FINANCIAL CONDUCT AUTHORITY

Prohibiting the sale to retail clients of investment products that reference cryptoassets

Policy Statement
PS20/10

October 2020

This relates to

Consultation Paper 19/22
which is available on our website at
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1 Summary

1.1 In July 2019, we published Consultation Paper (CP)19/22 – Prohibiting the sale to retail clients of investment products that reference cryptoassets. We consulted on rules to ban the marketing, distribution and sale of derivatives and exchange traded notes (ETNs) that reference certain types of cryptoassets to retail consumers. References to 'retail consumers' refers to 'retail clients' as in COBS 3.4.

1.2 The consultation fulfilled our commitment in the Cryptoassets Task Force Report, published in October 2018. The Task Force (CATF) consisted of the Treasury, the FCA and the Bank of England.

1.3 This Policy Statement (PS) summarises the consultation feedback we received. It sets out our final policy position and Handbook rules that will come into force on 28 October 2020.

1.4 Having considered the feedback, we are confirming the rules as consulted on, subject to some minor, technical amendments.

1.5 The rules will come into force on 6 January 2021 after the end of the transition period which has operated since the UK's departure from the EU on 31 January 2020. We have therefore amended the rules to reflect the end of the transition period and to ensure that the rules continue to apply to the same firms as would have been subject to the rules before that point. Due to a delay in publishing this Policy Statement, we amended the coming-into-force date of the rules after the rules were made to give firms more time to prepare for them.

Who this affects

1.6 Our proposals will directly affect:

- firms issuing or creating products referencing cryptoassets
- firms distributing products referencing cryptoassets, including brokers, investment platforms, and financial advisers
- firms marketing products referencing cryptoassets
- operators of trading venues and platforms
- retail consumers and consumer organisations

1.7 This is not a complete list, and the PS is likely to be relevant to other stakeholders, both regulated and unregulated.

The wider context of this policy statement

Our consultation

1.8 The concerns we outlined in CP19/22 are consistent with the CATF report. We consider that retail consumers cannot reliably assess the value and risks of derivatives and exchange traded notes that reference certain cryptoassets. This is due to the:

- nature of the underlying assets, which have no inherent value and so differ from other assets that have physical uses, promise future cash flows or are legally accepted as money
- presence of market abuse and financial crime (including cyberthefts from cryptoasset platforms) in cryptoasset markets
- extreme volatility in cryptoasset prices
- inadequate understanding of cryptoassets by retail consumers and the lack of a clear investment need for investment products referencing them

1.9 As a result, we think that retail consumers will suffer harm from potentially sudden and unexpected losses if they buy these products.

How it links to our objectives

1.10 This prohibition advances our objective of ensuring an appropriate degree of protection for consumers and supports our objective of protecting and enhancing the integrity of the UK financial system.

What we are changing and what outcomes we are seeking

1.11 We are prohibiting the marketing, distribution and sale in or from the UK to all retail clients, of derivatives and ETNs that reference certain types of unregulated, transferable cryptoassets.

Covid-19

1.12 Covid-19 is having a significant impact on firms and the wider economy and we have considered whether this is the right time to bring in the prohibition given the current circumstances. The risk of harm which the prohibition intends to address has not gone away as a result of COVID-19 and we think there is still a need to make the rules to protect consumers. We have, however, delayed publication of this Policy Statement and the implementation date so as to avoid imposing additional implementation work during the period when firms have been most impacted by Covid-19.

1.13 Since March 2020 we have continued to see extreme volatility in cryptoasset markets in line with other periods of price movements for cryptoassets. Our analysis of the harms from unregulated transferable cryptoassets has not changed.

Measuring success

1.14 Our intervention will be successful if we reduce the harm to retail consumers from buying crypto-derivatives.

1.15 We have updated our cost benefit analysis (CBA) to include additional data on client outcomes obtained since CP19/22. We now estimate that a ban on the sale, marketing and distribution of crypto-derivatives to retail consumers could reduce overall consumer losses by between £19m and £101m per year. Based on additional client data, in response to feedback and over a longer period, expected benefits are lower than our estimates of a reduction of consumer losses of between £75m to £234.3m in CP19/22. This reduction in losses is in large part because of leverage limits imposed on CFD trading by ESMA and the FCA.

Summary of feedback and our response

1.16 The consultation closed on 3 October 2019. We received 527 responses. These responses were from firms, trade bodies, retail consumers and EU national competent authorities (NCAs).

1.17 Respondents focused on:

- our argument that cryptoassets do not have intrinsic value, and that retail consumers are unable to value them reliably
- how proportionate a prohibition is and whether other, less restrictive measures would achieve our policy objectives
- our supporting CBA

1.18 Chapter 2 of this PS summarises the feedback we received and our response. Appendix 1 sets out our final rules.

Equality and diversity considerations

1.19 One individual commented on our equality impact assessment. They argued that because cryptoasset investors, not derivative investors, are mostly male and between the ages of 20 and 44, the policy will disproportionately affect younger, male consumers.

1.20 Even though age and sex are relevant protected characteristics under the Equalities Act, this information has not changed our assessment. The prohibition of crypto-derivatives is designed to protect all retail investors, and will apply to all investors regardless of their protected characteristics.

1.21 Our assessment of the impact of these changes on groups with protected characteristics remains unchanged from Consultation Paper CP19/22. We do not consider that this policy adversely impacts any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

Next steps

What you need to do next

1.22 If your firm carries out marketing, distribution or selling activities in, or from, the UK of the relevant products to retail clients, you are required to cease these activities by 6 January 2021.

1.23 Retail consumers with existing holdings can remain invested following the prohibition, until they choose to disinvest. There is no time limit on this, and we do not require or expect firms to close out retail consumers' positions unless consumers ask for this.

1.24 The rules apply to:

- MiFID investment firms, including Capital Requirements Directive (CRD) credit institutions as appropriate, who are marketing, distributing or selling crypto-derivatives in, or from, the UK to retail clients.
- MiFID optional exemption firms who are marketing, distributing or selling crypto-derivatives in, or from, the UK to retail clients.
- UK branches of third-country investment firms who are marketing, distributing or selling crypto-derivatives in, or from, the UK to retail clients.
- EEA MiFID investment firms which currently passport into the UK and which continue operating in the UK after 6 January 2021 under the temporary permissions regime or the financial services contracts regimes. The UK left the EU on 31 January 2020 with a Withdrawal Agreement. It has entered a transition period which is due to operate until 31 December 2020. When the transition period ends, EEA firms which currently passport into the UK and wish to continue operating in the UK will be subject to the temporary permissions regime or the financial services contracts regime (which covers supervised run-off firms and contractual run-off firms). We intend that our rules will apply to those firms in the same way that they apply to other firms.

1.25 We remind UK and third-country investment firms that the FCA regulates certain activities, such as dealing, arranging, advising, when carried on in relation to derivative instruments which reference or are backed by cryptoassets ('crypto-derivatives'). Carrying on these regulated activities in the UK generally requires authorisation.

What we will we do next

1.26 We expect firms to comply with the prohibition. Our supervision in this area will focus on:

- attempts to avoid the effect of our new Handbook rules by:
  - inappropriately 'opting up' retail clients to become elective professional clients
  - moving retail consumers to associated non-UK entities
- the conduct of inward passporting firms operating under the Temporary Permissions Regime

1.27 We will keep this prohibition under review in line with Article 42(6) of the Market in Financial Instruments Regulation (MiFIR). We will consider whether there is a need to review the prohibition if we see robust evidence indicating that the cryptoasset market has changed in ways which materially tackle the drivers of the harms we have identified.

2 Our response to consultation feedback

2.1 In CP19/22, we asked for views on our proposal to prohibit the sale, marketing and distribution of crypto-derivatives in, or from, the UK to retail consumers because of our concerns about the actual and potential harm these investments cause.

2.2 We received 527 responses to the consultation from a range of stakeholders including:

- firms that sell crypto-derivatives
- firms that issue crypto-ETNs
- exchanges that offer crypto-derivatives and unregulated cryptoassets
- firms involved in cryptoassets
- trade bodies representing cryptoasset firms
- trade bodies representing regulated exchanges
- an association representing law firms
- National Competent Authorities (NCAs)
- individuals, including retail consumers, a legal professional, and an academic

2.3 Most respondents (97%) opposed our proposal arguing that:

- cryptoassets have intrinsic value
- retail consumers are capable of valuing cryptoassets
- a prohibition was disproportionate and other measures could achieve our objectives
- our CBA did not represent accurately the costs and benefits of banning crypto-derivatives sold to retail consumers

2.4 Our response to the consultation feedback only applies to products referencing unregulated transferable cryptoassets that are within scope of our proposed ban. It does not relate to security tokens (ie those that qualify as specified investments), which are within our regulatory remit. Derivatives referencing security tokens are not within scope of our ban.

Cryptoassets' intrinsic value

2.5 In CP19/22, we outlined why we think unregulated cryptoassets have no inherent value. They differ from other assets that have physical uses, promise future cash flows or are legally accepted as money.

2.6 We concluded that cryptoassets are opaque, complex and unreliable as reference assets for investments for retail consumers.

