



House of Commons  
Treasury Committee

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**Government and  
Financial Conduct  
Authority Responses  
to the Committee's  
Twenty-Second Report:  
Crypto-assets**

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**Eighth Special Report of Session  
2017–19**

*Report, together with formal minutes relating  
to the report*

*Ordered by the House of Commons  
to be printed 19 December 2018*

## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue and Customs and associated public bodies

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### Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No. 152. These are available on the internet via [www.parliament.uk](http://www.parliament.uk).

### Publication

Committee reports are published on the Committee's website at [www.parliament.uk/treascom](http://www.parliament.uk/treascom) and in print by Order of the House.

Evidence relating to this report is published on the [inquiry publications page](#) of the Committee's website.

### Committee staff

The current staff of the Committee are Sarah Rees (Clerk), Peter Stam (Second Clerk), Marcus Wilton, Dan Lee, Aruni Muthumala (Senior Economists), Adam Wales (Chief Policy Adviser), Sarah Crandall (Senior Committee Assistant), Nicholas Berry (Committee Support Assistant), Matt Panteli (Senior Media and Policy Officer), Anne Stark (on secondment from HM Revenue & Customs), Tom Ludlow (on secondment from the Bank of England), Carolyn Draper (on secondment from the Financial Conduct Authority), Ria Gill-Williams (on secondment from the National Audit Office) and Sarah Goodwin (on secondment from the Prudential Regulation Authority).

### Contacts

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# Eighth Special Report

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On 19 September 2018 the Treasury Committee published its Twenty-Second Report of Session 2017-19, [Crypto-assets](#) (HC 910). The Government's response was received on 20 November 2018 and the Financial Conduct Authority response was received on 29 November 2018 and are appended below.

## Appendix 1: Government Response

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I am writing in response to the above report published by the Treasury Select Committee on 19 September 2018. I would like to thank you and the Committee for your work to produce this report on cryptoassets and the issues surrounding them.

The joint HM Treasury-Financial Conduct Authority (FCA)-Bank of England Cryptoassets Taskforce was established by the Government earlier this year, to explore the risks and potential benefits of cryptoassets and the use of the underlying distributed ledger technology (DLT) in financial services and consider appropriate responses. The Taskforce's report, which was published alongside the Budget on 29 October 2018, sets out actions the three authorities will take to protect consumers and markets, allow innovation to thrive, and maintain the UK's international reputation as a safe and transparent place to do business in financial services with high regulatory standards. The full report is available at: <https://www.gov.uk/government/publications/cryptoassets-taskforce>.

As detailed in the Taskforce's report, the Government shares the Committee's concerns about the substantial risks to consumers and market integrity associated with cryptoassets, as well as their potential use for illicit activity. As such, the Government and regulators' immediate priorities are to mitigate these risks. However, the Government also recognises the potential presented by DLT and considers that, while there is limited evidence of the current generation of cryptoassets delivering benefits, this may change in the future. The Government and regulators will therefore continue to encourage innovation and responsible development of legitimate DLT and cryptoasset related activity in the UK, while also taking strong action to manage risks.

### Cryptoassets and financial services regulation

Both the Committee and the Taskforce highlighted the need to ensure UK consumers are aware of the risks of investing in cryptoassets, and the lack of regulatory protections associated with many of these products. The Taskforce's Report noted that consumers should approach purchasing cryptoassets with a high degree of caution and be prepared to lose money. The authorities have taken steps to warn consumers of these risks and will continue to do so.

As set out by the Taskforce, some types and uses of cryptoassets fall within the existing financial services regulatory perimeter. Others fall outside the existing regulatory framework and pose new challenges for financial regulation.

