House of Commons

Treasury Committee

Oral evidence: The crypto-asset industry, HC 615

Wednesday 7 December 2022

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Watch the meeting

Members present: Dame Angela Eagle (Chair); Rushanara Ali; Mr John Baron; Andrea Leadsom; Anne Marie Morris; Alison Thewliss.

Questions 102 - 213

Witnesses

I: Joey D'Urso, Investigations Writer, The Athletic UK; Natasha de Terán, Member, Financial Services Consumer Panel; Dr Rebecca Driver, Member, Financial Services Consumer Panel.

II: Sarah Pritchard, Executive Director for Markets, FCA; Matthew Long, Director of Payments and Digital Assets, FCA.

Examination of witnesses

Witnesses: Joey D'Urso, Natasha de Terán and Dr Rebecca Driver.

Q102 **Chair:** Good afternoon and thank you to our guests for coming before us as part of the Treasury Committee's inquiry into the crypto-asset industry. We have two sections of our hearing today. We are starting off with the consumer panel for the next hour. I wonder whether our guests would introduce themselves.

Joey D'Urso: My name is Joey D'Urso and I am investigations writer for the Athletic, which is a sports news publication. The relevance of that will become clear in time, I am sure.

Natasha de Terán: I am Natasha de Terán. I am a member of the Financial Services Consumer Panel and the Payment Systems Regulator Panel.

Dr Driver: I am Rebecca Driver. I am here as a representative of the Financial Services Consumer Panel as well.

Q103 **Chair:** This entire area is new and emerging, if I could put it that way. In your submission, the consumer panel, you highlight concerns about crypto borrowing, stating, "It is highly unlikely that consumers will understand the unlimited losses they are exposing themselves to when taking out crypto loans". Could you explain why consumers might face unlimited losses, because this particular area of lending and borrowing is not exactly normal, is it?

Natasha de Terán: No. Thank you for having us and for looking at this. There are lots of different exchanges and platforms on which you can engage in crypto lending and borrowing, and they are very different. Let me just say that.

In the worst-case scenario, what could you be looking at? You could buy crypto and borrow against that crypto to 90% of its value. You could use that borrowing. You could convert it to fiat. You could reinvest in crypto. You could short crypto, thereby exposing yourself to unlimited losses.

The crypto that you deposit, depending on which platform you are using, might be staked. In other words, it might be reinvested by that lender and you would be exposed to the losses that they entertain as a result of their reinvestment, but you would still owe the money back. If the crypto collateral that you have deposited falls in value, you face a margin call, which you may or may not be able to meet. If you cannot meet it, you will get closed out and, as I understand it, you walk away with whatever you have borrowed, presuming that you can actually walk away with it.

On the other hand, the crypto lender could go into insolvency, which seems to be something of a frequent occurrence at the moment. I do not know—maybe we will find out in the wake of some of these collapses—but I would presume that, first, you lose your collateral, because you are just a creditor. As a debtor to that entity, you remain indebted to it to the value of the amount that you have borrowed. It is very high risk and most people would not lend against assets like crypto assets.

Q104 **Chair:** Given that a lot of these borrowing opportunities come online, they might look something similar to borrowing offers or potential offers for taking out loans from more regulated, more obviously backed-up institutions such as banks. From a consumer point of view, I am asking if you have worries about consumers not really understanding quite how risky this kind of borrowing on these exchanges actually is.

Natasha de Terán: From what I can understand, it is incredibly accessible. They talk about very low APRs, so it is quite compelling compared to, say, borrowing on a credit card or through a bank. They do not do credit checks, or at least some of them do not, so there are no suitability questions. To that extent, crypto loans are much more accessible than most regulated loans would be. I do not think that anyone who really understood what they were doing would necessarily engage in that unless they had a very high risk tolerance, including the lenders actually.

Q105 **Chair:** Rebecca, do you have any comments about this, in terms of how the sheer riskiness of this borrowing can be somehow highlighted to those who might just come across these offers online?

Dr Driver: I would echo everything Natasha has just said. In terms of what you come across online, I did a quick check yesterday as to how you go about borrowing. You need to deposit some crypto. You can borrow up to a certain percentage of the value of that crypto, but you are borrowing, typically, in fiat currency or stablecoin equivalents. If the value of the crypto that you have deposited suddenly plummets, which has happened—

Chair: It is very volatile, let us face it.

Dr Driver: It is very volatile.

Chair: Cryptocurrencies are not exactly stable.

Dr Driver: Then you face a margin call, which basically says, "Top up the amount of crypto that you have", so that the loan-to-value ratio in fiat currency remains the same. Nothing has changed on the crypto side of this. As Natasha said, if you cannot do that, the position is closed out.

If, in extremis, the value of the cryptocurrency that you have borrowed against has gone to zero, you presumably would still owe the money even though, in theory, the fact that you could only borrow a proportion of the cryptocurrency that you had staked should have protected you, or at least that is the narrative that you see. There are significant risks for consumers there. it is not necessarily clear that people would understand those risks.

That is before you get into what the people lending you the money do with the crypto that you have staked and whether that opens up investment risks. If they make a mess of it, potentially your stake is at risk as well.

Q106 **Chair:** Are you aware of UK consumers who have found themselves in that position, as a consumer panel?

Natasha de Terán: I am not. That is not to say that there would not be any, but I do not know how, necessarily, we would hear about them. Given the very ready accessibility of these loans, there might be some sort of skewed incentive. If I am the issuer of a crypto coin, I would be very willing to lend Joey money to invest in it, because then it would pump up the value of the coin. If you do not have proper separation of activities here, there are some very questionable risks. No, I cannot say I have read about anyone.

Q107 **Chair:** What help would there be for consumers who might find themselves in this position at the moment?

Natasha de Terán: I really do not know.

Chair: The answer is probably none then.

Natasha de Terán: I think there is probably none.

Q108 **Chair:** Do you think that the Government should be looking to change that in the future by maybe trying to regulate some of this? Do you think the Government should just be saying, "It is a wild west out there; you are on your own if you venture there"?

Natasha de Terán: Reading through some of the comments from the Bank and the FCA, one would assume that, in any sort of regulated crypto activities, there would be a separation of activities so that, for instance, a lender could not lend against its own coins. There is some wrong-way risk going on there. I am not sure how you actually manage that risk. I do not think you can completely stop it, because people can access things over the internet very readily.

As I understand it, there are some limitations on this in the United States. That is for regulated entities in the United States. It does not stop the US consumer, as far as I know, from accessing this stuff abroad. Clearly, investors need to be warned and crypto lending should be subject to the same appropriateness rules as anything else.

Q109 **Chair:** Do you think that some consumers who have no alternative options for a loan because they have a poor credit score are going to get caught up in doing this?

Natasha de Terán: I suppose that it could seem attractive, but they would have to invest in the crypto first. As I understand it, the biggest amount you can borrow is 90% loan to value, so you buy £500 of crypto and borrow back 90% of that. That would not give you more money than you started off with, unless you were to believe that the crypto would rise and therefore you would have more as a result, or you believed that the crypto was going to rise and you were going to use that 90% loan to reinvest back in the crypto. If you do not have the money in the first place, then perhaps no, but, if you have a little bit and want to leverage in the crypto world to improve your circumstances, it could seem a very compelling proposition with, potentially, very dangerous consequences.

Q110 **Chair:** There was the collapse of FTX recently. Do you want to make any observations about that and where that might leave this whole area?

Dr Driver: Certainly from my perspective, it brought to mind the fact that the crypto space seems to be rediscovering why specific regulations exist in the first place, for example why you have separation in respect of things such as custodial relationships and why client money is handled in a particular way. It is because of precisely the sort of risks that have come to bear in the FTX situation.

It reinforces to me the idea that, actually, if the product is creating the same sort of risks that you have in other spheres, it should be regulated in the same way or at least in a comparable way, so that it will deliver the same regulatory outcomes. You are trying to protect consumers consistently in the way that they are handling their money. Just because it has this nice shiny technology, it does not mean that there are not some of the same underlying risks that are well understood in the financial sector.

Most regulation comes into place precisely because a risk has arisen at some point in time. Just because it is new and shiny technology, it does not mean that the underlying risks associated with the crypto sphere are going to be different

Q111 **Rushanara Ali:** Good afternoon. Natasha and Rebecca, in your submission to the Committee, you welcomed the proposed changes to the financial promotions regime and crypto assets. Can you outline how you think these will enhance consumer protection?

Dr Driver: It will enhance consumer protection in a number of ways. First, it will bring crypto investing under the regulatory remit. The FCA is proposing to treat cryptocurrency as restricted mass market investments. That means there will be restrictions on the way that financial promotions can work and the way that consumers can access these investments.

If a crypto firm is not regulated by the FCA, it will need to employ a regulated firm or person in order to approve any crypto financial promotions. That means that the financial promotions will be checked. The proposals around crypto were part of a wider package and that included, for example, ensuring that financial promotions will be checked on a more regular basis, so it will not be just a once and done. For example, the processes around how clients are handled and whether people understand the risks are going to be checked as well.

One aspect of the proposals, which comes from the Treasury side, that the Financial Services Consumer Panel is particularly keen on is that crypto assets will not have an exemption that allows somebody to self-certify as a sophisticated investor. There are big problems with self-certifying as a sophisticated investor. Most people, if asked, "Are you sophisticated?", are going to want to say yes. The panel would like to see that pushed more widely. The fact that you will not be able to do that in the crypto sphere is really helpful.

There are a raft of protections, including, potentially, how consumers are warned about the risks and the fact that the language used will be very accessible. It will not be "your capital is at risk", but "you risk losing money", which has much more of an impact in terms of how consumers perceive the risks.

Q112 **Rushanara Ali:** Are you confident that the need for crypto firms to get authorisation from third parties will work sufficiently? Some are sceptical about that. Do you think that is about the right kind of balance? Is there an issue about third parties not having expertise?

Dr Driver: My pushback on that would be this: if third parties do not have enough expertise to authorise these promotions, should these promotions be being pushed to retail investors, who will certainly have much less expertise?

Q113 **Rushanara Ali:** Could you give an example of what an effective third party might look like? What sort of organisation might it be? Are there any comparables that you can point to, so that we can imagine what that third party is like and its competencies?

Dr Driver: That is a question that possibly would be better asked of the FCA.

Q114 **Rushanara Ali:** What would you like the third party to look like in order to have the competencies to be able to satisfy that criticism?

Dr Driver: The third party should be somebody who understands how the investment regime works, what exemptions exist and how they need to be regulated, how clients should be treated, including under the new consumer duty, what sorts of protections they should have and whether they are being imposed. That is from a consumer perspective. From an industry perspective, you obviously want somebody who understands the industry. As I said earlier, a lot of the risks that we are seeing in the crypto space are risks that we know about from non-crypto financial products, despite the claim to be new, shiny and different.

Q115 **Rushanara Ali:** I have a follow-up about whether there should be some sort of inbuilt system for compensation, even after all these arrangements get made, as we have with the banking sector, for instance if fraud takes place because there is something else going on and the consumer is not at fault. Is that not comparable because the consumer has already been told, "Do not invest in this stuff"? Should there be an industry-wide set-up so that they can be reimbursed, like the contingent reimbursement model, as I think it is called, in banking? I cannot remember the exact term. Is there an equivalent that needs to be set up?

