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

Lead regulator	Financial Conduct Authority (FCA)
Summary of proposal	The measure prohibits the sale, marketing, and distribution of derivatives and exchange-traded notes (ETNs) that reference particular types of unregulated, transferable cryptoassets to all retail clients by firms in or from the UK.
Submission type	EANDCB validation
Legislation type	Regulator
Implementation date	06 January 2021
Policy stage	Final
RPC reference	RPC-FCA-5233(1)
Opinion type	Formal
Date of issue	5 January 2023

RPC opinion

Rating[1]	**RPC opinion**
Not fit for purpose	The BIT assessment has not included sufficient evidence to support the assumptions made, or adequately explained the approach to the cost-benefit analysis undertaken to produce the EANDCB seeking validation. The assessment also fails to clearly establish what would happen to the market in the absence of the intervention, limiting the ability to determine the change resulting from the measure.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£17.4 million	Not validated
Business impact target (BIT) score	£87.2 million	
Business net present value	£139.7 million	
Overall net present value	£-268.5 million	

[1] The RPC opinion rating is based on the rating for the robustness of the EANDCB, as set out in the business impact target statutory guidance and the better regulation framework. The RPC rating will be fit for purpose or not fit for purpose.

RPC summary

Category	Quality[2]	RPC comments
EANDCB	**Red**	The assessment has not provided sufficient evidence or discussion of the analysis of the impacts, to enable the EANDCB to be validated. The assumptions made are not adequately explained and the analysis that they form part of, is not discussed fully or clearly. Therefore, the RPC are unable to validate the EANDCB of this measure.
Other comments	**Weak**	The assessment considers the negative impact to clients who may have been sold the products that are being prohibited. In addition, it briefly notes that there may still be international trade in these products which have been prohibited. Innovation is briefly mentioned, however the assessment does not discuss whether there will be a positive or negative impact on product innovation as a result of this measure. The assessment could have been strengthened through the inclusion of a more detailed description of how the measure will operate. While not a framework requirement for this measure, the assessment would benefit from considering if there would be any impacts upon small and micro businesses (SMBs), either as a seller or client.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Response to initial review

As originally submitted, the BIT assessment was not fit for purpose as it had not provided sufficient evidence to support the assumptions and calculations which informed the EANDCB, as well as not providing a clear explanation of the baseline position (i.e., what would happen in the absence of the measure over the appraisal period). In addition, the BIT assessment had not clearly considered all potential impacts, while those that had been identified were not clearly presented as direct or indirect impacts. In response to the initial review, the FCA has included some additional text to explain revisions to their CBA that was made based on stakeholder feedback received during consultation (particularly that on the '2:1 leverage limits for crypto-CFDs'), as well as text to support the use of lost revenue rather than profit (as is noted as the preferred approach in RPC guidance[3]).

In the FCA's revised submission, the EANDCB has increased, from £17.4 million to £18.5 million. However, this difference appears to be a result of presenting the EANDCB (and other metrics such as the NPVs) in a different price base year. In the original submission this was 2020, meanwhile the revised figures use 2018 as the price base year.

Summary of proposal

In July 2019, the FCA published a consultation paper on "*Prohibiting the sale to retail clients of investment products that reference cryptoassets*"[4], which invited views from stakeholders on rules to ban the marketing, distribution and sale of derivatives and exchange traded notes (ETNs) that reference unregulated transferable crytoassets.

The BIT assessment explains that the measure seeks to address significant concerns about the risks of cryptoassets to retail consumers. The FCA explains that due to information asymmetries, significant operational risk, and widespread misconduct, including cyber risk and financial crime, retail consumers cannot reliably value and predict likely returns from products referencing cryptoassets.

The FCA does not consider that the existing regulatory requirements could sufficiently address concerns about the harm posed by these products to consumers. The BIT assessment explains that the proposal will affect the following businesses:

- MiFID investment firms (as defined in the FCA Handbook Glossary but excluding collective portfolio management investment firms), including Capital Requirements Directive (CRD) credit institutions as appropriate, who are marketing, distributing, or selling cryptoasset derivatives or cryptoasset exchange traded notes (as defined in the FCA Handbook Glossary). ETNs that reference unregulated, transferable cryptoassets.

