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Treasury Committee

# Regulating Crypto

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# Summary

So-called "cryptoassets" span a wide and rapidly evolving range of digital instruments, although the market continues to be dominated by unbacked "cryptocurrencies" such as Bitcoin and Ether that we do not consider to have any intrinsic value. Given their potential impact on the financial services landscape, we have been paying close attention to cryptoassets for many years. Our predecessor Committee published a Report in 2018 that called for greater regulation to protect consumers from an industry it described as a "wild west". Nothing we have heard in our current inquiry has changed that impression.

Innovative technologies have the potential to bring benefits to financial services and the wider economy. Some of these innovations may include distributed ledger technologies such as those used in cryptoassets. The most convincing use case we have heard is the potential for cryptoasset technologies to improve the efficiency and reduce the cost of making payments, especially cross-border and in lower income countries with less developed financial sectors.

But cryptoassets also pose significant risks. In particular, unbacked cryptoassets pose significant risks to consumers, given their significant price volatility and associated risk of losses. They can consume very large amounts of energy and are also used by criminals in scams, fraud and money laundering.

Effective regulation of cryptoassets should help to foster innovation and maximise any potential benefits of cryptoasset technologies for the UK, while also mitigating risks. We therefore welcome the Government publishing proposals for how it plans to regulate cryptoassets used in financial services. It is important that the Government and regulators strive to keep pace with developments, including by ensuring that the Financial Conduct Authority's authorisations gateway is open and effective, so that potential productive innovation in financial services is not unduly constrained.

The extent of the benefits cryptoasset technologies may bring to financial services in the future remains unclear. In the meantime, the significant risks posed by cryptoassets to consumers and the environment are real and present. We therefore recommend that the Government takes a balanced approach to supporting the development of cryptoasset technologies, and seeks to avoid expending public resources on supporting cryptoasset activities without a clear, beneficial use case. The Government's recent foray into seeking (and subsequently abandoning) the production of a Royal Mint non-fungible token (NFT) is a case in point. It is not the Government's role to promote particular technological innovations for their own sake.

Consumer speculation in unbacked cryptoassets such as Bitcoin and Ether is one area where we have particular concerns, and think the Government needs to take a different approach in order to better protect consumers from harm. Unbacked cryptoassets have no intrinsic value, and their price volatility exposes consumers to the potential for substantial gains or losses, while serving no useful social purpose. These characteristics more closely resemble gambling than a financial service, an impression reinforced by the evidence we have received of consumer behaviour. We are concerned that regulating retail trading and investment activity in unbacked cryptoassets as a financial service will create a 'halo' effect that leads consumers to believe that this activity is safer than it

is, or protected when it is not. We therefore strongly recommend that the Government regulates retail trading and investment activity in unbacked cryptoassets as gambling rather than as a financial service, consistent with its stated principle of 'same risk, same regulatory outcome'.

We will continue to follow developments in this space as both the industry and the Government's regulatory approach develop. We are also considering central bank digital currencies separately from the wider cryptoasset market like the Government and Bank of England. In each case our focus will be on ensuring that the right balance is achieved between not standing in the way of productive innovation on the one hand and mitigating risks on the other.

# 1 Introduction

1. Cryptoassets span a wide and constantly evolving range of digital instruments.[1] Unbacked cryptoassets (also sometimes referred to as "cryptocurrencies"[2]) are not supported by any underlying asset and so have no intrinsic value.[3] Unbacked cryptoassets remain the most prominent form of cryptoasset, with the largest two (Bitcoin and Ether) alone accounting for around two-thirds of the total market capitalisation of all cryptoassets.[4] But there are currently more than 23,000 cryptoassets of various forms in existence.[5]

2. The size of the global cryptoasset market has fluctuated in recent years, reflecting the significant price volatility of many cryptoassets, but remains small relative to the size of traditional financial markets. The total market capitalisation of cryptoassets currently stands at $1.2 trillion (0.2 per cent of the $487 trillion of total global financial assets[6]), down from a peak of $2.9 trillion in November 2021.[7]

3. Our predecessor Committee undertook an inquiry into digital currencies in 2018. The Report from that inquiry highlighted the significant risks posed to consumers by cryptoassets, describing the cryptoasset industry as a "wild west" and recommending that the Government introduce regulation to protect consumers if it decided that the growth of the cryptoasset industry should be encouraged in the UK.[8]

## Potential benefits of cryptoassets and their underlying technologies

4. One of the most commonly cited possible benefits of cryptoasset technologies is their potential to improve the efficiency and reduce the cost of payments, particularly cross-border. Susan Friedman, Head of Policy at crypto technology company Ripple Labs Inc, told us:

> It is no secret that the cross-border transfer system is broken. It takes three to five days. Up to 6% is chewed up in fees. Blockchain and crypto can help solve those problems and help money move much more efficiently than it does in the current system.[9]

1 The Financial Services and Markets Bill (as amended in House of Lords Grand Committee), Clause 65 [Bill 124 (2022–23)] defines a "cryptoasset" to be "any cryptographically secured digital representation of value or contractual rights that – a) can be transferred, stored or traded electronically, and b) that uses technology supporting the recording or storage of data (which many include distributed ledger technology)".

2 The validity of the term 'cryptocurrencies' was discussed in our predecessor Committee's Report: Twenty-Second Report of Session 2017–19, 'Crypto-assets', HC 910, paras 5–6.