Natasha de Terán: You might see a much shrunken industry as a result. There might be a great shrinkage in the size of the industry if that were to be required of it and they had to insure each other.

Q116 **Rushanara Ali:** That would certainly protect consumers, would it not?

Dr Driver: Absolutely, and in our submission on the stablecoin side of things, for example, we talked about the fact that it would helpful if, where stablecoins are being used within the payment system, they have the same type of framework that commercial bank money does. For example, if a stable cost goes bust, there would be recourse to people who have been using it from the Financial Services Compensation Scheme.

Bringing crypto within the investment regulation regime—it currently sits outside the perimeter—would mean, for example, that you would have access to FOS if you feel that your treatment is against the rules. That would be useful. I read in the *FT* that the highest number of searches on the Financial Services Compensation Scheme's website are around crypto, which is not covered by the scheme.

Q117 **Rushanara Ali:** Do you think, on balance, the improvements to the financial promotions regime will result in fewer people losing their money through scams?

Dr Driver: I would certainly hope so. It would make it easier, for example, for the FCA to identify where promotions are fraudulent and to help tackle that. Scams and fraud in the crypto sector are difficult. I know the argument is that blockchain means you can trace it back, get the money and all the rest of it. My understanding is that, unless the amounts of money involved are over £1 million, that is not likely to happen. It is not going to be cost effective for that work to be done.

Q118 **Rushanara Ali:** Joey, from your work, do you think that the way crypto assets have been marketed has caused consumers harm?

Joey D'Urso: Yes, very much so. It is a scandal, to be honest. You spoke about the victims earlier. Many of them have not actually been in the UK. They have been in places like Vietnam and Turkey, countries where the domestic currency has often collapsed and people are desperate to seek out a hedge against inflation and look to crypto assets to do that. People have heard the story of Bitcoin and Ethereum and will have heard of people who made money up until early 2021. Since then, the direction has been pretty much all down, when the mass got into it.

People got there in the peak of the bubble, which was when football clubs and athletes poured into it. The connection to sport, primarily football, comes because there is basically a very simple way to become a millionaire, which is that you create a million cryptocurrency tokens, which costs a negligible amount of money, and convince a million people to buy them for £1 each, or 1,000 people to buy 1,000 of them. How do you do that? You market them through famous athletes or famous sports clubs.

Q119 **Rushanara Ali:** Or ex-Prime Ministers.

Joey D'Urso: Possibly, yes.

Rushanara Ali: He was speaking at a crypto conference recently.

Joey D'Urso: Yes, so I believe. I do not know much about that. You create these tokens; you convince people to buy them. Why do people buy them? People buy them because they have heard stories about people who live on an island now because of some crypto investment four years ago, which did happen. These graphs went up before they went down. People buy them with the expectation of high returns.

That is what I believe from speaking to people all around the world or even just looking at Twitter and clicking "translate from Turkish" a lot. A lot of these people happen to be Turkish, where the domestic currency has collapsed in value completely, so just to stand still financially you are looking to invest in assets with a very high interest rate.

Of course, these products will never say this to you. They will never say on the outside "This is a financial investment that will go up", because that, of course, is very strictly regulated. They have stories to tell you. They will say, "This is a piece of art. This is an exciting voyage into the metaverse in six months' time" and there is a sort of road map. There are some very famous footballers who sold pictures of cartoon monkeys for hundreds of pounds, pictures that you could copy, paste and save on your computer for free, or you could pay £1,000 to a link posted by a very famous footballer.

That was in six months. This was actually in about March or April. The story was that, during the World Cup, which we are of course in the middle of now, there will be some monkey football game in the metaverse and everyone will be playing it, really riffing off the back of Mark Zuckerberg's false promises about this metaverse that never amounts to anything. These things have a story. Fan tokens will say that these tokens are for fan engagement and a way to engage in your club.

This stuff is all nonsense. People are buying these things because they expect them to go up. In the last few months, we have seen that they have not gone up. They have gone down and ordinary people have, essentially, transferred their cash to some very wealthy people, who are now deleting their tweets and saying no more about it. If one of these people were to come out and apologise, that would be fantastic. That would be courageous and admirable. They are not doing that. It is a scandal and a disgrace.

Q120 **Rushanara Ali:** You make the point about promotions. Do you think famous sports stars, people with big followings—you mentioned footballers—and others need to take greater care in what they are promoting for their own reputational risk, but also for the damage it can do to consumers? The reason why I mentioned the former UK Prime Minister Boris Johnson is that he has spoken about it, although more around blockchain. We recognise that blockchain is seen in a different light and certainly I know of examples where blockchain can be a force for good in certain circumstances.

There is a lack of awareness of the differences between things, such as blockchain versus stablecoin. There are so many different spheres within this field that people are learning about and are unfamiliar with. Do you think that former Prime Ministers, current sport stars and others need to be much more careful about what they get involved in and how they can end up legitimising things that need to be carefully understood? There are clear demarcations between the things that are safe, or safe-ish, and that which is likely to be much more risky and potentially cause consumers harm.

Joey D'Urso: Yes, absolutely. The Advertising Standards Authority, by the way, has done same really good stuff on this and pressured some sports teams and others to use the classic #ad or lengthy disclaimers about the risks of something. That in itself is not really enough. These things clearly are investments and people are buying them for investment reasons. That is incredibly obvious just by looking at the social media activity around it.

Then they stamp on it, "This has nothing to do with investment" and create this bizarre alternative story about why people are interested in the things. My personal belief is that people are buying and selling crypto assets only for investment purposes. Everything else is just false or diversionary, frankly.

Q121 **Anne Marie Morris:** Putting the fan tokens to one side for a minute and looking at non-fungible tokens more generally, I was interested in what you said, Mr D'Urso. In effect, you are saying, I think, that all these categories of crypto assets are financial products. I wonder whether Dr Driver and Ms de Terán agree with that. There is an argument out there that, if you like, these NFTs are not of themselves financial products and therefore should be regulated differently, as consumer products. The sense I am getting from Mr D'Urso is that you would not agree with that. Would that be fair?

Joey D'Urso: Yes. I think that that is true. You sometimes hear the language of collectables—that these are like football stickers or old programmes that people have in their loft. That is nonsense. There is very little demand for that in those terms. People are almost universally buying and selling them for financial reasons—to try to buy low and sell high.

Natasha de Terán: It is quite a confused area at the moment. If you are buying a non-fungible painting, why are you doing that? We are quite confused as to why you might be doing that. On either basis, it seems an odd thing to be doing, whether it is for your financial reasons or for artistic reasons. It is tricky. Clearly, it needs some education and promotion questions. Whether it is a financial asset or not, I am not convinced.

Dr Driver: It is difficult. When I was doing my prep for the panel, I was reading about things like meme coins. It is clear that people are speculating on them in a financial sense. They are bought and sold on crypto exchanges, which puts them in the same category as other forms of crypto coin, which may or may not be less about social hype and impulse investing, as one site put it.

Just excluding non-fungible tokens generally from financial regulation is difficult, partly because of what the financial sector itself is starting to talk about, NFTs in relation to funds, infrastructure investment and all these sorts of things. As they move, or try to persuade regulators that they should be allowed to move, into those sorts of areas, it will be really important that the appropriate protections exist.

Take the example of infrastructure investment. I saw one article talking about the fact that local people will be able to invest in an NFT associated with their local shopping centre. Think about the agency problems that flow from that. Who really owns the shopping centre? Is it the company that is running it? Is it the holders of the NFT? Who sorts out the situation where there is a conflict of interest between what would be best for shareholders and what would be best for NFT holders?

There are already big tensions. The joint limited liability company has been brilliant for growth, but it is well understood that there are huge tensions with the fact that you have shareholders and managers, and their interests may not be aligned. You see some of the problems that occasionally flow from that. Now you are thinking about having three different players in the same place, all of whom may have different interests.

In terms of shareholders, they at least have the board. They have the non-executive directors who are supposed to represent their interests. Who will represent the interests of the token holders in these sorts of transactions? I do not know the answers to that, but I know that those sorts of questions, around who represents the interests of token holders and how any conflicts are dealt with, are going to be really important ones to answer if this is going to be safe and effective as a long-term bet.

Q122 **Anne Marie Morris:** What you are telling me leads me to conclude that one of the challenges is that the use of the term "NFT" is not as consistent as it might be. It seems to me that there is a huge difference with an artwork, which is effectively an initial digital creation. It is unique, is an original and can have an original mark or whatever. It is not denominated in any currency or cash term. A bit like a Van Gogh perhaps, people will do copies, but there is only one original and its value is not fixed, if you like, within its definition. That is about the market. That seems to me to be a truly non-fungible token.

The other things you were talking about seem to be things that are almost on the edge of being fungible or non-fungible. What you are describing sounds awfully like a share. This share that I have and this share that my colleague has are fungible. I suspect that maybe the term "non-fungible token" is being spread. In the distinction between what is fungible and non-fungible, the line is grey. It seems to me that whether it is fungible or non-fungible will impact the regulatory regime that you need.

The concern that I think Dr Driver is expressing is where, effectively, this becomes like a share. You articulated very clearly the conflict of interest that that will give rise to, which clearly is not going to happen if you have an original digital equivalent of a Van Gogh or whatever it is. Would you say that that is probably fair, that there is confusion and that we probably need to get clarity about what truly falls into the category of a non-fungible token, as opposed to something that maybe needs a different definition? Because some of the sports pieces, which we will come on to later, are different, maybe they should be regulated differently. What do you think?

Joey D'Urso: On NFTs and digital art, I personally think this is an emperor's new clothes situation. We talk about this being a unique digital piece of art, but that is not quite what it is. It is an image that you can copy and paste for free on the internet.

You imagine Van Gogh's sunflowers as an NFT. You have the image of it. Anyone can screenshot that on their phone, copy and paste it, send it to a friend on WhatsApp and they have the same thing. The image is inherently fungible. Pixels do not mean anything, unlike the thing that his hand once painted and a piece of art.

The NFT refers to a hash, a line of code, a load of numbers and letters in a row. That is the NFT. If you are paying £1 million for an NFT of Van Gogh's sunflowers, you are paying £1 million for a string of numbers that point to something that everyone can get for free. The whole thing is complete nonsense, frankly.

Q123 **Anne Marie Morris:** Can I unpick that a bit? We are not talking about, if you like, a digital replication of something that already exists in physical form. As I understand it, true NFTs are things that are absolutely original and do not exist in any other physical form.

Joey D'Urso: You are completely right, so perhaps that was a bad analogy. Imagine an original piece of artwork by a digital artist and exactly what I said still applies. Anyone can copy and paste it for free, but you can pay a huge sum of money for this line of numbers and letters.

That is what happened last year and people convinced themselves that this was actually worth a lot of money. The graph shot up and then the ordinary people got into it, the rich people cashed out and the graph fell to the floor. A lot of these things follow this same graph, which is huge shooting up at the start and then slowly bleeding to death, as the original people cash out and the poor people are left holding the bag at the end.

