



## **FI Supervision Report**

# Financial instruments with crypto-assets as underlying asset

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### **About FI Supervision Reports**

Finansinspektionen regularly publishes supervision reports in a numbered series. These reports are part of our communication. The reports share findings from supervisory investigations and other supervisory work. FI uses the reports to share observations, analytical conclusions and its expectations with regard to regulatory matters. This information may be of use to regulated firms.

## Summary

FI conducted a thematic review of the market for financial instruments with crypto-assets as an underlying asset. FI is of the view that there is a lack of adequate consumer protection regulation for crypto-assets. Valuing them is also challenging and the instruments are volatile. This makes the products unsuitable for most, if not all, retail consumers.

FI has previously warned consumers and firms of the risks involved in trading crypto-assets. This trading is volatile, the firms involved face operational risks, and there is a lack of adequate consumer protection regulation. We have also issued warnings regarding so-called Initial Coin Offerings (ICOs), a type of financing using crypto-assets, which are usually not covered by prospectus regulation rules or subject to information standards.<sup>1</sup>

The risks we have previously flagged in relation to crypto-assets are equally relevant when it comes to investing in financial instruments with underlying crypto-assets. The instruments are volatile and difficult to value. They are affected by the risks associated with their underlying assets - there are problems with the transparency of the markets for the underlying crypto-asset, and crypto-assets are frequently used for money laundering and terrorist financing. Financial instruments with underlying crypto-assets are therefore unsuitable for most, if not all, retail consumers.

FI requires firms subject to our supervision to maintain a high degree of consumer protection, which is evident in the report. We note that the consumer protection regulations that govern crypto-asset trading in many instances are inadequate. This is especially the case where crypto-assets are bought or sold directly.

The most common financial instruments in the Swedish market that have crypto-assets as an underlying asset are so-called tracker certificates. In the spring of 2020, we conducted a review of the Swedish market for these products. The review was carried out through an analysis of transactional data which firms had reported to FI and a questionnaire to market participants.

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<sup>1</sup> In Swedish: <https://www.fi.se/sv/publicerat/nyheter/2018/olampligt-for-konsumenter-att-investera-i-virtuella-valutor/>  
<https://www.fi.se/sv/publicerat/nyheter/2017/varning-for-risker-med-initial-coin-offerings/>

# What are crypto-assets and tracker certificates?

FI and many other supervisory authorities have issued warnings about the risks associated with trading in crypto-assets. Some Swedish consumers are also exposed to crypto-assets via the financial instruments they hold, primarily tracker certificates, which have crypto-assets as an underlying asset. These products are also risky.

## WHAT ARE CRYPTO-ASSETS

There is no one commonly accepted definition of crypto-assets. The European Commission, in its consultation on an EU framework for crypto-assets, defines crypto-assets as “a digital asset that may depend on cryptography and exists on a distributed ledger”<sup>2</sup>.

In the Regulation on Markets in Crypto-Assets (MiCA), crypto-assets are defined as “a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology”<sup>3</sup>.

The Swedish Central Bank (Riksbanken) defined crypto-assets as “digital units that are created and transferred between users through use of cryptographic calculations”. It defines the term cryptography as “the study of methods used to transfer information between a sender and a receiver without enabling a third party to access it. This encrypts the information. Only those who have the right to access the information have the key to enable the information to be interpreted”<sup>4</sup>.

This report will use the MiCA regulation definition of crypto-assets. Bitcoin is an example of a type of crypto-asset.

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## Bitcoin

Bitcoin is the best known and most commonly used crypto-asset. Bitcoin can be bought and sold on digital marketplaces and in some instances also be used as a method of payment.

The cryptography used to create new bitcoins mean that there is no central bitcoin issuer. The creation of bitcoin is governed by its

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<sup>2</sup>[https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/2019-crypto-assets-consultation-document\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-crypto-assets-consultation-document_en.pdf)

<sup>3</sup> [https://eur-lex.europa.eu/resource.html?uri=cellar:f69f89bb-fe54-11ea-b44f-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:f69f89bb-fe54-11ea-b44f-01aa75ed71a1.0001.02/DOC_1&format=PDF)

<sup>4</sup> In Swedish: <https://www.riksbank.se/globalassets/media/rapporter/ekonomiska-kommentarer/svenska/2018/ar-bitcoin-och-andra-kryptotillgangar-pengar.pdf>

protocol, i.e. rules that amongst other things determine how data can be shared between computers without a central counterpart. Bitcoin does therefore not represent a monetary claim on anyone, unlike Swedish kronor, which are formally a claim on the Riksbank (i.e. the state). The value of bitcoin is determined solely with reference to demand and supply amongst its users.

