

# The risks of token regulation

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Speech by Charles Randell, Chair of the FCA and PSR, to the Cambridge International Symposium on Economic Crime.



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**Note:** this is the speech as drafted and may differ from the delivered version

## Highlights:

- While platforms' efforts to crack down on fraudulent advertisements are welcome, a permanent and consistent solution to the problem of online fraud from paid-for advertising requires legislation.
- Speculative crypto tokens are not regulated by the FCA and consumers are not covered or protected by the Financial Services Compensation Scheme in the event of losses.
- In considering regulating crypto, legislators need to consider 3 issues:
  - how to make it harder for digital tokens to be used for financial crime
  - how to support useful innovation
  - the extent to which consumers should be free to buy unregulated, purely speculative tokens and to take the responsibility for their decisions to do so.

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The Augean stables hadn't been cleaned for 30 years when Hercules was set the labour of cleaning them. For 30 years, 3,000 animals had been doing in those stables what 3,000 animals have to do.

The first website was published 30 years ago last month. And like the Augean stables, over the last 30 years the internet has filled up with a great deal of ... well, let's just call it 'problematic content'.

People used to think of the internet as a free space, outside the law, impossible to regulate. And while there's no doubt that it has enabled businesses to innovate and grow in ways that serve us well, their awesome power must be matched with responsibility. As we live more and more of our lives online, we can't allow online business to operate in ways we wouldn't tolerate with any other business. The tide of regulation is turning all over the world, and online platforms should expect a future where regulation addresses the significant risks they pose in the same way as other businesses. Same risk, same regulation.

That includes rules which protect people from investment fraud and scams.

When [I last spoke at this Symposium in 2019](#), I said that online platforms, including the search and social media giants, needed to step up and stop publishing and profiting from fraudulent content. Since then, we have seen some progress. Google has committed to stop promoting advertisements for financial products unless an FCA authorised firm has cleared them. Google is doing the right thing and we will monitor the impact of its changes closely. We now need other online platforms – Facebook, Microsoft, Twitter, TikTok - to do the right thing too. And we think that a permanent and consistent solution requires legislation.

I noted in 2019 that the Government's proposed legislation about online harms didn't cover financial scams. Since then, the Government has brought some financial harms within its proposals. That's welcome, but paid-for advertising, the main source of online investment scams, is still not covered. We consider it should be.

Even with better targeted laws, the internet will continue to be a very challenging space for regulators. Hercules rerouted two rivers to wash the stables out, and we'll need 2 streams to tackle the problem of online financial scams: appropriate regulation, including self-regulation by online platforms and robust enforcement by the authorities; and greater consumer awareness about online scams.

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Enforcement must be a team effort, involving the National Crime Agency, the Serious Fraud Office, police forces and sectoral regulators like the FCA, coordinating with international partners. All these players need to have the right focus and resources.

Consumer awareness requires online platforms to step up. They can give advice about scams in the moment when consumers are about to make bad decisions. We'll work with online platforms who want to protect both consumers and their own brands – and we'll call out those who aren't playing their part and are destroying the trust of their users.

## Crypto scams

Which brings me on to Kim Kardashian. When she was recently paid to ask her 250 million Instagram followers to speculate on crypto tokens by 'joining the Ethereum Max

Community', it may have been the financial promotion with the single biggest audience reach in history.

In line with Instagram's rules, she disclosed that this was an #AD. But she didn't have to disclose that Ethereum Max – not to be confused with Ethereum – was a speculative digital token created a month before by unknown developers – one of hundreds of such tokens that fill the crypto-exchanges.

Of course, I can't say whether this particular token is a scam. But social media influencers are routinely paid by scammers to help them pump and dump new tokens on the back of pure speculation. Some influencers promote coins that turn out simply not to exist at all.

There are no assets or real world cashflows underpinning the price of speculative digital tokens, even the better known ones like Bitcoin, and many cannot even boast a scarcity value. These tokens have only been around for a few years, so we haven't seen what will happen over a full financial cycle. We simply don't know when or how this story will end, but – as with any new speculation – it may not end well.

Despite this, the hype around them generates a powerful fear of missing out from some consumers who may have little understanding of their risks. There is no shortage of stories of people who have lost savings by being lured into the cryptobubble with delusions of quick riches, sometimes after listening to their favourite influencers, ready to betray their fans' trust for a fee.

