

Treasury Committee

Oral evidence: Digital Currencies, HC 910

Wednesday 4 July 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Charlie Elphicke; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 166 – 220

Witnesses

I: David Geale, Director of Policy, FCA; Martin Etheridge, Head of Note Operations, Bank of England; David Raw, Deputy Director Banking and Credit, HM Treasury.

Examination of Witnesses

Witnesses: David Geale, Martin Etheridge and David Raw.

Q166 **Chair:** Good afternoon. Thank you very much to our second panel for today. We are not entirely sure whether we are going to be voting at some point. My colleagues are sceptical as to whether we will be, but you can never tell in this place, so we will make some progress. Can I ask the panel to introduce themselves, first of all?

Martin Etheridge: I am Martin Etheridge, head of division at the Bank of England.

David Geale: I am David Geale, director of policy at the FCA.

David Raw: I am David Raw, deputy director for the banking and credit team at the Treasury.

Q167 **Chair:** Lovely. Thank you very much indeed. This is part of our ongoing inquiry into crypto and digital currencies. I am going to start with Mr Raw. As part of the Committee's inquiries, we have heard a lot of evidence about the supposed benefits of cryptocurrencies and distributed ledger technology, but we have also heard a lot of scepticism and instances of considerable consumer detriment. We are going to begin to look at the regulations in more detail, but more broadly perhaps you can tell us about the decisions that have been taken so far in the UK not to enter into the regulation of initial coin offerings, cryptocurrencies and exchanges. Is the view in the Treasury that the UK could be behind the curve?

David Raw: The place to start is to say that, when we talk about cryptocurrencies or crypto assets, the data is not particularly great, but we know there are at least 1,600 of these things out there. There is not one thing called crypto assets. That includes digital coins like bitcoin, but it also includes utilities tokens and securities tokens, which we normally talk about as ICOs.

The Treasury's view is that, before we can regulate them, we need to understand them. We are not starting from a zero base. We know about some of the benefits and risks already. Particularly from the work the FCA has done in relation to its sandbox, for instance, we know there are potential benefits relating to money remittance and there could be benefits in relation to SMEs being able to raise capital more efficiently. We also know where the benefits are less realised. We know they do not work particularly well as a currency, for instance.

On the risks, part of the answer is that we have taken some action. For instance, on the basis of assessments that have been done in the past, although it is a low risk, we know there is a risk around money laundering and terrorist financing. We did a call for evidence on crypto



assets back in 2014. On the back of that, we decided to bring the exchanges and wallets into money laundering regulations. The Europeans then caught up with us, so that is now being taken forward through 5AMLD and will probably be transposed next year. We will need to consult on precisely how we do that. The FPC looked at the prudential aspect of this in March, concluding that there is no prudential risk currently.

So it is not true that we have not yet looked at any of the risks. It is fair to say that, in relation to consumer conduct risks, market integrity risks, cybersecurity and environmental risks, we need to move beyond the anecdote and explore them in more depth. That is very much the work the taskforce has been set up to do.

We also recognise there is an international element to this. The Chancellor was talking with colleagues in the G20. Some of the international bodies in this space, like the FSB and the Financial Action Taskforce, have been tasked with doing some work, which will report later in July, on what the risks are and internationally what action can be taken, because the risk of regulatory arbitrage here is quite high. I suppose my position would be that we have taken some action where we are aware of the risks. In those other areas, we need to do further work. The Chancellor's position has been quite clear: we want to approach this in the same way as we approach other bits of the fintech sector, in that we do not want to stifle innovation, particularly in relation to the underlying technology, but equally we want to manage the risks.

If we compare this with some of our international colleagues or counterparts where action has been taken, it is fair to say one example of that would be Japan, where they have taken some action. They are in quite a different position to us, so there is a lot more activity taking place in relation to crypto assets in the Far East than there is here: 70% of all trading activity—some of the data is not entirely reliable—is in the Japanese yen. They are in a slightly different place. We have met them as part of this work already. They see what they have done as a kind of stopgap. They are not applying it to existing firms; they are only applying it to new firms. Quite a lot of countries around the world are in that same place of trying to understand the benefits and the risks, map out precisely where the regulatory perimeter is and make recommendations for next steps.

Q168 Chair: That is very helpful. We are going to come on to explore a number of those issues and ask the panel about them. It is interesting that you talked about it in the fintech space. Of course, there is a question over whether it does fall within that space. Is it more that the distributed ledger technology might fall into that space? Should the fact that there is an asset or currency—this is perhaps a question to the whole panel, in terms of the detail about regulatory perimeters and things—change the way we look at this particular class of asset? Is it more than just clever financial technology?



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Martin Etheridge: I am happy to give our perspective on this. We draw a clear distinction between the underlying technology, in particular distributed ledger technology, and the assets, tokens or coins that often rely on that technology. When it comes to the tokens themselves, we tend to call them crypto assets rather than currencies, because they are not currently functioning as currencies; they are not acting as a medium of exchange; they are not particularly good as a store of value, given the volatility; and they are certainly not being used as a unit of account. Although about 500 independent shops might say they accept bitcoin, you do not see many people pricing or receiving their wages in bitcoin.

From the Bank's perspective, the primary lens through which we look at this is one of financial stability. As David mentioned, the Financial Policy Committee of the Bank issued a statement in March confirming its view that it did not see a current material threat to financial stability. These things are not currently functioning in payments and settlement, so that is not a particular worry. In terms of the linkages with systemically important firms or systemically important markets, right now, those linkages are pretty negligible. The market itself is small in comparison to other large financial markets. In terms of the activities of UK firms, that is also pretty small.