3 The International Monetary Fund, 'Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets', 26 September 2022

4 CoinMarketCap, 'Global Cryptocurrency Market Charts', accessed 2 May 2023

5 CoinMarketCap, 'Cryptocurrency Prices, Charts And Market Capitalizations', accessed 2 May 2023

6 Financial Stability Board, 'Global Monitoring Report on Non-Bank Financial Intermediation 2022', 20 December 2022, p 3

7 CoinMarketCap, 'Global Cryptocurrency Market Charts', accessed 2 May 2023

8 Twenty-Second Report of Session 2017–19, 'Crypto-assets', HC 910

9 Q11

5. Cryptoassets also have the potential to improve the efficiency and reduce the cost of domestic payments. Ian Taylor from the trade association CryptoUK told us that "merchants are starting to see the benefit in the UK of accepting a stablecoin as a means of payment versus a credit card payment, because it is significantly cheaper. Credit card fees are over 2% now. A stablecoin issuer can get that down to 1%."[10]

6. We were also told that cryptoasset technologies have the potential to improve financial inclusion.[11] Several respondents noted though that the scope for any financial inclusion benefits in the UK was limited given that people who were digitally excluded or don't already have bank accounts were unlikely to adopt cryptoassets.[12]

7. The Payment Association told us that there might be greater scope for cryptoasset technologies to improve financial inclusion in developing countries with low levels of payments infrastructure. They noted that:

> […] a move to peer-to-peer payments on the blockchain can be seen as a natural solution to quickly gain traction and improve financial inclusion. An example of a [non-crypto] peer-to-peer system that has worked successfully is the mobile money service M-Pesa that started in Kenya and is now providing more than 51 million customers access to payments across seven countries in Africa, with over 314bn USD in transactions per year.[13]

8. Fintech industry body Innovate Finance told us about some of the wider potential benefits that the technology underlying cryptoassets could bring for financial services:

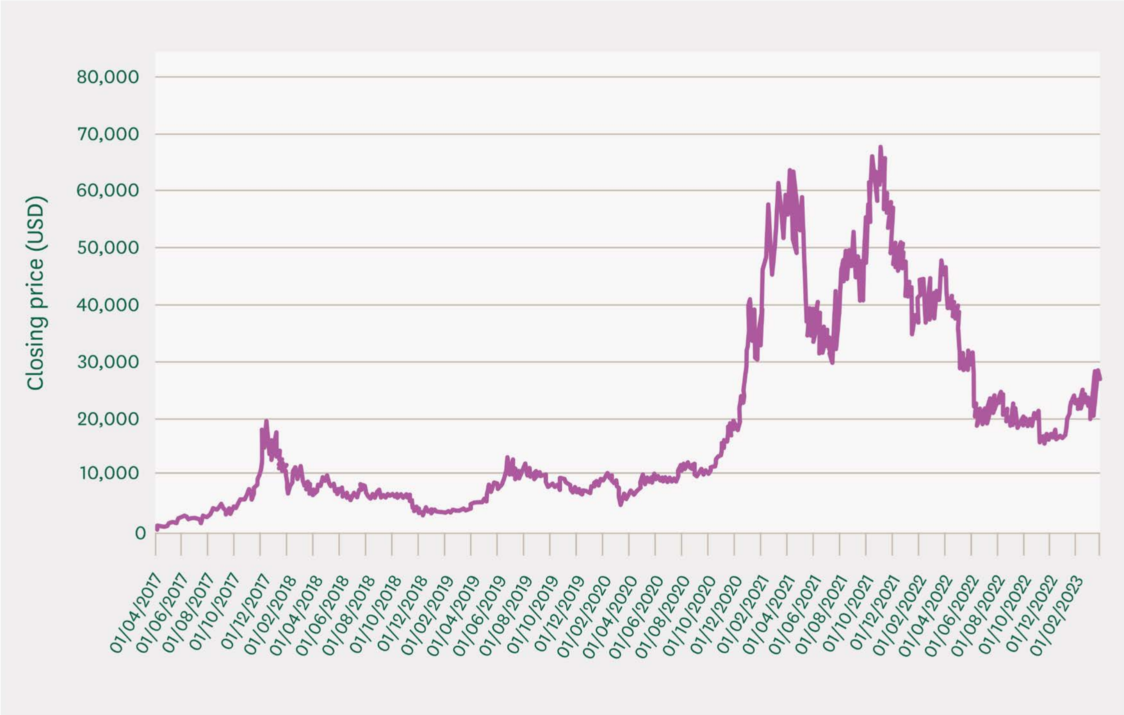
> The first wave of FinTech innovation over the last decade transformed the customer experience and the 'front end' of financial services (user interfaces and consumer-friendly apps and platforms). The next wave of innovation, driven by new technologies that enable crypto-assets, will be likely also to transform the 'back end' of finance, including payment systems and the infrastructure of capital markets, the ways in which transactions are carried out, legal records are maintained, and also the very nature of financial assets.[14]

## Risks from cryptoassets

9. Unbacked cryptoassets such as Bitcoin and Ether typically display considerable price volatility, with periods of strong price appreciation in value often followed by equally rapid price falls (see Figure 1).

10 Q38
11 See, for example, Electronic Money Association (CAI0067)
12 See, for example, Qq85–89
13 The Payments Association (CAI0034)
14 Innovate Finance (CAI0038)

**Figure 1: The price of Bitcoin**




Source: Yahoo Finance[15]

10. The price volatility of unbacked cryptoassets exposes consumers to significant risks of losses. Research by the Bank for International Settlements (BIS) into the retail adoption of cryptoassets estimated that 73–81% of the users that entered the Bitcoin market over 2015–2022 were likely to have lost money on their investments. They also noted that "[…] in periods of price increases, small Bitcoin holdings tend to increase, while especially the largest Bitcoin holders–the humpbacks–tend to sell. This […] is consistent with a market sustained by new entrants, allowing early investors and insiders to cash out at their expense."[16]

11. Cryptoassets are used by criminals to perpetrate scams, fraud and money laundering, with estimates of the proportion of global cryptoasset trades that are related to crime ranging from 0.15 per cent to 46 per cent.[17] According to the Government's second Economic Crime Plan (2023–2026), "intelligence demonstrates growing criminal acquisition and abuse of cryptoassets linked to a wide range of predicate offences, alongside their widespread adoption by money launderers and International Controller Networks". The Plan also noted the National Crime Agency's estimate that "illicit cryptoasset transactions linked to the UK in 2021 likely equated to at least £1.24 billion (~1% of total transaction value) with a realistic possibility they were significantly higher".[18] According to the Financial Ombudsman Service "just over half of the investment scams we have seen

