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Financial Conduct Authority
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By email: cp19-22@fca.org.uk

3 October 2019

Dear Sir or Madam

FCA CP19/22 – Consultation Paper on prohibiting the sale to retail clients of investment products that reference cryptoassets

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

Our response relates to question 3 raised in the consultation paper: "*Do you have any comments on the draft Handbook rules and definitions we propose to achieve our policy intention?*"

We understand and agree with the FCA's intention to draft the rules sufficiently broadly to avoid the rules being gamed and to cover substantially similar products that may emerge in the future. Nevertheless, we have some concerns regarding the approach that has been taken to the relevant definitions, which we anticipate may feed through into other similar definitions adopted in the future in relation to cryptoassets.

The FCA proposes to prohibit the sale, distribution and marketing of cryptoasset derivatives (that is, derivatives whose underlying is an "unregulated transferable cryptoasset") and cryptoasset exchange traded notes (debt securities whose return tracks the performance of an unregulated transferable cryptoasset) to retail clients. An unregulated transferable cryptoasset is defined as:

"*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 any platform or other forum;

(b) is not limited to being transferred to its issuer in return 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."

The definition builds on the definition of a cryptoasset suggested in the final report of the Cryptoassets Taskforce of HM Treasury, the Financial Conduct Authority and the Bank of England dated October 2018, ie "*a cryptographically secured digital representation of value or contractual rights that uses some type of DLT and can be transferred, stored or traded electronically*" (paragraph 2.10). It should be noted that this definition goes to the form but not the substance of a cryptoasset. As regards the substance, the Taskforce report put forward a taxonomy for cryptoassets by categorising them into three types: exchange tokens (cryptocurrencies); security tokens (which provide rights such as ownership, entitlement to a future share of profits or repayment of a specific sum of money and which are specified investments under the Regulated Activities Order); and utility tokens (which can be used to access a service or product, typically provided on a DLT platform) (paragraph 2.11). The consultation paper refers to and adopts this taxonomy.

The definition of an unregulated transferable cryptoasset suggested in the consultation paper adopts the definition suggested in the Taskforce report as regards the form of a cryptoasset, but as regards the substance of the asset it uses (except in paragraph (a)) a negative scope by excluding certain types of cryptoasset. In other words, it starts by including every conceivable type of asset having the form described and then carves out certain types of assets by reference to their substance.

The intention behind the exclusions in the proposed definition seems to be to exclude both security tokens (paragraph (d)) and utility tokens (paragraph (b)) as well as certain types of exchange tokens that are already subject to regulation (paragraph (c), leaving only unregulated exchange tokens as being subject to the prohibition. We wonder whether a more straightforward way to achieve this policy intention would be to refer to the substance of the types of assets intended to be covered in a positive rather than a negative way. For example, the Fifth Money Laundering Directive, which brings cryptoasset exchanges and custodian wallet providers within the scope of anti-money laundering regulation, defines an exchange token as "*a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess the legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically*."

Our concern with using a negative rather than a positive scope in the substantive part of the definition is that it risks catching a variety of other types of asset which are not intended to fall within the scope of the definition and which have not been identified as posing risks to consumers. Moreover, if the FCA was concerned that there are derivatives referencing types of cryptoasset other than unregulated exchange tokens that pose risks to consumers, it would have been helpful for these to have been clearly identified in the consultation paper and been subject to a cost-benefit analysis.

We also note that the new definition is being introduced before HMT's consideration of a potential broadening of the regulatory perimeter in relation to cryptoassets. We wonder whether it would be more appropriate at this stage to frame the scope of the prohibition in a more focused and narrow way and wait to take account of the conclusions reached following HMT's consultation in relation to the risks posed by various types of cryptoassets before considering broadening the prohibition.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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