That is not to say that we are not also remaining vigilant. Recently, the PRA issued a "dear CEO" letter. The chief executive of the PRA wrote to the CEOs of banks and insurance companies to outline our expectations with respect to how they are interfacing with crypto assets, but also to ensure that we are getting the information we need from the firms to continue to make that assessment.

Q169 **Chair:** Mr Geale, how does the FCA see this? Where do crypto assets, cryptocurrencies and DLT sit within the FCA?

David Geale: I would concur with my colleagues. We would be very keen to separate the underlying technology from the crypto assets themselves. Indeed, we see a number of positive uses of distributed ledger technology. You may be aware that we are carrying out a trial ourselves on mortgage transaction reporting for regulatory reporting purposes.

In terms of crypto assets, on the currency side, I would agree with Martin. I would also draw a distinction between securities tokens and utility tokens. Securities tokens would fall within our regulatory remit as they would come under the definition of a financial instrument. Where they come under the definition of that instrument, the activities need to be carried out by authorised firms, which we would authorise in the normal way. They would come under our usual conduct of business regulation and be required to meet our usual standards around things like promotion, how they deal with their customers and so on. We do regulate some of this now.

The challenge comes when you see that the bulk of this activity seems to be in the unregulated space, around things like the utility tokens, where



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you are buying, for example, future rights to access a theme park or something that does not exist at the moment. Is that the sort of thing we would regulate? It is certainly not the sort of thing we regulate at the moment, and that seems to be the approach being taken internationally as well.

Finding good data on what is what at the moment is a significant challenge. That is one of the challenges for the taskforce, as indeed is trying to define what should be in or out of the regulatory perimeter. We have concerns about the fact that, for example, consumers may think they are operating in a regulated space when they are not.

Chair: We are going to come on to look at that, and that is a good point to hand over to Alison on the regulatory perimeter.

Q170 **Alison McGovern:** Mr Raw, this has been around for some time, hasn't it? Cryptocurrencies have been around as an idea or a concept at least since 2009. Have we been a bit slow? Why have we not decided about the regulatory perimeter already?

David Raw: Cryptocurrencies have only taken off in any particular volume in the last couple of years. Even when they peaked in January of this year, their market capitalisation was \$800 billion; it has now dropped to around \$300 billion, which is still a tiny, tiny percentage, less than 0.3%, in relation to the size of the securities markets.

Alison McGovern: Yes, but tell that to a consumer who has been through this.

David Raw: Sterling still accounts for less than 1% of worldwide trading. It has been around as a concept, sure, but in terms of volume they have only really taken off very recently. Initial coin offerings were worth £10 billion between January and May this year. That far, far outstrips the whole of 2017. They are increasing very rapidly.

Q171 **Alison McGovern:** Given that increase, what is the plan?

David Raw: The plan is to carry out a taskforce and to report in September.

Q172 **Alison McGovern:** It is unclear whether the Treasury thinks there is social value here, so it is a valuable activity, and therefore it ought to be regulated or whatever the taskforce finds, or whether we think there is activity here with no social value.

David Raw: Again, I would agree with Martin and David: we need to distinguish between the crypto assets or cryptocurrencies and the distributed ledger technology on which they are based. Particularly through the work of the FCA sandbox, we are finding that there potentially is some social value attached to the crypto assets themselves. I was particularly interested in some of the test cases around money remittance, which have shown that it potentially offers quicker, cheaper money remittance. There is also some potential benefit for SMEs being



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able to raise capital more efficiently. However, the potential benefits of the underlying technology are even greater. We see significant benefits there in terms of being able to manage data more efficiently, in terms of transparency and in terms of regulatory reporting. David talked about the test case going through the sandbox. We need to distinguish between those two things. The Treasury sees risks attached to crypto assets; you are absolutely right. But we see benefits as well, particularly in relation to the underlying technology.

Q173 Alison McGovern: We are basically letting the situation ride in order to discover more about the benefits. Is that what we are doing?

David Raw: We are carrying out work very rapidly under the taskforce, which we are going to report on in September.

Q174 Alison McGovern: Does the current inconsistency right now, today, never mind what happens in September, not create a lot of confusion for consumers? For yourself, imagine being sat on the Tube or whatever, and seeing a lot of these adverts. What are you supposed to think? Do the Government think that is okay or not?

David Raw: Interestingly, all the adverts I have seen are very clear that they are not currently a regulated product. You are absolutely right: there is a consumer risk there, which is why we have identified the need for the taskforce. It was a key part of the fintech sector strategy the Chancellor announced in March and it is why we are taking this work very seriously. The kick-off meeting in May was attended by Andrew Bailey, Katharine Braddick and Dave Ramsden, Deputy Governor at the Bank of England. We are taking it extremely seriously.

Q175 Alison McGovern: Let us come to the Bank, Mr Etheridge. What kind of engagement have you had with the Treasury on bringing crypto assets into your remit?

Martin Etheridge: As you say, crypto assets have been around for a long time. The Bank of England first looked at this a number of years ago and published some materials back in 2014. Looking through the lens we are responsible for, monetary and financial stability, the Treasury is an observer of our Financial Policy Committee, where we have made our current assessment of the financial stability threat associated with crypto assets. As I talked through earlier, we do not currently think there are material threats to UK financial stability. That is also a position shared by our counterparts overseas as part of the Financial Stability Board, which has reported to the G20 that it does not currently believe there are material threats to global financial stability.

When it comes to the individual on the street who may have been mis-sold the promise of crypto assets, I absolutely sympathise with that. There is a potential for people to be exposed to that, but when it comes to our remit around financial stability we wanted to make an assessment before there was any meaningful threat to financial stability and then



continue to monitor that over time so we can understand what is going on.

