CAI0084

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Overview

The social purpose of regulated financial markets is to facilitate economic growth by enabling people's savings to be channelled to productive business ventures.

The issue and trading of speculative cryptoassets serves no such social purpose. The aim of promoters of speculative cryptoassets in lobbying for a regime which legitimises their issue and trading is to obtain the "halo" of financial services regulation in order to persuade more people to part with real money in exchange for volatile tokens with no inherent value. As recent events have shown only too clearly, speculative crypto not only serves no social purpose: it often impoverishes vulnerable people; and on the way there, it often gravely damages our environment.

It is, therefore, disappointing that the government's Consultation and Call for Evidence about the Future Financial Services Regulatory Regime for Cryptoassets proceeds on the false premise that speculative crypto is a "financial service". From this premise, it proposes that the issue and trading of speculative cryptoassets should be endorsed by regulating it as a financial service, even though it provides no useful service to consumers.

The Consultation asserts that there are "potential benefits offered by crypto". While this may be true of certain types of stablecoin and security or utility tokens, the Consultation provides no evidence of these benefits in relation to speculative crypto. The Consultation also asserts that "risk taking is a desirable part of the cycle of innovation"; but risk taking produces no sustainable benefits to the economy if the only people taking risks are ordinary consumers hoping to win at a game of digital roulette, and the only certainty is that the house will win.

In the light of the government's recent emphasis on the importance of cost benefit analysis in financial regulation, it is surprising that no material about the costs and benefits of speculative crypto is provided in the Consultation.

Speculative crypto is gambling pure and simple. It should be regulated and taxed as such, with levies to support the debt advice and addiction services for which it will fuel demand. If the issue and trading of speculative crypto are instead treated as financial services, conferring the "halo" of financial services regulation, then increased consumer loss and calls for compensation provided by taxpayers or financial services levy payers will inevitably follow.

The following paragraphs comment on a number of statements in the Consultation.

Detailed comments

1. Paragraph 1.3 of the Consultation states that "*the government's view is that cryptoassets and the activities underpinning their use should follow the standards expected of other similar financial services activities*".

There are, fortunately, very few regulated financial services activities that share the characteristics of speculative crypto: most are connected in some way to the real economy. The most analogous regulated financial services activity is probably spread betting: the overwhelming majority (around 80%) of consumers speculating on contracts for difference (CfDs) lose money, giving rise to significant economic hardship and mental and physical health problems.[1] CfD firms are rent-seeking operations[2] which do not channel their profits to productive business ventures.

With hindsight, it was a significant policy error by Parliament to treat retail CfDs as a regulated financial services activity, conferring the halo of FCA authorisation on the firms providing them. It is important not to repeat this policy error with speculative cryptoasset firms. Instead, both CfD firms and speculative cryptoasset firms should be treated and regulated as gambling firms, since that is essentially what they are; they should be subject to additional tax, as gambling is, to help to offset the significant externalities they create; there should be a ban on the use of credit cards by consumers to finance these activities; specific requirements should be imposed to prevent problem gamblers from losing further money, with funding and signposting to counselling services; and consideration should be given to banning sport-related advertising - and possibly all advertising.

2. Paragraph 1.12 states that "*the financial services regulators should avoid applying disproportionate or overly burdensome regulation to entities, particularly where end users are aware of the risks*."

The FCA has an operational objective of protecting consumers. Fulfilling this objective requires the FCA to consider real world consumer behaviour. Consumers may be formally made "aware" of risks through mandatory risk warnings, but nevertheless drawn to make unsuitable decisions as a result of high pressure advertising involving social media influencers and the creation of peer group pressure, playing on their lack of financial experience and biases, including fear of missing out.

This is the real world of speculative crypto and this is the real world for which the FCA needs to regulate.

It is disappointing that the Consultation chooses to focus on the interests of the speculative crypto industry in avoiding "disproportionate or overly burdensome regulation" without mentioning the extent of consumer harm which regulation is there to prevent.

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[1] See **"**FCA highlights continuing concerns about problem firms in the CFD sector", 1 December 2022.

https://www.fca.org.uk/news/press-releases/fca-highlights-continuing-concerns-about-problem-firms-cfd-sector

[2] Hence the prominence of their founders or owners as major political donors.

3. Paragraph 2.5 states that "*it is not the government's intention for FSCS protections to apply to investor losses arising from cryptoasset exposures*".

There is a clear risk that taxpayers or financial services levy payers will nevertheless pick up the bill when speculative crypto firms fail. Although the proximate cause of these failures may be the actions of the firms' management, accusations will inevitably be levied at both the financial regulators for any actual or alleged operational errors and at the government for creating a regime which encourages consumers to make financial decisions which are likely to be harmful to them.

The government should, therefore, explain how it proposes to further mitigate the significant moral hazard which its proposals will create.

4. Paragraph 3.10 notes "*the government's plan to introduce legislation to address the significant risk of misleading cryptoasset promotions*".

Many of the worst promotions for crypto are disseminated through social media and other online platforms by overseas actors. Without the enactment of a clear regime to prevent online platforms from disseminating illegal financial promotions, the extension of the financial promotions regime will be ineffective in protecting UK consumers.

5. Paragraph 5.15 proposes that "*liability [for public offer documents for issues of crypto] would be applied to the preparer of the document, which could be the issuer*".

Unlike a business issuing shares or bonds to finance a productive venture, the issuer of speculative crypto has little or nothing of value to support claims against it: it is simply a vehicle containing nothing other than, perhaps, some computer code. A claim by one buyer is part of zero sum game, harming other buyers.

The Consultation therefore goes on to state that "*some prudential requirements are likely to be necessary for issuers to ensure they are able to absorb losses arising from liability*", but it does not explain the extent of these prudential requirements or who will be responsible for ensuring that they are maintained and for how long.

In reality, it will be impossible to ensure that adequate funds are available to meet claims against an issuer of speculative crypto. If there is to be any worthwhile responsibility attached to the issue of a document offering speculative crypto, that responsibility also needs to attach to the individuals and the professional advisers sponsoring the transaction.

6. Paragraph 13.5 seeks "*views from respondents as to what information about environmental impact or energy intensity would be useful for consumers making decisions about investing in cryptoassets*."

It is clear that Proof Of Work (PoW) systems have massive negative impacts on the environment, but that those who speculate on PoW tokens such as Bitcoin do not care.

Accordingly, this issue cannot be addressed through disclosure. If the government is serious about its commitment to tackling the climate emergency, it will not permit PoW tokens to be promoted on UK regulated financial services markets.

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