2.7 Some respondents argued that some cryptoassets have intrinsic value because they are:

- accepted as a means of payment for goods and services, highlighting that Starbucks and Microsoft accept bitcoin through a service offered by Bakkt (a US cryptoasset company backed by Intercontinental Exchange (ICE))

- readily exchanged for fiat currency on numerous exchanges
- limited in supply and can act as a potential store of value, like gold

Our response

We recognise that some companies accept cryptoassets as a means of payment. These companies price their goods and services in fiat currency and convert the price into bitcoin at the time of sale. In effect, fiat currency remains the underlying medium of exchange. The Bank for International Settlements (BIS) states that cryptoassets cannot reliably provide the standard functions of money because they are currently too volatile to become accepted as a standard of value. Lower volatility is necessary for them to be widely accepted for purchasing goods and services.

We do not think that cryptoassets being exchanged for fiat currency equates to intrinsic value. We remain of the view that the price of cryptoassets is determined by sentiment and speculative behaviour. As a result, future valuations are highly subjective. We provide below our analysis of data supporting this view. This is because cryptoassets do not commonly have consistent valuations based on assumptions on dividends/coupons, or use of materials in production or consumption.

We recognise the argument that some cryptoassets could potentially act as a store of value in the future. To act as a genuine and reliable store of value, we think those cryptoassets would need to demonstrate that they are not prone to the same level of volatility that existing exchange tokens, such as bitcoin and ethereum, currently exhibit. Cryptoassets do not currently benefit from the same social, economic, cultural and physical-usage related factors that have established other assets as a store of value, such as gold.

We recognise that retail consumers may assign a subjective value to cryptoassets. However, this does not mean that they can value cryptoassets reliably or consistently, or the derivatives that reference them.

Businesses that have tested cryptoasset products in a controlled environment in the FCA's Sandbox have demonstrated that some cryptoassets (not their derivatives), can reduce costs and transaction times, particularly for cross-border payments. We recognise that cryptoassets can, in some circumstances, be beneficial to consumers. We will continue to help firms through our Innovate support functions, like 'Direct Support' and the Sandbox, where cryptoassets can potentially bring benefits to consumers and markets. We will also continue to consider whether our regulatory framework enables the legitimate use of cryptoassets, while managing the harms associated with some cryptoassets. These potential benefits do not, however, mean that unregulated cryptoassets are currently an appropriate underlying asset from which to price derivatives intended for sale to retail consumers.

The valuation of cryptoassets

2.8 We said that retail consumers cannot value cryptoassets reliably because they have no intrinsic value, and the valuation model inputs are subjective and vary significantly, which results in significant differences in valuations. Without a reliable model on which to base value, it is impossible for retail consumers reliably to value crypto-derivatives. This makes the risk of unexpected losses high.

2.9 CP19/22 contained analysis supporting our view that retail consumers are unable accurately to price cryptoassets and derivatives referencing them, including:

- **price dislocation across exchanges** – exchange data showing significant differences in bitcoin prices between exchanges over a 14-day period
- **correlation between different cryptoassets** – data showing a high correlation between different cryptoasset prices, supporting our view that cryptoasset prices are driven by speculative behaviour and sentiment rather than economic factors such as use or technological developments
- **data demonstrating speculative behaviour** – Google trends data (used as a proxy for retail consumers' interest in cryptoassets), showing a strong correlation between the prices of bitcoin and ethereum, and the number of Google searches for these cryptoassets.

2.10 Industry bodies, exchanges, and manufacturers of crypto-derivatives and ETNs said we had not considered valuation models adequately. They disagreed with us, believing that retail consumers are able to value cryptoassets accurately. To demonstrate this, they provided various examples of cryptoasset research and valuation methodologies. They argued these show cryptoassets can be valued like other assets that are the reference point for derivatives we allow to be sold to retail consumers.

2.11 The same respondents said that the volatility of cryptoassets does not mean that retail consumers cannot value them. They also said we should not ban crypto-derivatives on the grounds of volatility, as we allow firms to sell products to retail consumers with the same or higher levels of volatility. If cryptoassets can be reliably valued, then crypto-derivatives should be treated the same as other 'high risk' assets. That is, require leverage limits and enhanced disclosures.

2.12 One firm said that retail consumers are just as capable at valuing cryptoassets as institutional investors. Respondents also said that retail consumers are unable to value foreign exchange derivatives reliably.

2.13 Some firms argued that the data we relied on to demonstrate that cryptoassets cannot be valued reliably and are driven by speculative behaviour, was inaccurate and unrepresentative, and so misleading. They cited:

- **Price dislocation across exchanges** – the data we used to demonstrate divergence in cryptoasset prices across exchanges were not representative because the exchanges whose data we relied on were not reputable. They said we should not rely on data from a sample of exchanges that were suspected of publishing inaccurate trading volumes. One respondent said that the 14-day period (10 to 24 December 2017) was too short to be representative of the performance of cryptoasset markets.

- **Correlation between cryptoasset prices** – showing correlation between markets within the same general industry, does not demonstrate that markets are driven by speculative behaviour rather than economic factors. They said, for example, that equity indices (eg FTSE 100 and S&P 500) are also highly correlated.
- **Demonstrate speculative behaviour** – 3 firms said that Google Trends data do not demonstrate that cryptoasset prices are driven by speculative behaviour, as we cannot demonstrate causality. These respondents said it was not clear whether higher prices led to higher search volumes on Google, or whether higher search volumes on Google led to higher prices. Another respondent argued that speculative behaviour is normal in well-functioning financial markets, and leads to price discovery.

Our response

We analysed and considered the alternative valuation models provided (see Technical Annex). The models use a variety of techniques and factors to value cryptoassets, including different subjective inputs, suggesting there are no clear indicators to predict the price of cryptoassets reliably. The models produced a wide range of valuations from US$0 to US$50,000 for the same cryptoasset. As a result, the models provided by respondents support our conclusion that cryptoassets cannot be reliably valued.

We recognise that professional clients will face the same difficulties as retail consumers in reliably valuing cryptoassets. However, as stated in CP19/22, we think that professional clients and institutional investors may, in general, have greater understanding of the risks and greater capacity to absorb potential investment losses. So we are not extending the prohibition to professional clients.

We recognise that foreign exchange derivatives are difficult for retail consumers to value. But there are a set of objective valuation factors, such as interest rates, trade flows and economic growth, that inform their valuation. These factors do not apply in the same way to cryptoassets.

We have considered the feedback on the data we used to demonstrate that cryptoassets cannot be reliably valued. We then conducted the following additional analysis.

- **Price dislocation across exchanges** – in response to the feedback, we undertook further analysis of other exchanges to assist in our considerations around price dislocation, using data from a set of exchanges that respondents suggested better reflected actual trading values. We undertook additional analysis to examine the spreads across 5 different exchanges from January 2016 to December 2019. We chose these exchanges as they are all verified by the Blockchain Transparency Institute (BTI) which tests the accuracy of data collected from exchanges and monitors instances of wash-trading.

  This additional analysis reinforces our conclusions in CP19/22 that there is a wide dispersion between the spreads at the highest price on a given day. Between January 2016 and November 2019, we

observe similar periods of sustained price dislocation between the sampled exchanges with spreads of over $1,500 across exchanges (see Technical Annex for further detail). The significant differences in prices across exchanges supports our conclusion that cryptoassets cannot be reliably valued.

- **Correlation between cryptoasset prices** – We analysed data from the 5 exchanges listed above over a longer period of time (January 2016 to December 2019). These show a high correlation between cryptoassets over a rolling 30-day period, and that the correlation increases over time (see Technical Annex for further detail).

We do not think the high correlation between equity indices (eg FTSE 100 and the S&P 500) is an appropriate comparison, as it does not explain the correlation between cryptoassets. Equity indices will be highly correlated partly because their rise and fall will be a function of common economic factors, eg interest rates and growth prospects. However, individual shares may diverge because of factors particular to each company, such as demand for their products and their relative competitiveness. As cryptoassets are differentiated by their underlying technology, yet compete in the same market, we would expect, if valuation was based on economic factors, to see a greater level of variation between cryptoasset prices based on how widely they are used.

On the use of Google data to demonstrate that cryptoasset prices are driven by speculative behaviour, we think it is reasonable to conclude that:

- Google trends data are an appropriate proxy for retail investors' interest in bitcoin. A Google search shows consumer engagement which may take the form of background research, price information or looking for an exchange to buy the cryptoasset.
- Retail investor interest, evidenced by Google searches for Bitcoin, is correlated to increases in the price and trading volumes of bitcoin. An 'investment mania' as the Financial Times called it, where price increases and reports of gains encouraged more retail participation.
- Higher prices and higher investor returns for bitcoin generated more media exposure and increased retail interest, which contributed to the price bubble in December 2017. The data shows a rapid rise in searches for bitcoin then a sharp decline once prices began to fall.

Our conclusions, based on the use of google data to show speculative behaviour, are supported by the analysis of professor Frode Kjærland's of the NTNU Business School. He concluded that, 'based on our full and reduced model, past price performance, optimism, and Google search volume all play significant roles in explaining Bitcoin prices.'

We think that, taken together, the Google data and the wider evidence cited in CP19/22 paragraphs 3.15 and 3.16 support our view that cryptoassets prices are driven by speculation, which makes it difficult for consumers to value them reliably.

This is supported by our recently published consumer research that found that 47% of consumers surveyed bought cryptoassets 'as a gamble that could make or lose money,' compared with only 31% in the 2019 consumer research. While 22% of respondents bought cryptoassets due to a fear of missing out. This shows that the majority of retail clients are not investing in cryptoassets for a legitimate investment need.