Q176 **Alison McGovern:** Could you comment from the FCA's point of view?

David Geale: Similarly, as David said, Andrew Bailey is a member of the taskforce. There is a working group that sits below that, which is attended by one of our executive directors, Christopher Woolard. At exec level, we are taking it very seriously indeed. We have quite a lot of work, through things like the sandbox, that we have fed in, as experience we have of these things working in practice. The sandbox is somewhere where we can look for the benefits but we can do so in a controlled environment, so we can control the risks and explore how they can be controlled.

Q177 **Alison McGovern:** Forgive me for interrupting, but do you see crypto assets coming within your remit in the future?

David Geale: I would not like to prejudge where the taskforce will land. As I have said, some of these assets already come within our regulatory remit. There is a question of whether they do and, if so, how far and how to expand that. David made a very important point earlier around the international nature of this. It is fine for us to look at this on a domestic basis, but this is global. It is a global internet phenomenon and we need to engage with people like—

Q178 **Alison McGovern:** With due respect, global international co-operation is not going that well at the moment on a range of issues.

David Geale: In this particular case, there is a lot of interest among bodies like IOSCO, the international securities agency, and at the level of the Financial Stability Board. There is quite a lot of work going on to ensure proper information sharing so that we know the approaches we are all taking and why. We also need to think about things like the taxonomy so we are talking about the same things at the same time, and to think about the risks that are emerging and the most appropriate ways to deal with those. Everybody is feeling their way into this regulation a bit at the moment. Various jurisdictions are taking various steps. We have not yet seen which is going to be the most effective.

Q179 **Charlie Elphicke:** Looking at how you could introduce a regulatory framework, it seems to me that there are two channels. You could either go through the Regulated Activities Order or you could design an entirely new framework of regulation. What are the pros and cons of each route?

David Raw: This will be something for the taskforce to consider. Frankly, it is difficult to answer the question until we have answered some of the prior questions in relation to the taxonomy and precisely where the regulatory perimeter currently sits, and in relation to understanding the risks. If you look at precedent, when we introduced a new regime for peer-to-peer, we did it by amending the Regulated Activities Order. That would certainly be one option open to us, but it is too early to speculate as to which route we would take.



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Q180 **Charlie Elphicke:** One of the oddities is that Barclays, I believe, was fined massively by US regulators for having bearer bank accounts, whereas these cryptocurrencies are effectively bearer in nature—if you have the key, you own them. How do you go about introducing a regulation to deal with the fact that it is bearer by nature?

David Raw: It is a very good question. It would certainly be something for the taskforce to consider. It would be one of the challenges.

Q181 **Charlie Elphicke:** It seems to me that them being bearer in nature means they are well suited for terrorists and others who want to engage in criminal activities, as a perfect tool for criminal finance. How can we stop it?

David Raw: Interestingly, the latest risk assessment from the National Crime Agency is that use for money laundering and terrorist financing is currently low. They are seeing cases of it, but it is not widespread. The key thing there, in terms of tackling money laundering and terrorist financing, is the action that is already being taken to bring the exchanges, which is the point at which fiat currency exchanges for cryptocurrencies, into the money laundering directive regulations.

Q182 **Charlie Elphicke:** Is there not a risk in saying that terrorists do not currently use this very much, so it is okay? Back in the day, terrorist organisations did not use Twitter very much until they discovered that it was a great vehicle to spout their evil. Is there not a real risk in being complacent about the risks of terrorists and other criminals using cryptocurrencies as a vehicle for their activities?

David Raw: There is definitely a risk. Against saying that it is an anonymous way of paying for illicit activity, there is the fact that you are potentially creating a more transparent record of the transaction, which is potentially auditable. There is a question over whether terrorists would want to use this method. There are other methods available to them, many of which are easier, such as cash couriers. That is currently what the latest risk assessment for the National Crime Agency suggests.

Q183 **Charlie Elphicke:** But let me challenge that. Is that not complacent? If you send a cash courier, a cash courier can be caught. A key can be transferred by text message. If I am over in Syria or wherever, I simply send a text message with a wallet passcode to someone who lives in London. Hey presto, they have access to all this cash so they can get up to all the terrorist financing stuff they need to do.

David Raw: I am not being complacent; I agree there is a potential risk that needs to be examined. That is one of the risks the taskforce is examining very closely.

Q184 **Charlie Elphicke:** I guess this is the question I am asking: how can we introduce a regulation or how can we use regulation to put a stop to that? How do you design a regulatory system to ensure that cryptocurrencies effectively stop being bearer?



David Geale: From my perspective, I agree this is something we need to look at through the taskforce. We are certainly not being complacent. In the interim, we have last month written to the chief executives of the banks, asking them to think about the use of crypto assets in terms of whom they are dealing with, the due diligence they do on the customers they have and who those people are dealing with, the jurisdictions they are dealing in, the underlying technology and the governance that is being put around that.

There are interim steps that we can take and are taking to remind the banks of their own responsibilities under existing anti-money laundering laws. The new ones will help in terms of what actually comes through the exchanges. But it is a very significant challenge, and we do not have a specific answer at this point in time. It is something we are looking at.

Q185 **Charlie Elphicke:** Let us look at security. A key part of traditional bank regulation is that banks need to be secure. People cannot just hack into my account and steal my money. Unfortunately, it seems to have happened a bit lately with one bank that has had one or two little problems with its IT upgrades. Let us talk about cryptocurrencies. They can be hacked. In January 2018, \$534 million in bitcoin was stolen from Coincheck. \$573 million in bitcoin was stolen from Mt. Gox. Parity lost \$32 million in ether. These things get hacked all the time; they are not safe at all. How can we make sure there is a level of safety in regulation? Is it just hopeless? Are they just cowboys?