The price of bitcoin has varied significantly since launch (see Diagram 1).

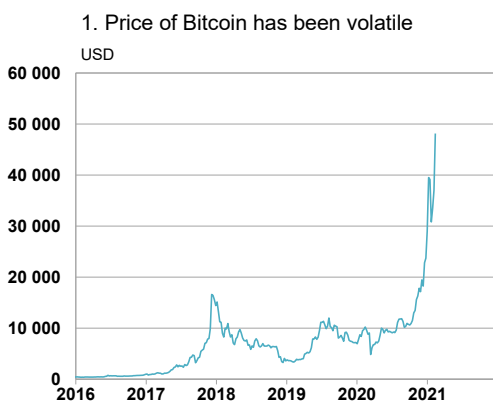
## REGULATION OF CRYPTO-ASSETS AND INSTRUMENTS WITH CRYPTO-ASSETS AS AN UNDERLYING ASSET

Crypto-assets may require authorisation and be subject to FI supervision. Depending on how the crypto-asset is designed. For instance, it may be subject to the law on electronic monies or the law on trading financial instruments. The majority of crypto-assets however are not subject to regulation by FI. The fact that they are mostly unregulated means that consumers of these assets do not enjoy the benefits of consumer protection regulations.

The crypto-assets underlying the financial instruments discussed in this report are unregulated. The financial instruments themselves, however, are subject to a number of different regulations and requirements (see section “Regulatory requirements for market participants”).

Even though the sale of the financial instrument is regulated, this does not sufficiently mitigate the consumer risks posed by the unregulated crypto-asset.

The focus of this report is on financial instruments with crypto-assets as an underlying asset.



Source: Refinitiv Datastream.

## TRACKER CERTIFICATES ARE MOST COMMON

The most commonly traded financial instrument linked to crypto-assets in Sweden is a so-called tracker certificate.

Tracker certificates are a type of investment product where the certificate strictly follows (1:1) the value development of the underlying asset.

The certificates are designed to give the consumer exposure to an individual crypto-asset, a basket of crypto-assets, or an index based on such assets. The issuer of the certificate commits to buying and storing the same amount of crypto-assets represented in the certificates. The issuers of these certificates are not regulated by FI.

Issuers receive their revenue by applying a fee to the sale of the certificate (sometimes known as negative interest), and the issuer is also able to charge additional fees, e.g. for redeeming the certificate.

This means that the investor never comes into direct contact with the crypto-asset but instead receives a payment in a fiat currency such as SEK, EUR, or USD. The exposure for the investor, in other words, is entirely synthetic.

Tracker certificates are complex and associated with a high degree of risk for the consumer.

# The Swedish market

Swedish consumers make up a relatively large proportion of trading in certain tracker certificates. The number of consumers has varied over time, and the majority of sales are carried out on an execution-only basis.

## SWEDISH TRACKER CERTIFICATES HAVE LARGE EU MARKET SHARE

In the spring of 2020, FI conducted a thematic review of the Swedish market for financial instruments with crypto-assets as an underlying asset. The review was conducted through a questionnaire to Swedish investment firms and an analysis of the data firm reported in the transaction reporting system. The analysis focused on financial instruments that are traded on Swedish market places.

Data collected up until March 2020 shows that financial instruments had been issued by both Swedish and foreign firms. They had had their prospectuses approved in Sweden or in another EU member state and targeted Swedish consumers. In addition to these firms, a number of additional issuers have attempted or plan to enter the Swedish market.

The most common financial instrument connected to crypto-assets was tracker certificates which had bitcoin as an underlying asset. The instruments were primarily traded over the counter (OTC) but were also traded on Swedish market places regulated by FI. They were also traded on multilateral trading facilities (MTF) platforms elsewhere in Europe.

The Swedish institutions that sell crypto-asset certificates to consumers hold authorisation for either banking or investment services. Swedish institutions carry out a large proportion of European transactions in the most common certificates (see Diagram 2). This means that either a large number of Swedes are trading in these certificates or that those who do trade frequently. Swedish institutions, however, represent a smaller percentage of traded volume, indicating that Swedish investors are more active but make smaller trades in these products than their European counterparts.