Risks from financial crime, market abuse and operational issues

2.14 CP19/22 said that that the integrity of and confidence in the cryptoasset market affects retail consumers holding crypto-derivatives because their value is directly affected by any sudden devaluation or price dislocation in underlying token prices.

2.15 We recognised that that the Fifth Anti-Money Laundering Directive ('5AMLD') will help reduce money laundering risks from the anonymity of cryptoassets, but will not mitigate other financial crime risks such as abusive trading or cyber-thefts of unregulated tokens.

2.16 Industry bodies, exchanges and manufacturers of these products questioned our claims around financial crime, arguing that:

- instances of financial crime have reduced over time, which is due partly to improvements in market oversight by cryptoasset exchanges
- trading volumes associated with wash trading (where misleading and artificial activity in the marketplace occurs) are decreasing
- the evidence presented does not support our conclusions that financial crime affects the value of cryptoassets

Our response

We have considered the feedback that financial crime and market abuse is reducing. Reported hacks and thefts have decreased by 66% from 2018 to 2019. However, cryptocurrency user and investor losses due to fraud and misappropriation increased by 533% over the same period according to a report by CipherTrace. Industry commentators suggest that wash trading is increasing in cryptocurrency markets and, irrespective of the actual trend, remains significant. We think that our analysis evidences that financial crime, such as exchanges being hacked, affects cryptoasset prices. For example, the hack of Bitstamp, made public on 3 January 2015, resulted in a 15% decrease in the value of Bitcoin. More recently, in August 2019, the price of bitcoin decreased by 5% following the hack of Binance when around US$40m of bitcoin were stolen. These sudden changes in the price of the underlying tokens will be reflected in related changes in the value of the derivatives that reference them.

Crypto-derivatives do not serve a legitimate investment need

2.17 CP19/22 said that crypto-derivatives do not meet a legitimate investment need and most retail consumers lose money trading them.

2.18 Consultation respondents highlighted potential legitimate uses of crypto-derivatives, including:

- **hedging** – investors who invest directly in underlying cryptoassets use crypto-derivatives to hedge against volatility
- **bypassing custody issues** – crypto-derivatives offer exposure to the underlying without the custody issues associated with third parties. This removes the risk of scams and theft and exchange-traded notes also reduce the counterparty risk by transacting with an authorised firm
- **access to more liquid markets** – derivative markets are often more liquid than underlying cryptoasset markets
- **access to leverage** – CFDs and futures provide retail consumers with leverage that they otherwise would not have in the spot market

2.19 A regulated exchange and an individual respondent also said that crypto-derivative markets play a critical role in the effective price formation process for cryptoasset markets. Banning the retail crypto-derivatives market will undermine this.

2.20 Individual investors said that volatility and the prospects of high returns attract investors, and the prohibition would remove their ability to trade on these markets. This implies that they use crypto-derivatives to speculate on price movements in the hope of achieving a profit.

Our response

We continue to think that crypto-derivatives do not meet a legitimate investment need. We have considered and set out our response below.

- **Hedging** – We recognise that some retail consumers will use crypto-derivatives to hedge their exposure to the underlying cryptoasset market, but this is not common. Feedback from retail investors suggest that crypto-derivatives are primarily used for speculative purposes akin to gambling.
- **Bypassing custody issues** – We recognise that crypto-derivatives allow consumers to avoid the risk exposure of cryptoassets being stolen, or losing their encrypted key, that comes with investing in the underlying cryptoassets. We do not think this benefit outweighs our analysis of harm and the expected benefits to retail consumers from a ban (see our updated CBA). We continue to view unregulated cryptoassets as very risky and discourage consumers from viewing them as 'investments'.
- **Access to more liquid markets** – We recognise that some derivatives markets may be more liquid than underlying spot markets. However, improved liquidity does not address retail consumers' inability to value crypto-derivatives, or reduce the losses we have demonstrated that, on average, they will make trading these products.

- **Access to leverage** – While leverage will sometimes lead to increased profits, it will at other times make losses worse. Our analysis of the impact of leverage on retail consumers in CP18/38 – Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products concludes that lower leverage reduces trading losses. This is further supported by our analysis of client data for crypto-CFDs and crypto-ETNs (see our updated CBA).
- **Price formation** – We recognise that derivatives may play a limited role in the price formation of cryptoassets. This does not change our view that cryptoassets have no intrinsic value and cannot be valued reliably.

The proportionality of a ban

2.21 CP19/22 explained that we do not think that existing regulatory requirements sufficiently address the harms from crypto-derivatives. Having considered other, less restrictive policy measures, eg restricting marketing, we concluded that a prohibition is necessary to address the harm.

2.22 We also considered all of the applicable conditions in Article 42 of MiFIR and Article 21(2) of the Delegated Regulation of MiFIR and determined that the marketing, distribution and sale of crypto-derivatives to retail consumers gives rise to significant investor protection concerns and that the other relevant conditions are met (paragraphs 3.4 to 3.6 in CP19/22).

2.23 We consulted on applying the prohibition to all derivatives (ie CFDs, options and futures) and ETNs that reference unregulated transferable cryptoassets. We thought that all crypto-derivatives were harmful to retail consumers because of retail consumers' inability to value them. We also thought that crypto-ETNs pose similar risks to derivatives, although the risks are reduced because they are typically sold without leverage. We had also seen poor outcomes from the limited number of products currently available on EU trading venues.

Arguments that existing regulation addresses the harm

2.24 Several respondents, including an NCA, trade associations and firms offering crypto-derivatives, said that current regulations provide adequate consumer protections. Current regulations include applicable Markets in Financial Instruments Directive (MiFID) II conduct rules, including product governance and disclosure requirements, as well as the listing rules under the Prospectus Regulation, and the EU Benchmark Regulation (BMR).

2.25 One responding firm commented that the EU Benchmark Regulation is intended to ensure that authorised benchmarks have appropriate methodologies, systems and controls to ensure that they provide reliable prices. They said derivative instruments referencing authorised cryptocurrency benchmarks should not be captured by the proposed ban.

2.26 A trade association and 2 CFD providers argued that we had not considered the impact of 2:1 leverage limits for CFDs referencing cryptoassets, which came into force in August 2018. They argued that our CBA analysis should therefore include a longer timeframe to capture the impact of the leverage limits.

2.27 An NCA, firms that offer crypto-derivatives and an individual respondent said that a prohibition would harm retail consumers by reducing choice. They also argued retail consumers would lose existing regulatory protections by encouraging them to trade crypto-derivatives with third country firms on their own initiative, and trade cryptoassets with unregulated entities.

Our response

We still view the prohibition as proportionate to the harm, and do not think that existing regulatory requirements address our significant investor protection concerns, as set out below.

- **Adequacy of existing protections** – Existing conduct and disclosure regulations are intended to address the risk from regulated products (eg derivatives and transferable securities) rather than harm from the underlying assets that regulated products reference. Many of the rules referred to, such as product governance, appropriateness assessments, and suitability, are intended to improve the distribution of products that are suitable for a sub-set of retail consumers. We do not think that crypto-derivatives are suitable for any retail consumer. We recognise that the Benchmark Regulation (BMR) seeks to improve the quality of market pricing and settlement by ensuring that benchmark methodologies and input data are sufficiently robust to represent accurately and reliably the market that the benchmark seeks to measure. However, this does not address our concerns about the integrity of the underlying cryptoasset market, and does not allow retail consumers to value crypto-derivatives reliably.
- **Impact assessment of 2:1 leverage limits for CFDs** – The timing of our original CBA meant that we were unable to consider the impact of 2:1 leverage limits over a longer period. In response to CP feedback, we have analysed additional client data from January 2019 to September 2019. This allowed us to assess client outcomes over a 13-month period when crypto-CFDs were subject to 2:1 leverage limits. These data show that leverage limits have reduced harm by reducing retail consumer losses, but most retail consumers still lost money trading crypto-CFDs and losses remained significant (see Chapter 3: Cost Benefit Analysis for further detail). We do not think leverage limits will adequately address the harm as they do not address the concerns we have with the underlying cryptoassets and retail consumers' inability to value these derivatives reliably.
- **A ban will drive consumers to unregulated exchanges or third country firms** – We recognise the risk that by banning crypto-derivatives for retail investors, consumers may choose to trade unregulated cryptoassets or look to trade crypto-derivatives with firms in third country jurisdictions. Despite this, we think that a prohibition will protect most consumers and will help inform retail consumers of the risks and harms of trading these products. Lower standards in other jurisdictions are not a reason for us to compromise our own investor protection standards.

In response to feedback on proportionality, we have also reconsidered all the applicable criteria in Article 42 of MiFIR and Article 21(2) of

the Delegated Regulation of MiFIR. We remain of the view that the relevant criteria are met and that the marketing, distribution and sale of all crypto-derivatives to retail consumers creates significant investor protection concerns and that a prohibition is necessary and proportionate. As part of feedback we have examined a range of alternative options and these do not address the harms we have identified.

Arguments that other, less restrictive measures would address the harm

2.28 Some respondents suggested we consider the following alternative, product-specific measures to address the harm:

- limiting leverage to 1:1 for derivatives products
- limiting marketing, and/or their sale and distribution, to high-net worth and self-certified sophisticated investors
- requiring a suitability test and/or requiring consumers to demonstrate they have adequate knowledge and understanding
- requiring enhanced disclosures
- excluding retail consumers who are using these products for hedging
- permitting crypto-derivatives on the 'top 20' cryptoassets

2.29 Some respondents suggested other measures to address the harm:

- requiring firms to hold specific permissions to offer crypto-derivatives
- restricting the firms that can offer crypto-derivatives to 730k firms
- conduct a review of trading fees
- requiring firms to use established and recognised exchanges when pricing derivative contracts
- prohibiting the use of cryptoassets as margin for trading

2.30 One CFD provider said that we should apply other, less restrictive measures first and assess whether those measures address the harm before imposing a ban. They argued this would reduce the costs to retail consumers and maintain the competitiveness of the UK market.