15 Yahoo Finance, Bitcoin USD price history & historical data, accessed 26 April 2023
16 Bank for International Settlements, 'Crypto trading and Bitcoin prices: evidence from a new database of retail adoption', November 2022, p 20
17 CoinDesk, 'How Big Is Crypto Crime, Really?', accessed 2 May 2023
18 HM Government, 'Economic Crime Plan 2 2023–26', 30 March 2023, p 28

involve cryptocurrencies, where consumers were promised an investment that did not materialise, or were persuaded to open a cryptocurrency account and inadvertently sent money to a fraudster."[19]

12. Despite some efforts to reduce the environmental risks of cryptoassets,[20] activity in some—most notably the largest, Bitcoin—continues to consume very large amounts of energy. According to the Cambridge Centre for Alternative Finance, the Bitcoin network's annualised energy consumption is estimated to be 131 terrawatt-hours, which is more than that of Norway or Sweden.[21]

13. There are also concerns around the corporate governance and controls within cryptoasset firms. There was a high rejection rate of 85 per cent for firms applying for registration under the Financial Conduct Authority (FCA) Anti-Money Laundering and Counter Terrorist Finance (AML/CTF) regime.[22] FCA Chief Executive Nikhil Rathi highlighted that this was "exceptional by any historical experience to us in terms of the quality and, frankly, the integrity of the answers we were receiving from some of the firms that were applying".[23]

14. The risks posed to cryptoasset holders by poorly-run businesses were also highlighted by several high-profile failures of cryptoasset firms over 2022.[24] These included the failure of the large Bahamas-based cryptoasset exchange FTX,[25] which resulted in consumers losing significant amounts of money.[26]

## The Government's ambition for cryptoassets in the UK

15. In April 2022 the Government announced its plan to make the UK a "global hub" for cryptoasset technology. The then-Chancellor of the Exchequer, Rt Hon Rishi Sunak MP, said:

> It's my ambition to make the UK a global hub for cryptoasset technology, and the measures we've outlined today will help to ensure firms can invest, innovate and scale up in this country.
>
> We want to see the businesses of tomorrow–and the jobs they create–here in the UK, and by regulating effectively we can give them the confidence they need to think and invest long-term.
>
> This is part of our plan to ensure the UK financial services industry is always at the forefront of technology and innovation.[27]

19 Financial Ombudsman Service, 'Quarterly complaints data: Q1 2022/23', accessed 2 May 2023
20 Qq94–97
21 Cambridge Centre for Alternative Finance, 'Cambridge Bitcoin Electricity Consumption Index', accessed 2 May 2023
22 Treasury Committee, Correspondence from the FCA relating to the session on 'The crypto-asset industry' on 7 December 2022, dated 19 January 2022 (26 January 2023)
23 Oral evidence taken on 8 March 2023, HC 142, Q504
24 Yahoo Finance UK, 'How crypto crashed in 2022', 22 December 2022
25 For more detail on the collapse of FTX, see House of Commons Library, 'Cryptocurrencies', CBP 8780, 22 February 2023, p 28.
26 The Guardian, ''The money is gone': people who lost out in FTX's collapse', 19 November 2022
27 HM Treasury, 'Government sets out plan to make UK a global cryptoasset technology hub', 4 April 2022

16. We launched our current inquiry into the cryptoasset industry in July 2022, with the aim of exploring the role of cryptoassets in the UK, including the opportunities and risks that cryptoassets may bring; the potential impact of distributed ledger technology on financial institutions; and the regulatory response to cryptoassets from the Government, FCA and Bank of England.[28]

17. The Government published a consultation paper in February 2023 setting out its overarching plan for the regulatory framework to be applied to cryptoassets used within financial services.[29] Other jurisdictions are also developing regulatory frameworks for cryptoassets, including the European Union through its Markets in Crypto-Assets (MiCA) regulation.[30]

18. This Report is focussed on the UK Government's approach towards cryptoassets, including the proposals in its consultation, and the implications for consumers and businesses, drawing on the evidence received through our inquiry. This Report does not therefore cover all aspects of our inquiry into the cryptoasset industry. In particular, it does not cover central bank digital currencies (CBDCs), which we are considering separately, consistent with the approach taken by the Government and Bank of England, which have published a separate consultation paper on a UK CBDC.[31] Our work on CBDCs will seek to build on the House of Lords Economic Affairs Committee's 2022 report.[32]

## The Government's approach to regulating cryptoassets

19. Prior to 2023, the regulation of cryptoassets in the UK had developed in a piecemeal way. In January 2020, an AML/CTF regime was introduced for businesses undertaking cryptoasset exchange or custody wallet services in the UK.[33] In January 2022 the Government signalled its intention to legislate for the regulation of cryptoasset promotions[34] by the FCA, to ensure promotions are clear, fair and not misleading[35] (the legislation was laid in Parliament in March 2023).[36] And the Government announced in April 2022 that it would legislate in the Financial Services and Markets (FSM) Bill to introduce a regime for the regulation of certain stablecoins[37] used for payments.[38]

28 Treasury Committee, 'Treasury Committee launches inquiry into crypto-assets', 13 July 2022

29 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023

30 European Commission, 'Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937', accessed 3 May 2023. We discussed the proposed MiCA regulation in an informal meeting with the ECON Committee.

31 Bank of England and HM Treasury, 'The digital pound: a new form of money for households and businesses? Consultation Paper', 7 February 2023

32 House of Lords Economic Affairs Committee, Third Report of Session 2021–22, 'Central bank digital currencies: a solution in search of a problem?', HL Paper 131

33 For more information, including the definition of the terms used, see: FCA, 'FCA becomes AML and CTF supervisor of UK cryptoasset activities', 10 January 2020; and FCA, 'Cryptoassets: AML / CTF regime', accessed 2 May 2023.

34 The Financial Services and Markets Act 2000, section 21, defines a "financial promotion" as "an invitation or inducement to engage in investment activity, communicated by a person in the course of business".