## NUMBER OF CONSUMERS HAS VARIED OVER TIME

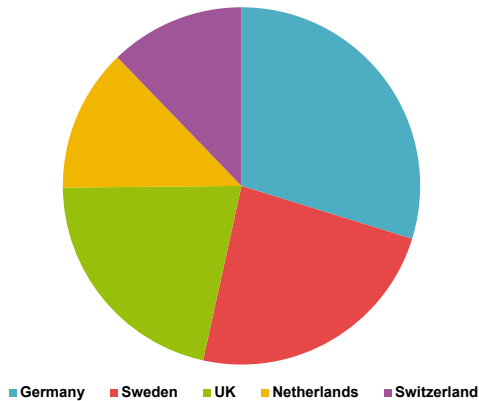
The number of Swedish consumers who held financial instruments with crypto-assets as an underlying asset grew sharply at the end of 2017 and the beginning of 2018. At its peak, around 35,000 Swedes held financial instruments with crypto-assets as an underlying asset. In November 2020, that number was closer to 27,000 (Diagram 4).

## MANY SWEDISH CONSUMERS INVESTED WHEN PRICE WAS HIGH

Many of the Swedish consumers who have invested in these instruments invested when the bitcoin price was rising (Diagram 5). When consumers follow the market and buy instruments with high price volatility, the risk of large losses increases.

2. A large number of transactions are carried out in Sweden

Percent

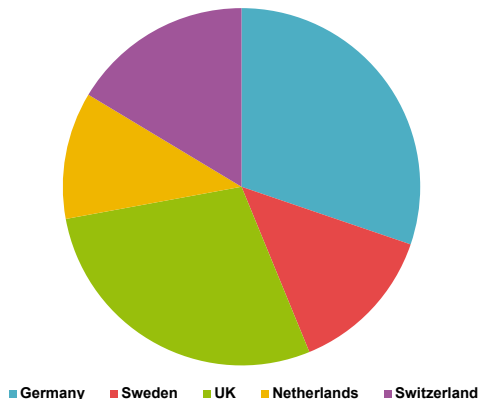


Source: FI's transaction reporting system (TRS 2).

Note – the number of transactions in the certificates is categorised by the nationality of the executing firm. Data from trades carried out in 2019.

3. Turnover is lower than in some other countries

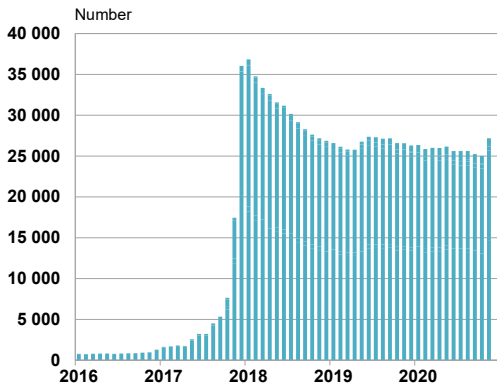
Percent



Source: FI's transaction reporting system (TRS 2).

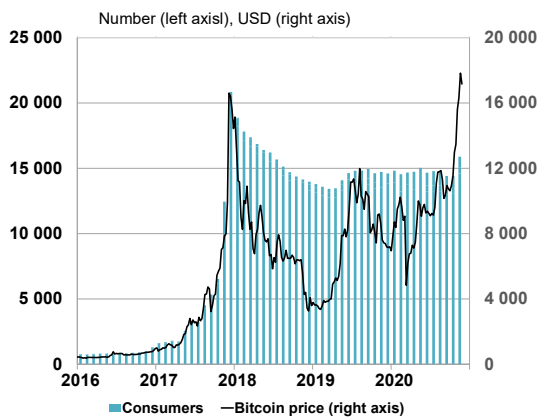
Note – the amount of turnover in the certificates is categorised by the nationality of the executing firm. Data from trades carried out in 2019.

4. The number of consumers who have invested in tracker certificates based on crypto-assets rose sharply during 2017



Source: Data from regulated firms  
 Note – refers to consumers who have invested in certificates with crypto-assets as an underlying asset

5. The number of consumers increased when the price rose



Source: Data from regulated firms and Refinitiv Datastream.  
 Note – refers to the number of consumers who have invested in certificates with bitcoin as an underlying asset.