2.31 Firms offering crypto-derivatives to retail consumers said that a prohibition would be significantly more restrictive than the policy approach of other EEA and third country jurisdictions.

2.32 A large number of individual respondents said that we should not proceed with imposing a ban, as they would be forced to assume losses.

2.33 A trade association representing cryptoasset firms said that we should introduce a code of conduct to address our concerns about the underlying market by ensuring they are more transparent and efficient.

2.34 An NCA agreed with our analysis of the key risks and harm posed by these products, and agreed with our proposal to prohibit the sale, marketing and distribution of derivatives and ETNs referencing relevant cryptoassets to retail consumers.

Our response

We have considered whether other, less restrictive measures would address the harm. We do not think they would, for the following reasons:

- **1:1 leverage limits** – Similar to the impact of applying 2:1 leverage limits to CFDs that reference cryptoassets, we expect that retail consumers would lose less money if they were unable to trade with leverage. However, most retail consumers would probably still make losses. Our updated CBA (see Chapter 3: Cost Benefit Analysis) shows that the majority of retail consumers lost money trading crypto-ETNs, which are not leveraged, during a representative data period outside the cryptoasset bubble.
- **Restricting crypto-derivatives to high-net worth and self-certified sophisticated investors** – Client data suggest that wealthier consumers are more likely to experience higher losses and higher profits from trading. We do not have any evidence to suggest that wealthier retail consumers are more capable of valuing these crypto-derivatives. We recognise that these consumers are more capable of absorbing losses, but do not think this alters our assessment of the drivers of harm we have identified, or justifies applying less restrictive measures for these consumers. We do not consider crypto-derivatives to be suitable for any retail consumers. Firms that offer crypto-ETNs also indicated that it would be costly to restrict these products to a sub-set of wealthier consumers.
- **Applying a suitability test and/or requiring consumers to demonstrate knowledge and understanding** – Our analysis concludes that cryptoassets cannot be reliably valued so we do not think that retail consumers would be able to demonstrate adequate knowledge and understanding of crypto-derivatives.
- **Enhanced disclosure requirements** – This would potentially improve retail consumers' understanding of the product risks. But disclosure would not alter the lack of intrinsic value and would not improve retail consumers' ability to value them reliably.
- **Permit crypto-derivatives for hedging** – We believe that only a small minority of retail consumers use crypto derivatives for legitimate hedging purposes. While we acknowledge that these clients could benefit from a hedging exemption if consumers use it to hedge effectively, we think that overall this will still lead to net harm. It is also difficult for firms to implement and for us to supervise.
- **Permit crypto-derivatives on the top 20 cryptoassets** – We do not think this is appropriate as the 'top 20' cryptoassets pose the same harms to retail consumers and we have not seen evidence that these cryptoassets can be valued more reliably than any other unregulated cryptoassets.

We have also considered whether applying measures to firms offering cryptoassets to retail consumers would address the harm. We think that the harms from crypto-derivatives are due to the risks of the underlying assets rather than the way that these products are offered. So, we do not think it is effective or more proportionate to apply firm-specific measures.

We recognise that our prohibition is more restrictive than other EEA and most third country jurisdictions at the current time. But our analysis demonstrates that crypto-derivatives are harmful to retail consumers and the prohibition meets the relevant product intervention criteria (Article 42 of MiFIR). We consider it appropriate and proportionate to prohibit crypto-derivatives to protect retail consumers.

We welcome market-based initiatives to improve the transparency, efficiency and effectiveness of the underlying cryptoasset markets. In compliance with Article 42(6) of MiFIR, we will keep the prohibition under review in light of any evidence of significant market improvements that appropriately mitigate the drivers of the harms we have identified.

Some firms suggested that we prohibit firms from accepting cryptoassets as collateral for margin when trading CFDs. We remind firms that only cash can be accepted as margin for CFD trading involving retail consumers (per COBS 22.5.10R).

Less restrictive measures would not address our significant concerns about investor protection. So we remain of the view that a retail prohibition is necessary to address the harms.

We have considered potential costs to consumers with existing positions. As indicated in CP19/22, retail consumers with existing holdings can remain invested following the ban, until they choose to disinvest. We do not require or expect firms to close out consumers' positions unless consumers ask for this.

Relative harm of crypto-ETNs

2.35 Firms that distribute exchange-traded products argued that ETNs should not be prohibited because they benefit from protections that derivatives do not. ETNs are listed and traded on a regulated exchange, for example, and require a prospectus. They are not leveraged, and typically charge lower trading fees compared with CFDs. As such, some respondents argued that these products have lower risks and they should be subject to less restrictive measures. These respondents suggested this was supported by our CBA, which showed most retail consumers profiting from crypto-ETNs over the period we examined, while consumers suffered losses from crypto-CFDs and crypto-futures. They also suggested that we consider a longer data period (before June 2017) as this would show retail consumers experiencing even higher profits from trading crypto-ETNs.

Our response

In response to feedback, we have considered whether to exclude crypto-ETNs from our prohibition or to apply less restrictive measures to them. To do so, we considered whether the features of these products reduced the risk of consumer harm compared with crypto-CFDs, options and futures (see table below).

Table 1: Comparison of crypto-ETNs, CFDs, futures and options

Product	ETNs	CFDs	Futures	Options
Provides exposure to cryptoassets	√	√	√	√
Leveraged	X	√	√	X
Limit losses to their initial investment	√	X Losses are limited to cash in the client's trading account	X	√
Subject to MiFID-derived conduct rules	√	√	√	√
Subject to an appropriateness assessment	X	√	√	√
Sold with a prospectus that complies with the Prospectus Directive	√	X	X	X
Traded on a trading venue	√	X Most commonly traded over-the-counter (OTC)	√ Some crypto-futures are traded OTC	√ Not currently offered in the UK, but can be traded on trading venues or OTC

We recognise that derivatives and ETNs have different features and that crypto-ETNs do not share all of the riskier features of derivatives. For example, they are not leveraged products. We also recognise that crypto-ETNs have to meet some additional regulatory requirements because of the way that they are structured. Specifically:

- ETNs are sold with a prospectus in compliance with the Prospectus Directive. This will potentially help retail consumers understand how the product is structured and appreciate the risks associated with crypto-ETNs. But this will not allow retail consumers to value crypto-ETNs reliably.
- ETNs are always traded on a traded venue. It is argued that exchange-traded products generally receive better prices when compared with OTC derivatives. However, retail consumers are still unable reliably to predict potential price impacts caused by issues in the underlying cryptoasset markets. As a result, these consumers cannot value them or the ETN reliably.
- ETNs are not leveraged. As discussed above, the lack of leverage is likely to reduce consumer losses but will not address the harm from retail consumers' inability to value crypto-derivatives.

Despite the differences between crypto-ETNs and crypto-derivatives, we think that these products have the same key risk features in common. As crypto-ETNs' value is derived from cryptoassets that

cannot be reliably valued, they expose retail consumers to the same harms. This is evidenced by the additional analysis of client data that we conducted since CP19/22. Our data show that a majority of retail consumers trading crypto-ETNs lose money, which is similar to outcomes from trading crypto-CFDs and futures (see Chapter 3: Cost benefit analysis). We conclude that crypto-derivatives and crypto-ETNs should be subject to the prohibition due to our significant concerns about investor protection.

Arguments that a prohibition is contrary to our policy objectives

2.36 An NCA, a trade body, a trading venue and a manufacturer of these products said that a prohibition was contrary to our policy objectives, including:

- consumers having responsibility for their own investment decisions
- our approach to other, highly volatile derivative products, eg EU carbon credits
- our wider objective to promote innovation and entrepreneurship as part of our competition objective

Our response

We believe that a prohibition is consistent with our wider policy objectives for the following reasons.

- **The general principle that consumers should take responsibility for their decisions** – We are prohibiting crypto-derivatives because we believe that the information asymmetries retail consumers face when choosing whether to invest are too great. We have concluded that retail consumers cannot value these products reliably, meaning they are not able to make informed investment decisions.
- **Promoting effective competition** – Our policy proposal seeks to ensure that UK firms compete in the interests of consumers. This is as opposed to lowering conduct standards and/or offering products or services to retail consumers for whom they are inappropriate, and who may suffer harm as a result. We have considered the competition impacts of the prohibition and whether alternative measures would address the harms and provide appropriate protections for consumers. We have not identified any alternative approaches which better promote competition while addressing the significant investor harms identified.
- **Promoting innovation in support of our competition objective** – We support innovation that is in the interests of consumers. We do not believe that crypto-derivatives sold to retail consumers meet this test, as our analysis indicates that these products are harmful to retail consumers. We continue to welcome innovation that supports competition, improves the effective functioning of markets and is in the interests of consumers, including through the FCA Sandbox. This includes innovation based on distributed ledger technology, or using cryptoassets to benefit markets and consumers, for example, increasing efficiency of existing processes like cross-border money remittance. We note the following:

- A third of all tests in the sandbox are based on distributed ledger technology, and many of these tests have involved the use of cryptoassets. We will continue to support sandbox tests involving cryptoassets where the proposition is truly innovative, provides a genuine consumer benefit, is within scope of the sandbox, there's a need to test and the firm is ready.
- Firms testing cryptoasset-based propositions in the sandbox have benefited from FCA support in developing and testing compliant products. These tests have also helped us learn more about market developments and to ensure our approach supports legitimate innovation.