35 HM Treasury, 'Cryptoasset promotions: Consultation response', 18 January 2022

36 See Treasury Committee, Correspondence from the Economic Secretary to the Treasury and City Minister relating to the Financial Promotions Order, dated 6 April (18 April 2023), and references therein.

37 Stablecoins are a form of cryptoasset designed to stabilise (or 'peg') their value, typically with reference to a fiat currency such as the US Dollar.

38 HM Treasury, 'UK regulatory approach to cryptoassets, stablecoins, and distributed ledger technology in financial markets: Response to the consultation and call for evidence', 4 April 2022

20. The Government's consultation published in February 2023 made proposals for the financial regulation of a broader range of cryptoasset activities. By seeking to establish a regulatory framework for cryptoassets in the UK, the Government stated that it was pursuing four overarching policy objectives:

(i) encourage growth, innovation, and competition in the UK

(ii) enable consumers to make well-informed decisions, with a clear understanding of the risks involved

(iii) protect UK financial stability

(iv) protect UK market integrity.[39]

21. In addition, the Government stated that it will be guided by a set of core design principles:

- Same risk, same regulatory outcome[40]
- Proportionate and focussed
- Agile and flexible.[41]

22. The detailed regulatory proposals set out in the consultation cover the areas the Government states are associated with both "a higher degree of risk from a consumer and overall market perspective" and "greater opportunities to support the UK's growth agenda".[42] The Government intends the regulations to capture cryptoasset activities provided in or to the UK.

23. The Government's proposed legislative approach is to bring cryptoassets within the framework established by the Financial Services and Markets Act 2000 (FSMA), which governs the regulation of a wide range of financial services. It will do this by expanding the list of specified investments in Part III of the Regulated Activities Order, made under FSMA, to include cryptoassets. Once the relevant legislation is made, the FCA would need to consult on the detailed rules it will apply.

39 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023, p 10

40 The concept of "same risk, same regulatory outcome" refers to the principle that activities presenting the same risk should be regulated to ensure the same degree of resilience against that risk, irrespective of the technological form of the activity.

41 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023, p 10

42 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023, p 12

# 2 Key issues

## Approach to supporting innovation

24. When launching the Government's consultation on the future financial services regulatory regime for cryptoassets, the Economic Secretary to the Treasury Andrew Griffith MP explained the Government's intention that "[…] Effective regulation will create the conditions for cryptoasset service providers to thrive in the UK, and give people and businesses the confidence to invest with an understanding of the often high risks involved."[43]

25. Evidence we received prior to the publication of the Government's consultation revealed appetite from some in the industry for more regulation, with several respondents also noting that the Government's slowness in developing a regulatory framework for cryptoassets risked the UK falling behind other jurisdictions, in terms of international competitiveness and consumer protection. Financial technology firm Circle said:

> The years after the 2017 bull market were an ideal time for the U.K. to develop a holistic regulatory regime for cryptoassets. Unfortunately, the U.K. did not act on the [2018] recommendations of the Treasury Committee. To regain its footing and status as a global financial services leader, the U.K. must act now.[44]

26. The crypto investment app company Luno told us that "multiple jurisdictions across the world have implemented comprehensive regulatory regimes, with Singapore's becoming law in early 2019. Meanwhile, the UK has repeatedly delayed taking action".[45] Luno argued that a "failure to tackle this issue at pace increases the risk of consumer harm and reduces the chances of the UK retaining its position as a world leading fintech hub".[46]

27. Ian Taylor from the trade association CryptoUK told us that appropriate regulation of cryptoassets should help to mitigate some of the risks consumers face in holding them:

> […] As our founder members of CryptoUK testified to this Committee in 2018, we need regulation of certain centralised market participants. Perhaps if we had had some regulation, some of these recent events may not have taken place, where we have seen some pretty poor business practices.[47]

28. Some respondents to our inquiry also noted that delays in the FCA's processing of applications under its AML/CTF regime had caused some firms to relocate overseas. Fintech firm Curve UK Limited told us:

> At present, both companies in the space and individual users - and the development of the UK's own cryptoasset industry - have been hampered by a lack of regulatory clarity and the slow pace of regulatory change. For example, a number of cryptocurrency firms have taken the decision to

43 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023, p 5
44 Circle (CAI0083)
45 Luno (CAI0048)
46 Luno (CAI0048)
47 Q2

> move offshore owing to the delays in the FCA dealing with the cryptoasset firm registration regime, which had to be extended owing the huge backlog of firms that remained on the temporary register.[48]

29. In similar spirit, others noted the challenges faced by the FCA in keeping pace with developments in cryptoasset markets. The software company R3 said:

> The investment required in the FCA to meet the stated ambitions of the UK Government should not be underestimated. Ensuring that investment is commensurate to the challenge will be another factor determining whether the UK Government realises its ambitions for [Distributed Ledger Technology] DLT's contribution to economic growth.[49]

The FCA itself acknowledged to us the practical, policy and resourcing challenges it will face in implementing proposed new cryptoasset regulations.[50]

30. **We recognise the potential for some forms of cryptoassets and their underlying technologies to bring benefits to financial services and markets. The most convincing use case we have heard is the potential for cryptoasset technologies to improve the efficiency and reduce the cost of making payments, especially cross-border and in lower income countries with less developed financial sectors. An effective regulatory framework would support development of such technologies in the UK, while also mitigating some of the risks cryptoassets pose. We therefore welcome the Government publishing proposals for how it plans to regulate cryptoassets used in financial services.**

31. **It has been more than four years since our predecessor Committee's Report called for greater regulation of the cryptoasset industry, and the FCA faces challenges in implementing existing and proposed crypto regulations. It is important that the Government and regulators strive to keep pace with developments, including by ensuring that the Financial Conduct Authority's authorisations gateway is open and effective, so that potential productive innovation in financial services is not unduly constrained.**

32. Some respondents to our inquiry suggested that the Government's approach had placed too much emphasis on supporting the development of new cryptoasset technology over protecting consumers. For example, the Financial Services Consumer Panel (an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services) told us:

> Whilst there have been some welcome moves regarding advertising, we have concerns around [the Government's] approach focussed on welcoming, nurturing and encouraging the crypto industry to develop in the UK in pursuit of competitive advantage. We are concerned that consumer protection is thereby deprioritised at precisely the time that it needs to be made a priority. […]

48 Curve UK Limited, and ICDEF Limited (CAI0008)

49 R3 (CAI0064)

50 Treasury Committee, Correspondence from the Financial Conduct Authority, relating to the 'The work of the Financial Conduct Authority' session on 8 March, dated 20 April (25 April 2023)

> Harm to consumers needs to be prevented (in line with the FCA's new Consumer Duty), and this is particularly the case where there is a disparity in either knowledge or power, which is likely to be the case in the crypto-asset sector, particularly with respect to retail investors.[51]

33. Despite the potential for cryptoasset technology to help improve cross-border payments, Mastercard noted that technology is not the only impediment to doing so, describing a range of other barriers:

> Crypto-assets have significant potential concerning cross-border payment use-cases, such as trade finance and remittances. However, as has been clearly identified by the G20 Cross Border Payments Roadmap, existing barriers to the speed, efficiency, transparency, and accessibility of payments are not exclusively–or even primarily–technological. A range of issues, including fragmented regulatory requirements, unharmonized messaging standards, and barriers to the cross-border flow of data would need to be resolved alongside the deployment of new technologies in order to deliver transformational improvement in the cost/speed of remittances and/or cross-border B2B [business to business] flows.[52]

34. While the Government believes that "crypto technologies can have a profound impact across financial services",[53] others were less convinced. Dr Larisa Yarovaya, Associate Professor of Finance at the University of Southampton, told us:

> The Government should stop believing the myths of 'ground-breaking' features of blockchain technology. It is simply another way to record and store information based on ideas that had already emerged in the 1980s, which became possible to fulfil in the last decade thanks to the increase in computer power.[54]

35. Alongside the Government's announcement in April 2022 that it planned to make the UK a global hub for cryptoasset technology, the Government announced that it would work with the Royal Mint on the creation of a Non-Fungible Token[55] (NFT) "as an emblem of the forward-looking approach the UK is determined to take".[56] The Government has since dropped its plan for a Royal Mint NFT.[57] Explaining this change of heart, the Chancellor, Rt Hon Jeremy Hunt MP, told us: "We always want to be at the cutting edge of new technology in the UK, but the world has changed significantly since then and we are not convinced that the demand will be there in the same way."[58]

51 Financial Services Consumer Panel (CAI0017)
52 Mastercard (CAI0022)
53 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023, p 5
54 Larisa Yarovaya (Associate Professor of Finance, Deputy Head of the Centre for Digital Finance at University of Southampton) (CAI0019)
55 Non-Fungible Tokens are cryptoassets which confer digital ownership rights of a unique asset, using a technology such as distributed ledger technology to support the recording or storage of data.
56 HM Treasury, 'Government sets out plan to make UK a global cryptoasset technology hub', 4 April 2022
57 WPQ 162176, 27 March 2023
58 Oral evidence taken on 29 March 2023, HC 1217, Q272

36. **While we support financial innovation where there are potential benefits, the extent of the benefits cryptoasset technologies may bring to financial services in the future—and the areas in which the technologies may have the most impact—remains unclear. In the meantime, the risks posed by cryptoassets to consumers and the environment are real and present.**

37. ***We recommend that the Government takes a balanced approach to supporting the development of cryptoasset technologies. It should seek to avoid expending public resources on supporting cryptoasset activities without a clear, beneficial use case, as appears to have been the case with the Royal Mint NFT. It is not the Government's role to promote particular technological innovations for their own sake.***

## Approach to regulating retail activity in unbacked cryptoassets

38. One area of the cryptoasset landscape where we heard serious concerns about the balance the Government is striking between supporting innovation and mitigating risks is on the approach to regulating consumer activity in unbacked cryptoassets.

39. A 2022 survey showed that around 10 per cent of UK adults—five million people[59]—hold or have held cryptoassets, with "cryptocurrencies" the most commonly held type (79 per cent).[60]

40. The same report found that the most mentioned reason for holding cryptoassets was that they were a 'fun investment' (52 per cent). There is also anecdotal evidence of school children speculating in cryptoassets.[61]

41. As we noted earlier, unbacked cryptoassets such as Bitcoin and Ether exhibit significant price volatility, exposing holders to substantial potential gains and losses.

42. The Government's intention is that *activities* in cryptoassets will be regulated, rather than the specific *assets* themselves. Hence any form of cryptoasset—including unbacked cryptoassets—could be captured by the proposed regulation of the following activities:

- Issuance activities
- Payment activities
- Exchange (trading) activities
- Investment and risk management activities
- Lending, borrowing and leverage activities
- Safeguarding and/or administration (custody) activities
- Validation and governance activities[62]

59 Based on a UK adult population of 53 million, as calculated from ONS population estimates: The Office for National Statistics, 'Estimates of the population for the UK, England, Wales, Scotland and Northern Ireland', accessed 3 May 2023.

60 HM Revenue & Customs, 'Individuals holding cryptoassets: uptake and understanding', 5 July 2022, p 5

61 Financial Times, 'Crypto in the classroom: Lucy Kellaway on the kids' new craze', 19 November 2021

62 HM Treasury, 'Future financial services regulatory regime for cryptoassets: Consultation and call for evidence', 1 February 2023

43. Given the risks inherent in unbacked cryptoassets and their use by consumers for speculation, some have questioned how they should be regulated, and whether it is right to give them the so-called 'halo' of a 'regulated financial service' that might make consumers believe they are safer than they are. Charles Randell, former Chair of the FCA, told us:

> 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. […]
>
> 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.[63]

44. In addition to the risk of conferring a halo on activities that become regulated, there is a risk that the regulation of some cryptoasset activities confers a halo on those activities that are not. This may lend unwarranted legitimacy to the wider sector, especially where those unregulated activities are provided by a regulated firm. Our work on the collapse of London Capital and Finance provides a case study for the risks of consumers believing that all products and services offered by a firm are regulated just because some are.[64]

