Advice Matters

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The CPD Solution For Financial Professionals

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In Tech Check we address aspects of technical knowledge that you need to keep abreast of and that will enable you to have better conversations with your clients.

In this issue we focus on Cryptocurrencies.

What's new in Cryptocurrencies

Where is the UK financial services heading when dealing with this fairly new piece of technology?

Deal or no deal, Brexit is happening, and our government are fully aware of its potential impact. One of the main concerns for London is remaining the hub of innovation post Brexit and what we can do to maintain such status. The Crypto Asset Task Force was put together involving the Financial Conduct Authority (FCA), HM Treasury (HMT) and Bank of England (BoE) for the purposes of protecting consumers and market integrity to mitigate the risks posed by crypto assets and digital ledger technology (DLT), the alternative name to blockchain.

The report was released a day before the 10th birthday of Bitcoin, the very first digital currency that was invented at the back of the 2008 financial crisis. It is worth reminding ourselves that this innovation like any other innovation came to life to meet a need. To give people the power back over their money instead of governments and central banks having control over it and messing it up through poor management and bad decision makings.

10 years later, the UK government still own 51.5% shares in RBS, which basically means public money is still tied up to rescue a bank in crisis. An average consumer had no say over this government decision considering all of the risks involved. Decentralised crypto currencies came to life to serve the basic needs that fiat money serves but without the oversight of centralised banks. To be used as a means of exchange, to act as a medium to hold value and to facilitate investment returns, very similar to how people make profit due to fluctuation of the currency market. So, what seems to be the issue and all the noise for? The phrase **'the genie is out of the bottle'** is perhaps the best way to describe the whole innovative space. Like anything else in life, something new is gradually working its way through a legacy system and it is facing many challenges until it becomes common knowledge and merges into everyday use.

In the UK there are 500 independent shops, bars and cafes around the country that accept Bitcoin as a means of payment and the numbers are dropping. There are fewer than 15 crypto asset spot exchanges headquartered in the UK, which put trade volumes of above $249 million. This is 2.66% of daily global trading volumes. So for bitcoin and its peers to become mainstream there is still a journey to go through. But the key question here is "what has stopped the journey to be more progressive, where does the hesitation lie?" Is it that we don't know enough about it or that we are too worried, which of course is a consequence of a lack of knowledge?

The FCA, HMT and BoE collectively have drawn a conclusion that the DLT has the potential to deliver significant benefits in both financial services and other sectors, and all three authorities will continue to support its development. They also have agreed to take actions to mitigate the risks that crypto assets pose to consumers and market integrity, which in summary are;

- to prevent the use of crypto assets for illicit activity
- to guard against threats to financial stability that could emerge in the future; and
- to encourage responsible development of legitimate DLT and crypto asset-related activity in the UK.

Having spent the last 8 months as Chief Compliance Officer for one of the UK's leading crypto currency exchanges and consequently having had many interactions with the FCA as an entity seeking regulations in the custodial space as well as electronic money, I am of the view that whilst the competent authorities are responsible and accountable for market integrity and consumer protection, the firms that are active in this space can still adhere to the principles of existing regulations and best practices to serve the same purpose. Until the law of the land can enforce and prosecute regulatory frame works in this space, the ethical mindset of senior leadership among crypto active businesses can act as if regulations are already in place. The basics have not changed when dealing with a different asset class. The 'right thing to do' is to ensure the firm knows its customer, understands the purpose of transactions and has verified source of funds. This is to prevent facilitating money laundering and terrorist financing and many other types of financial crime.

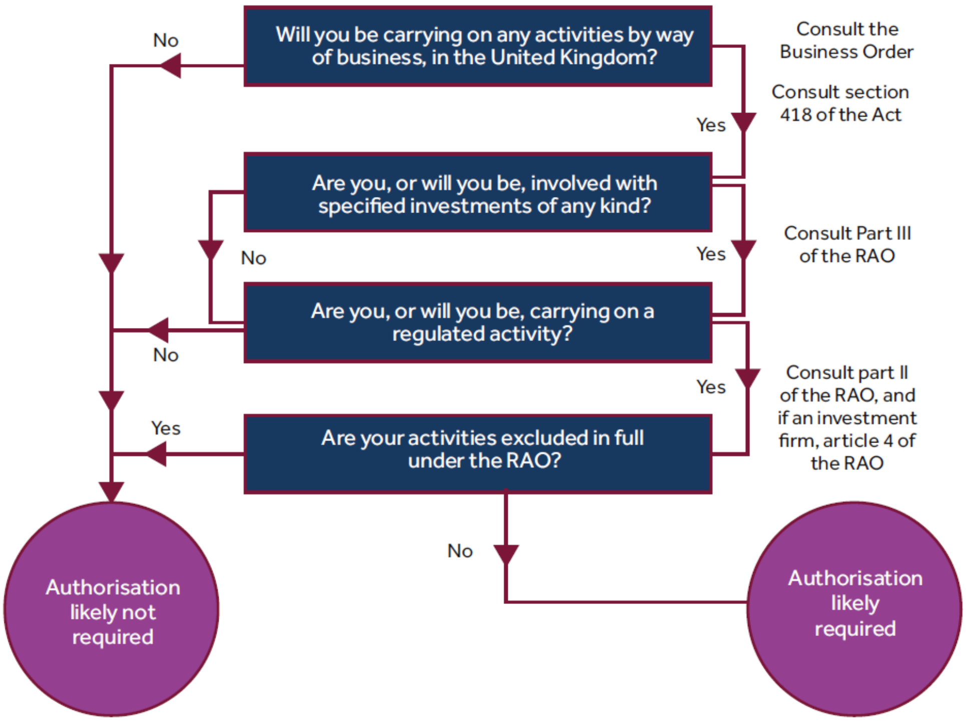
The task force has promised to produce the most comprehensive response globally to the use of crypto assets for illicit activity. The FCA has now issued a consultation in January 2019 to further explore whether and how exchange tokens and related firms such as exchanges and wallet providers could be regulated effectively.

The consultation paper has attempted to clarify where the different categories of crypto asset tokens fall in relation to the FCA's regulatory perimeter. It outlines where tokens are likely to be:

- Specified Investment under the Regulated Activities Order (RAO)
- Financial Instrument under MiFID II
- E-Money under the Electronic Money Regulations (EMR)
- Captured under the Payment Systems Regulator (PSR)

Figure 1 shows some of these considerations; however, the focus of the guidance is predominantly on the second step, understanding Specified Investments. This is the area market participants have told the FCA they struggle the most to understand and the FCA agree that it warrants further regulatory clarity.

Figure 1: Do I need to be authorised by the FCA?



Furthermore, the authorities will continue to warn consumers of the risks of investing in crypto assets and monitor potential implications for financial stability. This is to ensure the UK maintains its international reputation as a safe and transparent place to do business in financial services; to ensure high regulatory standards in financial market; to protect consumers; to guard against threats to financial stability that could emerge in the future; and to allow those innovators in the financial sector that play by the rules to thrive so that the benefits of new technologies can be fully realised.