Disproportionate activity-based own fund requirements

The FCA's proposed own funds requirements aim to mitigate risk by reflecting the nature and scale of a cryptoasset firm's operations. We agree with the objective that these requirements should be tailored and proportionate, avoiding a broad brush, flat prudential standard. However, we highlight the following key points which are cause for concern:

- **We believe strict alignment with MiFIDPRU is unsuitable for crypto firms and creates a substantial risk that firms will not set up in the UK, negatively impacting consumer choice and harming market liquidity**.

We support the FCA's decision to develop a bespoke prudential regime for cryptoasset firms rather than applying MiFIDPRU wholesale, but believe the FCA must go further to avoid disproportionate results which would act as a barrier to growth. As demonstrated under MiCA, which deliberately diverges from the EU Investment Firms Prudential Regime from which MiFIDPRU derives (including by not applying K-factor requirements), cryptoasset activities present a materially different risk profile, particularly in relation to operational resilience, technology dependency, custody and safeguarding, and orderly wind-down, which is not fully captured by a securities focused framework. Applying elements of MiFIDPRU in full would risk disproportionate outcomes, including capital requirements calibrated to credit and market risks that many cryptoasset business models do not generate, duplicative or misaligned requirements for firms and reduced flexibility to reflect rapidly evolving technologies and operating models.

In this context, we consider that the FCA should go further in articulating and embedding a crypto-specific prudential framework, using MiFIDPRU as a point of reference rather than as a default template. Drawing on MiFIDPRU principles where risks are comparable can support supervisory consistency and international credibility, but requirements should be tailored to crypto-specific risks. To this end, a bespoke regime would enhance proportionality, reduce the risk of mis-scoping and regulatory arbitrage, and better support the FCA's objectives of market integrity, effective competition and international competitiveness.

- **We do not believe the K-factors proposed are sufficiently justified by risk, and the FCA should consider alignment with MiCA which does not apply them.**

Through substantial activity based ‘K-factors’, the FCA’s proposals would lead to own funds requirements for cryptoasset firms that scale to a significantly higher level than other jurisdictions without otherwise demonstrating such a need. In particular, an assets-under-custody or transaction/order volume scalar should not apply to firms that are not dealing as principal on their own risk – including firms servicing clients on a riskless principal or undisclosed agency basis – because the activity does not reflect the risk exposure for which these measures are designed. The levels set for the proposed K-factors act as an effective linear tax on growth and many are not sufficiently justified; they are included solely for the purpose aligning with requirements for MiFID investment firms, which reflects different market activity and need for CET1 capital. Applying these requirements would unnecessarily create one of the most capital intensive cryptoasset regimes in the world, which will not be viable for a range of firms.

The nature of cryptoasset services means that many firms can operate with reduced overhead costs compared to firms in the traditional financial sector. Many are agile, capital-light start ups with the ability to scale their activity without substantially growing the size of their physical operations. The FCA reflects this through the inclusion of the fixed overhead requirement, but this is undermined by K-factor and high permanent minimum requirements based on activity. For a smaller firm, these could act as a brake on growth, potentially forcing them to exit the market, merge, or pivot to arranging models which may not suit their clients who require a principal counterparty.

- **The FCA should examine a tapered approach to own funds requirements in order to prevent a regime which will push institutional business overseas and unintentionally penalise UK presence.**

Institutional businesses subject to CRYPTOPRU would face significant hurdles from the levels selected for K-factors. We appreciate the need for prudential requirements to consider the scale of business conducted, but there is insufficient evidence that risk and transaction/custody volumes are linearly correlated. For institutional business, an unlevel playing field will be created between offshore firms servicing UK clients, and UK firms subject to much higher capital requirements.

- **Punitive crypto capital charges could create cliff-edge risks for firms and consumers - the 100% charge on the majority of cryptoassets should be significantly lowered to avoid liquidity risk being passed to consumers**.