[3] https://www.gov.uk/government/publications/rpc-case-histories-other-bit-methodology-issues-march-2019
[4] https://www.fca.org.uk/publication/consultation/cp19-22.pdf

- UK branches of third-country investment firms who are marketing, distributing, or selling derivatives or ETNs that reference unregulated, transferable cryptoassets.
- Temporary Permission firms which are EEA MIFID investment firms (as defined in the FCA Handbook Glossary but excluding collective portfolio management investment firms) who are marketing, distributing, or selling cryptoasset derivatives or cryptoasset exchange traded notes (as defined in the FCA Handbook Glossary).
- Prospective retail investors in crypto-derivative products.

Based on figures provided in the Consultation Paper, the FCA estimates that a ban on cryptoassets to retail consumers could reduce consumer losses by between £75 million and £234.3 million. As noted above, the FCA now estimate the EANDCB to be £18.5 million, while the BNPV and NPSV are estimated at -£288.5 million and -£161.2 million, respectively.

EANDCB

Baseline/counterfactual

The FCA state in the BIT assessment, that they assume that "*without our intervention, the market would continue to develop as it is*" and that this position is based on the longitudinal nature of their analysis. However, the FCA has not gone any further and provided a clear explanation of what specifically would happen, in the absence of the measure over the appraisal period. The absence of this clear establishment of a counterfactual, makes it difficult to attribute impacts (and their magnitude) to this measure.

Direct and indirect impact classification

The assessment would benefit from describing in more detail the actions required of businesses, such as the removal of marketing material related to cryptoassets and updates to application forms and websites. Although the business impacts that have been monetised appear to be direct impacts, the BIT assessment should have been clearer in confirming whether the impacts discussed are considered direct or indirect, in line with RPC guidance[5].

Methodology

The FCA describes a variety of data that has been collected and refined through stakeholder engagement and forms the basis of their analysis. However, the BIT assessment or supporting documentation do not provide a clear explanation of the methodology and calculations to estimate the costs and benefits.

[5] https://www.gov.uk/government/publications/rpc-case-histories-direct-and-indirect-impacts-march-2019

The assessment has used the loss of revenue, rather than the lost profit, which is the preferred approach in the RPC guidance as the preferred approach, to estimate the cost to businesses offering these products to retail clients. In the revised assessment submitted in response to the initial review, the FCA has provided additional detail explaining that they did not consider it "proportionate or helpful" to attempt to establish the rate of profit on the products in scope.

Assumptions, risk and sensitivity

The FCA notes that a number of the assumptions made in the analysis were, not challenged during consultation. However, despite this statement the assessment must first clearly explain what assumptions have been made, what the initial justification for these was and (if utilising an approach from a prior intervention) clealrly explain why the approach taken is appropriate at this time.

Other comments

Consideration of impacts to small and micro businesses

While not a requirement when undertaking a BIT assessment, the FCA could have considered whether smaller businesses may have faced different impacts from the proposal, or whether larger businesses are able to absorb costs more effectively. Furthermore, although the measure came into force in 2021, in light of the Government's recent announcement[6] of plans to widen presumed exemptions on regulations to businesses with fewer than 500 employees (see link below), the assessment could benefit from proportionately discussing impacts on businesses of this size.

More detailed explanation of the measure

The BIT assessment would be strengthened by providing a more detailed discussion of the measure, including a stronger rationale for intervention, the options considered, evidence to support the preferred option and a description of the expected impacts. It would also benefit from defining 'unregulated transferable cryto-assets' and clarifying what this includes. In addition, the BIT assessment should consider whether there are any competition and innovation impacts from the measure. For example, it should consider the potential competition effect if other jurisdictions do notadopt similar measures.

Wider impacts

The assessment has included a brief reference to the potential that retail investors may "look to trade crypto-derivatives with firms in third country jurisdictions". While the FCA notes that they view this will not lead to additional consumer detriment, the assessment would be improved by considering whether this may lead to some customers taking additional business (in addition to that prohibited) to firms in third country jurisdictions.

[6] https://www.gov.uk/government/news/red-tape-cut-for-thousands-of-growing-businesses

Similarly, the assessment makes a blanket statement about the FCAs position on supporting innovation and specifically that relating to blockchain. However, the assessment does not comment on whether this prohibition will have an impact, positive or negative, on the product innovation by those no longer able to sell these products.

Regulatory Policy Committee

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