Keeping a prohibition under review

2.37 A large number of respondents said that our prohibition should be kept under review.

Our response

We agree that our prohibition should be kept under review. This is in line with Article 42(6) of MiFIR. We will reconsider our position if there is robust evidence that the cryptoasset market is sufficiently changing to address the drivers of the harms we have identified.

Scope of products caught

2.38 In CP19/22 we proposed prohibiting the sale, marketing and distribution to retail consumers of all derivatives (ie CFDs, options and futures) and exchange traded notes referencing unregulated transferable cryptoassets.

2.39 Our proposed definition of unregulated transferable cryptoassets was intended to capture derivatives referencing cryptoassets that we called transferable exchange and utility tokens in CP19/3: Guidance on Cryptoassets.

2.40 We also explained that we did not intend to capture:

- security tokens – because these tokens already qualify as specified investments and do not pose the same risks as exchange and comparable utility tokens since they will have a basis for valuation according to the legal rights or promise of payment they will provide
- tokens that are not widely transferable (eg tokens used on a private network that can only be redeemed with the issuer)
- e-money tokens

2.41 A law firm and an association representing law firms said that our proposed rules would capture products that we did not intend to capture. The law firm said our rules would prohibit derivatives referencing commodities, such as gold, where ownership of the underlying commodity was recorded on the blockchain and that this was inconsistent with our policy objectives.

2.42 These same respondents said that we should define the scope of our crypto-derivatives ban by specifying the key features of cryptoassets that we think should be within scope. For example, we should consider using the definition of virtual currencies used in the Fifth Anti Money Laundering Directive (5AMLD).

Our response

We recognise that the definition of unregulated transferable cryptoassets that we proposed could have captured crypto-derivatives we did not intend to be subject to our rules. These are:

- commodities where ownership is recorded on the blockchain (crypto-commodities)
- currencies issued or guaranteed by a central bank or public authority, commonly known as central bank digital currencies (CBDCs)

We agree that derivatives referencing crypto-commodities and CBDCs should not be subject to our prohibition because they do not pose the same harms. For example, a crypto-commodity could be reliably valued as it represents ownership of a commodity that is used as a raw material for an industrial process, is a commercial good or is a recognised store of value. To our knowledge, these products are not available today. However, capturing these products would unnecessarily undermine innovation and competition in financial markets by discouraging firms from applying new technology to existing financial products and services.

In response to feedback, we are amending the definition of unregulated transferable cryptoassets that are within scope of the prohibition to exclude crypto-commodities and CBDCs.

We do not think that there are any other cryptoassets that should be excluded from our prohibition for derivatives or ETNs referencing them. But, we will consider amending the scope of our prohibition if products become available that do not pose the same harms.

We will consider amending the scope of the prohibition if we find new products that are not within the current scope cause similar harms to crypto-derivatives and ETNs referencing cryptoassets.

3 Changes to Final Rules

3.1 We are making amendments to final rules that were made (but did not come into effect) by the Board in July 2020 without consultation. This is because the publication of the policy statement was delayed following the approval by the Board. These amendments change the:

- final rules to deal with deficiencies arising from EU exit; and
- coming into force date of final rules.

3.2 We are publishing both the original instrument (FCA 2020/34) and amending instrument (FCA 2020/46) on the FCA Handbook website.

Dealing with deficiencies arising from EU Exit

3.3 We said in CP19/22[1] that when the UK leaves the EU the rules we were consulting on would continue to apply to the same firms after exit as were covered by the rules before exit. The changes described below ensure that our rules will apply to the firms the rules would have applied to, had the rules come into force before 31 December 2020. They also deal with deficiencies in the rules arising from the UK's withdrawal from the European Union.

Territorial Scope

3.4 The rules will not apply to EEA firms unless they have temporary permission, are in the financial services contracts regime as a supervised run-off firm, are a contractual run-off firm, or they have a Part 4A permission.

3.5 As a result of the changes, EEA firms operating outside the temporary regimes will be treated in the same way as third country firms. This is due to changes being made to the glossary terms used in the application provisions. The rules will apply to temporary permission firms, supervised run-off firms and contractual run-off firms.

Passporting

3.6 We have also made some consequential changes to reflect the assumption that UK firms will lose passporting rights after exit day.

3.7 We are also deleting COBS 22.6.1R(2) and COBS 22.6.2 G., These rules contain a carve-out which provides that where another Member State has adopted more stringent rules covering the same products, then firms must comply with those instead.

3.8 The reason for this deletion is that the rules and guidance are premised on the assumption that UK firms can sell crypto-derivatives to consumers in other EEA states under a passport. If we assume no passporting in future (in line with the HMT baseline),

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then the carve-out becomes redundant. Hence, the deletion is consistent with the HMT baseline.

Changes to the Coming into Force Date

3.9 We are also amending the coming into force date of the instrument that was approved by the FCA Board in July 2020. This is because the publication of the PS was delayed. As we want to provide the industry with time to prepare for the new rules, we have amended the coming into force date to 6 January 2021.

4 Cost benefit analysis

4.1 In CP19/22, we conducted a CBA to assess the proportionality of our proposed intervention and its likely effects on retail consumers and market participants.

4.2 As mentioned in the CP, we are relying on our powers under Article 42 MiFIR as well as our rule-making powers under the Financial Services and Markets Act 2000 (FSMA) to make these rules. We set out our CBA in the CP to fulfil the requirements of FSMA and to assess the proportionality of the proposed prohibition in line with MiFIR. Specifically, section 138I of FSMA requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. MiFIR does not specifically require a CBA, however, we are required under Article 42(2)(c) of MiFIR to consider the proportionality of our proposed intervention including its likely effects on investors and market participants. We undertook a CBA for that purpose as well.

Benefits to consumers

4.3 In CP19/22 we considered the prohibition would likely benefit most retail consumers investing in derivatives and ETN products referencing cryptoassets.

4.4 We estimated expected benefits to retail consumers based on data requested from seven firms that make up a large proportion of the CFD, futures and ETN market in the UK during the collection period.

4.5 The data collection period covered a 19-month period from June 2017 to December 2018. This period captures important stages in the price evolution of cryptoassets (including periods of price increases and decreases as well as periods of relatively low volatility). When requesting data from firms we asked them to provide data for all products referencing cryptoassets that they offered to retail consumers.

4.6 Using this methodology, we concluded that our proposals would benefit most consumers by protecting them from future losses. We estimated potential benefits to be in a range from £75m to £234.3m annually (Table 2). This figure is obtained by using fees paid by retail consumers as a lower bound and total losses experienced by retail consumers (including fees) as an upper bound. We use this value to avoid short-term periods of (high) net profits and a small number of large profitable retail ETN clients distorting the performance of an average consumer. We do not consider a positive outcome over time is likely to be sustained and have found net losses to be £53.3m for all clients in the updated CBA (Table 3).

4.7 We recognised that some retail consumers made a profit over the period. However, we consider the significant variance in retail consumer outcomes to be consistent with our policy analysis. That is, the value of these products in the short run is highly unpredictable and prone to extreme volatility due to the nature of the underlying assets. While we cannot forecast future prices in this market, it is reasonable to base our proposals on a central scenario in which a bubble of the magnitude of the one experienced in 2017-18 is not repeated.

Table 2: CBA in CP19/22

Product	Net outcomes from trading* (Jun 2017-Dec 2018)	Total Losses from trading* Jun 2017-Dec 2018)	Total Losses from trading (per annum)*	Fees (per annum)
CFDs	(£55m)	(£245m)	(£155m)	(£68.5m)
Futures	(£36.5m)	(£87.3m)	(£55.1m)	(£2.3m)
ETNs	£117m	(£38.3m)	(£24.2m)	(£5.7m)
Total	**£25.5m**	**(£370.6m)**	**(£234.3m)**	**(£75m)**

*All figures are inclusive of fees

ETNs

4.8 Based on client data from June 2017 to December 2018, we estimated the total benefits of prohibiting crypto-ETNs to retail consumers to be in the range of £5.7m to £24.2m annually. We do however, recognise that some retail consumers made a profit over the period. We explained this in more detail in the CBA in CP19/22.

4.9 We also observed that the net aggregate outcome from trading crypto-ETNs by retail consumers was a profit of £117m (across all four crypto-ETNs offered). We concluded that client outcomes over this period were not a reliable indicator of likely future returns because:

- The period November 2017 to February 2018, a subset of the original data request used in the CBA, accounted for £116m (out of £141m profits). This suggests that that the large profits were the result of a large number of early buy-and-hold investors in the Bitcoin ETN, and a small number of clients investing very large amounts in the run up to the bubble.
- In the second half of 2018 most retail consumers made a loss. Between March 2018 to December 2018, we observed client outcomes from trading were an aggregate loss of £16.8m.

4.10 A provider of cryptoasset investment products questioned the validity of the CBA in relation to crypto-ETNs because:

- The CBA showed that retail consumers made profits from trading crypto-ETNs.
- The timeframe we used (June 2017 to December 2018) was not representative of expected client outcomes. They said we should have assessed retail consumer benefits based on client data over the entire period that the crypto-ETN was available and that this longer data period would have shown that retail consumers made more profits from trading crypto-ETNs.