45. Some witnesses suggested that speculative activity in unbacked cryptoassets should be treated as gambling rather than as a financial service. The Gambling Commission regulates gambling in the UK under the Gambling Act 2005. It provides advice and guidance to individuals and businesses, including on the prevention of problem gambling, and applies safeguards such as AML/CTF measures on that industry.[65] Businesses regulated by the Gambling Commission include bingo halls, lotteries, arcades, betting shops, racecourse bookmakers, online betting companies and exchanges, and casinos.[66] Charles Randell told us that "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."[67] Similarly, Dr Larisa Yarovaya said:

> We urge the Government to regulate crypto-assets as any other highly speculative financial asset, while crypto exchanges, online trading platforms, and other crypto-asset businesses should be regulated with

63 Charles Randell CBE (CAI0084)
64 Fourth Report of Session 2021–22, 'The Financial Conduct Authority's Regulation of London Capital & Finance plc', HC 149
65 The Gambling Commission, 'What we do', accessed 2 May 2023
66 The Gambling Commission, 'Full register of gambling businesses', accessed 3 May 2023
67 Charles Randell CBE (CAI0084)

> similar stringency as a gambling industry, since individual investors are often getting misinformed by crypto-asset businesses, particularly on social media platforms.[68]

46. Economist Dr Diarmid Weir told us:

> […] creating, purchasing and holding cryptocurrencies is nothing other than a form of gambling–with a zero-sum outcome and mainly benefitting scammers and those with inside access. They are parasitical on the financial system, economic capacity, energy and thus the environment, and on human capacity and well-being.[69]

47. Like gambling, cryptoasset speculation can be addictive. The FCA told us that "crypto gambling addictions are rising and there are limited controls in place to protect vulnerable consumers".[70] We further discussed the similarities between cryptoasset speculation and gambling with Nikhil Rathi, CEO of the FCA, who told us that, while many consumers invest relatively small amounts of money in cryptoassets, some people had lost "life changing sums of money":

> **Dame Angela Eagle:** Isn't the issue with this that you start off with a little bit and then, when you see the theoretical returns that are in your crypto wallet, you get drawn in more? There are cases like that.
>
> **Nikhil Rathi:** Yes, absolutely.
>
> **Dame Angela Eagle:** That is gambling. That is precisely what happens when you are at the roulette wheel.
>
> **Nikhil Rathi:** That is why we want to make it 100% clear. People get a bit fed up with us, because we keep saying it in all our statements and all our documents. You need to be ready to lose all your money if you go down this route.[71]

48. We also discussed the link between sports gambling and cryptoassets with Investigations Writer for The Athletic UK, Joey D'Urso, who told us:

> 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.[72]

68 Larisa Yarovaya (Associate Professor of Finance, Deputy Head of the Centre for Digital Finance at University of Southampton) (CAI0019)

69 Dr Diarmid Weir (Economist at Future Economics) (CAI0020)

70 Financial Conduct Authority (CAI0070)

71 Oral evidence taken on 8 March 2023, HC 142, Qq517–518

72 Q131

49. A 2022 survey found that cryptoasset owners in the UK tended to be younger than the general population (76 per cent were under 45 compared with 45 per cent of the general population), and most owners were male (69 per cent).[73] Bank for International Settlements (BIS) research similarly showed that about 40 per cent of new Bitcoin users over 2015–2022 were men under 35, which they noted is commonly identified as the most risk-seeking segment of the population.[74]

50. Even with effective regulation, unbacked cryptoassets will continue to pose significant risks to their holders, as emphasised by Nikhil Rathi, CEO of the FCA:

> […] On the crypto point, whatever we do on regulation, we are not going to be able to put in place a framework that protects consumers from losses. It is really important we make this point here, through you, to the public. Under no circumstances whatsoever should people expect compensation through this.[75]

51. **Regardless of the regulatory regime, their price volatility and absence of intrinsic value means that unbacked cryptoassets will inevitably pose significant risks to consumers. Furthermore, consumer speculation in unbacked cryptoassets more closely resembles gambling than it does a financial service. We are concerned that regulating retail trading and investment activity in unbacked cryptoassets as a financial service will create a 'halo' effect that leads consumers to believe that this activity is safer than it is, or protected when it is not.**

52. ***We strongly recommend that the Government regulates retail trading and investment activity in unbacked cryptoassets as gambling rather than as a financial service, consistent with its stated principle of 'same risk, same regulatory outcome'.***

73 HM Revenue & Customs, 'Individuals holding cryptoassets: uptake and understanding', 5 July 2022, p 5

74 Bank for International Settlements, 'Crypto trading and Bitcoin prices: evidence from a new database of retail adoption', November 2022, p 1

75 Oral evidence taken on 8 March 2023, HC 142, Q516

# Conclusions and recommendations

1. We recognise the potential for some forms of cryptoassets and their underlying technologies to bring benefits to financial services and markets. The most convincing use case we have heard is the potential for cryptoasset technologies to improve the efficiency and reduce the cost of making payments, especially cross-border and in lower income countries with less developed financial sectors. An effective regulatory framework would support development of such technologies in the UK, while also mitigating some of the risks cryptoassets pose. We therefore welcome the Government publishing proposals for how it plans to regulate cryptoassets used in financial services. (Paragraph 30)

2. It has been more than four years since our predecessor Committee's Report called for greater regulation of the cryptoasset industry, and the FCA faces challenges in implementing existing and proposed crypto regulations. It is important that the Government and regulators strive to keep pace with developments, including by ensuring that the Financial Conduct Authority's authorisations gateway is open and effective, so that potential productive innovation in financial services is not unduly constrained. (Paragraph 31)

3. While we support financial innovation where there are potential benefits, the extent of the benefits cryptoasset technologies may bring to financial services in the future—and the areas in which the technologies may have the most impact—remains unclear. In the meantime, the risks posed by cryptoassets to consumers and the environment are real and present. (Paragraph 36)