Chair: It is a bit like tulips.

Joey D'Urso: With NFT art, that is my personal opinion, yes. Lots of this is more complicated than that, but with NFTs I think that it is complete nonsense personally.

Dr Driver: There are also examples where the picture has been swapped because the customer has an NFT that links them to the token but what the token then links to can change. People have provided examples of that to demonstrate the risks associated with it.

Q124 **Anne Marie Morris:** It seems to me that there is confusion. The definition is not being properly attributed. The point that you are all making very clearly is that, because of that, the consumer is effectively misbelieving that something is an original when it is not, because this is all so new. As opposed to that, if you get a photocopy of Van Gogh's sunflowers, you kind of know that that is not the real thing. This is a physical space that we understand, whereas crypto is a space that we do not really understand.

Therefore, in this area of non-fungible tokens, given it includes these pictures, some of which are unique originals—all right, just like the sunflowers you can copy them, but there is one original—does the responsibility for Government Departments need to be different? You have a financial piece, which is very much in the area that we have been talking about, so like a share. Then there is the idea, "This is just an artwork", and therefore should that actually be consumer protection and DCMS? Do you think that there are two strands of Government work when we are looking at these ?

Natasha de Terán: I would not think that your football tokens or the art should be in the FCA's remit.

Q125 **Anne Marie Morris:** That is sensible. In terms of how we can use these going forwards, it seems to me—and Rushanara made this point earlier—that these NFTs can have a positive use for good, partly because of the nature of blockchain technology.

I was having a conversation the other day with someone who suggested that, the way this works, these non-fungible tokens could be used to store health records. In a way, what are we looking at? It is something that is unique. What is more unique than your health record? You do not want anybody else fiddling with it or changing it. You want it such that that cannot be done. It seems to me that, maybe, if we get the definition right, there is a broader application for these NFTs that could be a cause for good. Would you say that that was a possible way forward?

Natasha de Terán: I would not pretend to predict the future of these technologies. Thinking about health records, if you said to me, "Would you be happy for your health records today to be immortalised on a blockchain?", I would say, "No, thank you very much". Someone tomorrow might be able to cryptographically break that and find out something I do not want them to find out.

Q126 **Anne Marie Morris:** Let us try to take something a little closer to home and easier to understand than health records, which I agree is something for the future. If we take a rare bottle of wine, as I understand it, there is a lot of fraud in the fine wine industry. If you can actually have the label as a non-fungible token, that gives you something unique, which enables you to absolutely identify that that is a genuine bottle of wine.

Is that a good use of this and therefore is this a technology that, used properly, should actually be allowed to grow, as opposed to the concern I think I am hearing from Mr D'Urso, who, frankly, would like the whole thing to just collapse? Is there some good in this?

Natasha de Terán: I think that, in the context you were talking about, you would like it to collapse. Are there potential useful applications? Potentially, yes, but if you want to commit fraud, you are going to commit fraud. If I want to falsify a painting or avoid paying an artist's rights when I buy a painting, I will say, "Rebecca, here is 100 quid. Just do not move it on the register. Thanks very much", much as I might fraudulently put a number and a label on a bottle of wine.

We should not think that, however great this technology is, it can avoid all those things. It can sound very compelling, but let us take a step back and ask, "Could I put my paintings on the blockchain and ensure that you could only transfer my painting if it was transferred in the blockchain—otherwise you did not own it—so I would get my artist's rights every time?" Yes, so long as everyone wants to be well behaved. If they do not want to be well behaved, no, it does not work.

Q127 **Alison Thewliss:** I have some questions for you, Joey, around some of the work you have done on fan tokens. Thank you very much for the consistent investigation you have done around this. It has been incredibly helpful. I wonder if you could just tell me, initially, what your overall thoughts are on fan tokens.

Joey D'Urso: My overall thoughts are that the fan token industry is talking to two audiences at once. It is saying very loudly to the British public, football fans, MPs and glitzy sports conferences that this is about fan engagement, about deepening your love for the game, whatever. There are vanishingly few users who use it for that. They are saying very quietly to a different audience, which is currency speculators in places such as Turkey and Vietnam, that this is a way to get rich quick.

Q128 **Alison Thewliss:** That is quite concerning if those two things are going on essentially at once. Some of the evidence that we had from Ian Taylor from CryptoUK on this was that he felt it was a good way to do fan engagement and get people involved. You do not think that that is really the case.

Joey D'Urso: No. If you look at the people who are excited about this and, as I said, the social media chatter about it, it is people in Turkey trying to guard their life savings. Fan engagement is a fantastically important thing in football. You have the fan-led review process in Parliament at the moment. You saw with the European Super League and all that fiasco how incredibly important this is. It is pretty outrageous to try to co-opt that really important thing as a means to sell crypto to people under false pretences.

Q129 **Alison Thewliss:** Is there anything they are doing differently from existing loyalty schemes that clubs already have?

Joey D'Urso: Many of these clubs have loyalty schemes. Think about Arsenal and Aston Villa, to go alphabetically, two clubs in the Premier League. They have schemes where you pay 50 quid a year and get priority access to tickets. You can enter prizes and meet players, all these kinds of things. Hundreds of thousands of people enter these things.

They also have a Socios scheme, which is supposedly fan engagement. It is all about fairly trivial things such as voting on which song they are going to listen to in the changing room. I think that that was the one that the ASA pulled them up on. Lots of these teams already have loyalty schemes and loyalty schemes are great.

Another odd thing about this is that it is billed as revenue generating for clubs. People in football love the term "revenue generating" because they want businesses to make money. Football fans should want their clubs to make money, because then they can be profitable, they hope charge less on tickets, sign great players and whatever else.

If you are generating revenue from selling someone an overpriced football shirt at £100, I personally think that that is a massive waste of money but, if someone else wants to buy it, they are aware of what is going on there in that transaction. A ticket is however much it is. Again, the buyer and seller understand the transaction. It is very clear. You can choose to buy or not to buy the ticket.

With the tokens, the transaction is not very clear. A lot of these people are buying them because they think that the line is going to go up. They are not buying them for fan engagement or whatever else. Then the line goes down and people just quietly disappear. People are embarrassed to complain about this stuff. It is incredibly humiliating. Imagine telling your family that you have no money for Christmas presents because you spent it all on cartoon monkeys and football tokens.

Q130 **Alison Thewliss:** Is there any sense of how much, in monetary terms, fans have lost out of these schemes, given what you are saying about people being quite shy about it or reticent to talk about it?

Joey D'Urso: The firms themselves would dispute the term "lost", because they have these tokens, which offer you votes on whatever else. In some of the big firms, they have turned over tens of millions of pounds' worth of these tokens. The primary holders are in places such as Turkey. Some of these smaller NFT schemes promoted by footballers have been hundreds of thousands or millions of pounds. There will be human stories here of people who have spent £2,000, £3,000, £5,000 or £10,000 on a token, thinking, "This is a great investment. I will flip it in two weeks or something", which has financially devastated them.

It reminds me a lot of the stuff around Football Index, which is a story I did a lot on. That is people quietly sitting in their upstairs bedroom during the pandemic, moving things around on a screen, not necessarily telling family members what they are doing. Then they are financially devastated and there is no recourse whatsoever.

Q131 **Alison Thewliss:** There is a further failure in regulation around that as well for people. Do you think that fans who are being encouraged to buy these things really understand to any extent what they are getting into? There have been issues for years about the prominent role of gambling within sport and gambling companies. A lot of these companies that are also involved are sponsoring clubs and events. Do you think that that attracts fans in and do they know what they are getting into?

Joey D'Urso: The link to gambling is very important because gambling in football is being increasingly scrutinised. There is the gambling review underway now and there have been lots of news stories about a potential ban on sponsors. The long-term trajectory of gambling in football has probably peaked. It will always be there, but cryptocurrency has almost filled the gap, particularly about a year or so ago.

I think that people do not understand what this is. Match-going fans in the UK are not the main audience for a lot of this stuff. The idea is that you create a token with your brand name that is known around the world as a top British football club and then you convince people on some weird exchange in some far-flung part of the world to buy it. The match-going fan is often fairly irrelevant to all this.

Q132 **Alison Thewliss:** Do you think that even the footballers who are getting involved in this understand what they are getting into as well and the harm that that could do to people who are getting involved?

Joey D'Urso: No, I do not think so. I think that some of them are perhaps very badly advised and paid lots of money to promote something on their feeds. Some of it is just very rich people with a lot of time on their hands. It is almost like buying an extremely expensive scratch card—buying an NFT for several thousand pounds. I think that they find it exciting. Footballers, of course, are not allowed to gamble on football itself. It is a way of getting that rush, perhaps.

Q133 **Alison Thewliss:** That makes sense. Do you think that there is a means of regulating fan tokens?

Joey D'Urso: Yes, they are regulated to an extent. In the US, these things do not exist because of securities regulations, so there are ways of regulating them. The UK seems to be fairly lax on that front.

Q134 **Alison Thewliss:** Should we go down a road like the US in that area?

Joey D'Urso: There is always the argument that banning things drives people to doing the same thing on a VPN. One thing I very strongly think is that football organisations, the Premier League, clubs themselves, have done nothing here. They have completely washed their hands of it. Individual clubs perhaps do not have the financial expertise within them to properly scrutinise this stuff, although then you think, "Why promote it to your fans?"

You can look at organisations like the Premier League, the Champions League and the English Football League. UEFA has a partnership with some of these schemes. Crypto.com is plastered all over the billboards at the FIFA World Cup right now. Some of these big footballing authorities do not want to know, as their products are being used to promote extremely dubious financial products around the world. There should be more pressure on them.

Q135 **Alison Thewliss:** You talked about the role that the Advertising Standards Agency had had in some of that. Does it have enough of a role? Is there more that it could be doing?

Joey D'Urso: I think that it has been really good, frankly. I know that its remit is very limited, but it has put out some pretty sternly worded stuff. It only responds to complaints, I believe, but it has done some good work on it and understands it. Maybe other Government bodies could speak to it, but I suppose it is fairly limited in what its scope is.

Q136 **Alison Thewliss:** Do you think that fan token providers, such as Socios, should be subject to some kind of regulatory requirements to help better protect consumers as part of this?

Joey D'Urso: Yes.

Q137 **Alison Thewliss:** What would that look like?

Joey D'Urso: It would mean recognising these products for what they are, which is financial investments, financial securities. This line every time is "these should not be used for financial investments". Then why create volatile cryptocurrencies that have to be bought using cryptocurrency? To buy one fan token, you have to buy two layers of cryptocurrency. You have to buy a certain amount. You cannot buy £10 worth. You have to buy a minimum threshold.

As I said at the start, the quickest way to become a millionaire is to create a million tokens and sell them to people. They are creating tokens, then creating more and more complex stories to sell them to people who are really excited. Another reason why sport is such a route in for this stuff is that people get incredibly excited about sport, to state the obvious. These highs and lows of cryptocurrency are almost mirrored by the highs and lows of sport. You saw that particularly during the pandemic.