We also collected information about the income of consumers who invested in these instruments. A high average income could indicate that the risks to consumers are more limited – that it is more likely the consumer’s financial circumstances would be able to absorb the types of losses that may materialise from investing in highly risky instruments. The information showed that the income of the average investor in these instruments is not significantly higher than the Swedish average income. This indicates it is important to continue to monitor how and to whom these products are distributed.

### PRODUCT PRIMARILY SOLD ON AN EXECUTION-ONLY BASIS

FI’s analysis shows that the firms selling the tracker certificates mostly do not actively recommend that consumers invest. Sales are usually on an execution-only basis, which means that consumers have to seek out the products themselves.

All of the firms that submitted responses to FI’s questionnaire on this topic reported that they had not received any complaints related to these products between January 2019 and February 2020.

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## Approval of prospectuses

The primary aim of the Prospectus Regulation, as well as the related conduct regulations, is to ensure adequate investor protection. The regulation therefore requires the publication of information in relation to issuers and securities in order to remove information asymmetries between issuers and investors. The information that must be published is dependent on e.g. the type of issuer, the type of security, and whether or not the security will be offered to retail (non-professional) investors.

The competent authority must review whether the information contained in the prospectus is comprehensive, consistent and easily understood. The purpose of the review is to ensure fulfilment of the aim to remove information asymmetries between investors and issuers. The information provided in the prospectus must enable investors to make a well-informed investment decision.

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# Analysis of the product and the Swedish market

FI is of the opinion that the lack of adequate consumer protection regulation for the underlying crypto-assets, the difficulties in assessing the value of these assets, and the volatility of the financial instruments make the products unsuitable for most, if not all, consumers.

## EARLIER WARNINGS ISSUED BY SUPERVISORY AUTHORITIES

Many national supervisory authorities, including FI, have issued warnings in relation to the risks associated with the trade of crypto-assets. Since the majority of crypto-assets are not regulated, they are not subject to the same consumer protection standards as many other assets. For instance, firms looking to raise capital by offering units in newly created crypto-assets are not required to get their public offers approved by the supervisory authority. This negatively affects consumer protection as well as public confidence in crypto-assets. Other key risks are related to the use of crypto-assets for money-laundering, terrorist financing, and investment scams. The creation of crypto-assets also often have a significant negative, effect on the environment.

The risks that FI has previously highlighted in relation to crypto-assets are also relevant to the financial instruments that use crypto-assets as an underlying asset. Like many other financial instruments whose value is dependent on the development of an underlying asset, the tracker certificates previously mentioned are risky and complex. This makes them unsuitable as investment products for most consumers.

But financial instruments connected to crypto-assets are riskier than many other products, including many derivatives. This is because crypto-assets lack any intrinsic value and there is an absence of reliable models for valuing them.

## PRODUCTS LACK RELIABLE BASIS FOR VALUATION

Crypto-assets are different from many other assets referenced by financial instruments, in that they lack intrinsic value. Unlike currencies, they also lack a central issuer and have difficulty maintaining a stable value.<sup>5</sup> They can therefore not be regarded as a well-functioning method of payment.

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<sup>5</sup> For a more in-depth discussion on this topic, see, for example, (Swedish only) <https://www.riksbank.se/sv/press-och-publicerat/nyheter-och-pressmeddelanden/nyheter/2018/bitcoin-ar-inte-pengar/>

There are big differences between crypto-assets and underlying assets such as raw materials and equities. Valuations of equities and firms reference information in balance sheets and the macroeconomic climate. Valuations of raw materials such as metals and oils reference physical supply and their economic value. In both cases, there are credible and generally accepted valuation models.

The absence of intrinsic value makes the valuation of crypto-assets more challenging. Crypto-assets do not generate future cash flows and do not have a physical use. It is unclear whether there are any valuation models for crypto-assets that can be viewed as reliable. The British supervisory authority (the Financial Conduct Authority (FCA)) conducted a technical analysis of different valuation models for crypto-assets and drew the conclusion that the models generate significant variations in the valuation of crypto-assets and none of them can be regarded as credible.<sup>6</sup>

Financial instruments with crypto-assets as an underlying asset are high-risk, volatile and complex. There are many risky and complex financial instruments that meet important investor needs, and the supply of these instruments contributes to a well-functioning Swedish financial services market. There are existing regulations for such products to ensure that they are only sold to consumers who are sufficiently knowledgeable about the product and the risks they are taking.