The 100% charge imposed on net positions in category B cryptoassets would strongly deter firms from holding such assets as part of the trading book. The criteria proposed for this grouping is likely to capture the vast majority of cryptoassets, which we do not believe achieves the risk-sensitive model the FCA is seeking. We believe the 100% charge risks an unintentionally negative effect by encouraging firms to pass liquidity risk to customers rather than holding assets on their order book, and presents a significant cliff edge risk for firms' positions given category A cryptoassets are subject to a much lower charge. We believe the FCA should allow firms to take a more dynamic, risk-based approach, rather than imposing arbitrary fixed thresholds.

- **Broader risk mitigations through activity-specific conduct requirements need to be reflected in own fund calibrations**.

Through other areas of the proposed FCA regime, UK-authorised firms will be held to comprehensive standards which address acute risks of harm. The proposed prudential standards appear to set 'gold-plated' own funds requirements which show very limited reference to these broader systems and controls. For instance, proposed requirements for all retail borrowing to be overcollateralised mean the punitive charges for retail counterparty default (K-CCD) do not address an outstanding residual risk. To achieve the FCA's stated aim of developing risk-based prudential standards, requirements must be recalibrated in light of the finalised framework in other areas, including broader activity-specific and cross-cutting requirements that have not yet been fully consulted on.

Opportunities to better reflect the cryptoasset market

We believe that additional amendments to the FCA's proposals are required to recognise the core characteristics of the cryptoasset market. In particular:

- **We believe the FCA should reflect where crypto may be needed to meet operating costs, allowing its use within capital requirements.**

We agree that firms should be prudentially well positioned to respond to operational risks. However, unlike traditional investment firms, many ongoing operating costs for crypto firms are carried out using cryptoassets. Liquid asset requirements should allow for crypto to make up a portion of the assets held, where crypto liabilities form a part of operating costs.

- **The location of liquidity in crypto markets should be considered when calibrating concentration costs**.

Consumers benefit from the low execution costs and latency of deep liquidity pools and any provision that penalises firms for accessing venues with concentrated liquidity creates incentive for capital to move to sites with potentially less reliable execution and higher costs. The FCA should consider greater flexibility for controlled increases in concentration, and clarify that DeFi pools do not constitute 'clients' for the purpose of these calculations.

Application of prudential requirements to third-country branches

We would welcome further clarity on the intended application of the proposed prudential requirements to third-country branches authorised in the UK. In particular, the FCA should confirm how COREPRU and CRYPTOPRU are expected to apply where a branch is subject to robust and equivalent home-state prudential supervision, and whether, consistent with the FCA's existing international firms approach and the direction of travel in the proposed international crypto firms guidance, reliance may be placed on home-state regulation in assessing compliance with the financial resource threshold conditions. Clear articulation of this point would support regulatory certainty, avoid duplicative capital outcomes, and reinforce the proportionate and internationally aligned framework that the FCA is seeking to achieve.

Conclusion

While we agree that a strong prudential framework is a crucial element of a proportionate and trusted regulatory regime for crypto, this should be consistent with the creation of operating conditions which allow firms to enter and grow in the UK market. Across the wider regime which the FCA has developed, a sensible balance between high standards and the accommodation of reasonable, controlled risk has been struck. Protections for consumers and market integrity can exist while reflecting the unique features of cryptoasset markets, recognising that overly punitive or gold plated prudential requirements risk a counterproductive effect - pushing activity offshore, and limiting the ability for effective competition to emerge through new entrants and a diversity of product offerings.

We believe that a recalibration of the prudential approach, rather than a strict adherence to MiFIDPRU alignment, would have a significant positive impact on the outcomes for firms and consumers under the UK crypto regime.

Answers to specific questions

Chapter 3 - Own funds requirements

Question 1: Do you agree with the proposed PMR for the various activities that cryptoasset firms will need to comply with?

As noted in our response to CP25/15 we believe the concept of a permanent minimum requirement (PMR) has merit to ensure a baseline standard for sufficient resources is met. Under the FCA's proposals these requirements vary from £75k to £750k depending on the activities a firm carries out. In many cases these minimum requirements align well with comparable jurisdictions, and we appreciate the recognition that a 'higher of' approach to firms carrying out multiple activities is more proportionate than a cumulative permanent minimum requirement.

However, the lack of justification or reasoning within the Consultation Paper for the levels selected for each activity, and the notably elevated permanent minimum for dealing as principal (£750k), raises significant cause for concern in the FCA's ability to deliver on its effective competition and international competitiveness objectives.

