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All Party Parliamentary Group FinTech

Roundtable Discussion on Cryptocurrencies

Secretariat
Innovate Finance

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APPG on FinTech Cryptocurrencies Roundtable Discussion

Location: Committee Room 20, Palace of Westminster

Date: Monday 2nd July 2018 **Time:** 4.00 - 5.30 PM

Parliamentarians:

- Adam Afriyie MP, Chair, All Party Parliamentary Group for FinTech (“APPG for FinTech”)
- Baroness Kramer, All Party Parliamentary Group for Entrepreneurship (“APPG for Entrepreneurship”)
- Lord Holmes of Richmond, Vice-Chair, APPG for FinTech
- Lord Vaux of Harrowden, Member, APPG for FinTech

Attendees:

- Abdul Basit, Elipses
- Adam Bryant, London Block Exchange
- Andrew Flatt, Archax
- Angus Young, Centre for Study of Financial Innovation (CSFI)
- Anthony Wooley, Societe Generale
- Catherine Thomas, Outlier Ventures
- Christopher Sier, HMT - Financial Technology Envoy for England
- Daniel Morgan, DIT
- Daniel Stack, Innovate Finance
- Darshita Gillies, NedonBoard
- Dean White, London Block Exchange
- Edd Carlton, CryptoUK
- Graham Rodford, Archax
- Jana Mackintosh, WorldPay
- Jennifer Powell, Headland Consultancy
- Jeremy Millar, Consensys
- Joshua Townson, Innovate Finance
- Karen Sandhu, London & Partners
- Laura Royle, FCA
- Mark Ridout, D-A-R
- Morgane Fouche, Deloitte,
- Natalie Suchecki, Bank of England
- Nick Swanson, GLA
- Obi Nwosu, Coinfloor
- Peter Cunnane, Innovate Finance
- Sameer Gulati, Innovate Finance
- Sara Feenan, Clearmatics
- Suchitra Nair, Deloitte
- Toby Pellew, Headland Consultancy
- Vaishali Dave, City of London Corporation
- William Archdeacon, Parliamentary Researcher Adam Afriyie’s office

Agenda:

1. Introductory Remarks

Adam Afriyie MP (Chair APPG FinTech) and
Lord Holmes, (Vice-Chair APPG FinTech)

2. CryptoUK Remarks

Edd Carlton, (Chair of CryptoUK’s Working Group)

3. Views from Industry

Sara Feenan (Clearmatics), Adam Bryant (London Block Exchange), Suchitra Nair (Deloitte)

4. Open Discussion/Q+A

5. Closing Statement

Adam Afriyie MP (Chair APPG FinTech)

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1. Introductory Remarks:

Adam Afriyie MP

- The All Party Parliamentary Group on Financial Technology is here to welcome the latest thoughts on cryptocurrencies from industry.
- Broad understanding by MPs on this topic. Recognition of a huge opportunity for the UK if we can support the FCA's regulatory approach.
- UK in a strong position to become a leader in global standards.

Lord Holmes of Richmond

- Recognise that if we don't get the regulation right, or act soon, other jurisdictions will and this will be damaging for both startups, and the UK in general.
- Bermuda is a good exemplar as to how to regulate cryptocurrencies*
- Issues remain surrounding AML, KYC, and the volatility associated with cryptocurrencies.
- The broader issue is around how we can create a regulatory framework? But equally (why) should we hold cryptocurrencies to a higher standard than other regulated financial activities? Yes a more applicable standard.

** Bermuda's road map includes rules to regulate ICOs and investment in cryptocurrency businesses. There has already been high levels of interest and agreements with companies such as Binance, the world's largest cryptocurrency exchange, that promises investments in companies, jobs and education for Bermudians. Policies include the Digital Asset Business Act 2018, which encourages inward investment for companies.*

2. CryptoUK Remarks:

Edd Carlton, Chair of CryptoUK's Working Group

- CryptoUK is the leading voice in the cryptocurrencies market, formed to be the UK's first self-governing trade body for cryptocurrencies.
- There is a [12](#) point code of conduct detailed on the CryptoUK website. It focuses on how consumers are protected, marketing/ promotion etc.
- Regulation could be targeted for the on/off ramps between fiat and digital currencies.
- Getting the right regulation is essential to how we treat markets and get from A to B.
- CryptoUK views on regulation can be found in our Treasury Select Committee [submission](#).
- Gibraltar is an example of an attractive jurisdiction thanks to its [DLT](#) (Distributed Ledger Technology) Regulatory Framework. Firms are moving there and to other countries as they prefer a framework ("jurisdiction-bleed") as opposed to operating in a vacuum. If we have a regulatory framework to operate within it would be beneficial for industry in the UK, and for it to become a centre for FS and FinTech focus on cryptocurrencies.
- It should also be noted that the total market cap for cryptocurrencies globally is approx. £260bn – therefore whilst not hugely market-shifting; interest in cryptocurrencies is not going away.