The question I always come back to with fan tokens is "why cryptocurrency?" In two years of trying, I have never got a good answer to that. Why not create and charge people money for these tokens, which allow you to vote on things and polls, and make money from it? That is great. As I said, like the match ticket, say what the price is on the tin. People can choose whether to buy it. I have no answer on why you need to sell people two layers of cryptocurrency to get them into all this.

Q138 **Alison Thewliss:** There is no really good reason to have them as cryptocurrency.

Joey D'Urso: I do not understand it still.

Q139 **Alison Thewliss:** Fan tokens from Socios can only be purchased, as you are saying, with a form of crypto asset called Chiliz. Does that now bring them into a financial promotions regime altogether really?

Joey D'Urso: Yes, people buy and sell Chiliz as a financial investment. It started off near zero and then skyrocketed to 70-odd cents. Now it is incredibly volatile, so people day trade it to try to make money. That is what all the activity is. There is millions of dollars sloshing round the world on these exchanges, buying and selling this thing, but what is the point of all this? What value is being generated by these tokens, apart from enriching the people who create them and the clubs who put their names to them, and harming people, as I have mentioned, in places such as Turkey and Vietnam?

Q140 **Alison Thewliss:** Is forcing fans into having to buy tokens to do the next thing and the next thing driving demand within their own business?

Joey D'Urso: Yes, absolutely.

Q141 **Alison Thewliss:** Are there any other ones outside of Socios that have been developed with similar requirements for the crypto tokens?

Joey D'Urso: Yes. There is a company called Bitsy. There are various others that have completely collapsed. There have been a few scandals like this in Formula 1. Socios has not collapsed. It is still going strong; it is expanding all the time.

It goes back to some of the positives of blockchain. Of course I believe that, potentially, when trading bottles of wine, that could be a great way to register things. Having looked at this very closely for two years, I am now incredibly sceptical of everything because I have seen so many stories where someone tells you a story about some great usefulness of this thing. Actually, it is all about creating the token, finding a reason to sell the token to people and then the token collapses. People have bought it because they think that it will go up. They have effectively transferred their money to a rich person for nothing.

Q142 **Alison Thewliss:** In one of your articles you made reference to a 2018 Chiliz white paper, which stated that acquiring Chiliz, which are required to purchase Socios fan tokens, is only suitable for financially sophisticated persons or other persons who have been professionally advised. In response, Socios said that this was not a true reflection of the views held today. Where does that currently sit?

Joey D'Urso: I do not know their latest opinion. I suppose the definition of "financially sophisticated" has shifted a lot in four years, particularly over the pandemic.

Q143 **Alison Thewliss:** We talked about that earlier—about who is and is not sophisticated.

Joey D'Urso: This stuff completely changed in the pandemic. A lot of people were financially devastated by the pandemic. A lot of people were also in a better place financially because they were not spending any money on anything. For the first time in their life, they had a bit of spare change. That drove demand for cryptocurrency. People had more time on their hands. People were working from home.

The graph of Bitcoin is similar to the graph for the pandemic. That created this mass of buyers for crypto who did not exist before, which has now dried up, hence the graphs are all going down. People will tell you that this goes in cycles—it went up and it went down—but now we are below the bottom of the last cycle, and more and more scandals are coming. If anyone thinks that it will go back up, you can make a lot of money from that bet. I think that it has exhausted this mass market now and the graphs are all heading in one direction.

Q144 **Alison Thewliss:** You think that that wider economic picture could put a bit of a halt to some of this stuff.

Joey D'Urso: Yes, the wider economic picture. If you are trying to pay your energy bills and you have £1,000 worth of Bitcoin, even if it is constantly declining, you sell it and have it in real money to pay your bills. Perhaps in the pandemic, when people had more disposable income, they were more likely to hold on to it.

Alison Thewliss: I do not know if you have anything in particular to add to this.

Dr Driver: Yes, not so much on the football tokens, but I was very struck last year, when I was starting to think about crypto investments in the context of my role on the panel, by an article by Lucy Kellaway in the *FT*, talking about crypto in the classroom. She provided anecdotal evidence from three or four London comprehensives that you had teenagers basically speculating in crypto assets.

My guess is that these sorts of football tokens, where you have to buy crypto in order to buy the token, are possibly a gateway to that sort of behaviour. Even though, theoretically, children or teenagers are not supposed to be trading crypto, there is potentially a link into that sort of behaviour.

Q145 **Alison Thewliss:** That is really interesting. Is that being driven by social media as well as other things, do you think?

Dr Driver: I guess, yes.

Alison Thewliss: That is really interesting.

Q146 **Chair:** With your role as consumer protection, you are not really having a lot of people who have invested in crypto assets contacting you about it, so how do you, on the consumer panel, best discharge your duties to consumers in this new area, when there are clearly a lot of nefarious things going on, as Joey has told us?

Dr Driver: The role of the consumer panel is to act as adviser on the impact or likely impact of financial regulation on consumers and small businesses. We are not directly consumer facing, if you like. We are not a complaints organisation like the FOS or anything like that. As part of the activities that the panel undertakes, we talk to organisations such as the FOS and the Money and Pensions Service, to understand the questions that they are seeing, as well as the Financial Services Compensation Scheme and a lot of FCA teams.

We try to understand the intelligence that they are seeing from their side but also to provide advice: "When we look at this, how do we see the risks? What do the risks look like from a consumer perspective?" You are right that we do not have a direct consumer-facing role. As panel members, we have quite a diverse background.

Q147 **Chair:** You are in the regulated space and this is a load of quite alarming stuff going on beyond the regulatory perimeter, which may well be affecting very young consumers, maybe in school, who are being conned out of their money by these things and are learning particular ways of being able to invest, which are pretty horrendous. It might not be your direct duty to do something, because it is not regulated, but how does the system pick up that kind of looming threat outside of the perimeter and try to at least be aware of it? Would you not really worry too much unless the Government decided in some ways to regulate in this area?

Natasha de Terán: We have a system. We have very different representatives on the panel, many of whom are involved in other consumer-facing organisations, be that Citizens Advice or otherwise. We would see it very much as our duty to have our ear to the ground on financialisation issues, such as your NFTs or crypto more generally. It has been something that we have been worrying about.

If I had made a crypto investment and it had gone wrong, if I had lost my money, or if I had been a victim of a crypto scam, I do not know that I would necessarily go to the FOS or the FSCS because, if I read my stuff, I would realise that they would have no locus. Would there be a formal way for us to hear about this?

Q148 **Chair:** I am not asking that. I am saying that it is clearly a developing issue outside of the regulatory perimeter. In America, it is in parts of the regulatory perimeter and that has stopped this activity. We will have the FCA people in very shortly to ask them what they think about this, but surely you have your ears to the ground. You know that this is going to be an increasing presence. Do you have a role to make some suggestions? It is really a con. It is a gigantic network to con people out of money. Do you have any worries about it systemically, or do you not consider it at all until it comes within the perimeter?

Dr Driver: Possibly in answer to that, we absolutely raise issues where we think the perimeter is in the wrong place in our consultation responses. Cryptocurrency investment is not regulated currently by the FCA, but we made the effort to respond to the Committee's consultation precisely because we recognise that this is a new and emerging area. It is an area that creates risks for consumers. In that sense, we are proactive.

We are not sitting there thinking, "That does not concern us" and only looking at the risks that are currently within the perimeter. We will actively think about how we respond and engage as appropriate.

When the FCA did its consultation on financial promotion rules, one of the aspects of that was on cryptocurrency. We tried to assess, "What are the risks from a consumer perspective?" We were very supportive of what the FCA was saying. We pushed in certain areas where we thought that more could be done. We are not directly a regulator, so we do not get to set the rules. We get to try to influence the rules. We respond to consultations by HMT. We respond to a wide range of consultations beyond purely the consultations associated with the FCA. A key role of the panel is to advise the FCA on consumer and small business issues.

Q149 **Chair:** Joey, do you think that the FCA should be looking at what has happened in America and thinking about regulating and perhaps banning some of this activity, especially when the people who are suffering appear to be in other countries?

Joey D'Urso: Yes, I do. I do not know about banning. As I said, are you forcing people underground? It is a hard one. You can definitely say that the UK is very different. In Switzerland, this stuff is really tightly regulated, as in the US and the EU.

Q150 **Chair:** What sorts of regulations work there to supress some of the worst aspects of this that we might consider here?

Joey D'Urso: More of these things are viewed as financial securities. A lot of these things clearly are viewed as investments, as securities, by the people who buy and sell them. The company spins a story about how it is about something else. Maybe the thing is not believing those stories and looking at how people use them.

Q151 **Chair:** If these things are defined as securities, that would bring them within the perimeter of FCA regulation.

Natasha de Terán: That would be a definition under primary legislation.

Chair: It would have to be done by Parliament to start with, before you were all given your orders at the FCA. Thank you very much for giving us some insight into what I know many people think is an obscure but growing area. We are going to get on to our next panel, so thank you very much.

Examination of witnesses

Witnesses: Sarah Pritchard and Matthew Long.

Q152 **Chair:** We come to the second panel of our hearing on cryptocurrencies today. Welcome to our new witnesses. Would you like to introduce yourselves for us?

Sarah Pritchard: I am Sarah Pritchard. I am executive director for markets at the Financial Conduct Authority. That means I jointly lead all our supervision, policy and competition work. I have the strategic lead for all things crypto.

Matthew Long: I am Matthew Long. I am a new director for the department that covers crypto, digital assets and payments in one department. I lead on the supervision.

Q153 **Chair:** The Government want to promote and foster a crypto industry within the UK. Are the FCA's views on crypto-asset regulation aligned with the Government, or are you perhaps more worried than the Government about the implications of this?

Sarah Pritchard: I would like to say up front that we think about crypto in three ways, each of which comes with its own set of risks and regulatory focus. First, there is the possibility of using crypto for payments, otherwise referred to sometimes as stablecoin. You will be aware that Government have announced their intention to introduce a regime for that. We are working closely with the Treasury and the Bank of England to formulate what the core ingredients of a regulatory regime for that could be.

Q154 **Chair:** Before you go into the next two bits, do you have any timescale on that?

Sarah Pritchard: The timescale on that is to be determined by the Government. We are working closely with them to make sure, at the point the Government are ready to take that forward, that there are provisions in the Financial Services and Markets Bill, which is being considered right now.

Chair: Yes, at this very moment.

Sarah Pritchard: We are giving early thought to that, alongside the provisions in the Financial Services and Markets Bill, so we can get ready for when Government are ready to take that forward.

Chair: There were two other parts of crypto that you were talking about before I interrupted you.

Sarah Pritchard: The second aspect is that crypto is a speculative investment. In that context, you have taken lots of evidence just now in relation to consumer protection risks and consumer issues. The FCA has a very narrow remit for crypto at the moment. We do not authorise under our normal financial services remit. There is no consumer protection remit for crypto. We have a very narrow registration regime, which looks at crypto-asset firms in relation to money laundering and terrorist financing standards.

