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## *FCA to Ban the Sale to Retail Clients of Investment Products that Reference Cryptoassets*

By [Nina Moffatt](#)

In July 2019, the FCA published its proposals<sup>1</sup> to ban the sale, marketing, and distribution to retail clients of derivatives (e.g., CFDs, options, and futures) and exchange traded notes referencing “unregulated transferable cryptoassets” by firms in, or from, the U.K.

These proposals follow a report published by the Cryptoassets Taskforce<sup>2</sup> in October 2018 which set out the U.K.’s policy and regulatory approach to cryptoassets and other work on cryptoassets and related investment products both in the U.K. and in the EEA.<sup>3</sup> These proposals further indicate the desire and intention of U.K. authorities to regulate cryptoassets.

“Unregulated transferable cryptoassets” include well-known tokens such as Bitcoin, Ripple, and Ether.

However, the proposed definition excludes certain types of tokens specifically:

1. *Tokens that are unregulated but not widely transferable* e.g., tokens used on a private network where they can only be redeemed with the issuer and not exchanged between third parties via platforms.
2. *E-money tokens* – The rationale behind this exclusion is that the regulations deriving from the Second Electronic Money Directive (such as safeguarding and capital requirements) apply to these tokens and therefore, do not pose the same risks.
3. *Security tokens* – The rationale behind this exclusion is that such tokens are specified investments for the purposes of the Financial Services and Markets Act 2000 and so do not pose the same risks as exchange or utility tokens. As such tokens offer contractual rights or obligations they have a basis for their valuation. Further, these tokens may be transferable securities offered to the public so may be subject to the Prospectus Directive and be listed on a regulated market, thereby affording them additional regulatory obligations.

These measures are being applied under Article 42 and 21 of the MiFIR Delegated Regulation and the FCA’s rule making powers under FSMA.



## Why Has the FCA Proposed This Ban?

The FCA is of the view that the U.K. market for investment products referencing cryptoassets creates actual and potential harm to investors and the existing regulatory requirements, including product governance, appropriateness, and disclosure do not sufficiently address these concerns.

This is because the FCA considers that cryptoassets cannot be reliably valued, which makes it “impossible” for consumers and product manufacturers to value the derivatives contracts linked to them. As a result, consumers cannot make informed decisions about the value of the investment. The FCA has stated that such tokens are “opaque, complex, and unreliable as reference assets for investment products”.

Moreover, the FCA considers that the value of a cryptoasset derivative is directly affected by sudden devaluations or price dislocation in exchange for utility token prices. As the cryptoasset market has seen high volatility and price movements in the past after incidents of market abuse and financial crime, this makes the value of consumers’ investment very volatile. It is interesting to note that the FCA does not consider that the implementation of the Fifth Money Laundering Directive will mitigate all relevant financial crime risks such as abusive trading or cyber-thefts in relation to unregulated tokens.

In the FCA’s view there is also a limited understanding in the U.K. about the cryptoasset market as well as the complex nature of derivatives. According to the FCA, despite its consumer warning issued in 2017 about the risks of investing in CFDs referencing cryptoassets, the FCA’s research suggested that consumers perceive cryptoassets as a “short cut to easy money”, while also overestimating their knowledge of cryptoassets and underlying technology.

## Who Will Be Affected?

The FCA does not intend to extend the ban to professional clients or eligible counterparties, although it has committed to monitor the risks to retail clients that have been inappropriately “opted-up”.

CFDs are the main derivative product that reference cryptoassets. According to the FCA, between August – October 2017 there was circa £3.4 billion in retail client trading volume, representing 0.7% of the total retail trading volumes. Other types of derivatives which reference cryptoassets appear to be less common although there are firms offering future contracts on exchange tokens versus the U.S. Dollar to retail customers in the U.K.

The FCA has said that it will consult with other National Competent Authorities in other EEA Member States that may be affected by the proposals. Specifically, the FCA has identified CFD firms regulated in Cyprus to be most commonly selling products referencing cryptoassets on a cross-border basis into the U.K.

## What’s Next?

The FCA is currently consulting on these proposals with the deadline for feedback being October 2019. The FCA aims to publish a final policy statement and final FCA Handbook Rules in early 2020.





*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:*

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<sup>1</sup> CP19/22.

<sup>2</sup> This taskforce is made up of HM Treasury, the FCA and the Bank of England.

<sup>3</sup> ESMA and the EBA published advice to the European Commission, Council, and Parliament on ICOs and Cryptoassets in January 2019. Before this work, ESMA intervened in 2018 to impose temporary restrictions on selling, marketing, and distributing CFDs to retail clients because of concerns regarding investor protection.