Similarly, we believe the PMR proposed for staking activities is too high, in particular because it does not account for models where the firm carrying out the regulated activity (which is defined as *arranging* cryptoasset staking), is not providing custody of the assets. In other regulated sectors, firms which make arrangements are subject to a lighter touch regime reflecting the reduced risk of their business model. We do not believe the FCA has set out sufficient justification for diverging from this principle, and applying onerous capital requirements to firms which are arranging staking.

PMR for dealing as principal

We understand that £750k aligns with the permanent minimum capital requirement for a firm that is *inter alia* dealing on its own account under MiFIDPRU. This requirement is five times higher than for equivalent cryptoasset firms under MiCA and five times the requirement for custodians. While we accept that dealing as principal poses a greater risk to firm solvency than agency or custody models, this difference is excessive and would act as a significant barrier to entry for newer firms. This requirement implicitly institutionalises the market by pricing out the innovators who often drive market efficiency in the crypto sector. This means squeezing out market participants who offer services which create value, with the market open only to those firms who can monetise other business lines. If potential market makers leave the UK perimeter to avoid these significant capital charges, UK-authorised venues may suffer from wider spreads and thinner order books, which would be against the interests of consumers utilising their services. Finally, there is a risk of over-calibration relative to risk, especially when combined with exposure-based K-factors (e.g. net position, counterparty default and concentration risk). Where those K-factors already scale capital to actual trading activity and balance-sheet exposure, a high fixed PMR may operate as a blunt instrument, potentially dampening innovation and liquidity provision without a commensurate prudential benefit.

Importantly, the principal dealer PMR does not account for firms operating on a ‘matched principal’ basis. Many crypto OTC desks and prime brokers interpose themselves between buyer and seller but do not hold open directional positions. These firms would be hit by the same £750k requirement as a proprietary trading firm taking significant directional bets. The FCA previously removed the ‘matched principal trading exemption’ for traditional brokers, and faced criticism for doing so as this neglected to consider the mechanics of riskless trading. This contested logic is re-visited here in a sector heavily reliant on sufficient liquidity provision. We believe the exemption should be reintroduced to avoid disproportionate prudential requirements which do not account for risk.

Question 2: Do you have any views on the operational risk K-factors we are proposing for cryptoasset firms?

We understand the FCA’s aim to develop a risk-sensitive prudential regime which scales with the activities carried out. However, we believe the K-factors currently proposed would have an adverse impact on growth. The FCA’s Strategy 2025-30 recognises that every notch higher can create a barrier to entry which ‘affects competition and innovation, and so this impacts the price people and businesses pay and the service they receive’.

We understand the K-factors are calculated specifically for cryptoasset firms, but are modelled in many cases on those utilised for traditional investment firms. We believe this approach needs revisiting for two reasons:

1. The EU determined, under its largely aligned prudential framework, that it was not appropriate to extend ‘K-factors’ to cryptoasset firms, even where these exist for traditional investment firms. The FCA has not set out the counterfactual of following the MiCA approach, which we believe would avoid critical barriers to a competitive UK regime, and prevent growing firms from exiting the market.

2. The IFPR / MiFIDRPRU in the UK is under increasing scrutiny for its gold plated approach to prudential levels, which even for firms in a much more established market with easier access to CET1 capital, create substantial barriers to operating in the UK. The CRYPTOPRU measures aligned with MIFIDPRU risk an even more

adverse impact because crypto firms, at least until the market develops, will have less access to CET1 capital and a less established UK market presence.

Examining some of the K-factors specifically:

K-CTF (principals) and K-CCO (agents): The K-CCO for agents appears oriented to generally attract a lower charge than the K-factors applied to principal dealers. The outsized K-CTF requirement applies a fixed 0.1% requirement based on daily value, which does not take into consideration the lower operational risks of executing trades on UK regulated venues. As this would impose a significant burden on liquidity providers and market makers, it could lead to a market shift with broker-dealers pivoting to pure brokerage models and sending orders to a small number of large firms that can afford the K-CTF and K-NCP charges. Such a concentration would likely harm competition and increase concentration risk in the market. In addition, we do not believe there is adequate justification to determine that operational risks from handling client orders are the same for cryptoasset firms as traditional investment firms when calculating the K-CCO. Smart contracts can facilitate much shorter windows between the placing of orders and the settlement of trades, and on-chain execution often involves much simpler intermediary chains, with greater transparency and auditability through blockchain records.