David Raw: This is what we need to explore very, very closely. You are right: the anecdotal evidence shows that there are some big hacks on these exchanges. There are different ways in which you can hold your cryptocurrency. There is a difference between custodian wallets and non-custodian wallets. Where you are holding your keys on third-party servers, there is potentially greater risk there, so that needs to be examined very closely. However, this is one of the things we need to look at, because there is a question around how much we can mitigate that risk. If we cannot mitigate that risk, what does that mean in terms of the warnings that need to be given to consumers or the limits that need to be put on the availability to consumers? It is something the taskforce is looking at very closely.

Q186 **Charlie Elphicke:** Mr Etheridge, the crooks are running wild. What are you going to do about it?

Martin Etheridge: When it comes to the Bank's responsibilities, they are focused on financial and monetary stability, so I would not expect the Bank to have any direct additional regulatory powers as a result of the taskforce. But I guess I would make three points. First, this reinforces the need for a distinction between the underlying technology and the tokens themselves, because people will tell you how resilient and secure distributed ledger technology is but, when you look at the system that is currently in operation, it is not the distributed ledger that is being hacked; it is the custodians, the wallet providers and the exchanges that



are being hacked. Some of these claims need to be looked at with a healthy degree of scepticism.

The other thing I would say is that this reinforces the need for international co-operation. As you say, if you can issue a text message from one country to another, the way in which you can respond to any threat needs to be co-ordinated internationally. I would also reinforce one of the things David said, which is that there are points in the system where individuals need to effectively cash out—i.e. they need to translate their crypto assets into a currency they can then use in the legitimate system and the legitimate economy. That has been the focus of many institutions globally in terms of their regulatory attention.

- Q187 **Charlie Elphicke:** Mr Etheridge, is there not a wider issue here? You say text messages are traceable, but WhatsApp and iMessage would be the perfect vehicle for untraceable terrorist activities. Plus you could transmit a key, so you have effectively transmitted money and the ability to carry out serious and organised criminal activity. How can we stop that? Can we build a registered system, for example?

Martin Etheridge: As David said, there are a number of ways of doing it. I am not sure I did say that text messages are traceable. When it comes to what we are seeing right now in terms of our responsibilities to the stability of those who are providing critical functions to the economy—the major banks and major financial institutions—we are not seeing a significant amount of activity when it comes to UK firms. We want to work very closely with the Treasury and the FCA as part of this taskforce to ensure the overall regulatory picture is well understood and comprehensive. In terms of our responsibilities around the stability of the system, we see those stability risks to be very small at the moment.

- Q188 **Charlie Elphicke:** Finally, is the reality that this is a market that you will simply not be able to regulate in any meaningful way because of its very nature?

Martin Etheridge: I would continue to ensure that we do not consider this to be one thing, “the market”. There are components of the system that are already within the regulatory purview. When it comes to our responsibilities, what is happening? We are not seeing these things being used meaningfully for payment and settlement right now. We are not seeing significant linkages between crypto asset markets and the UK financial system. That message is consistent with our partners in other jurisdictions.

In terms of what we are doing, we are stepping up our monitoring activity. We have reached out to the firms we supervise to ensure this is on their agenda just as much as it is on our agenda. The Financial Policy Committee will be monitoring the extent to which there is additional take-up for these asset classes. We are getting great intelligence from the FCA in terms of its sandbox work. When it comes to regulation, I am not expecting the Bank of England to get more powers or responsibilities



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as a result of this work. We want to work very closely with our colleagues to ensure the overall picture is clear.

Q189 **Alison McGovern:** Are companies using ICOs to raise funds because they cannot do so in a conventional way?

David Geale: That is broad brush. It is an option for companies to raise funds. For small companies, it is potentially quicker, easier and cheaper as a means of raising money. Therefore, it is attractive to them for that reason.

Q190 **Alison McGovern:** It is similar to crowdfunding.

David Geale: Potentially, yes. I would say there are certainly similarities with crowdfunding.

Q191 **Alison McGovern:** But that is a regulated activity.

David Geale: If we are talking securities in terms of ICOs, that is also regulated if they are a financial instrument.

Q192 **Alison McGovern:** Is there a gap there?

David Geale: It depends. Crowdfunding is a regulated activity, both on the peer-to-peer lending side and on the equity side. Where the underlying coin or token is classed as a financial instrument, it is regulated and is subject to the firm being authorised, meeting our threshold conditions and meeting our conduct of business standards around things like advertising, the way it deals with its customers, treating customers fairly and so on. In that context, no, there is not a gap there.

The question with ICOs is that a large proportion of them are not treated currently as financial instruments. They are for the promise of a reward. In the example I used earlier, you might give your money over to someone who is building a theme park or who has a particular project. Rather than a share of ownership, you get might in return, for example, family rights to use the theme park for the first five years without paying. That is not something we regulate. The question is about what it is there that requires that delivery. There you are looking to things like the common law and advertising standards, rather than it being something that any of us would be regulating.

David Raw: But identifying the gaps and working out whether we need to recommend doing something to fill those gaps is precisely what we are aiming to do over the next couple of months.

Q193 **Alison McGovern:** Basically, we are agreed with the SEC's principle that, if something looks and acts like a security, it will be regulated as such, but you also acknowledge that there is a gap where things are not identifiably securities but are something else with a function that, at the moment, is unregulated.



David Geale: The “something else”, as you describe it, is currently unregulated. That is part of the question for the taskforce, as David said: should some or all of that come within a regulated sphere? I would not say it is completely unregulated, because, if there is misleading advertising, there may be a role for people like the Advertising Standards Authority, just not necessarily the FCA.