At the FCA we have repeatedly warned about the risks of holding speculative tokens. To be clear: these tokens are not regulated by the FCA. They are not covered by the Financial Services Compensation Scheme. If you buy them, you should be prepared to lose all your money.

But [around 2.3 million Britons currently hold this type of token](#). Worryingly, 14% of them also use credit to purchase them, thereby increasing the exposure to loss. And 12% of them, so around a quarter of a million people, seem to think that they will be protected by the FCA or the Financial Services Compensation Scheme if they go wrong. They won't.

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So the potential level of consumer harm that these purely speculative tokens bring raises the question of whether the activity of creating and selling the tokens themselves should be brought within FCA regulation.

It isn't an easy question. Especially when it is clear that the underlying technology has potential uses which I will come to – that could benefit our society.

A [Treasury consultation](#) on the UK approach to cryptoassets and stablecoins closed earlier this year, and the FCA is working closely with the Treasury and Bank of England as part of the Cryptoassets Taskforce.

## FCA's current role

The FCA currently has a limited role in registering UK-based cryptoasset exchanges for anti-money laundering purposes. Exchanges can be used to launder the proceeds of crime and we must contribute to the global effort to address financial crime by demanding that businesses with a UK presence meet the necessary standards. While some of the business which have applied to us have shown evidence of adequate systems and controls, many others fell well short of acceptable standards and many have withdrawn their applications as we have scrutinised them. The state of those firms ignoring the requirement to register with us or which have moved off-shore to avoid registration could be even worse.

We have published a list of unregistered crypto exchanges that we suspect are operating in the UK, to help consumers avoid using them. Banks and other authorised firms should be very wary of transactions involving unregulated crypto exchanges wherever they are based, and should use the list of suspect UK businesses to identify customers and transactions which may be money laundering.

Where digital tokens are used to constitute or represent investments that we already regulate, like shares and bonds, we will use our existing powers in the same way as for investments that are not tokenised. In 2019 we set out [guidance to clarify our approach](#) to transferable securities of this kind.

And where other activities we regulate reference digital tokens, we will pursue our consumer protection objective in limiting the harm. That's why last year we banned the sale of crypto-derivatives to retail consumers.

## Token regulation?

But we don't have currently have a general remit from Parliament to regulate the issue or promotion of speculative tokens. Should we?

There is a live debate in [many major financial jurisdictions](#) about whether regulators need [more powers and tools](#) and clarity of remit to regulate crypto. It's difficult for regulators around the world to stand by and watch people, sometimes very vulnerable people, putting their financial futures in jeopardy, based on disinformation and fear of missing out.

But here in the UK there are many other purely speculative activities that we don't regulate. You can buy gold and other commodities, foreign real estate, foreign currencies, or even old school tokens like Pokemon cards, using unregulated markets. There is no shortage of consumer harm in many of those markets. So why should we regulate purely speculative digital tokens? And if we do regulate these tokens, will this lead people to think that they are bona fide investments? That is, will the involvement of the FCA give them a 'halo effect' that raises unrealistic expectations of consumer protection?

One thing is clear: because of the decentralised way that these speculative tokens are created, any effective system of regulation would require a business seeking registration or authorisation with the FCA to bring itself firmly within our reach, with people and resources that we could access in order to supervise and enforce our requirements. We are not going to award FCA registration or authorisation to businesses which won't explain basic issues, such

as who is responsible for key functions or how they are organised. That would be token regulation in the worst sense.

Action against businesses which choose not to bring themselves within the reach of an effective national regulator needs to be international, with regulators across the world working together to limit the harm. IOSCO has recently published reports on how to [educate consumers about the risks of crypto](#) and [considerations for regulating crypto exchanges](#), and I hope this is the start of a consistent collaborative effort.

## Reaping the benefits

An effective system of regulation of digital tokens has to allow the more promising use cases for the innovative technology that underlies the tokens to flourish – especially the potential to make payments and financial infrastructures more efficient and accessible.

It's essential to find the right balance between appropriate regulation to protect consumers and markets and encouraging useful new ideas in this space.

## Digital tokens as a means of payment

For example, digital tokens might be useful to improve the payments market. As the Treasury's consultation document sets out, digital tokens can be issued with the aim of being maintained at the value of an underlying sovereign currency and used to make payments outside the conventional payment systems. These are generally referred to as 'stablecoins'. There are promising use cases for both retail and wholesale payments, particularly retail cross-border payments where frictional costs can be high for some of the most financially excluded people in our society.

