



SUMMARY: REALISING GOVERNMENT'S VISION FOR THE UK TO BECOME A GLOBAL HUB FOR CRYPTOCURRENCY & FINTECH INNOVATION

**Inquiry of the All Party Parliamentary Group
for Crypto & Digital Assets**

JUNE 2023



**All-Party Parliamentary Group
Crypto & Digital Assets**

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“ We want this country to be a global hub - the very best place in the world to start and scale crypto-companies.... If crypto-technologies are going to be a big part of the future, then we - the UK - want to be in, and in on the ground floor. ”

Keynote Speech by John Glen, Economic Secretary to the Treasury, at the Innovate Finance Global Summit during Fintech Week April 2022.

Foreword



Dr Lisa Cameron MP,
Chair of the Crypto
and Digital Assets
APPG

As chair of the Crypto and Digital Assets All Party Parliamentary Group in Parliament, I am delighted to present the group's inaugural report considering the potential opportunities and challenges of realising the Government's vision for the UK to become a global hub for Cryptocurrency and Digital Assets.

This is the first report of its kind compiled jointly involving Members of Parliament and the House of Lords and we are keen that it contributes to evidence-based policy development across the sector.

The Crypto and Digital Assets All Party Parliamentary Group was formed in response to growing interest and scrutiny of the sector in Parliament and exists to help policymakers better understand the ever evolving world of cryptocurrency and digital assets and explore the urgent need for UK regulation.

Following the Government's announcement of its vision for the UK to become a global hub for cryptocurrency, the APPG launched our Inquiry to help identify the issues that policymakers will need to consider moving forward.

I am grateful to everyone who has contributed to our initial APPG Inquiry: to industry, the world of regulation and the banking sector; they have shared their views and expertise which has helped to inform this report and have informed our recommendations to Government.

Given the rapid growth of cryptocurrency and digital assets, the timing of this report is vital to protect consumers whilst ensuring the UK's leadership in this sector can be realised.

Lisa Cameron

Dr Lisa Cameron MP

Executive Summary

In April 2022, the UK Government set out its landmark vision to make the UK the global hub for cryptocurrency investment, committing to create the right conditions for cryptocurrency and digital asset businesses to set up and to scale up in the UK.

In response to the growing interest amongst Parliamentarians and the media regarding regulation of the UK cryptocurrency and digital asset sector, the Crypto and Digital Assets All Party Parliamentary Group (APPG) launched its initial Inquiry in August of 2022 to learn more about the opportunities presented for growth alongside the current challenges faced.

The Inquiry has focused upon a number of key areas including the UK's approach to regulation of cryptocurrency; the role and current approach of UK regulators including the Bank of England, the FCA and the ASA; the potential offered by Central Bank Digital Currencies - 'a Digital Pound'; and risks faced in terms of Consumer Protection and Economic Crime.

The APPG sought views from across the sector including from operators, regulators, and industry experts on the need for regulation of the sector. We invited written submissions from interested parties and subsequently held a number of evidence sessions in Parliament on the considerations that need to be made in order for the Government to achieve its vision for this innovative sector.

The Inquiry has identified a number of opportunities and potential challenges that are set out in this report. The recommendations are

intended to establish a foundation for further discussion regarding the future of cryptocurrency and digital asset regulation in the UK to help inform policymakers.

KEY CONCLUSIONS AND RECOMMENDATIONS:

Cryptocurrency and digital assets have the potential to significantly transform our established financial services system and the way we deal with money. The rapid growth of cryptocurrency and digital assets in recent years and the increased interest and adoption amongst consumers and investors, suggests that the sector is here to stay and that it therefore needs to be regulated to protect consumers and to ensure guardrails for investment and economic growth.

The cryptocurrency and digital assets industry presents a number of potential opportunities in the UK including efficiencies and innovation in financial services and payments, economic growth, contribution to careers of the future, research and collaboration opportunities and greater financial inclusion for those who are currently marginalised. The UK is well placed to harness these opportunities but it will require cross governmental strategic planning to realise them.