4. *We recommend that the Government takes a balanced approach to supporting the development of cryptoasset technologies. It should seek to avoid expending public resources on supporting cryptoasset activities without a clear, beneficial use case, as appears to have been the case with the Royal Mint NFT. It is not the Government's role to promote particular technological innovations for their own sake.* (Paragraph 37)

5. Regardless of the regulatory regime, their price volatility and absence of intrinsic value means that unbacked cryptoassets will inevitably pose significant risks to consumers. Furthermore, consumer speculation in unbacked cryptoassets more closely resembles gambling than it does a financial service. We are concerned that regulating retail trading and investment activity in unbacked cryptoassets as a financial service will create a 'halo' effect that leads consumers to believe that this activity is safer than it is, or protected when it is not. (Paragraph 51)

6. *We strongly recommend that the Government regulates retail trading and investment activity in unbacked cryptoassets as gambling rather than as a financial service, consistent with its stated principle of 'same risk, same regulatory outcome'.* (Paragraph 52)

# Formal minutes

## Tuesday 10 May 2023

### Members present:

Harriett Baldwin, in the Chair

Dame Angela Eagle

Emma Hardy

Danny Kruger

Andrea Leadsom

Anne Marie Morris

Draft Report (*Regulating Crypto*) proposed by the Chair, brought up and read.

*Ordered*, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 52 read and agreed to.

Summary read and agreed to.

*Resolved*, That the Report be the Fifteenth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

### Adjournment

Adjourned till Wednesday 17 May at 2.00 pm

# Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

### Monday 14 November 2022

**Susan Friedman**, Head of Policy, Ripple; **Ian Taylor**, Executive Director, CryptoUK; **Daniel Trinder**, Vice President Government Affairs, Europe and MENA, Binance; **Tim Grant**, Head of EMEA, Galaxy Digital Q1–101

### Wednesday 07 December 2022

**Joey D'Urso**, Investigations Writer, The Athletic UK; **Natasha de Terán**, Member, The Financial Services Consumer Panel; **Rebecca Driver**, Member, The Financial Services Consumer Panel Q102–151

**Sarah Pritchard**, Executive Director for Markets, Financial Conduct Authority; **Matthew Long**, Director of Payments and Digital Assets, Financial Conduct Authority Q152–213

### Tuesday 10 January 2023

**Andrew Griffith MP**, Economic Secretary, HM Treasury; **Laura Mountford**, Deputy Director, Payments and Fintech, HM Treasury; **Daniel Rusbridge**, Deputy Director, Financial Services Strategy, HM Treasury Q214–281

### Tuesday 28 February 2023

**Sir Jon Cunliffe**, Deputy Governor for Financial Stability, Bank of England; **Sasha Mills**, Executive Director, Financial Market Infrastructure, Bank of England; **Sarah Breeden**, Executive Director, Financial Stability Strategy and Risk, Bank of England Q282–361

# Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

CAI numbers are generated by the evidence processing system and so may not be complete.

1 AAT (Association of Accounting Technicians) (CAI0003)

2 Advertising Standards Authority; Committee of Advertising Practice; and Broadcast Committee of Advertising Practice (CAI0024)

3 Alice SI Ltd; Resonance Ltd; and Curiosity Society (CAI0046)

4 Alternative Investment Management Association (AIMA) (CAI0056)

5 Andersen in the UK (CAI0062)

6 Anonymised (CAI0074)

7 Argent Labs Ltd (CAI0039)

8 Association for Financial Markets in Europe (AFME) (CAI0033)

9 Atrum (CAI0014)

10 Barclays (CAI0066)

11 Binance (CAI0026)

12 Bitso (CAI0058)

13 Block Inc (CAI0051)

14 Blockchain.com (CAI0044)

15 British Standards Institution (CAI0009)

16 Broby, Professor Daniel (Chair of Financial Technology, Ulster University) (CAI0004)

17 Centre for Commercial Law at the University of Aberdeen (CAI0055)

18 Chainalysis (CAI0057)

19 Charity Commission for England and Wales (CAI0059)

20 Chartered Institute of Taxation (CAI0023)

21 Circle (CAI0083)

22 CoinShares (CAI0073)

23 CryptoUK (CAI0012)

24 Curve UK Limited; and ICDEF Limited (CAI0008)

25 Digital Currencies Governance Group (CAI0030)

26 Digital FMI Consortium; and The Payments Association (CAI0060)

27 Digital Moneybox Limited (CAI0025)

28 Digital Pound Foundation (CAI0047)

29 Electronic Money Association (CAI0067)

30 Euroclear UK & Ireland Limited (CAI0080)

31 Financial Conduct Authority (CAI0070)

32 Financial Services Consumer Panel (CAI0017)

33 Galaxy Digital (CAI0049)

34 Gemini Europe, Ltd (CAI0050)

35 Gregoriou, Professor Andros (Professor of Finance , University of Brighton) (CAI0069)

36 HSBC (CAI0052)

37 Howard Kennedy LLP (CAI0032)

38 Imperial College London, Centre for Financial Technology; and Quantstamp (CAI0075)

39 Information Commissioner's Office (CAI0072)

40 Innovate Finance (CAI0038)

41 International Regulatory Strategy Group (IRSG) (CAI0063)

42 Kraken (CAI0078)

43 LMAX Group (CAI0065)

44 Link Scheme Holdings Ltd (CAI0053)

45 Low Incomes Tax Reform Group (CAI0040)

46 Lugnani, Ludovico (Solicitor, BDB Pitmans LLP) (CAI0042)

47 Luno (CAI0048)

48 Mandiant (CAI0031)

49 Mastercard (CAI0022)

50 Mendis, Professor Dinusha (Professor of Intellectual Property & Innovation Law, Bournemouth University) (CAI0043)

51 Meta (CAI0016)

52 Milton, Mr Philip (Managing Director, Philip J Milton & Company Plc) (CAI0001)

53 Payment Systems Regulator (CAI0077)

54 Portdex Ltd (CAI0018)

55 Positive Money (CAI0036)

56 Preyer GmbH (CAI0054)

57 R3 (CAI0064)

58 Randell CBE, Charles (CAI0084)

59 Ripple Labs Inc. (CAI0027)

60 Royal United Services Institute (RUSI) (CAI0029)

61 Shillito, Dr Matthew Robert (Lecturer in Law, The School of Law and Social Justice, University of Liverpool) (CAI0081)