K-CCD (counterparty default): The FCA states that assigning an 83.33% risk factor to retail exposures ensures that lending to retail clients would need to be significantly overcollateralised. We believe this is an inappropriate method of regulating the activities that firms carry out. Firms' own risk appetite and the conduct standards in the CRYPTO sourcebook should be used to guide appropriate lending and borrowing practices, rather than outsized prudential restrictions. This would ensure prudential regulation remains strictly risk-based. We have responded in more detail to the FCA's position on retail lending and borrowing in our response to CP25/40. In addition, we believe a flat 8% charge for exposure to non-UK firms does not sufficiently distinguish between the type of counterparty and its home regulatory status.

K-NCP (net cryptoasset positions): We agree that the risk profile of different cryptoassets varies, but the categorisation proposed sets a binary approach which does not adequately reflect an assessment of market risk. The approach to K-NCP creates a two-tiered system and incentivises the trading and holding of a very small range of cryptoassets over others through the substantial additional risk adjustment for category B cryptoassets - a category which we believe would capture the vast majority of tokens. We respond to this classification in more detail in our response to question 4, but we believe this binary approach risks creating an anti-competitive environment in the UK that privileges a small number of incumbent cryptoassets, brings cliff edge risks for firms in the event of reclassification, and may unintentionally incentivise firms to pass liquidity risk on to customers, rather than holding assets on their trading book.

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K-CON (concentration risk): We believe that the calculations proposed for concentration risk would result in some instances with charges which exceed 100% of the value of the relevant position. We believe exceeding this 100% cap within K-factors acts as an effective restriction on certain activities. In cryptoasset markets, particularly as regimes develop, accessing good liquidity often relies on a smaller number of exchanges and liquidity pools. Penalising access to liquidity could unintentionally lead to worse outcomes for consumers if it forces the fragmentation of capital and less reliable execution.

K-QCS (custody): 0.04% of assets under custody is a substantial amount of permanent capital for custodians and exchanges and acts as a barrier to entry for new incumbents. In a constantly innovating environment, businesses can scale quickly, and many startups would be dissuaded from establishing in the UK, fearing they would be unable to attain the significant capital requirements required under K-QCS. In addition, the proposed application of K-QCS to specified investment cryptoassets, on the basis that safeguarding such assets is within scope of the RAO activity, results in a position by the FCA to disapply MIFIDPRU requirements for these assets in favour of the CRYPTOPRU requirement. This could unintentionally harm the level playing field between traditional securities and tokenised securities without sufficient justification for their different treatment.

Finally, while the proposals seek to align crypto K-factors with MiFIDPRU concepts, and in some cases to substitute one charge for another, overlap may still arise in practice where firms undertake both MiFID and crypto activities, operate mixed trading books, or sit within group or branch structures subject to both regimes. For example, operational risk captured through MiFIDPRU activity-based K-factors may overlap with CRYPTOPRU operational K-factors, and exposure-based charges under MiFIDPRU may intersect with K-NCP, K-CCD or K-CON where economically similar risks are present.

Without clear and consistently applied allocation, disapplication and netting rules, firms may be required to hold capital more than once against the same underlying risk. This creates a risk of disproportionate outcomes and undermines the principle of risk sensitivity. Further clarification in the final rules and guidance on how MiFIDPRU and CRYPTOPRU K-factors interact in practice is needed to ensure the regime operates as intended and avoids unintended double counting.

We believe the FCA must revise its position on K-factors, and consider aligning with the EU in relying on permanent minimum and fixed overhead requirements. These provide sensitivity to both activity conducted and operational scale, and would avoid the significant risk of an unviable regime for smaller firms, and the offshoring of institutional firms.

Question 3: Do you have any views on our proposals for positions in the trading book, including the definition, management and additional value adjustments?