As you will be aware—I am very happy to talk about this in more detail, if that would be helpful—we have seen a really significant failure rate or withdrawal rate for firms not meeting our standards at the gateway. That is a registration regime only focused on money laundering and terrorist finance. Notwithstanding the fact we do not have a consumer protection regime, we are really concerned that consumers do not understand the risks they are getting into with crypto, which is why you will have heard the FCA say repeatedly, "Crypto is a high-risk investment. Be prepared to lose all of your money".

It is a real concern for us that there is a disconnect in relation to the understanding of risk by consumers, particularly young consumers. That is why we are very focused on working to support the introduction of rules on financial promotion, the marketing of crypto assets, which Government have signalled will come into our regime. It is dependent on legislation to be given to us.

While we have not confirmed the final set of rules for how that will operate, we have said that you can very much expect us to take a similar approach to the new rules we confirmed for high-risk investments back in August. We were really focused on making those rules as effective as we could, being quite innovative and doing some behavioural testing in terms of what labelling or regime can really assist in helping consumers to understand the levels of risk.

We had really simplified risk warnings. We are moving away from the "your capital is at risk" warnings and towards saying, "Do not invest unless you are prepared to lose your money. This is a high-risk investment". We introduced cooling-off periods. There is a 24-hour cooling-off period for first-time investors in high-risk investments. We also introduced a ban on inducements, such as "refer a friend" bonuses.

While those rules do not apply yet to crypto because crypto is not yet in our remit, we have said that we will take a similar type of approach when crypto does come into our remit. We would very much support that coming into our remit because we are concerned about the levels of risk and the disconnect in terms of the level of understanding.

Q155 **Chair:** Are you concerned that there is quite serious damage being now because there is no regulation whatsoever? As we heard earlier, people are losing a lot of money and sometimes all their investments by falling for some of these crypto-based scams.

Sarah Pritchard: What concerns me is that disconnect in terms of consumers' levels of understanding. We launched an InvestSmart campaign back in September 2021, linked to our consumer investment strategy. That is an £11 million campaign over a number of years, with some quite innovative digital media content—we are on Instagram and TikTok—to try to reach young investors.

We are trying to explain the basics of the factors to consider when investing. We want people to have the confidence to invest, but we know very much that there is a disconnect, particularly with those young consumers.

We did a survey linked to the launch of that campaign, and it showed that 68% of young people thought that crypto was protected, for example. That is a concern. We have no consumer protection remit or mandate in the UK for crypto at present. That is why you do hear us repeatedly saying, "Crypto is high risk. Be prepared to lose all of your money if you invest".

Q156 **Chair:** Are you worried that a greater regulation of crypto assets might provide a halo effect that leads consumers to believe that it is a regulated product when it is not, despite all these dire warnings that thankfully will be appearing on the adverts?

Sarah Pritchard: We run that risk right now because there is a narrow registration remit for crypto firms in relation to money laundering and terrorist financing. We take routine press queries, many of which are asking us questions about what our consumer protection mandate is. We repeatedly say that we have no consumer protection mandate right now.

Bringing financial promotion into our remits should help put a clearer focus on requiring firms to label and demonstrate that this is a high-risk investment. It does cause me concern that there is that disconnect around the level of understanding of risk and where people are choosing to invest their money.

Q157 **Chair:** Would an outright ban be better until you have this sector properly within the regulatory ambit?

Sarah Pritchard: Ultimately, it is a decision for the UK as a whole—for Parliament and Government—as to whether the UK wants to introduce a crypto regime. Right now we do not have an authorised crypto regime. We do not ban other high-risk investments in the UK.

With that said, you may have seen that in October 2020—it was confirmed to be permanent in January 2021—we did ban crypto derivatives for retail consumers because we were concerned about the ability to properly value the underlying assets and the volatility. That is an example where we took the steps that we could do, recognising the risks to retail consumers.

Q158 **Chair:** If something particularly worrisome emerges like that, you are prepared to take action and just ban it.

Sarah Pritchard: What is important is that we can only take action on things within our remit. Even though our remit for money laundering and terrorist financing purposes is really narrow, we have done what we can do to shine a spotlight on the risks we are seeing.

Looking at the standard of the firms that are coming to us in the first place, we have seen a really poor standard of applications. When we had our temporary registration remit, only 5% of the applications that came before us were of a sufficient standard that we were able to progress them; 30% required significantly more work.

Applications for registration have to meet what are at times quite basic money laundering and terrorist financing standards. Overall, 73% of the applications have either been withdrawn or have failed because we have said no. That is the most significant withdrawal or failure rate we have had when taking on a new remit such as this.

Q159 **Chair:** Matthew, is that because there is a lot of dark money involved on these exchanges?

Matthew Long: In terms of dark money, there is money laundering that runs through crypto. Our job has been to look at the anti-money laundering regime and make sure the firms that are operating in the UK have very good measures in place. For example, we will look at transaction monitoring; we will look at the structure of the board; and we will look at all the ways the crypto is moving and see whether there are safeguards in place.

For example, if someone was moving £100 of crypto a week and then suddenly £1 million moves through, you would expect that to be picked up either by a human or by automation. We would then expect to see a suspicious activity report and then something like a defence against money laundering, which would give law enforcement a chance to intervene. It is not just about it flowing through; it is about having processes so that law enforcement can take the right response.

The firms that we have put through—there were 39 on the list; there are now 38—are those that have gone through those checks and we have checked them personally. All of the others did not meet that standard. It is a robust standard, because we do not want money laundering through crypto in the UK.

Q160 **Chair:** Several overseas jurisdictions have begun to implement crypto-asset regulatory regimes. What, if anything, can the UK learn from the people who have already done this?

Matthew Long: In terms of what we can learn as the UK, the Financial Conduct Authority has taken the lead for the international securities group. We are the chair for that group. We have those 130 countries, and we are learning from each of those. For example, we will take the learning from the FTX collapse and other experiences and we will put that into our regime.

Q161 **Chair:** There is quite a lot of learning from that, is there not? What would you say your learning from that was?

Matthew Long: FTX was a crypto-asset exchange that was not authorised or regulated by the FCA. Not only that, but we put out a warning saying that we thought they were conducting unauthorised activity on 16 September. Once they collapsed, we made a number of observations.

If you take a step back from FTX, you have issuance, so minting a coin and then issuing it; then you move through and you have trading of it in the same place. You then have wholesale market activity and custody, as in where the funds are safeguarded, all in the same place. In our view, that is extremely dangerous because you can have an interaction between each of those things. In other regulated areas, there would be separate legal entities or there would be sterile corridors so they could not influence each other.

The learning that we have taken in our international role, through the IOSCO consultation we are currently running, which will lead into the UK consultation, is about splitting out each of those areas and asking, "What does best practice look like? What safeguards should we have in place? As an international organisation, can we make some recommendations that would mean we had international safeguarding that ran in parallel to the UK safeguarding model?"

Q162 **Chair:** Famously, the existence of Bitcoin and various other cryptocurrencies is about libertarian freedom from regulation and government of itself. Will attempting to regulate it and bring it into a regulatory space tend towards the creation of Government-backed stablecoins rather than this libertarian free-for-all that we have seen on the web to date?

Sarah Pritchard: You will have seen many regulators and international regulators talk about same risk, same regulatory outcome. As Matthew has described, some of the risks here can exist elsewhere in the traditional finance sector, but they are managed through conflicts of interest, client asset regimes and the standards that apply in the event that firms collapse.

It has been a relatively interesting question to ask, "What would the approach to defi firms be in relation to regulation?" We ran a crypto policy sprint back in May this year. That was the very first policy sprint we have ever run in the FCA. It was informed by the successful approach we have taken in relation to tech sprints, where you bringing together a number of people in a room. In this context, it involved about 200 people from academia, industry, regulation and consumer groups.

In that policy sprint, we worked around some problem statements to ask what the ingredients would be for a safe regulatory system, if crypto were brought in. That policy sprint in May this year was us trying to get ahead and get ready to consider what the key ingredients would be.

The outputs of that, which we published in June on our website, were very much around the consensus among the participants in the room that there should be regulation and there should be similar types of standards. That is not necessarily a given, given the defi nature of how many of the technologies and firms established themselves to start with.

The real consensus in that room was that regulation will be required to make this a success and to ensure that consumers are protected and the market is working well, taking a "same risk, same regulatory outcome" approach.

Q163 **Chair:** At the moment, different regulatory regimes are beginning to develop in different areas. Clearly, when something is globalised in the way this is, we know that your weakest regulatory area is the only protection you have. How worried are you about the fragmentation of regulation, as it is developing at the moment? Might that leave you with a weak regulatory system that is not effective?

Sarah Pritchard: The global nature of this is really important. It is really important that the FCA is playing a strong role on the international stage. We are leading some of this work and fully inputting into all the relevant global standard-setting bodies in this context.

Where we see harm—we see this right now in the way the money laundering regime works—is that the money laundering regime bites only on firms with a physical presence in the UK. We know that consumers are able to buy crypto from entities that are outside the UK. Whatever regulatory regime the UK ends up with—that will be a matter for Treasury and for Parliament to determine—it will be really important that we have strong global standards and strong global relationships.

It will also be really critical—this goes back to the consumer understanding—for consumers to continue to know that it remains high risk. It will also be important for them to understand—this can be very complex—where the entity is, what protections you have and whether the protections differ if the entity is outside of the UK.

When the financial promotions regime is brought into our remit, it will be broader and it will catch financial promotions that are offered to people in the UK. We will have a broader geographic remit than we have currently under the money laundering and terrorist financing regulations.

Q164 **Mr Baron:** Can I just turn to the issue of proposed changes to the rules around financial promotion? We know crypto assets are unregulated and therefore presently sit outside of the promotion regime. Well-intentioned proposals are coming forward to protect consumers. Can you tell us how they would do that? How is it going to make a difference on the ground or in front of the keyboard?

Sarah Pritchard: You are absolutely right: the financial promotion of crypto assets is not yet in our regime. We have not yet fully confirmed the set of rules that would apply, but we know it will come into our regime. That was signalled earlier this year.

In January, we consulted on what the potential framework could be for crypto assets alongside all the other high-risk investments we were consulting on. We have confirmed the rules for everything other than crypto. You can expect us to take a very similar approach in relation to the standards we would expect, subject to the rules being confirmed.

Q165 **Mr Baron:** Have you firmed up what those rules are going to be and how they are going to protect consumers? Are you in touch with the Treasury about this? When are they likely to be introduced? These are all issues that seem very vague at the moment. I am particularly interested in the discussions you are having with the Treasury, if you are having any at all. Presumably, you are.

Sarah Pritchard: We are in very close contact with the Treasury as it looks to shape all of the various different ingredients of the crypto regulation framework. The new high-risk rules we have are very much informed by behavioural testing with consumers. They contain some key elements.

Firstly, there is a very simplified risk warning. There are risk warnings for high-risk investments that say, "Do not invest unless you are prepared to lose your money. This is a high-risk investment. Click here for two minutes to learn more". That is a risk warning that we tested through behavioural testing. It is much more simplified compared to the "your capital is at risk" type of warnings you might be familiar with that have previously existed.