Cryptoassets that are security tokens fall within the existing regulatory perimeter as specified investments. However, the Taskforce recognised that the novel nature, complexity and opacity of many cryptoassets means it is difficult to determine whether

they qualify as security tokens. To provide further clarity in this area the FCA will consult on perimeter guidance on the application of regulation to these tokens by the end of this year. In addition, the Government will consult early next year to explore whether other cryptoassets, that have comparable features to specified investments but that fall outside the current perimeter, should be captured in regulation. Subject to the outcome of this consultation, the Government stands ready to legislate to expand the regulatory perimeter to ensure that FCA regulation can be applied to all cryptoassets that have comparable features to security tokens, regardless of the way they are structured.

Some other types of cryptoassets, including exchange tokens such as Bitcoin, are unlike other financial services products and present new challenges to traditional forms of financial regulation. The Taskforce concluded that further consultation is required to consider the most appropriate response to these cryptoassets. Therefore, the Government will issue a consultation in early 2019 to further explore whether and how exchange tokens and related firms, such as exchanges and wallet providers, could be regulated effectively, in the case that other measures outlined in the Taskforce's Report do not adequately address all relevant risks.

The Government also recognises the specific concerns raised in the Committee's Report about the risks to consumers investing in tokens issued through Initial Coin Offerings (ICOs). However, the Government also believes benefits could potentially develop in the future through the use of ICOs as a capital raising tool. As outlined above, the Government and the FCA will take steps to manage these risks and ensure the consistent application of regulation to all tokens that have comparable features to specified investments, regardless of how they are structured. This will help to protect investors, eliminate fraudulent activity and ensure market integrity, while allowing legitimate activity to thrive in the UK should ICOs prove to have benefits in the future.

## Money laundering and other illicit activity

The Government shares the Committee's concerns about the possibility of cryptoassets being used to facilitate money laundering and other illicit activity. The Government is developing one of the most comprehensive responses globally to the use of cryptoassets for illicit activity. The Government will address these risks by going significantly beyond the requirements set out in the EU Fifth Anti-Money Laundering Directive (SMLD). As recommended in the Committee's Report, the Government has asked the FCA to consider taking on the role of supervising firms in fulfilling their anti-money laundering and counter-terrorist financing obligations. The Government will consult on its proposed actions in the new year, and will legislate during 2019 to give effect to this response.

## International coordination

In considering many of these issues, international coordination will be essential given the global nature of the market. A consistent international approach and action by other jurisdictions will also help mitigate risks to UK consumers, many of whom invest in cryptoassets through firms based outside the UK. UK authorities will continue to be actively involved in a variety of international fora, and the UK will be a thought leader in shaping future regulatory approaches.

## Distributed ledger technology

The Government considers that DLT has the potential to deliver significant benefits in financial services and other sectors. However, the technology is at an early stage of development. As set out in the Taskforce's Report, the FCA and the Bank of England will continue to encourage and enable experimentation and innovation, so that DLT and other new technologies can develop and be adopted safely in the financial system. The Government is also acting to support DLT in and beyond financial services. For example, the Government has invested over £10 million through Innovate UK and the research councils to support a diverse range of DLT projects, and many Government departments are building proofs of concept to trial the use of the technology.

Allow me to again thank the Committee for its contributions on this issue. The cryptoasset market and DLT are rapidly evolving. It is therefore crucial we take the time, both domestically and internationally, to fully consider the most appropriate and proportionate response to mitigate the risks posed by cryptoassets, enable developments in the underlying technology, and allow innovators in the financial sector that play by the rules to thrive.

John Glen

## Appendix 2: Financial Conduct Authority Response

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I am writing in response to the Treasury Committee's Cryptoassets report of 19 September 2018, published following its inquiry into digital currencies and distributed ledger technology.

In its report, the Committee recommends that the cryptoasset market be regulated, with anti-money laundering and consumer protection considerations given priority. Your report specifically recommends that Initial Coin Offerings and cryptoasset exchanges be brought within the Regulated Activities Order (RAO) and into our perimeter.

As I am sure you are aware, the Cryptoasset Taskforce, a combined effort between the FCA, Bank of England and HM Treasury, published its final report on 29 October 2018. The report commits to prioritising actions which mitigate risks to consumers, ensure market integrity and prevent the use of cryptoassets for illicit activity.