We believe these requirements do not sufficiently consider the differences in how cryptoasset markets operate compared to traditional investment services.

Under the proposed rules, firms would need to distinguish positions which are held with trading intent, but in crypto markets this line is often blurry. For instance, a principal dealer may hold an amount of a cryptoasset to facilitate instant withdrawals, but stake a portion of this holding to earn yield. If this staked amount is deemed to be in the trading book, it attracts K-NCP market risk charges, and if it is not then it would be treated as a non-trading asset, attracting a deduction that does not recognise the liquidity. Firms in this case may be unwilling to stake their idle inventory for fear of triggering a spike in capital requirements, disincentivising low-risk methods of increasing capital efficiency.

Question 4:

Do you have any views on the categorisation of cryptoassets, particularly on the conditions attached to a cryptoasset being included in category A?

We recognise and welcome the objective of the FCA's proposals to ensure that the resilience and liquidity of different cryptoassets is reflected in prudential proposals, to avoid a blunt approach to weighing up positions held. We appreciate the provisions set out in CRYPTOPRU 4.9.11, which provide helpful guidance on how double-counting is avoided. We agree that being traded on a UK trading platform is a relevant factor in categorising cryptoassets, given this is a legislative requirement to be offered to the UK public in many cases. Extreme volatility over the last 12 months is similarly a logical measure through which to classify cryptoassets for the purpose of risk weightings.

However, we believe that the categorisation proposed would reduce the competitiveness of the market because it is likely the vast majority of cryptoassets would be classed as category B. In particular, three years of stable operational history and a volatility below 5% over 12 months are incredibly stringent measures which will exclude most cryptoassets in a developing and relatively nascent market. The proposed requirement to make assessments on an intra-day basis suggests a requirement, in effect, to carry out real time monitoring to build sufficient justification for a category A classification, which would be disproportionate. We believe the FCA should clarify this position and what is expected of firms.

The classification of category A and B cryptoassets becomes particularly problematic because of the extremely punitive weightings (100%) proposed for category B cryptoassets. This suggests the focus is on *preventing their use* rather than reflecting their risk profile. The effect could be that regulatory intervention privileges the position of a very small number of large incumbent tokens, exacerbating concentration risk and poor liquidity. We urge the FCA to reconsider the conditions in CRYPTOPRU 4.9 to target the core metrics of presence on a UK trading platform and an absence of recent extreme volatility.

While we welcome clarity that positions in UK-issued qualifying stablecoins are not included in this calculation, we note that there is a cliff-edge risk introduced for firms holding significant amounts in stablecoin liquidity were a non-UK authorised stablecoin to move from one category to another. In such cases capital requirements would jump significantly overnight, posing a risk to the stability of firms and their customers. Particularly for qualifying stablecoins regulated for their issuance in other jurisdictions, we believe the FCA should also exclude these positions from the K-NCP given their fully-backed nature and stable value.

In addition, we would suggest that the FCA introduces a 'whitelist' of category A cryptoassets which gives firms the certainty to hold them on their book without fearing massive instability in the event they are reclassified.

We believe the FCA should recalibrate the category B classification criteria to capture only extreme volatility and lack of listing on a UK trading platform.

Do you agree with the proposed capital charges for each category under our net cryptoasset position (K-NCP) proposals?

As noted above, we believe the risk weightings applied under each category are excessively differentiated, and appear designed to alter market behaviour in favour of trading and holding longer-standing cryptoassets - for the vast majority of cryptoassets the FCA is applying a 100% capital charge, dissuading firms from holding them and encouraging a move to an order-book model where customers bear the liquidity risk.

Given cryptoassets are forced into binary categories, edge cases would see substantially different treatment depending on an assessment under qualitative and somewhat subjective conditions, with significant cliff edge risks in the event that they are reclassified.

We urge the FCA to revise this 'gold plated' approach to risk adjustment and replace the 100% capital charge for the majority of cryptoassets with a more risk-sensitive calibration at significantly lower levels, placing greater reliance on the overall risk assessment to reflect firm-specific controls, while avoiding cumulative or overlapping capital requirements.