The growth of the cryptocurrency and digital asset sector, without comprehensive regulation, also presents considerable risks particularly in terms of consumer protection, economic crime, and financial stability. Regulation of cryptocurrency and digital assets within financial services is vital to addressing consumer risks whilst harnessing the sector's potential and contribution towards economic growth.

A number of countries around the world have moved quickly to develop clear regulatory frameworks and to provide necessary clarity attracting companies to their jurisdictions. The UK must move within a finite window of opportunity within the next 12-18 months to ensure early leadership within this sector.

The APPG also welcomes the proactive steps that Government is taking alongside the Bank of England to explore the potential of a digital pound. The public and consumers are increasingly embracing more digital means of payments and it is right that Government and regulators too respond to this trend and actively explore the need for further regulation in this space. Any decision to introduce a digital pound in the future will be a profound decision and will require significant trust amongst the public and consumers. Government must ensure that there is sufficient and appropriate education and awareness amongst the wider public which will be a determining factor in the success of any future digital pound.

UK regulators will play a key role in delivering the Government's vision for cryptocurrency and digital assets. Significant concerns remain regarding whether regulators currently have the resources, capacity and technical expertise required and further support and monitoring must be provided to ensure progress is made.

Given the broad nature of cryptocurrency and digital asset regulation, Government will need to ensure that it has a joined up and coordinated approach across all Governmental Departments and agencies that will be impacted by the growth of cryptocurrency, digital assets and blockchain technologies. Government should consider the appointment of a

'Crypto Tsar' who can help coordinate across departments to ensure a consistent approach.

The APPG supports the position of HM Treasury that cryptocurrency and digital assets are best regulated, in so far as is possible and appropriate, within existing and new financial services regulations, which has a track record in mitigating risks to consumers and investors. The APPG also agrees with the recent recommendations by the International Organization of Securities Commissions (IOSCO) that regulators "should seek to achieve regulatory outcomes for investor protection and market integrity that are the same as, or consistent with, those that are required in traditional financial markets."

Annex: All Conclusions and Recommendations

1. THE UK AS A GLOBAL HOME OF CRYPTOCURRENCY AND DIGITAL ASSET INVESTMENT:

Recommendation 1: The UK is well positioned to become a global hub for cryptocurrency and digital asset investment. Government should seek to build on its existing strengths as a leader in financial services and as a hub for Fintech investment as it seeks to realise its vision for the UK cryptocurrency and digital asset sector and to leverage the UK's post Brexit opportunities to chart its own bespoke course in terms of regulation.

Recommendation 2: The UK should seek to capitalise on the significant investment opportunities presented by the growth of the cryptocurrency and digital assets industry.

Recommendation 3: The UK should seek to harness the significant opportunities in terms of economic growth, and the potential for job creation in its approach towards the sector.

Recommendation 4: Government should look to create the right conditions to attract inward investment in the UK cryptocurrency and digital assets sector and should also support development of businesses that have already set up in the UK so as not to risk losing growth to other jurisdictions.

Recommendation 5: Government should explore how it can support regional growth and leverage the strength of its existing regional fintech hubs across the UK.

Recommendation 6: Government should look at ways to cultivate and attract the right talent and skills needed to support the growth of emerging technologies in fintech and the digital assets industry. A review should be undertaken of educational and business opportunities across the UK in order to develop sector skills required and to support the Government's Levelling Up agenda.

Recommendation 7: Government should explore the potential for improved access to financial services for the 1.2 million people in the UK who do not have access to mainstream financial services. We encourage further research into the potential for digital financial inclusion.

Recommendation 8: Government should be mindful of the potential risks presented by the continued growth and popularity of the cryptocurrency and digital asset sector, particularly in terms of any potential risks to financial stability, consumer protection, and risks identified from economic crime.

Recommendation 9: The Inquiry heard that cryptocurrency and digital assets do not at present pose a systemic risk to the financial system; however Government should continue to monitor the growth of the sector and take risk management action should cryptocurrency and digital assets reach a scale where they could impact wider financial stability.

Recommendation 10: Government must keep pace with the rapid developments in emerging technology and not risk falling behind other countries overseas in the race to regulate the industry in achieving its goal of becoming an international hub of cryptocurrency, digital assets and fintech.