As I said when I wrote to the Committee earlier this year on the regulatory perimeter and its impact, cryptoassets are a good example of activity for which the perimeter was not specifically designed at the time it was put into effect, and therefore there is a strong case to reassess the perimeter definition and scope.

For the purposes of assessing the perimeter, it is important to start with a more basic point, namely what are crypto-assets? We need a clear taxonomy. The report does this by separating cryptoassets into three categories:

1. **Exchange tokens** - which are often referred to- incorrectly in my view- as 'cryptocurrencies', such as Bitcoin, Litecoin and equivalents. They utilise a distributed ledger technology platform and are not issued or backed by a central bank or other central body. They do not provide the types of rights or access provided by security or utility tokens, but are used as a means of exchange or for investment. We do not believe that they constitute money or currency.
2. **Security tokens** - which amount to a 'specified investment' as set out in the Financial Services and Markets Act (2000) (Regulated Activities) Order (RAO). These may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits. They may also be transferable securities or financial instruments under the EU's Markets in Financial Instruments Directive II (MiFID II).
3. **Utility tokens** - which can be redeemed for access to a specific product or service that is typically provided using a DLT platform. I hope it is helpful to summarise what we are doing in this field.

### Financial Crime

We will not tolerate the use of cryptoassets for money laundering, fraud or criminal financing. Money-to-crypto exchange firms and custodian wallet providers will be in scope of the Fifth Anti Money Laundering Directive (SMLD). As the Taskforce indicated, the Government will consult next year on broadening the UK's regime to go beyond the activities listed in SMLD. This will include exchange between different cryptoassets,

cryptoasset ATMs, peer to peer platforms and non-custodian wallet providers. As the Government has indicated, they have asked us to consider taking on the role of supervising firms in fulfilling their AML/counterterrorism financing obligations but will seek views on this through consultation before confirming the identity of the supervisor. We are working closely with the Government on transposition of SMLD.

## Consumer protection

Following ESMA's restriction on the sale of contracts for difference which reference cryptoassets, we have committed to consult on a prohibition of the sale of all derivatives referencing exchange tokens like Bitcoin to retail consumers. We are concerned that retail consumers are purchasing complex, volatile and often leveraged derivatives products based on exchange tokens. This consultation will include CFDs, futures, options and transferable securities. In addition, some regulatory provisions within our Handbook-including the Senior Managers Regime and the Principles for Business-can apply to unregulated activities carried out by regulated firms. We will continue to hold this in mind through our supervision of regulated firms using cryptoassets.

## Market integrity

The Committee's report asks what steps we would take with regard to market manipulation were the entire cryptoasset market to be brought within our remit. We will not authorise or approve the listing of a transferable security or a fund that references exchange tokens (for example, exchange-traded funds) unless we have confidence in the integrity of the underlying market and other regulatory criteria for funds authorisation are met. We would have to be satisfied that any listing of a security with cryptoassets as the underlying asset would not be detrimental to investors' interests. We have not approved such a listing to date.

## Perimeter

As part of the Taskforce's work, we have committed to consult on perimeter guidance for security tokens- which already fall within the RAO- in order to clarify the way regulation applies to them. In the interim we will continue to monitor for potential breaches by those carrying out regulated activities without the appropriate authorisation. Where firms issue cryptoassets which are similar to specified investments (e.g. shares) through Initial Coin Offerings or other mechanisms, we want to ensure these are not structured so as to avoid regulation. The Government has committed to consulting on whether this is something which can and should be addressed through FCA regulation. There is a need to consider whether regulation could meaningfully and effectively address the risks posed by exchange tokens and what, if any, regulatory tools would be most appropriate as a result. The Government will consult next year in order to explore whether and how exchange tokens and the firms which provide them could be regulated. I hope that the Taskforce's report has given some of the clarity that the Committee's report calls for. We will of course continue to monitor developments in the market both domestically and work with international partners, and will keep the Committee updated on our work in this area as it progresses.

Andrew Bailey