Question 5: Do you have views on our framework for calculating cryptoasset counterparty default requirements (K-CCD) for cryptoasset firms? Are there any transactions that you think would give rise to counterparty credit risk but are not covered by our proposed rules?

We agree with the intended outcome of ensuring firms can absorb the shock of a borrower defaulting, and appreciate the FCA's efforts to calibrate this framework for the crypto market. We support the scoping of this measure around cryptoasset lending.

K-CCD allows firms to reduce their Exposure Value by holding collateral. However the punitive haircuts proposed for the majority of crypto collateral means that to avoid a K-CCD charge firms would need to demand, in effect, super-collateralisation. As outlined in our response to question 2 we do not believe the weighting applied to retail clients is justified by risk, and is an inappropriate vehicle through which to exercise a policy preference for overcollateralised retail lending models. If firms seek to expose themselves to the risk of borrower defaults, it should be for the firm to assess its risk tolerance for potential loss. This proposal prevents cryptoasset lending models from operating on an equal footing.

In addition, we believe the flat 8% charge applied to exposures to non-UK firms does not recognise the significant differences in risk profile between different overseas counterparties, in particular those that are regulated for their activity in their home jurisdiction where firms should have the ability to reflect the lower counterparty risk - in some instances this counterparty risk may be lower than that for UK equivalents, depending on the business model of the party and its regulatory compliance.

Finally, while we support the exclusion of UK-issued stablecoins from the K-CCD calculation, we believe this should extend to qualifying stablecoins issued under sufficiently similar regulatory regimes. Exposures in regulated, fully-backed stablecoins do not present an analogous counterparty risk to unbacked cryptoassets with variable value.

Question 6: Do you have any views on the proposed framework for calculating concentration risk requirements (K-CON)?

The intention of the K-CON proposal is to help mitigate concentration risk by penalising concentrated exposure to a single client or group. We welcome the recognition that exposure to a group including a CRYPTOPRU firm, credit institution, or investment firm does not bring the same risk as concentrated exposure to an unregulated group. We believe this should go further, with the same higher concentration limit applied to exposures to overseas firms which are prudentially regulated for their cryptoasset activities. This would recognise that such firms are regulated to ensure they are well-resourced, and therefore the reduced risk from exposure to them.

Access to sufficient liquidity is crucial to serving clients' needs in cryptoasset markets. While the diversity of firms offering deeper liquidity is improving with a more competitive ecosystem, liquidity remains relatively concentrated in major venues and DeFi pools. There is a significant risk that the punitive K-CON charges will dissuade firms from accessing the best liquidity, encouraging them to fragment capital across potentially riskier venues to avoid capital penalties. The calculations proposed could lead to capital charges which exceed the value of the positions held by the firm. At a minimum, **we believe the FCA should cap the K-CON charge at no greater than 100% of the value of the relevant position. This ensures that prudential requirements are sensitive to risk without placing an effective restriction on activity.**

Where firms are subject to K-CON charges, we believe there is a risk that calculations based on exposure value could amplify volatility. A firm may have an exposure in a given cryptoasset which is below the 25% limit. The sudden appreciation of the asset could lead to a breach of the 25% limit through price action. As the firm would then be subject to punitive K-CON charges, it may need to fire sale the asset into a rising market to bring its exposure back under the limit. This pro-cyclicality is more acute in crypto markets than in traditional investment markets.

We believe that where breaches are due to price appreciation, firms should have a rectification period to allow the reduction of exposures in an orderly manner. An alternative would be to calculate exposure values based on multi-day moving averages rather than the immediate spot price.

It is not clear if the FCA would class a decentralised liquidity pool as a 'client'. Decentralised pools operate differently from centralised liquidity providers and do not bring the same concentration risks. If the use of a DeFi pool is treated as a single exposure, the K-CON rules could prevent deep liquidity provisioning in DeFi which many business models rely on, as firms would be unable to scale their position beyond 25% of their own funds.

Chapter 4 - Overall risk assessment

Question 7: Are our expectations of firms regarding the overall risk assessment sufficiently clear? If not, which areas could benefit from further clarification?