3. Views from Industry

Sara Feenan, Business Development Manager, Clearmatics

- Clearmatics are currently working with fiat currency to build distributed Financial Markets Infrastructure.
- Technology company using blockchain & economic incentive mechanisms to enable mutualised, member owned, member governed business models.
- Single points of failure prevalent in financial services – which both concentrate risk and exhibit monopolistic tendencies. Blockchain in this respect is revolutionary for its decentralised qualities.

- Regarding research and development there is a lot around confidentiality whilst maintaining security of the system. Clearmatics are currently researching consensus mechanisms, interoperability and privacy of transactions, while developing economic incentive mechanisms that disincentivise those who don't propagate the network properly/economically incentivize those that do.
- Other areas of research are similar to the public blockchain space, such as scalability issues – using side chains, and transacting with lower costs.

Adam Bryant, Executive Chairman, London Block Exchange

- Combining software and financial skills, London Block Exchange (LBE) was set up to provide easy access for consumers to buy cryptocurrencies.
- LBE believes that regulation in this space should match financial regulation; LBE wants to help the regulators in a way to help AML regulation.
- Cryptocurrencies are not going away anytime soon; a new asset class is emerging that has longevity for mainstream adoption.
- There is also a calming in the market, as the institutional and retail markets want to be 'backed' by regulators.
- VCs want to be in the space and there is a cautious enthusiasm with regard to ICOs.
- There were new highs for 2018 with over \$13.7bn worth of investment, average size \$25m. US / Swiss/Singapore seems to be the important hubs.
- United States regulators view cryptocurrencies as a security. They demark cryptoassets into 3 different classes:
 1. Asset Tokens
 2. Payment Tokens
 3. Utility Tokens
- Defining the way in which we approach cryptocurrencies is an important first step. Their clients are worried about the security and banking with FinTech companies remains a key issue, as banks refuse to engage with many startups.
- In regard to volatility, hedge funds view it as a good thing.

Suchitra Nair, Director in the EMEA Centre for Regulatory Strategy, Deloitte

1. What do we want to regulate?
 - Our collective approach to regulation depends on what exactly we want to regulate i.e. the technology or the product itself? It is often hard to delineate.
 - Regulation is typically technology-neutral. Historically we regulate based on the activity. If we take the route of regulating a product / service can the technology be guided and developed in the right way? There are framework and classification issues. The industry doesn't always accept the view taken by the finance/investment sector.
 - As an example, Canada treats Bitcoin trading in the same manner as 'gambling' and has banned payment aspects of ICOs.
2. When should we regulate?
 - *There is also a question about when we should regulate it. Is it appropriate now? Or, rather, is it too early?*
 - We may lose the best talent if we wait to do so. The flip side of this is we could wait for the industry to further develop.
 - There is also a scalability issue - can we effectively guide and develop the technology, addressing standards at the development stage?
3. Why should we regulate?
 - Regulators have previously stepped in for stabilising issues, but it is not quite necessary yet, for example ICO's not materially significant.
 - It depends on whether we want to foster innovation or manage risks. [Project Innovate](#) could be a valuable tool in meeting these criteria, for example in the partial authorisation route / using competition mandate to accelerate development.
 - The level of regulation could also be driven by the risk threshold posed.
4. Do we need to regulate vs. standards?

- Then there are also questions about whether we actually need to regulate or pursue standards? Do we go the open-source route – providing iterative initial parameters? If so, there could be a task force looking at new ways of approaching a framework.
5. What's happening in the market?
- Lloyds / Virgin Money – can't buy crypto using a credit card – there is always a balance between fostering innovation vs. risk compliance.
 - Likewise exchanges want to be subsidised – but need standards & consistencies there.

4. Open Discussion topics

A wide-ranging discussion covered the following ground:

- The UK's new Cryptoassets Taskforce and the other regulatory standards emerging around the cryptocurrency space:
 - The Cryptoassets Taskforce was launched in March jointly with HM Treasury, the Bank of England and the FCA. The commitment to a report that will be out in September shows the ambition from regulators in this area.
 - A key question is what is the standard we want to hold?
 - The report itself will look towards: a taxonomy on cryptoassets – how are they categorised (e.g. utility, security, payments etc.) and how do the regulations sit here currently. It will also look into major areas of risk e.g. consumer detriment. And benefits associated with cryptoassets.
 - It is not about moving the regulatory perimeter.
- The difficulty in trying to put in a place a regulatory framework whilst also maintaining confidence:
 - It's largely achieved through forcing amendments in FS bills.
 - Industry and the FCA require confidence in making representations to HMT in order to make their case for additional regulatory powers.
 - For example, the regulatory framework for peer-to-peer lending was resisted heavily for a while - and yet peer-to-peer is an example of where the introduction of regulation - despite being at times a painful and laborious experience - has worked.
 - Approaching regulation with a 'light-touch' approach is not always the most appropriate route and trying to get primary legislation requires the people to recognise it is an important issue. This requires vast amounts of education.
- **Adam Afriyie MP:** Issues which remain/ key recommendation: would be the enabling of access to bank accounts, and ensuring KYC/AML regulation
- Regulation applied to the user and the difficulties from an exchange perspective:
 - Coinfloor is the largest running cryptocurrency exchange in the UK and a founding member of CryptoUK and GDF.
 - A problem used to be that exchanges didn't operate in a secure or transparent manner. 30% of crypto used to be for illicit uses - this figure is now below 1%. Through the lens of time, changes are occurring.
 - For the global community, regulation is a massive challenge, especially as it is near impossible to regulate the technology itself. Regulation should be applied towards the users.
 - There should be an FCA mandate to regulate this market.
 - The industry now has the impetus (under AML5) to act with the FCA in regulating this space, and the FCA should press to regulate AML / KYC / CFT.
 - To note: this could prove important, as AML legislation may not be automatically included by the EU Withdrawal Bill.
- The relationship/issues with banking:

- There also needs to be clarity over the direction of travel - banks at the moment do not feel comfortable that we want to be leaders in this industry. They also have other compliance issues with regulations, such as MIFID II, and individuals from the 'old guard' who might be less technologically comfortable, hesitant to become leaders in this area.
 - This can be coupled with 10 years of under-investment in IT.
 - No one tells you why you're not getting a bank account.
 - An electronic money institution might approach a bank. This is not a direct bank account.
 - Take P2P as a blueprint, members sign up to a standard.
 - Not doing A, B, C etc. to get a bank account – up to banks.
- The need for a global financial system and enabling a better set of definitions:
 - There is no such thing as a global, unified financial system. Instead, there are hundreds of national financial systems cobbled together by expensive linkages. Ethereum and blockchain-backed assets have built an environment of trust that could become the impetus for a self-reporting global financial system in which international transactions are unhindered.
 - Creating global consistency will be difficult. We are now heading towards Crypto 3.0 – building an infrastructure on digital terms of exchange.
 - *What does it mean to be a crypto investor, operator, or user?* Must look at all players. Each one has to deal with a myriad of different regulations.
 - A unifying a set of regulations will enable better classifications of these definitions. One such example is the Brooklyn Project, an American initiative to hold discussions on the legal and regulatory opportunities resulting from cryptocurrencies.
 - Do we need regulation at all? There is no precedent yet as no there have been no cases of people being sued, which has led to a need for clarity over what we mean by regulation. It is hard to build global standards.
 - The three things firms in this area would like to know most are i) what they can talk to the regulator about, ii) what they are allowed to offer investors and iii) what would they be sent to jail for
 - What industry wants from the FCA:
 - We need to look at consumer detriment in terms of threats to consumer assets and wealth.
 - The other-time the FCA had an interest in regulating firms in a similar fashion was in line with anticompetitiveness practice. The FCA tends to get involved to improve competitiveness in the UK marketplace.
 - Industry needs to be on top of this as quickly as possible (self-regulate), this is so that FCA doesn't inadvertently slow things down.
 - Setting a standard in lieu of governance and the need for a taxonomy:
 - Global FX code and the crowdfunding codes of conduct are examples of industry self-regulating and setting a standard in lieu of governance - this made it easier for regulators to see what the standard will be.
 - Global Digital Finance (GDF), the body driving acceleration and adoption of digital finance, has published a draft of its crypto-assets Code of Conduct for public review and consultation (online until end of August). The Code is accompanied by a taxonomy document, designed to promote a shared understanding of relevant terminology around digital assets.
 - Regulation also depends on the definition - 99% of the USA will regard cryptocurrencies as securities.
 - The GDF looks similar to Finma and the Brooklyn Project. Essentially delineating by payment token, asset (security), or consumer token (utility).
 - The UK is now at a tipping point - Gibraltar and Malta have already made legislation. But these are small places - to make a global standard for regulation there needs to be a financial hub that leads the way.
 - For this to happen there needs to be an open dialogue on how to operate this, as it is too big a task for self-governance.
 - It is feasible to take existing legislation on financial services and apply it in this area.
 - The difficulty facing VCs getting in the space:
 - ICOs start out as a capital investment. How do you foster innovation at the start?
 - Corporate VCs can't get involved in the space – for example they can't write this down on their balance sheet?

5. Closing Statement

Adam Afriyie MP, Chair APPG FinTech

- Further clarity on the definitions, and who will provide international or domestic buy-in so that there is comfort in applying a code of conduct, is sought.
- Questions about what our overall view and approach should be need to be considered, as do the issues of consumer protection and how the FCA engages with these matters.
- The message that the UK is open to business needs to be encouraged, together with the people's ability to take up visas, and meet with the FCA, etc.
- There is a need for a pragmatic approach, which is not necessarily enshrined in law. This would involve a set of principles or a code of conduct that is recognised as a standard.
- There may even be a case for authorisation of a certain type of organisation: e.g. FCA-recognised criteria or licenses.

END