The challenges associated with the valuation of crypto-assets mean that financial instruments with such underlying assets pose a different level of risk for consumers than many other products that are also categorised as high-risk and complex.

These instruments are therefore unsuitable for most, if not all, consumers. The absence of a generally accepted credible method of valuation means that investments in financial instruments with underlying crypto-assets are fraught with difficulties for all investors, even those with a good knowledge of the market. Tracker certificates are often bought for purely speculative reasons. Financial instruments with underlying crypto-assets should only be bought by consumers who fully appreciate that the price fluctuations in these instruments are difficult, if not impossible, to predict, and that the instruments can be very volatile.

### INADEQUATE CONSUMER PROTECTION REGULATIONS

Crypto-assets and the direct trade of these assets are for the most part not covered by consumer protection regulations. Newly announced initiatives (such as the European MiCA-regulations) may partly change this (see below).

The trading of financial instruments with underlying crypto-assets is covered by existing regulations. However, the lack of sufficient

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<sup>6</sup> <https://www.fca.org.uk/publication/consultation/cp19-22.pdf>,  
<https://www.fca.org.uk/publication/policy/ps20-10.pdf>,  
<https://www.fca.org.uk/publication/policy/ps20-10-technical-annex.pdf>

consumer protection regulation for the underlying asset means that there is still insufficient transparency connected to the trade.

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## The MiCA regulation

On 24 September 2020, the European Commission published a proposal for a new regulatory framework for crypto-assets (known as the Markets in Crypto-Assets Regulation, or MiCA for short).

The purpose of the MiCA regulation is to create unified rules on crypto-assets. The majority of crypto-assets are not covered by the EU's existing regulatory framework for financial services – with the exception of anti-money laundering and terrorist financing legislation. This new regulation aims to ensure a high degree of consumer and investor protection, create legal certainty, mitigate financial stability risks, and protect monetary sovereignty. The proposal establishes unified rules for issuers and providers of services related to crypto-assets at a European level and will replace national crypto-asset regulation where present.<sup>7</sup>

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## PRICE MANIPULATION COMMON IN UNREGULATED MARKETPLACES WHERE CRYPTO-ASSETS ARE TRADED

The trading platforms where crypto-assets are bought and sold are outside of FI's regulatory remit, but they are registered with FI.<sup>8</sup> The platforms, therefore, can best be described as unregulated.

Trading of crypto-assets on unregulated market platforms has been plagued by wash trades, where individuals trade with themselves for the purpose of market manipulation. In April 2019, Forbes estimated that as much as 95 percent of crypto-asset trading volume could consist of wash trades.<sup>9</sup> In December 2018, Blockchain Transparency Institute, an online initiative that scrutinises crypto-asset trading data,<sup>10</sup> estimated that 80 percent of trades on large trading platforms consisted of wash trades.<sup>11</sup> The latest report shows some improvement.<sup>12</sup>

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<sup>7</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593>

<sup>8</sup> For more information regarding the difference being registered and being subject to supervision please see (Swedish only): <https://www.fi.se/sv/vara-register/foretagsregistret/tillstand-av-fi-eller-enbart-registrering/>

<sup>9</sup> <https://www.forbes.com/sites/tomrodgers/2019/04/04/99-of-volume-could-be-wash-trading-as-bitcoin-takes-back-5000/#24a7aaf323d5>

<sup>10</sup> <https://www.bti.live/about-us/>

<sup>11</sup> <https://www.bti.live/reports-december2018/>

<sup>12</sup> <https://www.bti.live/bti-september-2019-wash-trade-report/>

ESMA's Security and Markets Stakeholders Group referred in a report in 2018 to an estimate that 78 percent of issued ICO's were scams, i.e. no crypto-asset was actually offered and the public offer was solely an attempt to scam consumers of their money.<sup>13</sup>

FI has received a large number of complaints connected to investment scams referencing crypto-assets.

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## Investment scams with crypto-assets

The format of investment scams has varied over time, but often the focus is on linking offers to investments that have received significant media attention. In recent years, media references to crypto-assets have been common. Criminals have scammed a significant number of consumers, in part by widely circulating mendacious advertisements on websites and social media. The adverts often feature a celebrity who has ostensibly quickly and easily earned large sums of money through investments in crypto-assets.