Equally, I would not go quite so far as to say we are in the same place as the SEC, because the tests it applies are different. It applies them on the basis of case law, which is more like asking, “Does it look and feel like an investment, because you are investing for some form of speculative return?”, whereas the definitions of a “financial instrument” are laid down in legislation here. It is different, but if it is a financial instrument that looks like a form of security, or if there is a form of security, I should say, it will be regulated. If it is securities-based, it is regulated. For utilities, where it is not conferring rights to future returns but there might be a future reward of some description, it is outside the perimeter.

Wes Streeting: Good afternoon. We have previously noted at the Committee the high regard the FCA is held in internationally, particularly in relation to the sandbox and global leadership. However, there is a “but”. That notwithstanding, we have heard criticism of the FCA that the consumer warnings issued have not gone far enough. The criticism is that the FCA has been late to the game. Is that a fair criticism? Why is the FCA not doing more? What more should the FCA be doing?

David Geale: I do not think that is a fair criticism. We noted back in 2014 that there was a lot going on in the innovation space. That is why we set up our innovation hub and, as you said, we are very pleased with the recognition we have had through that. Part of the role of that is to understand what is happening in the fintech space. Financial services is changing quite significantly at a rapid pace, and regulation needs to keep up. For example, we see firms wanting to use the cloud for some of their data storage. In many ways, actually using cloud data storage may be more secure than cardboard boxes in the back office, or whatever it may be, and we needed to make sure our regulation kept pace with that. One of the things we did through our innovation hub was to look at whether there were ways we could remove some of the barriers to firms using the cloud in a safe way. We have used it in that context.

The consumer warnings are there because we saw particular issues around people thinking they were operating in a regulated space when they were not, because we wanted people to realise that they could potentially lose a lot of money very quickly. We take this on a case-by-case basis, so we regulate the securities-based ICOs, which are in particular where we have issued our warnings. We have issued additional warnings around crypto derivatives. We are working with the European supervisory authorities around contracts for difference and regulation of that more generally, which includes crypto assets. There, again, it is very important that we have an international solution, because



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should we restrict leverage in the UK, if firms are able to offer the same levels they offered before from abroad, we end up with regulatory arbitrage.

We are active on a number of fronts and we are taking action where we see firms operating without being authorised when they should be in the perimeter. We have a number of firms under investigation, which is in the press. There are 24 firms we are investigating currently where they should be authorised and are not.

Q194 Wes Streeting: If crypto assets were to become a regulated activity, how would the FCA protect consumers from the price volatility of crypto assets?

David Geale: We cannot specifically protect people from price volatility, in the same way we cannot in any other form of investment. The standard warning applies, which is that the value of your investments may go down as well as up. The important thing is that people understand that and understand what it is they are getting into. If they were to come into our regulatory remit, I imagine the protection we applied would be similar to that we apply elsewhere. We would look at things like the customers the firms are dealing with, who they are targeting through their marketing, the standards of their marketing, the standards of their disclosures through things like risk warnings, the balance and sufficiency of those, and so on. We would not be in a position to stop that volatility.

There is nothing inherently wrong with high-risk investments that potentially come with high volatility. It is about who buys those investments and whether they understand what it is they are buying. For crowdfunding, for example, we have taken steps to restrict the marketing to people who are inexperienced investors at the outset, to try to stop them putting all their life savings into it. There are a number of routes we could take if they were to come into our regulatory remit, but those are the sorts of tools we could apply.

Q195 Wes Streeting: Implied in your answer there is a concern about advertisements and whether these are misleading customers. What is the FCA doing to prevent customers from being misled by bad or misleading advertising?

David Geale: The question, again, is whether it is a regulated firm or a regulated instrument. If it is not a regulated firm or a regulated instrument, we do not have power to act. We can issue a consumer warning to help people understand that they can lose large sums of money quite quickly. We have issued consumer warnings on that. Our chief executive has been in the national press, the national media and on television repeating those messages. For example, you should not put money into bitcoin unless you are prepared to lose it all.



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Where we have regulated firms issuing regulated products or financial instruments, our usual powers apply to require promotions to be fair, clear, not misleading, balanced and so on. If we find promotions that are not meeting that, and they are regulated and we have the power to do so, there are a number of steps we can take. They are the usual steps we would take. In the first instance, we may contact the firm and ask them to change it. If we think it is serious enough, we can take enforcement action.

- Q196 **Wes Streeting:** Alison mentioned Tube adverts. We have all seen the daily bombardment people are subjected to in terms of advertisements for these sorts of investment opportunities. You have mentioned the FCA's warnings, the national newspaper advertisements and the news coverage that follows from those. How are you tracking or monitoring the reach of these interventions and the extent to which they are genuinely reaching the sorts of people who might be at risk if they are misled or they do not understand the type of product they might be buying into?

David Geale: It is very difficult to follow that all the way through to whether people understand what they are buying, but one of the things we are looking at through the taskforce is engaging with consumer organisations and thinking about whether we need consumer research. For example, we know there is a fairly high proportion of people who have heard of these types of investments. It is much harder to work out whether they understand them. We track things like the number of people who click on to the website.

- Q197 **Wes Streeting:** I was going to ask about reach. Do you have any numbers to share with us in terms of the reach of your advertising campaigns, social media click-throughs and readership in terms of newspaper coverage and column inches? Do you have that data? Is that something you are looking at?

David Geale: We have data on the number of people who have viewed the warnings we have. I do not have it in my head, I am afraid, but we can send it to you.

- Q198 **Wes Streeting:** That is all right. We are not trying to trip you up, but it would be interesting to know. That would be helpful.