We have also introduced in those high-risk investment rules a 24-hour cooling-off period. For first-time investors in high-risk investments, there must be 24 hours before the investment can be made to enable cooling off. Our research shows that, for high-risk investments, many people are driven by hype, a sense of competition and a sense of losing out. Previous research shows that 45% of self-directed investors do not realise that losing money is a risk of investing. We think it is important that people have that cooling-off period and a moment of positive friction. We have also introduced a ban on "refer a friend" bonuses and on inducements.

Those are the rules that were confirmed in the summer. The simplified risk warning element has already come in during December, and the rest of those rules will come in during February, in order that the firms subject to those rules have sufficient time to prepare. We had some strong feedback through that consultation that firms needed six months to prepare their processes to have those rules in place.

We would take a very similar type of approach to crypto. You might have seen just yesterday that we consulted on a strengthened gateway for those who are approving financial promotions on behalf of others. Again, that is a provision within legislation. It is a provision within the Financial Services and Markets Bill that is being heard this afternoon. Again, we are trying to get ready for what that will look like in practice when that legislation comes in.

Q166 **Mr Baron:** What work are you undertaking to ensure the industry itself is ready for the regulation? It will not be welcomed in all quarters, will it?

Sarah Pritchard: We have detailed industry engagement on crypto broadly. I talked about the crypto policy sprint that we ran in May this year, trying to get consensus at an early stage over the key issues to resolve in a regulatory regime.

Once Government have signalled what their intent is in terms of developing the crypto regime, the expectation would be that we would then go out for consultation and have some quite extensive consultation involving our panels—members of the consumer panel, who were here just before us, and our other statutory panels too. That would be the right moment in time to do that in relation to what a full-scale crypto regime could look like.

We have already consulted and had industry engagement through the consultation process in relation to the financial promotions aspect that was issued earlier this year.

Q167 **Mr Baron:** When is all this going to be ready to press the button on? When is the Treasury going to be introducing these new regulations?

Sarah Pritchard: This is where it is important to break down the various constituent elements that are being talked about. The stronger gateway for us to require those approving financial promotions to be approved by us will come into effect once the Financial Services and Markets Bill comes into effect.

The Treasury has signalled an intent to consult on the proposals on stablecoin. I would expect that relatively shortly, but it will be for Treasury to confirm.

The confirmation in relation to the UK's appetite in an overall crypto framework, again, would be a subject for Treasury to confirm. We are working very closely with them and with colleagues in the Bank of England because, for a stablecoin and crypto regime, it is important that we are working with our key regulatory and Government partners as well as all the international stakeholders that Matthew has been talking about.

Q168 **Mr Baron:** You are basically saying that the timetable is ultimately down to the politicians.

Sarah Pritchard: It is, yes.

Q169 **Mr Baron:** Can I quickly move on to the issue of third-party firms? It was suggested that the need for crypto firms to get authorisation from third parties will not work in practice, as the third parties often do not have the level of expertise to act as a third party.

The risk of this is that a lot of the operators—most are decent and so forth—will go overseas. How are you going to deal with that initially? The feeling is—there is quite a consensus on this—that initially you are going to be bereft of companies or firms that can provide third-party authorisation.

Sarah Pritchard: I know there has been quite strong feedback in relation to whether there are people who could give that approval on behalf of financial promotions. The way in which the legislation under the financial promotion order operates is that you need to be either authorised or exempt. Treasury will confirm how that will be brought into our regime, and we will be working with Treasury to get ready for that.

The rules will bite. If the concern is that financial promotions coming into our remit will force activity offshore and outside of the UK, this will apply to anybody marketing to UK consumers. It will be a stronger protection for UK consumers than exists currently.

Q170 **Mr Baron:** I take that point, but you cannot just conjure up expertise and authority in an area that is still relatively new, particularly when you are looking to third parties to provide the authorisation. If you do not mind me suggesting, you still have not addressed that point.

How are you going to deal with the lack of expertise that will make it difficult to find companies and firms to provide that third-party authorisation? There will be a gap there initially. Are you suggesting to me that they are building their expertise up now in the hope that they will be ready when the regulations on promotions come into force?

Sarah Pritchard: Ultimately, Treasury will determine how it comes into our regime. There has been strong feedback on the number of third parties that are available. I would expect that feedback to be taken into account.

In terms of us getting ready for what that regime looks like, we are already seeking to recruit and grow our capacity because we are expecting significant numbers of applications to come through and are keen to get ahead of that in terms of people and processes. Ultimately, it will be important to see how Treasury brings that into our regime.

Q171 **Mr Baron:** You realise the importance of this. Without that third-party authorisation, financial promotions will have, or could be seen to have, less efficacy. They will certainly have less credibility because they do not have the weight of what you see as important, and we perhaps would agree, being third-party authorisation.

Sarah Pritchard: The concern has been that in fact it will be a de facto ban if there is nobody able to authorise, rather than over efficacy in terms of the ability of consumers to be protected. The feedback has come through the consultation, and it will be for Treasury to decide exactly how they bring it into our remit.

Q172 **Mr Baron:** You are basically saying that you are going to try to tangle with the Treasury to make sure there is an authorisation capacity to ensure, when the new regime comes in with regards to financial promotions, it is going to fly.

Sarah Pritchard: We are seeking to get ready ourselves so that, when the regime comes into place, we are ready and resourced to deal with any new applications we get, yes.

Q173 **Anne Marie Morris:** We are where we are. We now have at least a framework for registration, which, as I understand it, was one of the last acts as we left the EU. We were required to implement this as part of the fifth directive. As you rightly say, it really covers money laundering and terrorism.

In a sense it was a reactive, rather than a proactive, measure. Now we have the registration system—imperfect as it is, as we have discussed—what are the advantages? If I am a registered crypto-asset business, what is the benefit to me? What is the benefit to the consumer? On the flipside of that, if I am not registered, what is the disbenefit to me? What is the disbenefit to the consumer?

Sarah Pritchard: Let me start with the benefit, and then I might ask Matthew to come in on the disbenefits to not being registered. You are right: it is very narrow. To Matthew's point earlier, we know that crypto is open to exploitation by serious and organised crime and to terrorist financing. That is why it is part of the money laundering and terrorist financing regulations.

We have taken a strong stand because we think the right thing to do is to make sure the firms that do come through—there are 39 of them to date—have the ability to show that they meet those standards, that the red flags for money laundering are identified, and that they are proactively able to manage money laundering issues on their platform.

It does not equate to a benefit from a consumer perspective, other than knowing that you are dealing with an entity that has the right money laundering standards in place. It is not a consumer protection regime. There is no additional benefit for you in terms of compensation or an ability to complain, which is why you will have heard us repeatedly using our voice—notwithstanding that this is outside of our remit—to say, "Crypto is high risk. Be prepared to lose all of your money".

There are firms that have come through the gateway, though. There are 39 of them. I talked earlier about the really low standards that we saw in our assessment. To start with, 5% had enough information for us to make a determination. We worked with 30% to support them through the gateway and 39 are now registered. They are at least able to demonstrate that they meet those standards, that they have those in place and that they have got through the UK's tough standards at the gateway for money laundering.

We believe that was the right thing to do. We know the dangers that can happen if harm is let into the financial system through the gateway. We believe that has been the right thing to do in terms of taking tough standards at the gateway.

We have worked with firms to help them through that process. We have published some guidance on our website on how to go through the application process for registration and what pieces of information you need to tell the FCA. If you take a look at those, some of those are relatively basic bits of information. How are you going to operate? Who is your beneficial owner? Where are you domiciled? What is your governance?

Matthew might want to say a little bit about those that are unregistered and what we do in relation to those.

Matthew Long: In terms of those that are unregistered, we have an unregistered business list. It is not the same as a FSMA warning, where we are saying, "You are doing unregistered activity". This is a list where we are saying, specifically for anti-money laundering, "They are behaving in a way that we do not agree with". We publish that. Of the 244 we have published, 65% have ceased trading. It will be looked up, it is taken note of, and there is a response to it. Two-thirds of those already having ceased trading is a big number.

Q174 **Anne Marie Morris:** That is interesting. What you are saying is that, even though there is no consumer protection benefit, the reality is that reasonably intelligent investors are reading what you are putting out and recognising that, if they are not registered, this is not a place to go. Therefore, trade is not going to these businesses and they are choosing to give up. Therefore, there is a result, albeit a rather indirect one.

Matthew Long: I would describe it as a direct result. I would make the point that, to be registered for AML, we look at a number of due diligence things in terms of your money laundering structure, your board, your governance and your processes, which gives us some level of assurance. It is small and narrow, as we have said all the way through, but it gives some assurance.

It also gives you a facility to prove that you know how to deal with money laundering and how to report it properly. From a business model perspective, that is a positive thing. If you are laundering money, that is a problem. You have proved that you know how to report through that process.

Sarah Pritchard: We have sought to be as proactive as we can be beyond our perimeter, using the tools we have available. Matthew gave the example of the list of unregistered businesses. You might have seen that we did some similar work in relation to crypto ATMs. No crypto ATMs have permission to operate; none are registered under the regime we have. We wrote out to highlight that. To the extent we have been able to verify the stats, we have seen the number decrease from 80 to 21 since we wrote out in March this year.

Q175 **Anne Marie Morris:** In a nutshell, is about trying to work out whether the crypto asset has somehow been wrapped into some financial product, which then means it is a financial service, so it is regulated and therefore within your main scheme. That means you can get much more involved rather than just in the money laundering.

Sarah Pritchard: No, sorry. To make myself clear, it is us highlighting through the use of our warning list and amplifying, using our voice, where people are operating without permission. It is us using that soft power to drive the right outcomes. It is not as a result of things coming inadvertently into our regime.

Q176 **Anne Marie Morris:** If it is a crypto derivative—derivatives would be regulated—presumably that does come within your ambit and therefore it gets a lot more scrutiny than just on AML and antiterrorism.

Sarah Pritchard: On the crypto derivative side, yes, that is captured. That is why back in October 2020—it was made permanent in January 2021—we issued a ban on crypto derivatives for retail consumers.

Q177 **Anne Marie Morris:** Do you keep a watching eye for things where you could step in, such as these integrated crypto financial services? You are constrained in what you can do, but, nonetheless, you spot them and then you stop them.

Sarah Pritchard: In that context, clearly, we receive reports of unauthorised activity and other information. We scan over 100,000 websites a day for scams. Where we see that, we will take action. In relation to scam sites, that could be writing to the host and asking for them to be taken down. It could be a referral to law enforcement and to the Advertising Standards Authority.

We will seek to do that. Absent a full regulatory regime, we do not have the normal data inputs and the normal regulatory reporting regime that you would have in other parts of the sector. We do not have that information pushed to us in the way you would expect us to in the rest of our regulatory regime.

Matthew Long: As a helpful concrete example, in the FTX scenario, we reached out to the 38 firms. We have done tests with them through the prism of money laundering—it is a good question about the vulnerability for the UK—and then brought it back and acted on it. We use those authorised firms in a positive way when we see something that we have issued a warning over.