Our response

In response to feedback on our assessment of benefits in relation to crypto-ETNs we collected additional client data for the same instruments from firms that provided data for the original CBA. These additional data covered the period from June 2015 – when the crypto-ETN was made available – to April 2019 – the latest month that we could have reasonably requested data from firms before publishing CP19/22 in July 2019. One firm was unable to provide data prior to January 2016.

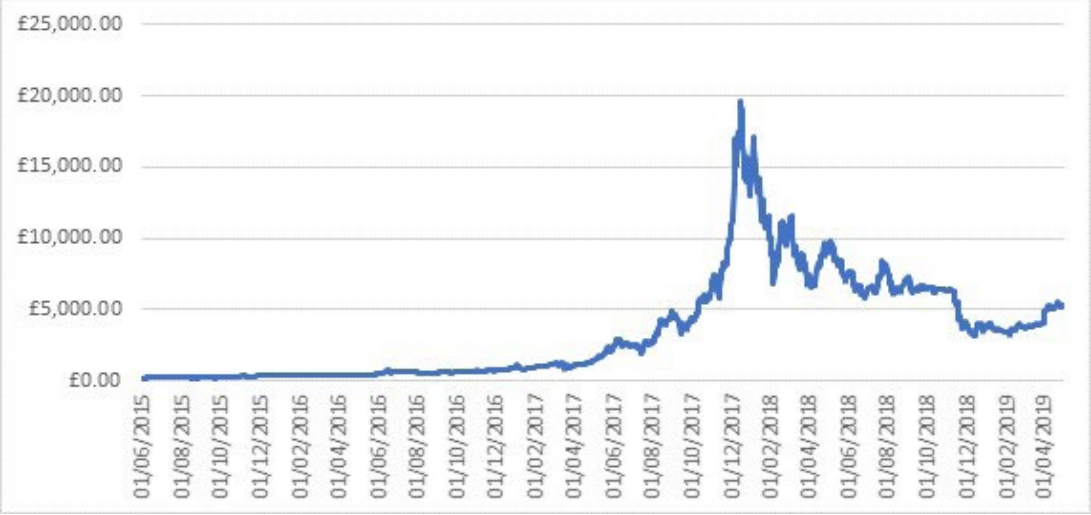
Client outcomes from trading crypto-ETNs between **June 2015** and **April 2019** are as follows:

- 60% of retail consumer accounts made a profit and median outcomes were positive.
- The net aggregate outcome from trading was a profit of £122.5m. This compares with a profit of £117m over the period covered in CP19/22.
- Profits were highly concentrated as the top 1% of retail consumer accounts (256 retail consumers) made £111m in profits or 71% of the £143m in total profits from profit-making accounts. Profits were also concentrated over the period analysed in CP19/22.
- Loss-making retail consumer accounts made a loss of £20.5m, which is less than retail consumer losses in the period covered by CP19/22 (£38.3m).

Client outcomes over the longer data period are not significantly different from client outcomes over the period covered in our assessment of client outcomes in CP19/22.

We still think that client outcomes between June 2015 to the peak of the bubble in December 2017, when prices rose by 8,700% (see Figure 1 below) are unlikely to be repeated. It is reasonable to base our proposals on a scenario which avoids the bubble seen in 2017.

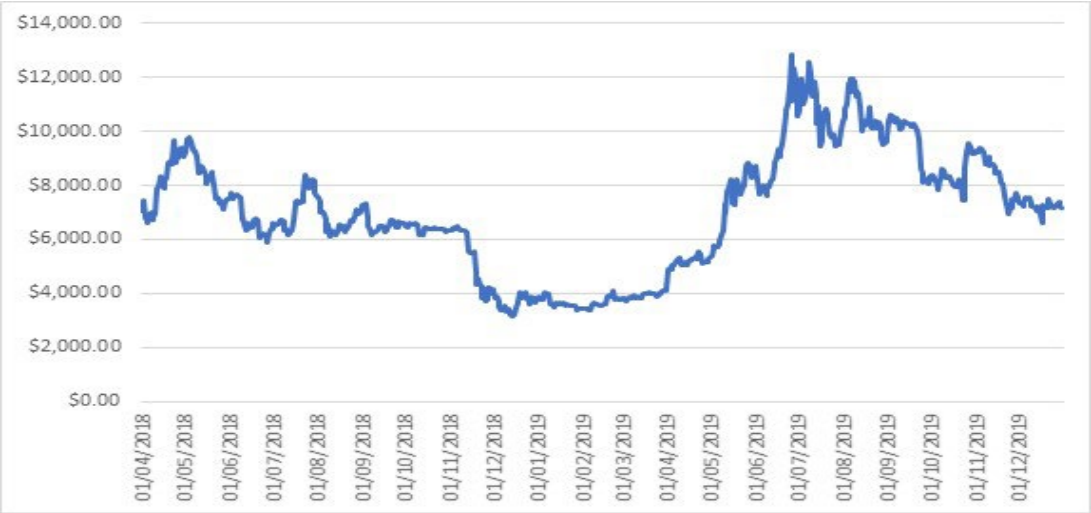
Figure 1: Bitcoin prices between June 2015 and April 2019



We also tested our conclusion that retail consumer outcomes over the data period in the original CBA (June 2017 to December 2018) were not a reliable indicator of future returns.

We analysed client outcomes from trading using client data from 1 April 2018 to 31 December 2019. We chose this period because it does not cover the period where we see large increases and decreases in the price of cryptoassets which could distort outcomes. We think this period reflects market conditions that are less affected by extreme volatility (see Figure 2 below and Technical Annex), and therefore better estimates the expected benefits from a prohibition. We have used this data to calculate our revised CBA for ETNs.

Figure 2: Bitcoin prices between 1 April 2018 and 31 December 2019



Client outcomes from trading crypto-ETNs between April 2018 and December 2019 were as follows:

- 57% of retail consumer accounts made a loss and median outcomes were negative
- aggregate outcomes from trading was a loss of £2.7m
- total losses from loss-making retail consumer accounts was £14.3m.

These data support our view that retail consumers are unlikely to experience sustained profits from trading outside the historical cryptoasset bubble (Q3 and Q4 2017). This analysis, we believe, supports that retail consumers cannot value cryptoassets reliably because the majority of retail consumers lost money despite the significant increases in the price of the underlying assets.

Table 3: Clients outcomes from trading ETNs across three data periods

	June 2017 to December 2018 (Original CBA)	June 2015 to April 2019	April 2018 to December 2019 (Updated CBA)
Loss-making client accounts	41%*	40%	57%
Net outcomes from trading	£117m	£122m	(£2.7m)
Gross Profits[1]	£141m	£143m	£11.6m
Gross Losses[2]	(£24m)	(£21m)	(£14.3m)

* This figure is based on a different methodology to the percentage of loss-making client accounts over other period (ie it is calculated on an instrument-by-instrument basis), but we think it reasonably estimates the percentage of profitable client accounts. Due to rounding, numbers presented may not add up precisely to the totals indicated.

1,2 Gross Profits and Gross Losses are the sum of all the profits and losses made by profit-making and loss -making clients. This is not calculated on an annualised basis in contrast to Table 3.

All 3 data sets show that a significant amount of retail clients lost money and that for the updated CBA a majority (57%) of clients lost money, with a net loss of £2.7m.

CFDs

4.11 Based on client data from June 2017 to December 2018, we estimated the total benefits of prohibiting crypto-CFDs to retail consumers to be in the range of £68.5m and £155m annually. We also observed that net aggregate client outcomes from trading crypto-CFDs was a loss of £55m.

4.12 A range of respondents including CFD providers, retail consumers and trade associations argued that we had not fully considered the impact of 2:1 leverage on cryptoasset CFDs.

Our response

For crypto-CFDs, we collected additional client data covering the period between August 2018 and September 2019. This provided 14 months of data to assess the impact of 2:1 leverage limits on client outcomes when trading crypto-CFDs.

These additional crypto-CFD data show that:

- annualised net aggregate losses were £37.2m per annum compared to £155m in the original CBA
- fees were lower, with retail consumers incurring fees of £13.9m compared with £68.5m

The reduction in client losses is explained by:

- the impact of 2:1 leverage limits and fewer consumers trading crypto-CFDs after the bubble, which resulted in lower trading volumes
- CFD providers lowered their fees after the bubble

This is unsurprising and we would expect the intervention to have this effect.

The additional analysis shows that although ESMA's product intervention imposing 2:1 leverage limits reduced harm, we still see harm from crypto-CFDs traded at lower leverage levels. The crypto-ETN data (as these products are unleveraged) also suggest that reducing leverage further (eg to 1:1) would not sufficiently address the harm as the majority of retail consumers would still make losses, as seen by the updated CBA. So, we think that prohibiting crypto-CFDs remains appropriate and proportionate.

Futures

4.13 Based on client data from June 2017 to December 2018, we estimated the total benefits of prohibiting crypto-futures to retail consumers to be in the range of £2.3 and £55.1m annually. We also observed that client outcomes from trading crypto-CFDs was a loss of £36.5m.

4.14 We did not receive feedback on our assessment of benefits in relation to crypto-futures.

Costs to firms

4.15 In CP19/22, we said that firms would not incur any ongoing costs from implementing our proposals and will face minimal costs from withdrawing products from retail consumers and ceasing marketing activities to retail consumers. This also leads to minimal familiarisation costs for firms. Our proposal would, however, lead to a loss of revenue for UK firms from fees and charges of around £75m per annum across all products.