David Geale: I can check whether we have anything in terms of people's understanding, following things like Andrew's appearance on the television. I suspect it is a bit like pushing water uphill, because it is difficult when there is a lot of advertising going on the other way as well. But we keep trying.

- Q199 **Wes Streeting:** Let me finally ask all of you a broader question. In January, Facebook and Google decided to ban cryptocurrency adverts. The question is this: why is Facebook, a private company, having to lead the way when it comes to regulating the advertisement of crypto assets? Do you agree with the criticism that has been levelled in this context that regulators are asleep at the wheel while private companies are getting on



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with it? It is not often, by the way, that I would be particularly praiseworthy of Google and Facebook when it comes to some other content. Never mind the terrorists; at least they are clamping down on crypto assets.

There is a serious point there. Technology is changing all the time. With the best will in the world and with some humility about this place and its pace, there is a concern that regulators are not moving as fast and are not as front-footed as you could and perhaps ought to be. Is it fair to say that you have been sleeping at the wheel while Facebook has been getting on with banning the advertisements in this space? Who wants to take that on the chin first?

David Geale: I will start. I do not think that is fair. Where we see advertisements that breach our rules, by a regulated entity, related to financial instruments, we can and will take action. That can happen in a number of ways, going from specific enforcement action, which may involve fines and so on, through to a simple phone call with the firm if it is something we spot at a very early stage that we can just get them to change, and we think no detriment has occurred as a result, because, for example, they may have other controls around the onboarding of clients. There is a whole range of things that can and do happen in that space. It is not just about the advert itself.

We have taken steps to issue warnings where we have the remit to do so. We have gone a little bit outside of our remit and reminded people that there may be people operating outside the regulated space there and that they should consider very carefully whom they are dealing with and the protections that may or may not apply. I do not see that as being slow. We also have to keep in mind that this can be a useful way for some small and medium-sized enterprises to raise capital. We do not want to do something that is disproportionate and end up cutting off something that might be of value to the economy as a whole and to financial services in terms of development. We need to find that balance, and that is partly what the taskforce is there for.

There are some positives in terms of companies like Facebook and Google, which may be doing something in spaces where we cannot operate, where there are utility tokens, if they have significant concerns with that. Having said that, it has not been entirely effective, because we still get reports of people signing up for those things through those channels.

Q200 **Wes Streeting:** Martin, what is your view?

Martin Etheridge: I do not believe the Bank of England is asleep at the wheel. When bitcoin was not particularly in the national consciousness, even back in 2014, we anticipated that this could be meaningful. We issued reports that highlighted the potential channels through which monetary or financial stability could be affected. We have been monitoring the situation since then, but the significant activity we saw



and the significant raising of public awareness in the latter half of last year in particular led the FPC to conclude that it needed to make a statement, even though this is not something that is posing a financial stability threat right now. Our monitoring activity has been many years in the making and will continue to assess those threats.

I would not accept that the Bank of England has been asleep at the wheel in relation to this. We have also been heavily leading work internationally on these issues. The Governor of the Bank of England is the chair of the Financial Stability Board, which in March reported to the G20. There will be vigilant monitoring of these matters on a global basis.

Q201 Wes Streeting: David, is the Treasury satisfied with the job the regulators are doing?

David Raw: We are definitely satisfied with the job the regulators are doing. I would also have the same answer, by the way, in relation to the Treasury: we are not asleep at the wheel. As Martin said, back in 2014 when bitcoin was not in the public consciousness—the concept may have been around for longer than that, but it was not in those days—we had a call for input on cryptocurrencies and we led the way in terms of recommending that the wallets and exchanges were brought in to money laundering regulations. Frankly, the Europeans have caught up with that now, in what they are doing through 5AMLD.

We are very actively involved in international discussions, as Martin said, including the Chancellor through the G20. He was also discussing it in San Francisco on a recent trip to the US. Most international countries are in exactly the same place as we are, in terms of trying to understand the benefits and the risks and take action accordingly.

Martin Etheridge: Where you are right is that things are moving very quickly and there are lots of people spending lots of money trying to improve on the current generation of crypto assets. That might be in improving the ability of transactions to go through, improving issues associated with privacy and all these things. It is an area of very active interest on the regulatory side of the fence, but also in the private sector.

David Geale: One of the big challenges for us through the taskforce is to get some good data. Because a lot of this happens outside the regulated space, it is not something we collect data on between us. The stats vary wildly. When we look, for example, to track the impact of our consumer warnings, it is very difficult to see who the customers of these asset investments are.

Wes Streeting: That was a very good and comprehensive response to the “sleeping at the wheel” charge. I have just been passed this advertisement from easyJet’s magazine. “Ladies and gentlemen, give your bitcoin wings”. Do you see what they did there? There is no warning that products are unregulated and no warning about prices going up and down. “In 2017, we have witnessed the bitcoin rise from \$1,000 to



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\$19,000". That is a 1,800% increase; that is what they are suggesting there. Yes, I absolutely take what you say about the global leadership that is being shown, but there is a nice little reminder. I probably should not give them free advertising, as it has no warning on it.

Chair: We will see if it goes into our report.

Wes Streeting: But it is just a reminder that there is no room for complacency. Thank you. I appreciate your robust response to that slightly harsh criticism, not from me.

Q202 **Rushanara Ali:** I am going to ask you to focus on the future. If you look at subprime mortgages pre-crisis, it was seen as a niche market but it led to the financial crisis. How do you feel about some of the risks that cryptocurrency assets and all these new types of currencies pose? Can we have some futurology for the rest of the afternoon, please? Who wants to start? Are you concerned about it? You have obviously mentioned the warning from last week.