Q178 **Anne Marie Morris:** Is there any risk that where we are now is forcing legitimate business overseas? By the looks on your faces, I am guessing you do not think so. Up to now, you have said that, if you are a good business, you are going to get through the system and therefore you are not going to be driven overseas. If they are somewhat on the difficult side and perhaps not entirely as they should be, frankly, you spot them and they are out.

In a sense, those are probably the higher-risk firms. They test whether you will engage or whether they can still sell to British people outside your envelope. You have that group of people who are not doing the right thing and will come outside your envelope, so you cannot do anything about them, even though individuals in this country are vulnerable. Then you have the others, who are doing it all right but did not quite get through. Because they want to do things properly, they are not selling within our market and, therefore, we are losing that to elsewhere until we have a different regulatory system in place.

Sarah Pritchard: If your question is, "If the UK has such tough standards that no one can meet them, is there a risk that activity is therefore displaced outside the UK such that it becomes even more harmful for consumers?" I would say that we do really strongly support innovation in financial services. We have 39 firms through the gateway. It can absolutely be done. There is not a risk of displacement through tough standards.

The third plank of what is constituted under crypto is DLT type technology. We have a really strong reputation for supporting firms to test new propositions through our regulatory sandbox. We were the first regulator to introduce a regulatory sandbox back in 2016. We have supported 56 firms using DLT type technology in that context. We have a good track record and a firm commitment to support innovation through our regulatory sandbox and innovation pathway services.

Previously, as an organisation, we had our sandbox open only at certain points in the year. As part of our commitment to support innovation across all of financial services, we have now switched that to an "always on" model. Firms can come to us at any point for that support and assistance.

Q179 **Andrea Leadsom:** Good afternoon. Would you say that stablecoin is the good end of crypto assets?

Sarah Pritchard: Under regulation and if stable, stablecoin can have benefits for payment systems. There are some good use cases there for efficiency of payments, particularly cross-border payments. Through the sandbox work I have talked about before, we have seen the utility and use cases that some of that payments technology, that DLT type technology, could bring for cross-border payments.

The UK does not have a regulatory framework for stablecoin at the moment. If that is introduced, which Government have signalled it will be, it will require a safe regulatory regime to make sure those coins are stable.

Q180 **Andrea Leadsom:** With regards to the FCA's new duty to consider competition, could having a strong regulatory regime for stablecoin give UK plc a global leading edge in cryptocurrencies or is it not that grand?

Sarah Pritchard: I would go back to my comment on our really strong commitment as an organisation to support innovation in financial services. We have done a lot of that already with the 56 firms that we have supported in relation to DLT type technologies. We are really strongly committed to working with Bank of England and Treasury on how to design a stablecoin regime that would ensure innovation with high standards, ensure there is a system that protects consumers and ensure the market works well, but also have the benefits that can come with a stablecoin.

Q181 **Andrea Leadsom:** Having been on the Treasury Committee between 2010 and 2014, I recall that the then Chancellor, George Osborne, was very keen that the UK should lead the world in this emerging cryptocurrency and that the Bank of England should come up with a regulatory framework so it would be a real core strength. Either that has been a very slow burn or we simply deprioritised it. In the context of international competitiveness, are we playing catch-up or do we have a leading edge? What is your view from the point of view of UK plc and our global financial services sector?

Sarah Pritchard: Ultimately, the ambition for the UK on crypto, stablecoin and central bank digital currency is a matter for Parliament and Government. As a regulator, our role is to make sure we are supporting that, but with high standards. That is the key ingredient in ensuring that there is long-term competitiveness in the UK.

We have already sought to get ahead of that by calling together our policy sprint, which I talked about earlier, in May this year. That was way in advance of any consultations on a broader crypto regulatory regime. We bought partners together over the course of two days in person, then followed up virtually, to try to understand what the core ingredients would be.

As a regulator, our role is to stand ready to support that. We have a really strong track record in terms of the sandbox and the innovation pathways type service. We are proactively looking at what the core ingredients of a regulatory regime could look like both for the UK and informed by international standards too.

Matthew Long: We also sit on the FSB, which has all of those countries. We sit on the subgroup for stablecoin. All those countries are in a room, and we are discussing this with them and alongside them. In terms of being competitive, we are a member of that group. I described the work with IOSCO earlier, where you have 130 countries. That is considered in that piece of work on regulation. To answer your question around the international point, we are in both of those groups at the same time.

Q182 **Andrea Leadsom:** I am really trying to get at how proactive you are going to be. You have said that it is for Parliament and Government to decide, and then you try to get ahead of it and anticipate. I wonder whether it would not be for the FCA to lead the charge and say, "This is the direction of travel globally—stablecoin or a central bank digital currency. This is the way forward because it is going to reduce transaction costs and friction costs, make businesses more competitive, make exports easier and reduce money laundering".

Are these things you are proactively considering yourselves? Do you have task forces doing that? Are you simply saying, "If the Government want us to do it, we will do a jolly good job of it"?

Sarah Pritchard: We have been proactive already. We are working closely with Treasury and the Bank of England. We are members of the crypto-assets task force. In May of this year we called together the policy sprint. Back in January this year, we sought to consult on what the rules for the financial promotion of crypto would be. We are already looking to strengthen our teams in order that, when financial promotion comes in, we have people ready to assess applications.

We are being proactive and bringing the successful regulatory sandbox type approaches already, notwithstanding the fact that it will ultimately be for Government and Parliament to decide on how to bring that regime in.

Q183 **Andrea Leadsom:** Can you explain the sort of regulation that stablecoin will be subject to if it is defined as a payment system?

Sarah Pritchard: The key elements to consider—this is where we go back to "same risk, same regulatory outcome"—will include a need to look at valuation, what happens in the event of failure, how client assets are protected and how conflicts of interest work. Those are the key ingredients you would expect in other parts of the financial services sector. "Same risk, same regulatory outcome" is not just a phrase we use in the UK. It is the strong international consensus on how to regulate all things crypto.

Q184 **Andrea Leadsom:** If it became a regulated payment system, it would receive the same access to FSCS compensation, would it?

Sarah Pritchard: That is something to be considered as part of the future consultations that will occur. It will be important to consult on that and to determine exactly whether that is in scope.

Q185 **Andrea Leadsom:** What would your expectation be? If I am going to spend stablecoins rather than cash, would you expect there to be some sort of compensation scheme available to retail users?

Sarah Pritchard: This will be important for Government to consider. It will come down to how widely people expect stablecoin to be introduced. Your very question suggests that, if it is introduced like for like with fiat currency, it ought to have the same protections. I am sure that will be very live in any consultation.

Q186 **Andrea Leadsom:** As the FCA, you must have a view. There must be certain expectations you would have. If it were to be introduced as something sitting alongside fiat currency, and you had older people and people who are less familiar with such concepts trying to use it or being persuaded to use it by scammers and so on, would you not expect, as an absolute bare minimum, some kind of retail compensation scheme to apply to it? You must have a view, surely.

Sarah Pritchard: I do not want to front-run too much what our consultation or our view might look like. Our statutory objectives will be very important: ensure consumers are protected, ensure there is market integrity and promote competition in the interest of consumers. Those will very much feature.

Q187 **Andrea Leadsom:** Does the FCA have the resources to create or support the development of stablecoin or other cryptocurrencies?

Sarah Pritchard: The resourcing around what that would look like in terms of regulating crypto is very much in focus. I talked already about building our capacity to deal with financial promotions coming into our remit. We are looking at that very closely. We will want to make sure we are ready to support that. At the point at which crypto is subject to a broad regulatory regime, we will want to make sure there is the right lead-in time both for firms and for the FCA in terms of how we are resourced and organised.

Matthew is here today, next to me, as our new director of payments and digital assets. The very creation of a new directorate within our supervision, policy and competition function for payments and digital assets signals that we believe it is important to resource and strengthen this. We are quite deliberately bringing together digital assets with payments. Some of the risks, issues and supervisory tools will be broadly similar between both constituent parts.

It will be important, in terms of any new applications, that firms have sufficient lead-in time to get ready, and that we are getting ready in terms of recruiting.

Q188 **Andrea Leadsom:** Do you agree with those who speak up for stablecoins and say they would provide new channels for financial inclusion of people who are currently excluded from much of financial services?

Sarah Pritchard: The financial inclusion question is quite difficult. There are some good use cases in terms of cross-border payments. We have seen a much cheaper ability to transmit funds from one country to another through the use of DLT type technologies.

Whether stablecoin and crypto is the answer to financial inclusion is very difficult to say. Our recent research shows that 96% of people have a UK bank account. Currently, in the way the system is set up, you normally would expect to have a bank account in order to participate in crypto. At the moment I am not sure crypto or stablecoin are necessarily the answer to financial inclusion issues.

Q189 **Rushanara Ali:** I wanted to focus my question on FTX and the FCA. Before I do that, having listened to the earlier questions and answers about this field, I just wanted to ask you an overarching question.

If you were to make a parallel comparison, we had the dotcom boom. At that time, some people might have thought that was the end of that or that the sceptics had been proven right, perhaps. I do not know whether these parallels are appropriate, but indulge me for a minute. We have seen e-commerce and all sorts of things come out after that, much of which has been positive.

Can you see a way through this? I am assuming you might say that regulation is part of the story. If this industry hits a particular low point, hopefully something worthwhile and better might come out of it, or is it very different and not really comparable to that?

Sarah Pritchard: The technology is here to stay. We already see firms testing that in our sandbox. The efficiencies that the underlying technology can bring will remain with us. Again, in the Financial Services and Markets Bill this afternoon there is the proposal to create a financial markets infrastructure sandbox. We will work with the Bank of England to support that. The technology is here to stay.

On cryptocurrencies, in relation to very live events, I do not like to predict the future. What is very important is that consumers understand that this is a high-risk investment. "Be prepared to lose all of your money". I have talked about there being some use cases for stablecoin. Going back to our role as a regulator, it is important that we stand ready to support its introduction. The technology itself is here to stay.

Q190 **Rushanara Ali:** I have another follow-up on the points you made about regulation. There is a narrow focus at the moment in what you can do around money laundering and terrorism. Could you give a sense of the scale of the things that have come to your attention through that particular area of activity that you can intervene in, in terms of the registration points you made earlier?

Sarah Pritchard: In terms of the 73% that did not meet our standards, that is of concern. That means they do not meet the standards we have in place.

Q191 **Rushanara Ali:** That 73% will fall into the category of money laundering and terrorism, would it?

Sarah Pritchard: Those would be entities that do not meet the standards that we expect. They do not have the right money laundering systems and controls.

Q192 **Rushanara Ali:** The standards you are measuring them against are on money laundering and terrorism. Is that right?

Sarah Pritchard: That is correct.

Q193 **Rushanara Ali:** Therefore, 73% of those who are coming to your attention are not passing the money laundering and terrorism test.

Sarah Pritchard: Those firms are not meeting the standards that we would expect them to be able to meet. Yes, that is correct.

Q194 **Rushanara Ali:** That is very serious. Tell me in numbers how many firms that 73% is.

Sarah Pritchard: To date, we have determined 258 applications for registration and 39 have been approved.