Recommendation 11: The APPG believes that there is significant potential for blockchain technology in helping to ensure that UK financial aid overseas reaches the most vulnerable and encourages Government and in particular the UK Foreign, Commonwealth & Development Office (FCDO) to actively consider how it can harness this technology going forward.

2. THE UK'S CURRENT APPROACH TO REGULATION OF CRYPTOCURRENCY AND DIGITAL ASSETS:

Recommendation 1: The Inquiry heard that the industry is overwhelmingly in support of regulation and Government and regulators should seize the opportunity to work with industry to help develop fit for purpose regulation.

Recommendation 2: The Inquiry heard that in spite of the Government's vision to make the UK a global hub for cryptocurrency and digital asset investment, the UK still remains in the very early stages of regulation of the industry. Government should continue to develop a comprehensive framework that provides regulatory clarity which will be a key factor in attracting inward investment in the UK.

Recommendation 3: The Inquiry heard that stablecoins could provide a range of benefits and improvements to existing payment systems. Regulators will need to insist that stablecoins are backed by high-quality assets, and ideally by fiat currency, to provide trust and confidence in any new form of payment.

Recommendation 4: Government should continue to monitor developments in relation to NFTs and Fan Tokens and consider how appropriate regulation of NFTs could support growth and innovation in this space whilst protecting consumers from potential harm.

Recommendation 5: The Inquiry heard that while the progress being made is welcome, much of the progress thus far has focused on specific issues without being part of a wider strategy. It was felt that there still needs to be a clearly defined overarching strategy and an action plan to deliver on the Government's vision for the UK.

Recommendation 6: Regulatory clarity will be a key factor in attracting inward investment in the UK and Government should ensure that there are clear pathways for legitimate and responsible businesses to operate and grow in the UK, while acknowledging the clear need to sift out bad actors.

Recommendation 7: The Government should ensure that regulation is balanced and proportionate to protect consumers and so as not to stifle innovation, whilst also ensuring that any regulatory regime is agile enough to adapt easily to the fast pace of change in the sector. There may be a need to acknowledge the unique nature of some assets with a 'same risk, same regulation' approach.

Recommendation 8: Given the unique nature of different cryptocurrency and digital assets, Government should consider whether existing regulations and frameworks are appropriate or could be amended and if not should consider new, domain specific regulation.

Recommendation 9: Other jurisdictions are making significant headway in delivering legal and regulatory certainty and there is a real risk of the UK being left behind by more advanced and more cryptocurrency and digital asset friendly regulated markets overseas. The Government must move within a finite window of opportunity within the next 12-18 months to ensure early leadership within this sector.

Recommendation 10: The APPG welcomes the recent commitment by Government to Ministerial Level engagement with industry and strongly encourages Government to ensure that these forums represent the leading operators and professional bodies from the cryptocurrency and digital asset sector.

Recommendation 11: The Inquiry heard that it must be made as easy as possible, through passporting arrangements or similar, for UK-based cryptocurrency and digital asset businesses to access strategically important global markets. Government should also seek to play a leading role in driving forward a consistent global approach to cryptocurrency and digital asset regulation through international forums such as the G7 and others.

Recommendation 12: Government must take a 'whole of government' approach to cryptocurrency and digital asset regulation and ensure that there is a consistent approach across all government departments and regulatory bodies. Government should consider the appointment of a 'Crypto Tsar' who can help coordinate across departments to ensure a consistent approach.

Recommendation 13: Government should ensure that it has the sufficient resources and expertise to deliver on its vision. Government and regulators should consider developing specialist knowledge and expertise within Departments in order to properly understand and regulate the sector. We believe that Government would benefit from dedicated units to ensure it has the necessary skills and understanding required to achieve its vision.

Recommendation 14: Government should consider issuing updated guidance on the taxation of cryptocurrency and digital assets in the UK and also consider a comprehensive tax framework which ensures that the UK remains internationally competitive, provides clarity for investors and ensures tax revenue.