Martin Etheridge: This is an area where it is necessary to remain vigilant. When it comes to the parallels with the financial crisis, they are not completely irrelevant. It is worth ensuring that we learn the lessons from the past and ensure we are front-footed in our assessment on these things. When it comes to the current size, it is small, but we recognise that it can grow materially.

Q203 **Rushanara Ali:** Earlier on, you mentioned the point about cross-border movement. With technology, that could happen at the speed of lightning, if not faster, in a few years' time. Again, there are parallels. Whether it is on the rise of Facebook, Google and other technology, or the deficiencies in regulation without cross-border co-operation—and the same with banking—there are lots of parallels. You mentioned that, given that it is not a regulated sector, it is hard to understand who the consumers are and what is actually happening.

Perhaps "market failure" is not the right word, but you have a sort of failure in the system in trying to capture what is actually happening outside your organisational responsibilities and remit. How do we deal with that? What should we be doing to try to address those points? Before you say "the September report", I am going to ask whether that is going to be in the September report. Will you be able to give us a pretty good idea about where the direction of travel is and what you are going to do about that?

Martin Etheridge: Maybe I can also come in on this question about the availability of data. When it comes to questions that we are interested in around the stability of the financial system—understanding the linkages between crypto assets and the financial system, understanding the linkages between crypto assets and existing systemically important markets—there is reasonably good data to understand what is going on. In the US, it is not that long ago that we saw the launch of bitcoin futures. The fact that they are on regulated exchanges means there is good data to understand the trading activity that is happening there.



Q204 **Rushanara Ali:** But not on consumers.

Martin Etheridge: Indeed. Ultimately, I believe the stability of the financial system gives benefit to consumers, but I understand the point when it comes to the direct consumer interface. Maybe I can hand over to David on that point.

David Geale: The September report will not give us the answers to all those questions. It will help us understand what questions we need to answer, what data we need to gather and where we can get it from relative to what we have at the moment. There will be further work that has to come out of it. It is not going to solve everything.

In terms of looking to the future, we need to understand where we think the development is going to come. Through our sandbox work, we are doing specific tests that look at the application of the technology and its uses in a controlled environment, so we can see what risks emerge, operational risks for example, such that the appropriate controls can be put in place. The sort of test we have done at the moment on cross-border transactions would be around restricting the number of users, the size of the transaction that can take place and the number of transactions. We are looking to see what things emerge from it that we can learn from. Then we can design around that accordingly, so we can highlight the risks before they go out to the firms and the users. If we need to make changes to the regulation, given that it is in the regulated space, there are things we can do.

Q205 **Rushanara Ali:** You keep rightly saying “if it is in the regulated space”. David, do you want to talk about things that are not in the regulated space, including consumers, their experience and where they go if things go wrong?

David Raw: I will not just talk about the September report, but one of the outcomes of that report will have to be mapping out the regulatory perimeter; it will have to identify what is not in the regulatory space and what the risks are, including to consumers, and set out steps we may take to deal with those. David is right: it will not be the final word, but it will be more than an analysis of what is currently the state of play. It will be forward-looking and it will set out our plans.

Q206 **Rushanara Ali:** Should they just be treated like banks?

David Raw: We have to wait and see.

Rushanara Ali: We have to wait until September.

David Raw: We have to look at the analysis.

Q207 **Rushanara Ali:** Beyond September, what do you think?

David Raw: It could be that the right answer, as has been set out and as CryptoUK has suggested, is to amend the Regulated Activities Order and put in place a regime that looks similar to the regime we have for



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peer-to-peer, where there are restrictions in relation to the sale to consumers and protections in place in terms of the amount of capital that exchanges need to hold or the way in which things are marketed to consumers. I am not sure that means treating them like banks, but that could be a model we end up following.

Q208 Rushanara Ali: I will come on to why I am asking that, but it is obviously linked to where consumers go for redress. Where would they go in the current unregulated space? If they were treated in a similar way to banks—I am not saying they are the same—could they at least go to the FOS? What is the equivalent for redress? Where do people go when things go badly wrong? Where should they go, if it does not exist?

David Geale: We have to separate the regulated space from the unregulated space. In the regulated space, if it is a regulated firm that has done something wrong, they have a right to complain. They complain to the firm. Our rules require the firm to deal with that in a particular way. If they remain unsatisfied, they can go to the FOS. If the firm has failed and has left a loss on the consumer that is not a trading loss—for example, if the firm has misappropriated client money—they may have a call on the Financial Services Compensation Scheme. That is obviously for UK firms. If they have lost money because of price volatility and they have not been misled—they have been appropriately given the right information and so on—they would not have any call on the Financial Services Compensation Scheme and the ombudsman would treat that based on what they have in front of them in terms of how they would consider it.

In terms of people in the unregulated space, they do not have access to the ombudsman service and they do not have access to the compensation scheme. The question, then, is what they do have. Unless there is some kind of fraud involved or something, their options are very limited.

Q209 Rushanara Ali: I have one final question. That is not really satisfactory, is it? Again, it is this thing about what we can pre-empt so people are protected. Even with established banks, things are going badly wrong, as in the TSB case, where hundreds of thousands of people are affected. If this stuff takes off, with the kind of advertising that Wes has just shown, the technology could really widen its reach to a lot of people. If this becomes, as it is already, particularly for young people, the thing of the 21st century, you are looking at a major problem if things go wrong but people do not have anywhere to go. Should there be a new institution or entity whose job is to look at both the regulated and non-regulated space to provide support to people who find themselves in that situation? Are you prepared for that?

David Raw: The assumption behind the question is that the regulatory perimeter is set in stone. One of the things we are looking at is whether the regulatory perimeter needs to change. If we discover that there are huge risks to consumers outside the regulatory perimeter where people



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do not have recourse to the FOS or the FSCS, the answer may well be that the Treasury legislates or takes action to change where the regulatory perimeter is.