Q195 **Rushanara Ali:** So 39 have been approved out of 258. The other 219 fall into the category of money laundering and terrorism concerns.

Sarah Pritchard: In that context, 10 have been refused or a warning notice has been issued and 180 have been withdrawn because the firm did not meet the standard or has decided to apply at a later date.

Q196 **Rushanara Ali:** Can you tell me how many of them did not meet the standards around terrorism and how many did not meet the standards around money laundering? Are they interconnected?

Sarah Pritchard: They are interconnected.

Q197 **Rushanara Ali:** How much co-operation do you have with other legal entities like the NCA when you are looking at these sorts of cases or at money laundering and terrorism in relation to those that do not meet those standards?

Sarah Pritchard: I might ask Matthew to come in, in a moment. We have been very proactive in publishing our warning notices in order that they are available to members of the public. Perhaps Matthew might want to come in on the co-operation we have with our law enforcement and other partners.

Matthew Long: I would just repeat the point I made earlier as well. For those firms that have not got through, we will then put out an unregistered business list. Effectively, this list says, "You should not be dealing with these people". Of those, 65% have ceased trading. I understand that your question was about those where we had money laundering or counterterrorism concerns. Of those we have put out, 65% have ceased trading completely. They no longer exist.

Q198 **Rushanara Ali:** I know, but I am not really asking that question. If they are raising alarm bells around terrorism, that is serious. What is the process? Ceasing trade is not necessarily the end of terrorism financing. What happens? Can you give us some reassurance that, beyond ceasing trading, further actions are taken, where needed, through your relationships and interactions with law enforcement agencies?

Matthew Long: I have just come from the National Crime Agency myself, where I was head of the UK Financial Intelligence Unit. We work directly side by side. We have staff from the FCA in the National Economic Crime Centre working on this issue. We also have staff working alongside the UKFIU. Any of those entities at any point in time can submit a suspicious activity report.

Q199 **Rushanara Ali:** Have there been any prosecutions, to your knowledge, in relation to those that have come to your attention and been shared with the law enforcement agencies? If you are not able to share it publicly, you can write to us.

Matthew Long: I could follow up on that one in writing.

Rushanara Ali: Thank you. That would be very helpful.

Sarah Pritchard: Can I just clarify one point? We will issue a warning notice if the firms we reject are continuing to operate in the UK. That unauthorised business list will also include people who have not come to us to apply for registration, if we believe they should.

For the remainder, the 70% that withdraw, some of those might come back to us at a later date to resubmit once they meet our standards. We are looking at whether the right standards are in place to identify and spot money laundering. Do they have the right systems in place? Have they been clear in terms of beneficial ownership and geographic location?

Albeit we were quite shocked by the standards we saw to start with, it does not necessarily follow that there will be criminal activity in all of those that have withdrawn. It is really important to us that we work in partnership with our key regulatory partners, the National Crime Agency and the National Economic Crime Centre in particular. That is why we have the ongoing commitment to have FCA secondees there.

Q200 **Rushanara Ali:** You have just prompted another question on this. What percentage of the ones that raise alarm bells are not necessarily in that category of criminal activity? Is there a percentage around that? You are very welcome to write to me about it, if you cannot answer that now.

Sarah Pritchard: If we could follow that up in writing, that would be helpful.

Q201 **Rushanara Ali:** Thank you. Turning to FTX, what lessons can the UK learn from the collapse of FTX?

Matthew Long: There are a number of lessons we can learn. There are four particular areas. When you have issuance, trading, wholesale and custody in the same place, that is a significant number of risks that can interplay, which can result in the collapse of a firm.

What this says to us, in terms of both the international work we are doing and the domestic work, is that we need a regulation that deals with those sterile corridors so we can make sure we do not see what we have already seen. There is a piece here about how minting your own coin and then being able to offer and trade it in the same place, having that cyclical process, is a risk for us both in the UK and internationally.

Q202 **Rushanara Ali:** If this example is replicated a number of times in different jurisdictions and so on, does that pose a risk to financial stability?

Matthew Long: There is a risk at the moment. We look at the notion of contagion. At the moment we do not see further contagion, but that does not mean that cannot change over the coming months. That is why we are co-operating internationally to come up with a set of standards that look at regulation for the whole of IOSCO.

Q203 **Rushanara Ali:** What is the timeframe for getting somewhere with that?

Matthew Long: It is pacy. At the end of this week, we are in Paris. After that, we are then doing the academic roundtable. For mid next year, we will do a report with recommendations for international regulation. That will then go to each of the jurisdictions. We are running in parallel alongside the Treasury timescales.

Sarah Pritchard: Can I add one thing on financial stability? Yesterday, the Financial Stability Board put out a release following its plenary talking about the financial stability risks as a result of FTX. They said, "While financial stability risks to date from crypto asset market turmoil remain limited, growing linkages of crypto-asset firms with core financial markets and institutions increase the risk of spill-overs". This is being monitored quite carefully. The FSB in particular is looking at it.

Again, the risks here are being amplified. While the spotlight is on FTX, these are risks that can exist in other parts of the financial system, but there is a regulatory framework to deal with them. The FSB has said it is not concerned for the time being in relation to financial stability risks.

Matthew Long: Of course, if there were a firm that we were concerned about, in the same way as we did about FTX, we would put out a further warning.

Q204 **Rushanara Ali:** I am just going to ask you a hypothetical. Earlier, one of the witnesses talked about certain countries like Turkey, Vietnam and others where people can promote crypto. Footballers and other high-profile people can promote it to legitimise it and so on. People are desperate to find alternatives, given their currency issues and all sorts of domestic economic issues.

In a particular jurisdiction where the economy is extremely vulnerable and so on, if you have a situation like an FTX, or multiple, in which a lot of people invest and lose out, that could spill over as a risk to financial stability as well as wider instability, could it not? Is there a risk of that?

Sarah Pritchard: There is potential for that, which is exactly why the Financial Stability Board has been looking into it. Already, through the

FSB, a set of recommendations has been made to members in terms of aspects to look at. We have not seen that here, but the very fact that the FSB has been looking at indicates that there is that potential.

Q205 **Rushanara Ali:** Can you outline why the FCA felt it necessary to include a warning to investors about FTX back in September? Was FTX under investigation for trading in the UK at the time of its collapse?

Matthew Long: We cannot specifically comment about FTX due to FSMA confidentiality rules, and I am sure you understand why. If we see any activity across the market that we think is concerning for consumers, we will put a warning out.

Q206 **Rushanara Ali:** Despite the warnings about FTX on the FCA website, it has been reported that almost 80,000 UK investors have been affected by its collapse. Was the warning on your website sufficient?

Matthew Long: As we have said, the regulation we have at the moment is very tight around money laundering. If we had wider regulation—say it was a payments firm, for example—we would be able to test more on UK vulnerability and so on.

Q207 **Rushanara Ali:** You put that warning up because you were concerned about money laundering and terrorism under the standards you have to implement. Is that correct?

Matthew Long: We put that warning up because we were concerned that FTX could be conducting financial services or products that could affect the UK without permission.

Rushanara Ali: Can you clarify that?

Matthew Long: We put the warning out because we were concerned that FTX was conducting financial services or products without permission. If a firm does not have that permission, we are very concerned for the consumer. They will not get the standards we expect in the UK.

Q208 **Rushanara Ali:** Given that 80,000 investors were affected despite the warnings, can you just give us an idea of who these people are? What is their profile? If you cannot answer, you could give us an overarching sense so we can understand this better. It would be really helpful to get a breakdown of the profile of people who are investors and what sort of order of money they have lost. That would be really helpful.

Matthew Long: We do not have the tools that we would normally use to answer those questions. We can follow up in writing by reaching out to other regulators that are dealing with the court case, such as the Bahaman authorities we were speaking to recently. We do not have the things we would normally use to answer those questions. We can give you the best estimate from another regulator's court case. We will happily follow up in writing.

Sarah Pritchard: I go back to some of the challenges around the halo effect question that was raised earlier. There is no consumer protection regime in the UK.

Rushanara Ali: There needs to be, right?

Sarah Pritchard: We are really concerned that consumers do not realise that it is high risk and they could lose all their money. That is why you hear us repeatedly say, "It is high risk. Be prepared to lose all of your money." Even if we had not put out a warning on FTX—as we did on 16 September, saying that we believed it to be operating here without permission—there would still be no consumer protection remit there.

Matthew Long: If it was in regulation, we would have a wind-down plan where we would be considering each of those people's investments and making plans for their reimbursement to be properly considered.

Q209 **Rushanara Ali:** Yes, which is the point I was making in the earlier panel. Finally, to put it into context or perspective for this Committee, where would you rank 80,000 UK investors losing all their deposits in terms of the collapses over the past 20 years? Is this one of the biggest examples of consumer detriment in that period?

Matthew Long: We are concerned about any single consumer losing their money. In terms of the volume, I cannot confirm or agree that volume. We will come back to you in writing. There have been a number of concerning collapses. I do not have a particular rank I would give it, but I would say it is a lot of money for a lot of consumers that we are genuinely concerned about.

Q210 **Rushanara Ali:** It would be pretty high up in the ranking order, if you were to rank it. Maybe you can add that to your list of things to write back to me on. What would the ranking order look like and where would it go?

Sarah Pritchard: It is not good for UK financial services. Circumstances where significant numbers of consumers lose their money are not good for confidence in financial services. That is why we talk about innovation with high standards. If there is to be a crypto regime, it has to be a regulatory regime with high standards.

We need standards so that client assets are protected. What happened in the event of insolvency? It is not good for overall confidence to see events such as FTX, where likely a significant number of UK consumers have lost money.

Q211 **Rushanara Ali:** Yes, 80,000 is a lot of people. We had LCF and a number of others. This is yet another frontier on which investors and consumers find themselves being exploited.

Matthew Long: We are genuinely concerned about any consumer who might lose their money, which is why we use the powers we have to reach out to the 38 firms and get an informed assessment of what we could do for those individuals.

Q212 **Rushanara Ali:** It sounds like, despite your very limited remit, you are using it as much as you can. It is not enough.

Sarah Pritchard: We have tried to use our voice as much as possible to highlight the risks. We are trying to be as proactive as we can be, with the remit we have. It is not good for confidence overall. If the UK does introduce that regulatory regime, it needs to have those really strong standards. FTX and others bring really live examples to the consumer of what can go wrong.

Q213 **Chair:** Thank you very much. That brings us to the end of this panel. One thing that I feel is ringing in my ears after the evidence we have taken today is your warning that, at least until we get to the stage when crypto is regulated, this is a high-risk investment and you can lose all your money.

Perhaps that could go on Instagram and TikTok as well as across your website so we can get it heard by as many people who may be tempted by this as possible.

Sarah Pritchard: I would like every consumer walking down the street to have that ringing in their ears. That is the most crucial part for consumers. It is high risk. If you are aware of that and you are prepared to lose all of your money, that is okay. We are aware that there is that disconnect in terms of levels of understanding.

Chair: Yes, that has come over loud and clear. Thank you very much for your evidence. With that, I would like to bring this session to an end.