Recommendation 15: We welcome the work of the Law Commission on the classification of cryptocurrency and digital assets. We encourage the Government to carefully consider any recommendations from the Law Commission and move quickly on the legal classification of these assets where this may provide further clarity for the sector, regulators and the legal system.

Recommendation 16: UK cryptocurrency and digital assets firms are struggling to secure access to UK banking services which could fundamentally undermine the Government's ambition for the UK to become a cryptocurrency and digital asset hub and could be a significant barrier to growth and innovation. The Government should take urgent steps to ensure that there are clear pathways for legitimate and responsible companies to be able to access fundamental services required to operate regulated businesses, such as adequate insurance and banking facilities. The APPG encourages the Government to take the lead on this issue to find a solution for both the banking and cryptocurrency and digital assets industries. Guidance on how traditional financial institutions can work with the sector productively would be welcome and Government should seek to use its convening power to help facilitate a dialogue between the banking and cryptocurrency and digital assets industry on this issue.

Recommendation 17: Government should consider the environmental impact of cryptocurrency and digital assets and build a strong evidence base to properly understand the scale and impact of these challenges when making decisions over future regulation of the sector.

Recommendation 18: The APPG supports the position of HM Treasury that cryptocurrency and digital assets are best regulated, in so far as is possible and appropriate, within existing and new financial services regulations, which has a track record in mitigating risks to consumers and investors.

3. THE ROLE AND CURRENT APPROACH OF UK REGULATORS:

Recommendation 1: Following the collapse of exchange FTX and others the cryptocurrency and digital asset industry must seek to rebuild the trust of regulators and demonstrate its commitment to high standards of regulatory compliance and good corporate governance.

Recommendation 2: The Inquiry heard that at present the process for cryptocurrency and digital asset businesses to enter the UK is too burdensome and lengthy, resulting in many businesses ultimately choosing to invest outside of the UK. Government must ensure that regulators are properly equipped to be able to deliver the Government's streamlined vision for the UK sector.

Recommendation 3: We have concerns as to whether authorities and regulators have sufficient resources and the appropriate knowledge and skills internally to deliver on their new cryptocurrency and digital asset responsibilities. The FCA registration regime in particular is in need of significantly greater resource to ensure firms' applications can be reviewed within a reasonable period of time. All UK regulators related to the sector should have dedicated cryptocurrency and digital assets units with proper resource and sector understanding to deliver on their responsibilities.

Recommendation 4: The APPG welcomes the steps to extend the UK's financial promotions regime to cover cryptocurrency and digital assets. Government should ensure that cryptocurrency and digital asset promotions are fair, clear and not misleading and carry sufficient warnings regarding the potential risks for consumers. It is important that Government takes a consistent approach to the promotion of cryptocurrency and digital assets to that of other similar-risk investments and ensures that the UK has robust yet fair standards for the promotion of these assets, whilst ensuring that there is a level playing field for all legitimate businesses that are licensed in the UK.

Recommendation 5: There is a need for improved coordination between Government and regulators in delivering the Government's vision for the UK to be a global cryptocurrency and digital asset hub. Government should also ensure that there is continued and meaningful dialogue and engagement between regulators and industry.

4. CENTRAL BANK DIGITAL CURRENCIES:

Recommendation 1: The APPG welcomes the proactive steps that Government is taking alongside the Bank of England to explore the potential of a digital pound. The public and consumers are increasingly embracing more digital means of payments and it is right that Government and regulators too respond to this trend and actively explore the need for further regulation in this space.

Recommendation 2: Access to cash should be protected and we welcome the steps that Government is taking to legislate to protect access to cash alongside any future digital pound.

Recommendation 3: Government should carefully consider the potential benefits of any future digital pound and seek to harness the opportunities this could bring in terms of greater efficiencies in our financial and payments system as well as encouraging further innovation in this area.

Recommendation 4: The Inquiry heard that while there are a number of potential benefits, Government should carefully consider and seek to mitigate any potential risks surrounding the development and potential introduction of a digital pound, particularly in relation to financial stability, privacy and security risks.

Recommendation 5: Government should be careful to ensure that the introduction of any future digital pound does not stifle private sector innovation.