Overall we agree with the objective that firms should take a holistic approach to identifying and mitigating risks of harm to themselves and their customers. We welcome the confirmation by the FCA that a firm subject to the ICARA process under MIFIDPRU and the ORA under CRYPTOPRU will only need to carry out a single risk assessment to comply with both obligations. Provisions around wind-down planning and reverse stress testing will help firms to position themselves well as resilient market actors, and enhance trust among broader market participants.

Our concerns with these proposals centre on aspects of the ORA which require additional capital to be held, which we view as unjustified and potentially counterproductive to the effective management of operational risk.

Unjustified additional capital

We agree that firms should hold adequate financial resources and remain financially viable, while placing themselves in a position to wind down in an orderly manner without harming customers or the market. As the ORA is modelled on the ICARA process in MiFIDPRU, this signals that the FCA views crypto firms as presenting similar prudential risks to a traditional stockbroker or wealth manager. However, additional capital controls acts as an effective multiplier on the already substantial own funds requirements set out. The FCA is seeking to produce a risk-sensitive model, but in our view this has been overcalculated. The PMR and FOR proposals together are sensitive to the activity carried out and the nature and size of the business. The FCA has in many areas set these requirements at a very high level compared to international peers who do not go on to apply an additional K-factor or own funds threshold requirement. For firms with anything but the simplest business models, the ORA will likely result in a capital requirement significantly higher than the already significant published base figures. The resultant uncertainty, and significant administrative burden to produce complex risk modelling, risks an uncompetitive regime which does not offer the certainty of comparable regimes such as MiCA, where firms are more aware of the total capital cost upfront.

The FCA should not apply additional capital requirements for risks which are already covered by own fund requirements.

The need for crypto-denominated assets

Many cryptoasset firms operate in a way that is relatively capital light. These proposals require them to be very capital heavy and force crypto-native firms to maintain a

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significant fiat treasury. For firms whose revenue and cost base (e.g., gas fees, on-chain developer payments) might be crypto-denominated, this creates a permanent currency mismatch or forces costly, constant FX conversions. There is a lack of clear justification for why the significant own funds requirements leave residual risk which must be countered with more capital. Many of the operational risks that cryptoasset firms face, such as blockchain congestion events or liquidity crunches, could be actively more difficult to respond to if firms are required to lock up fiat at the expense of greater *crypto* liquidity.

At a minimum, we believe that if additional liquid asset requirements will be in place, firms should be able to hold a portion of these in cryptoassets to meet their crypto-denominated operational liabilities.

Chapter 5 - Public disclosure of prudential information

Question 8: Do you have any views on our proposals for the public disclosure of prudential information, in particular on group arrangements and for firms that undertake dealing in cryptoassets?

We agree with the FCA's objective that communicating the prudential position of cryptoasset firms benefits transparency and overall trust within the market. Generally we agree with the proposals for public disclosure, and welcome the thoughtful approach taken to ensure that the required information for disclosures aligns with information that must be collated under other requirements (including risk assessment information and own funds calculations).

We believe there should be an express exclusion from the disclosure requirements for commercially sensitive information, where this would prejudice the interests of the firm. This would be consistent with the approach to delayed disclosures under the forthcoming market abuse regime.

While we generally support the clear disclosure of key information, granular reporting in some areas could increase risk rather than ensure good outcomes. For instance, detailed reporting on K-QCS (custody) metrics would implicitly reveal certain features of custody arrangements such as the scale of assets held in hot vs cold wallets, through risk descriptions. Similarly, granular disclosure of concentration risk under K-CON could help bad actors in narrowing the target surface for attacks by helping to identify 'whale' entities. To help resolve these risks, the FCA should focus on outcomes-based measures for prudential reporting, in line with the approach taken to broader disclosures under CP25/41, giving firms discretion to responsibly and appropriately determine how disclosures should be presented in the interests of consumers and the market.

We note that the requirements related to group structures require the public disclosure of significant amounts of otherwise non-public information related to intra-group activity and the financial position of parent undertakings. For large groups operating multi-jurisdictional models, this could act as a deterrent to UK establishment, and the FCA has provided limited rationale for such a wide-reaching disclosure requirement.

We urge the FCA to focus disclosure obligations on information lines most directly relevant to the activities and financial position of the UK entity, noting that group risks will need to be considered as part of the overall risk assessment.