Many consumers who have contacted us have said they transferred money to the scammers and lost it all. The investment offer was only a façade to trick people into handing over money and was never linked to any real investment. In many instances, consumers invested several times and in total lost large amounts of money.

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## CRYPTO-ASSETS FREQUENTLY USED FOR MONEY LAUNDERING AND TERRORIST FINANCING

Several supervisory authorities and international organisations have highlighted the use of crypto-assets in money laundering and terrorist financing.

Crypto-assets permit users to trade and transfer large sums on an anonymous basis. Unlike bank transfers, there is no link to the user or a particular account, and there is also no central issuer who can be held responsible for monitoring the transaction. Anonymised payment solutions like crypto-assets promote layering, through which a series of transactions is carried out with the purpose of making it harder to trace the origin of the funds.<sup>14</sup>

In light of this, the Fifth Anti-Money Laundering Directive was expanded to also include the administration and trade of crypto-assets

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<sup>13</sup> Källa: [https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338\\_smsg\\_advice\\_-\\_report\\_on\\_icos\\_and\\_crypto-assets.pdf](https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338_smsg_advice_-_report_on_icos_and_crypto-assets.pdf), sida 7. The original report they refer to can be found here:

[https://research.bloomberg.com/pub/res/d28giW28tf6G7T\\_Wr77aU0gDgFQ](https://research.bloomberg.com/pub/res/d28giW28tf6G7T_Wr77aU0gDgFQ)

<sup>14</sup> In Swedish only: <https://polisen.se/aktuellt/nyheter/2019/juni/mer-samarbete-behovs-for-att-motverka-penningtvatt-och-finansiering-av-terrorism/>

and improved the ability of supervisory authorities to exchange information.<sup>15</sup>

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<sup>15</sup> In Swedish only: <https://www.fi.se/contentassets/5a89ed7d9d1a4776b455c64d7d43b460/fis-arbete-mot-penningtvatt-fin-terrorism.pdf>

# Ensuring appropriate degree of consumer protection

FI has considered what is required to ensure a high degree of consumer protection in this area and assessed the degree of risk present in the Swedish crypto-asset market, taking into account the number of relevant consumers and existing regulations.

## DEVELOPMENTS IN THE SWEDISH MARKET

The consumer protection risks associated with the sale of financial instruments with underlying crypto-assets are serious. The difficulties relating to valuing the crypto-assets, their volatility, and the lack of adequate consumer protection regulation mean that financial instruments with underlying crypto-assets are unsuitable for most, if not all, consumers.

This was the reasoning behind FI's thematic review, the purpose of which was to gain a better understanding of how extensive sales of the product are in Sweden and whether or not the products are actively being marketed.

The fact that, in Sweden, the number of frequently traded financial instruments with underlying crypto-assets is relatively limited is positive. In November 2020, around 27,000 consumers made these types of investments, which is significantly fewer than in 2017. Despite the increase in the price of bitcoin in the second half of 2020, our data showed no dramatic corresponding growth in the number of Swedish consumers who bought the products.

The fact that the main distributors are not actively marketing the products to retail consumers also lowers the risk of harm to consumers. Consumers who purchased these products in most cases actively sought out the products and were not encouraged by the financial institutions to buy them. This does not necessarily make the sale more suitable for the consumer, but it lowers the risk for unpremeditated purchases.

Financial institutions that design and sell these instruments are also subject to existing regulation (see below).

There continue to be serious risks connected to the direct trade and investment in crypto-assets. FI supports and actively contributes to ongoing international work to improve the regulatory framework pertaining to these assets and increase consumer protection.

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## Regulatory requirements for market participants

As mentioned above, there is a dearth of regulation pertaining to the direct trade of crypto-assets. However, when crypto-assets serve as an

underlying asset to a financial instrument, there are a number of rules and regulations that come into force.

Since the financial instruments are complex and primarily sold without investment advice, investment firms distributing the product need to carry out an appropriateness test.<sup>16</sup> The appropriateness requirement ensures that consumers understand the risks they take if they chose to invest. The firm gathers information from the consumer and uses this information to assess whether the consumer has sufficient knowledge and experience to invest.