Rushanara Ali: If that is the answer—

Chair: I am going to move on, because we are literally up against it. If there is anything else on that, go ahead.

Q210 **Rushanara Ali:** It is just the “when?”—the timing. What would be your timing around this?

Chair: September?

David Raw: We are reporting in September. How we report in September remains to be seen, but it will get a clear sense of direction.

Q211 **Catherine McKinnell:** Another thing it would be helpful to get some sense of direction on is in relation to money laundering and how that is being tackled. The features of crypto assets pose very significant risks in terms of irreversible transactions and hidden user identities. What are the Government doing on this? Should they really have been moving a bit more quickly?

David Raw: As I said, we did a call for evidence in 2014. 5AMLD comes into force in a few days on 10 July. We will be consulting on how to transpose that over the remainder of this year and the course of next year. The precise timings are still being worked out, but by the end of next year it will be transposed so we will know precisely what that new money laundering framework looks like in relation to crypto assets and exchanges, including who the responsible regulator is. We will know precisely how we are going to deal with it.

Q212 **Catherine McKinnell:** That sounds like quite a slow timeframe, to be honest, considering the level of assets that could potentially be moved within that time. One of the questions being asked is why the Government have waited for the European framework. Should they not have been dealing with this on a national basis more proactively and more speedily?

David Raw: In terms of the timeframe for the end of next year, that is the backstop by which we need to have transposed the directive, so it may well happen sooner. I suppose you could ask the question as to why we did not do it domestically. After the call for input, when it started being discussed at a European level, the view was taken that it would be better to take co-ordinated action at a European level. I know 5AMLD has been in discussion for some time.

Q213 **Catherine McKinnell:** Will the transposition into UK law happen faster than the backstop date? Is this a matter of urgency?

David Raw: It is certainly a matter of urgency. I cannot give you a precise timeframe at the moment, I am afraid.



Q214 **Catherine McKinnell:** But it is a matter of urgency. That is helpful to know. Is the UK happy with the directive in its entirety? Are there likely to be any debates about how it is transposed?

David Raw: The directive is coming into force in a few days, so we are certainly happy with the directive. We will still need to consult on precisely how we transpose it, but the issues are not with the directive itself.

Q215 **Catherine McKinnell:** What stage is that at? Has there been significant progress in the last three months?

David Raw: There will have been informal discussions between the Treasury and interested parties. The actual transposition has not happened, because the directive has not yet come into force.

Q216 **Catherine McKinnell:** Is there sufficient capability within the Treasury to get this transposed as a matter of urgency?

David Raw: Yes.

Q217 **Catherine McKinnell:** In the written evidence to the inquiry, the FCA stated, "We now view the potential harm in this space to be greater than previously assessed". How significant do you see the threat to be, in terms of crypto assets and money laundering, and why is it greater than previously assessed?

David Geale: It is because of the pace of growth in this particular market. If we look at the number of ICOs that were launched last year, we have already exceeded that this year. The pace of growth is very, very fast. That is the most basic answer. That is what we are seeing at the present moment in time. As that pace increases, the quality of data that is available is not that strong. That is something we need to pick up. This is one of the gaps we are potentially looking at.

Q218 **Catherine McKinnell:** In what sense are you looking at that? Is there more that could be done to mitigate some of the risk that is currently clearly out there?

David Geale: As I say, we are taking steps to mitigate the risk as we can at the present moment in time. We consider cases on a case-by-case basis. If we see people operating outside the regulatory perimeter where they should be within, we can and do take action, and we have a number of firms under active investigation there. We consider each application for authorisation on its merits. The usual standards apply. For example, the people operating the firm have to be fit and proper; they have to have proper business plans and so on. We have issued warnings around ICOs; we have issued warnings around crypto contracts for difference for consumers; we have also issued warnings to firms on derivatives in terms of the fact that we consider these to be financial instruments and they should be within the regulatory perimeter. We have told people what we think.



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We have updated our ScamSmart site, which has been very successful in promoting concerns around fraud, for example. We have written to the banks about how they deal with actors in the crypto asset space, around things like how they consider operational risk. We work with other agencies, including the National Crime Agency and the fraud agencies, and we are working with a number of international bodies. The other thing that is relevant is that the senior managers and certification regime will apply to those who are regulated entities when that comes into force at the end of next year, so the regulated firms will be caught by that as well.

Q219 Catherine McKinnell: Is the FCA happy with the directive as it looks to be implemented in the UK? Does it go wide enough? Does it cover enough wallet-holders? In terms of custodial and non-custodial, is it encompassing enough to get ahead of the curve on these issues?

David Geale: Getting ahead of the curve is a constant challenge; it is not something where we can say, "That is it; job done; move on". It is something we need to continually look at. It is a significant step forward and we will take account of the Treasury's consultation and what it means for us and other regulators in terms of how it is implemented.

Q220 Catherine McKinnell: I got a categorical yes from the Treasury in terms of capacity for dealing with this. FCA, do you have sufficient capacity? Do you have sufficient expertise? Do you have enough people who are able to keep a handle on this?

David Geale: In terms of 5AMLD, it depends what our role in that is. I cannot answer that one just yet. Is this a significant enough issue for us to devote significant resource to? Yes.

Catherine McKinnell: You have been saved by the bell.

Chair: Thank you all very much. Apologies for starting late as well, but thank you for your expertise. If there is anything further that we have missed factually, we might write to you. If there is anything further that you had hoped to cover that we have not got to, please feel free to add to the evidence you have submitted. Thank you all very much indeed for your time this afternoon. It has been really appreciated.