4.16 One cryptoasset firm stated that we had not considered the loss of revenues from future product offerings. The same respondent and an individual respondent said that our proposed prohibition would reduce the attractiveness of the UK to cryptoasset firms and that this would result in a loss of tax revenue for the UK Government.

Our response

We do not have any evidence to suggest that firms will soon significantly expand their crypto-derivative offerings. As indicated in our assessment of consumer benefits (see above), consumer demand for crypto-derivatives has declined significantly. Furthermore, any loss of revenue for firms will form an equal and offsetting part of the benefits to retail consumers.

Again, we have no evidence that business will expand their offerings which would increase profits and tax revenues. In response to feedback regarding the loss of tax revenue for the UK Government, loss of tax revenue is already accounted for in the CBA through the loss of revenue to firms and consumers for those that experienced profits (as tax is transferred from their profit to the government).

Based on our additional analysis of client outcomes we have lowered our estimates of costs to firms because revenues from fees and charges have decreased after demand for crypto-derivatives fell following the cryptoasset bubble and the introduction of 2:1 leverage limits for crypto-CFDs. Based on our revised estimate, our prohibition will cost firms around £19m through lost revenue.

Updated cost benefit analysis

4.17 The tables below display our revised CBA based upon additional client data (as explained above). Our methodology for calculating the costs and benefits of a prohibition remains unchanged.

4.18 We remain of the view that our proposals will ultimately benefit the majority of consumers by protecting them from future losses.

4.19 We estimate that expected range of benefits to be between £19 and £101m on an annualised basis. The lower range benefit of £19m represents the annualised figure of retail consumer losses from fees incurred from trading across the three product types. The estimated upper range benefit of £101m represents the annualised total losses

experienced by retail consumers for all products. We estimate that the annualised net benefits to consumers will be towards the middle of this range at £53m.

4.20 We remain of the view that we do not expect firms to incur any ongoing costs from implementing our proposals, and will face minimal costs from withdrawing products from retail consumers and ceasing marketing activities to retail consumers.

4.21 We do not consider the costs and benefits of the prohibition for crypto-options, even though they are in scope of the prohibition, because these products are not currently available in the UK.

Table 3: Revised CBA following additional client data

Product	Net Aggregate Outcomes from trading*	Total Losses*	Fees*
CFDs	(£18.1m)	(£37.2m)	(£13m)
Futures	(£33.7m)	(£55.1m)	(£2.3m)
ETNs	(£1.5m)	(£8.2m)	(£3.7m)
Total	**(£53.3m)**	**(£100.5m)**	**(£19m)**

* All figures are calculated on an annualised basis. Aggregate outcomes from trading and total losses are inclusive of fees.

Annex 1
List of non-confidential respondents

Abidemi Oludipe

Achim Reimers

Adam Cleary

Adam Trojanowski

Adrian Bomd

Afeez Ajagbe

Afikile Manyamalala

AJRCoin

Alex Howard

Alexander Abed

Alexander Green

Alexander Patrick Harrod

Alison Agley

Alistair Milne

Amir

AmTrust

Anders Haglund

Andrea Dalla Val

Angus Campbell

Anna Kogan Nasser

Ant

Anton Agoshkov

Archie Archer

Arthur Clarke

Augusta Nyatedzu

Aymeric Bruneau

BCB Payments Limited

Ben Austin

Ben McFeeters

Benjamin Berry

Benjamin Whitby

Billy Munroe

Bob Noyen

Börse Stuttgart

Catherine Sarah Green

CEX.IO LTD

CF Benchmarks

Charles Stanley & Co

Chris Cable

Chris Dowling

Christina Costaridi Crosby

Christopher Bendiksen

Christopher Pia

Credify

Crypto Composite Ltd

Daniel Masters

David Frantz

David Hillier

David Parkinson

David Rushton

David Tiessen

Declan Mac Guinness

Diego Zunino

Drin Gjerqeku

Elisabeth Prefontaine

Elizabeth Newton

Elizabeth Tomlin

Eric Jansen

Esme Palas

Ethan Winigrad

Eversheds Sutherland LLP

Fadi Aboualfa

feanyichukwu fidelis Ekeokwu

Fintan Knight

Fitch Carrere

Francis Lea

Francis Lea

Franck Sidon

Frederick Stone

Fumihiko Matsumura

Gareth William Peters

Garry Morrill

Gary Christie

Gary Williams

Gavin Burgess

George Henderson

Graeme Moore

Hassan Bassiri

Henrik Åberg

Honour Masters

Howard Atkinson

Huckelberry Finnlan Yuill

Intercontinental Exchange Inc./ Bakkt Holdings LLC

ION Energy Group

Jack Jones

Jakob Elijah Levison

James Bennett

James Bonner

James Harris

James Ladbrook

Jamie Moy

Jan Kotze

Jared Hrabovsky

Jason Steele

Jason Whitten

Jay Dacey

Jay Rayatt

Jeffrey DiMarco

Jens Andersen

Jeremy Swan

Jesper Forsberg

Jill Goodman

John Abrams

John Christovich

John Moylan

John Schlesinger

Jon Pemberton

Jos Evans

Jose Antonio Bravo Mateu

Juho Ikäheimo

Julie Landrum

Karl Turner

Kelsey Friesen

Ken Barrow

Ken Coughlan

Kenneth Omoya

Kevin Anderson

Kevin Ballard

Kevin Dalby

Koen Schamp

Kristin Morris

Lander Rubio

Laurent Kssis

Lee Kinloch

Louis John Damian Curran

Louis Tsu

Lucas Auriemo

Luis Miguel Moreira

Luke Ashton

Luke Seaman

Lyle Pratt

Manbyt Escamera

Marc Squire

Marcel Burger

Marisa McKnight

Mark McAllister

Mark Spratt

Mark Sugden

Martin Cooper

Martin Lang

Martin-Zack Mekkaoui

Matthew Dziedzom Dyer

Matthew Lisle

Max Lensvelt

Max Tannahill

Michael Anthony Church

Michael Chatterton

Michael R Wolf

Michael Stennicke

Michael Tucker

Michael Wolf

Mihir Bipinbhai Patel

Mike Burton

Miningstore.com

Nicholas Anderson

Nicholas Gonzales

Nick Metzidakis

Nigel Timperley

Oleg Giberstein

Owen Jones

Pål Fosland

Patrik Faerber

Patrik Johansson

Paul Brian Baker

Paul Charles Mark Francis

Paul Chervinsky

Paul King

Paul Michael Cotton

Paul Wells

Pavel Mikhaylov

Per Lind

Pernilla Andersson

Peter Clark

Peter Clive Haslam

Peter Longworth

Phil Baker

Philip Davey

Philip Greenwood

Philip Singh

Piotr

Polat Erad

Price Braswell Smith

Rapahel Shmertz

Reeves Tirao

Regina Dundelova

Richard Reich

Richard Stacey

Robbie Andrews

Robert Davies

Robert Lee David Morris

Rory Bell

Ross Anderson

Russell Newton

Sam Alexander Laughton-Scott

Samauel Kincaid

Sanath de Mel

Sean Gerald

Sebastian Kraft

Shaun

Shaun Conway

Simon Denham

Simon Johns

Softrack

Spencer James Bullard

Stephen Clement

Steve Orobec

Steven Whitton

Stewart Massey

SupraFin

Susan Furnell

Suzanne Howe

Svein Ølnes

Tarbunde Federick

Thomas Anderson

Tim Stannard

Tim Stannard

Token360 Ltd

Tom Slatter

Tommy Erlandsson

Trent Klarenbach

Venkat Muddana

Vimba.co

Wayne Lloyd

Wes Hansen

Wilfred Michael

William Fisher

Yi Lin

Yoann Franck Turpin

Yusuf Moshood Ayngbade

Annex 2
Abbreviations used in this paper

5AMLD	Fifth Anti Money Launder Directive
BIS	The Bank for International Settlements
BMR	EU Benchmark Regulation
CATF	Cryptoassets Task Force
CBDC	Central bank digital currencies
CBA	Cost benefit analysis
CRD	Capital Requirements Directive
CFD	Contract for difference
CP	Consultation Paper
EU	European Union
ETF	Exchange Traded Fund
ETN	Exchange Traded Note
FSMA	Financial Services Markets Act 2000
FTSE 100	The Financial Times Stock Exchange 100 Index
ICE	Intercontinental Exchange
MiFID II	Markets in Financial Instruments Directive II
MiFIR	Markets in Financial Instruments Regulation
NCA	National Competent Authority
OTC	Over-the-counter
PS	Policy Statement
S&P 500	Standard & Poors 500 Index
US SEC	United States Securities and Exchange Commission

Appendix 1
Made rules (legal instrument)

CONDUCT OF BUSINESS (CRYPTOASSET PRODUCTS) INSTRUMENT 2020

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137D (FCA general rules: product intervention);
(3) section 137R (Financial promotion rules);
(4) section 137T (General supplementary powers); and
(5) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

C. The Financial Conduct Authority also makes the prohibitions contained within this instrument in the exercise of the power under article 42 (product intervention by competent authorities) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

Commencement

D. This instrument comes into force on 28 October 2020.

Amendments to the Handbook

E. The Glossary of definitions is amended in accordance with Annex A to this instrument.

F. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

G. This instrument may be cited as the Conduct of Business (Cryptoasset Products) Instrument 2020.

By order of the Board
23 July 2020

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions into the appropriate alphabetical positions. The text is not underlined.

cryptoasset derivative	a *derivative* where the underlying is, or includes, an *unregulated transferable cryptoasset* or an index or *derivative* relating to an *unregulated transferable cryptoasset*.
cryptoasset exchange traded note	a *debt security*: (a) which is traded on a *trading venue* or a market operated by a *ROIE*; (b) which features no periodic coupon payments; and (c) whose return tracks the performance of an *unregulated transferable cryptoasset*, minus applicable fees, whether featuring delta 1, inverse or leveraged exposure or other exposure to the *unregulated transferable cryptoasset* being tracked.
unregulated transferable cryptoasset	a cryptographically secured digital representation of value or contractual rights that uses distributed ledger technology and which: (a) is capable of being traded on or transferred through a platform or other forum; (b) is not limited to being transferred to its issuer in exchange for a good or service, or to an operator of a network that facilitates its exchange for a good or service; (c) is not *electronic money*; (d) is not a *specified investment*; (e) is not a representation of ownership or other property right in a *commodity*; and (f) is not *money* issued by a central bank.