Firms that make these products available must also have considered the product governance requirements, especially with regard to the identified target market.<sup>17</sup> This means that firms need to identify the group of consumers for whom a product would be suitable before offering it for sale. If the firm has made the assessment that the target market includes retail consumers, they also need to further specify who the relevant consumers are and explicitly state which consumers the product is not meant for. The goal is to protect consumers from buying products that were not designed for them.

Firms that choose to offer this type of financial instrument should also regularly review their offering to ensure that the identified target market and the chosen distribution strategy remain appropriate. An investment firm, when reviewing the products it offers, must take into account any event that could materially affect the potential risk to the identified target market. The firm must also re-assess the target market and update the product governance arrangements if it determines it has made a mistake regarding the target market or if the financial instrument no longer meets the needs of the target market.<sup>18</sup>

Persons who produce or disseminate investment recommendations shall take reasonable care to ensure that the information is objectively presented. This is especially important in instances where the financial instruments are complex and difficult to value, where the trade in the underlying assets is plagued by uncertainty and there is a lack of transparency.

The market abuse regulations also apply to tracker certificates and other listed products with crypto-assets as an underlying asset. This means that insider trading and market manipulation are prohibited. It also means that trading platforms and parties executing orders must have systems in place to flag suspicious transactions and report these to FI. Issuers must make insider information public and establish insider lists when required. Transactions conducted by persons discharging material responsibilities must be reported via the PDMR transactions register.

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<sup>16</sup> Implemented in Swedish law through 9 kap. 24 och 25 §§ lagen [2007:528] om värdepappersmarknaden.

<sup>17</sup> Implemented in Swedish law through 8 kap. 13 och 14 §§ lagen om värdepappersmarknaden.

<sup>18</sup> Implemented in Swedish law through 5 kap. 22 § Finansinspektionens föreskrifter FFFS 2017:2 om värdepappersrörelse.





# Significant risks associated with investments in crypto-assets

Crypto-assets are different from many other underlying assets for financial instruments in that they lack intrinsic value. They are volatile and complex, and there is insufficient consumer protection related to them. FI would like to remind consumers and firms of the risks associated with investments connected to crypto-assets and will continue to work to improve consumer protection in this area.

## PRODUCTS UNSUITABLE FOR MOST RETAIL CONSUMERS

FI and other supervisory authorities have previously highlighted the risks associated with crypto-assets. Financial instruments with crypto-assets as an underlying asset are associated with many of the same risks.

Like many other financial instruments, tracker certificates with crypto-assets as an underlying asset are high-risk and complex. But FI is of the view that financial instruments based on crypto-assets are riskier than many other high risk products such as derivatives. This is because crypto-assets lack intrinsic value and there are no generally accepted reliable models for valuation. Crypto-assets are not subject to consumer protection regulation and are frequently used for money laundering and terrorist financing.

FI therefore takes the position that financial instruments with crypto-assets as an underlying asset are unsuitable for most, if not all, retail consumers.

## WHAT CONSUMERS NEED TO CONSIDER

It is important that consumer who are considering investing in a financial instrument with underlying crypto-assets understand the risks they are taking.

Financial instruments based on crypto-assets have been very volatile. At the moment, there are no generally accepted valuation models that are considered reliable. This means that it is challenging, if not impossible, to predict how the price of the financial instrument will change over time.

Consumers should only invest in this type of product if they fully appreciate that they may lose all their money and can afford to do so. They should not assume that the value of the product will continue to appreciate.

## WHAT FIRMS NEED TO CONSIDER

Firms offering financial instruments with crypto-assets as an underlying asset must, as above, ensure that they are compliant with the existing regulations, including the requirements on identifying a target market and appropriateness. These firms must also carefully

monitor the sales of these products over time to ensure the chosen target market and distribution channel remains appropriate. The rules on market abuse are also applicable to tracker certificates and other listed products with crypto-assets as an underlying asset.

FI also notes that the regulatory framework governing crypto-assets is insufficient. This is also true for direct trading in crypto-assets, which does not fall under FI's regulatory remit.

#### NEXT STEPS

FI will closely monitor further developments in this market. If further analysis shows increased risk for consumer harm, additional legislation to protect consumers will most likely be required. To the extent that firms are subject to our supervision, we will consider taking appropriate action as required.

We will continue to engage in the international work that is ongoing to improve consumer protection and create stronger regulations to govern crypto-assets.



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