Recommendation 6: The Inquiry heard that a digital pound could play a key role in safeguarding the UK's payment autonomy. Government should carefully consider the potential impact of other countries' CBDCs in its strategy for exploring a future digital pound.

Recommendation 7: As other countries move at pace to develop and pilot their own CBDCs, the UK must be careful not to be left at a disadvantage. At a geopolitical level, there could be first-mover advantages of being among the first countries to have an internationally trusted and widely used CBDC. However, there is also value in a second mover approach allowing the UK to benefit from lessons learned from other countries' own CBDC initiatives. Government must decide if it wants to lead or follow in relation to CBDCs.

Recommendation 8: Any future digital pound requires careful consideration and testing. Government and the Bank of England should pilot, experiment and test any future digital pound with various design options, using different technologies.

Recommendation 9: Ensuring that Government and UK regulators have the appropriate knowledge and resource to be able to properly explore the case for a potential digital pound should be a priority. Government should take steps to ensure that regulators have the resources and skills they need, and ensure that there is meaningful and sustained engagement with industry and other experts moving forward.

Recommendation 10: Any decision to introduce a digital pound in the future will be a profound decision and will require significant trust amongst the public and consumers. Government must ensure that there is sufficient and appropriate education and awareness amongst the wider public which will be a determining factor in the success of any future digital pound.

5. CONSUMER PROTECTION AND ECONOMIC CRIME:

Recommendation 1: The Inquiry heard that if the UK is serious about becoming a global cryptocurrency and digital assets hub, high standards of protection for consumers will be a key factor in the success of the Government's vision. Government must ensure that consumer protection is at the heart of any future regulatory framework.

Recommendation 2: The level of understanding of cryptocurrency amongst consumers remains low. Improving consumer awareness and the potential risks associated with it should be a top priority and will be a key factor in protecting consumers from harm. There needs to be a renewed and joint effort by industry and policymakers to improve public digital finance education. We also recognise that there have also been calls for improved digital financial education in the school curriculum which Government may wish to consider.

Recommendation 3: Government must ensure that there are adequate safeguards and protections in place for consumers and ensure that measures are able to adapt to mitigate risks associated with new developments in the cryptocurrency and digital assets sector.

Recommendation 4: The Inquiry heard that consumers are often still unaware of the potential risks and also what to do and where to go if they do fall victim to a scam. Industry must do more to help raise awareness of the risks and we would like to see a joined up, coordinated and concerted effort by all players including industry, regulators, law enforcement and government to clamp down on scams.

Recommendation 5: Government should ensure that regulatory bodies and other law enforcement agencies are properly resourced to be able to tackle the threat from cryptocurrency related crime. Consistent training of regulators on these new avenues can aid in combating financial crime as well as continued engagement and sharing of best practice between industry, regulators and law enforcement.

Recommendation 6: Government should be alive to the emergence of new types of fraud and scams in relation to cryptocurrency and digital assets where criminals have sought to exploit consumers and also the risks posed by scams being promoted over social media. Government must ensure that regulators, and law enforcement continue to monitor and adapt to the latest techniques used by criminals to exploit cryptocurrency and digital assets. The Government should also put further consideration into guidance, support and redress for victims of scams.

Recommendation 7: While the overall level of economic crime associated with cryptocurrency and digital assets remains a relatively small proportion of overall activity, there remains potential for cryptocurrency to be used by criminals. Government should ensure that there are robust safeguards in place. Government should adopt a proportionate and risk based approach to addressing any potential risks and seek to establish a strong evidence base in relation to economic crime to inform its regulatory response.

Recommendation 8: Given the cross-border nature of cryptocurrency and digital assets, coordinated efforts between global regulators are required. Government should seek to use its leadership position through international forums such as the G7 and others to push for further action on global standards for cryptocurrency and digital assets regulation.

Recommendation 9: The Inquiry heard that the cryptocurrency and digital asset industry can be a key player in helping to tackle economic crime. Government should seek to work together with industry as much as possible in helping to identify and trace illicit crypto activity and should consider establishing formalised methods for sharing cryptocurrency and digital asset financial crime typologies between industry and law enforcement.