Amend the following definition as shown.

commodity	…

(2) (for the purpose of calculating *position risk requirements* and for the purposes of *COBS* 22.5) any of the following (but excluding gold):

…

…

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

4 Communicating with clients, including financial promotions

…

4.7 Direct offer financial promotions

…

4.7.6A G …

4.7.6B G *Firms* are reminded of the prohibitions in relation to the marketing, distribution and sale of *cryptoasset derivatives* and *cryptoasset exchange traded notes* in *COBS* 22.6.

…

22 Restrictions on the distribution of certain complex investment products

…

22.5 Restrictions on the retail marketing, distribution and sale of contracts for differences and similar speculative investments

…

22.5.5 R The *rules* in this section do not apply to: ~~*derivative* instruments for the transfer of credit risk to which article 85(3) of the *Regulated Activities Order* applies.~~

(1) *derivative* instruments for the transfer of credit risk to which article 85(3) of the *Regulated Activities Order* applies; or

(2) *cryptoasset derivatives*.

22.5.5A G *Firms* are reminded of the prohibitions in relation to the marketing, distribution and sale of *cryptoasset derivatives* in *COBS* 22.6.

…

22.5.11 R A *firm* must require a *retail client* to post *margin* to open a position of at least the following amounts:

…

(3) 10% of the value of the exposure that the trade provides when the underlying asset is a *minor stock market index* or a *commodity* other than gold; or

(4) ~~50% of the value of the exposure that the trade provides when the underlying asset is a cryptocurrency; or~~ [deleted]

…

Insert the following new section, COBS 22.6, after COBS 22.5 (Restrictions on the retail marketing, distribution and sale of contracts for differences and similar speculative investments). The text is not underlined.

22.6 Prohibition on the retail marketing, distribution and sale of cryptoasset derivatives and cryptoasset exchange traded notes

Application

22.6.1 R (1) Subject to (2), this section applies to:

(a) *MiFID investment firms*, with the exception of *collective portfolio management investment firms*;

(b) *branches* of *third country investment firms*; and

(c) *MiFID optional exemption firms*,

in relation to the marketing, distribution or sale of *cryptoasset derivatives* and *cryptoasset exchange traded notes* in or from the *United Kingdom* to a *retail client*.

(2) This section does not apply to the marketing, distribution or sale of *cryptoasset derivatives* and *cryptoasset exchange traded notes* to a *retail client* in another *EEA State* to the extent that those activities are subject to stricter requirements imposed under article 42 of *MiFIR* by the *competent authority* of that *EEA State*.

22.6.2 G The *rule* in *COBS* 22.6.1R(2) means that a *firm* must comply with the *rules* in this section unless there are stricter requirements in the *EEA State* where the *retail client* is. Given that the *rules* in this section are prohibitions, *firms* will, in practice, always need to comply with them when they are marketing, distributing or selling a *cryptoasset derivative* or a *cryptoasset exchange traded note* in or from the *United Kingdom* to a *retail client*. However, *firms* will also need to comply with requirements in the *EEA State* where the *retail*

client is if those requirements go beyond the scope of the *rules* in this section.

22.6.3 G *Firms* are reminded that the *Glossary* definition of *MiFID investment firm* includes *CRD credit institutions* when those institutions are providing an *investment service or activity*.

22.6.4 G For the avoidance of doubt, in *COBS* 22.6.1R, "marketing" includes *communicating* and/or *approving financial promotions*, and "distribution or sale" includes *dealing* in relation to *cryptoasset derivatives* and *cryptoasset exchange traded notes*.

Prohibitions

22.6.5 R (1) A *firm* must not:

(a) sell a *cryptoasset derivative* or a *cryptoasset exchange traded note* to a *retail client*; or

(b) distribute a *cryptoasset derivative* or a *cryptoasset exchange traded note* to a *retail client*; or

(c) market a *cryptoasset derivative* or a *cryptoasset exchange traded note* if the marketing is addressed to or disseminated in such a way that it is likely to be received by a *retail client*.

(2) "Marketing" includes, but is not limited to, *communicating* and/or *approving financial promotions*.

CONDUCT OF BUSINESS (CRYPTOASSET PRODUCTS) (AMENDMENT) AND ASSOCIATED EXITING THE EUROPEAN UNION AMENDMENTS INSTRUMENT 2020

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of:

(1) regulation 3 of the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018;

(2) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (the FCA's general rules);
(b) section 137D (FCA general rules: product intervention);
(c) section 137R (Financial promotion rules);
(d) section 137T (General supplementary powers); and
(e) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

C. The Financial Conduct Authority also makes this instrument in the exercise of the power under article 42 (product intervention by competent authorities) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

Commencement

D. This instrument comes into force as follows:

(1) Annex A comes into force on 6 October 2020; and

(2) Annex B comes into force on the later of:

(a) 6 January 2021 immediately after the Conduct of Business (Cryptoasset Products) Instrument 2020 (FCA 2020/34), as amended by Annex A, comes into force; or
(b) IP completion day as defined in the European Union (Withdrawal Agreement) Act 2020.

Amendment to instrument commencement date

E. The commencement date of the Conduct of Business (Cryptoasset Products) Instrument 2020 (FCA 2020/34) is amended in accordance with Annex A to this instrument.

Amendments to the Handbook

F. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

G. This instrument may be cited as the Conduct of Business (Cryptoasset Products) (Amendment) and Associated Exiting the European Union Amendments Instrument 2020.

By order of the Board
30 September 2020

Annex A

Instrument coversheet

Amend the commencement date of the following instrument as shown. Underlining indicates new text and striking through indicates deleted text.

Conduct of Business (Cryptoasset Products) Instrument 2020 (FCA 2020/34)

Commencement

D. This instrument comes into force on ~~28 October 2020~~ 6 January 2021.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

22 Restrictions on the distribution of certain complex investment products

…

22.6 Prohibition on the retail marketing, distribution and sale of cryptoasset derivatives and cryptoasset exchange traded notes

Application

22.6.1 R ~~(1) Subject to (2), this~~ This section applies to:

~~(a)~~ (1) *MiFID investment firms*, with the exception of *collective portfolio management investment firms*;

~~(b)~~ (2) *branches* of *third country investment firms*; ~~and~~

~~(c)~~ (3) *MiFID optional exemption firms*; and

(4) *TP firms* which are *EEA MiFID investment firms* with the exception of *collective portfolio management investment firms*,

in relation to the marketing, distribution or sale of *cryptoasset derivatives* and *cryptoasset exchange traded notes* in or from the *United Kingdom* to a *retail client*.

~~(2) This section does not apply to the marketing, distribution or sale of *cryptoasset derivatives* and *cryptoasset exchange traded notes* to a *retail client* in another *EEA State* to the extent that those activities are subject to stricter requirements imposed under article 42 of *MiFIR* by the *competent authority* of that *EEA State*.~~

22.6.2 G ~~The *rule* in *COBS* 22.6.1R(2) means that a *firm* must comply with the *rules* in this section unless there are stricter requirements in the *EEA State* where the *retail client* is. Given that the *rules* in this section are prohibitions, *firms* will, in practice, always need to comply with them when they are marketing, distributing or selling a *cryptoasset derivative* or a *cryptoasset exchange traded note* in or from the *United Kingdom* to a *retail client*. However, *firms* will also need to comply with requirements in the *EEA State* where the *retail*~~

~~*client* is if those requirements go beyond the scope of the *rules* in this section.~~

In addition to the *persons* listed above, *persons* (including *unauthorised persons*) who benefit from a temporary exemption or exclusion from the *general prohibition* under:

(1) Part 7 of the *EU Exit Passport Regulations*; or

(2) Part 4 of the Electronic Commerce and Solvency 2 (Amendment etc.) (EU Exit) Regulations 2019 (SI 2019/1361)

are required to comply with the *rules* in this section as a consequence of:

(3) regulation 59 of the *EU Exit Passport Regulations*; or

(4) regulation 19 of the Electronic Commerce and Solvency 2 (Amendment etc.) (EU Exit) Regulations 2019.

22.6.3 G *Firms and TP firms* are reminded that the *Glossary* definition of *MiFID investment firm* includes *CRD credit institutions* when those institutions are providing an *investment service or activity*.

…

Prohibitions

22.6.5 R (1) A *firm* or *TP firm* must not:

…

…

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