62 Socios (CAI0013)

63 TSB Bank (CAI0061)

64 The Aave Companies (CAI0035)

65 The Investment Association (CAI0028)

66 The Payments Association (CAI0034)

67 TheCityUK (CAI0045)

68 UK Cryptoasset Business Council (UKCBC) (CAI0082)

69 UK Finance (CAI0076)

70 Walker, Mr Christian (CAI0010)

71 Weir, Dr Diarmid (Economist, Future Economics; and Economist, Future Economics) (CAI0020)

72 Whittaker, Dr John (Senior Teaching Fellow, Lancaster University) (CAI0011)

73 Yarovaya, Dr Larisa (Associate Professor of Finance, Deputy Head of the Centre for Digital Finance , University of Southampton) (CAI0019)

# List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

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| 1st | Future of financial services regulation | HC 141 |
| 2nd | Future Parliamentary scrutiny of financial services regulations | HC 394 |
| 3rd | The appointment of Dr Swati Dhingra to the Monetary Policy Committee | HC 460 |
| 4th | Jobs, growth and productivity after coronavirus | HC 139 |
| 5th | Appointment of Marjorie Ngwenya to the Prudential Regulation Committee | HC 461 |
| 6th | Appointment of David Roberts as Chair of Court, Bank of England | HC 784 |
| 7th | Re-appointment of Sir Dave Ramsden as Deputy Governor for Markets and Banking, Bank of England | HC 785 |
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| 9th | Appointment of Ashley Alder as Chair of the Financial Conduct Authority | HC 786 |
| 10th | The work of the Sub-Committee on Financial Services Regulations | HC 952 |
| 11th | Fuel Duty: Fiscal forecast fiction | HC 783 |
| 12th | Appointment of Professor Randall Kroszner to the Financial Policy Committee | HC 1029 |
| 13th | Scam reimbursement: pushing for a better solution | HC 939 |
| 14th | The work of the Sub-Committee on Financial Services Regulations | HC 952-i |
| 1st Special | Defeating Putin: the development,implementation and impact of economic sanctions on Russia: Government Response to the Committee's Twelfth Report of Session 2021–22 | HC 321 |
| 2nd Special | Future of financial services regulation: responses to the Committee's First Report | HC 690 |
| 3rd Special | Jobs, growth and productivity after coronavirus: Government response to the Committee's Fourth Report | HC 861 |

## Session 2021–22

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| 2nd | The appointment of Tanya Castell to the Prudential Regulation Committee | HC 308 |
| 3rd | The appointment of Carolyn Wilkins to the Financial Policy Committee | HC 307 |
| 4th | The Financial Conduct Authority's Regulation of London Capital & Finance plc | HC 149 |
| 5th | The Future Framework for Regulation of Financial Services | HC 147 |
| 6th | Lessons from Greensill Capital | HC 151 |
| 7th | Appointment of Sarah Breeden to the Financial Policy Committee | HC 571 |
| 8th | The appointment of Dr Catherine L. Mann to the Monetary Policy Committee | HC 572 |
| 9th | The appointment of Professor David Miles to the Budget Responsibility Committee of the Office for Budget Responsibility | HC 966 |
| 10th | Autumn Budget and Spending Review 2021 | HC 825 |
| 11th | Economic crime | HC 145 |
| 12th | Defeating Putin: the development, implementation and impact of economic sanctions on Russia | HC 1186 |
| 1st Special | Net Zero and the Future of Green Finance: Responses to the Committee's Thirteenth Report of Session 2019–21 | HC 576 |
| 2nd Special | The Financial Conduct Authority's Regulation of London Capital & Finance plc: responses to the Committee's Fourth Report of Session 2021–22 | HC 700 |
| 3rd Special | Tax after coronavirus: response to the Committee's First Report of Session 2021–22 | HC 701 |
| 4th Special | The Future Framework for Regulation of Financial Services: Responses to the Committee's Fifth Report | HC 709 |
| 5th Special | Lessons from Greensill Capital: Responses to the Committee's Sixth Report of Session 2021–22 | HC 723 |
| 6th Special | The appointment of Professor David Miles to the Budget Responsibility Committee of the Office for Budget Responsibility: Government response to the Committee's Ninth Report | HC 1184 |
| 7th Special | Autumn Budget and Spending Review 2021: Government Response to the Committee's Tenth Report | HC 1175 |
| 8th Special | Economic Crime: responses to the Committee's Eleventh Report | HC 1261 |

## Session 2019–21

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| 1st | Appointment of Andrew Bailey as Governor of the Bank of England | HC 122 |
| 2nd | Economic impact of coronavirus: Gaps in support | HC 454 |
| 3rd | Appointment of Richard Hughes as the Chair of the Office for Budget Responsibility | HC 618 |
| 4th | Appointment of Jonathan Hall to the Financial Policy Committee | HC 621 |
| 5th | Reappointment of Andy Haldane to the Monetary Policy Committee | HC 620 |
| 6th | Reappointment of Professor Silvana Tenreyro to the Monetary Policy Committee | HC 619 |
| 7th | Appointment of Nikhil Rathi as Chief Executive of the Financial Conduct Authority | HC 622 |
| 8th | Economic impact of coronavirus: the challenges of recovery | HC 271 |
| 9th | The appointment of John Taylor to the Prudential Regulation Committee | HC 1132 |
| 10th | The appointment of Antony Jenkins to the Prudential Regulation Committee | HC 1157 |
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| 4th Special | Economic impact of coronavirus: Gaps in support: Further Government Response | HC 749 |
| 5th Special | Economic impact of coronavirus: the challenges of recovery: Government Response to the Committee's Eighth Report | HC 999 |
| 6th Special | Economic impact of coronavirus: gaps in support and economic analysis: Government Response to the Committee's Eleventh Report | HC 1383 |