When we come to assess stablecoin propositions, the FCA and the Payment Systems Regulator will be guided by our objectives of protecting consumers and users of payment systems, competition and innovation and market integrity.

The Bank of England is considering the risks that stablecoins could pose to the financial system and monetary policy, but we saw with the UK operations of Wirecard that a player in payments does not have to be systemically important to cause significant consumer distress. So, any stablecoin business we may come to regulate, even if it is not systemic, will need to assure that end users would be able to easily exchange them, access them and use them to make payments safely and securely, with the same level of protection we expect from other types of payment instruments. And for this to be assured even during times of financial distress.

It's difficult for regulators around the world to stand by and watch people, sometimes very vulnerable people, putting their financial futures in jeopardy, based on disinformation and fear of missing out.

Just as with other firms we regulate, we would need to understand how the firm makes money, taking into account its capital and liquidity requirements as well as its operating costs.

Stablecoins could provide valuable competition in a payments market where a small number of players hold very strong market positions. The Payment Systems Regulator has a [strategy to promote competition between payment systems](#), and stablecoins could be one way of doing this. But as it grows, a stablecoin payment system could rapidly benefit from network effects to occupy a central position, so we will also need to think about wider competition issues including fair access.

The UK is very well placed to work with stablecoin businesses which can innovate and bring competition in the interests of consumers. Our pioneering [Regulatory Sandbox](#), where we both scrutinise and support innovative business models as they engage with real consumers to test new ideas, has become the model for such sandboxes around the world. And we're now expanding it so firms can graduate to a regulatory nursery where we can continue to support useful new business propositions as they grow.

We understand how important it is to provide a predictable and stable regulatory environment in which businesses can innovate with confidence. We will work closely with our regulatory partners to ensure that our approach is clear and our actions are coordinated and complementary.

## Digital tokens that represent investments

A second promising use of digital tokens is to represent regulated investments, such as shares or bonds – security tokens.

Security tokens can be used in at least 2 different ways: first, to raise capital for businesses from investors, including potentially retail investors; and secondly, to provide alternative means of settling transactions in financial instruments.

Our Sandbox has already supported projects testing the use of security tokens to raise capital efficiently.

Distributed ledger technology may also help to make settlement and custody more efficient in closed permissioned networks which do not have the unacceptable environmental impact of some open proof-of-work systems. The Government has announced the creation of a financial market infrastructure sandbox for firms exploring how to use technologies like distributed ledger technology to innovate in the settlement of financial securities.

## Short term measures

It will take a great deal of careful thought to craft a regulatory regime which will be effective in the decentralised world of digital tokens. And it's clear that legislators need to consider 3 issues: how to make it harder for digital tokens to be used for financial crime; how to support useful innovation; and the extent to which consumers should be free to buy unregulated, purely speculative tokens and to take the responsibility for their decisions to do so.

In the meantime, it appears to me that there are 2 cases where regulators should have the powers to take action to reduce the potential harm to consumers from purely speculative tokens, not least to ensure that trust in the overall technology isn't destroyed by bad actors in this space.

The first is cryptoasset promotions. As I've mentioned, a surprisingly large proportion of people buying these speculative tokens seem to think they may be regulated already. When you combine that fact with the relentless and often misleading advertising techniques of some crypto businesses, there is a real risk of consumer confusion.

We are not going to award FCA registration or authorisation to businesses which won't explain basic issues, such as who is responsible for key functions or how they are organised.

The Treasury has recently [consulted on the case for regulating some cryptoasset promotions](#) and I look forward to their conclusions. But it's absolutely imperative that any regulation of cryptoasset promotions requires the risks to be clearly highlighted and does not give the impression that the token itself is subject to regulatory supervision or has regulatory approval. And, since these promotions are nearly all online and often made by unidentifiable promoters in other jurisdictions, it's imperative that any regulations in this area cover paid-for advertising on online platforms.

The second issue is the risk of contagion of the regulated business of authorised firms by unregulated activities in digital tokens. As a first step, the [Basel Committee is consulting on a proposal](#) which would ensure that speculative digital tokens attract a full capital charge for banks. It's essential that the boards of FCA authorised firms can show how they have addressed the risks that unregulated activities in relation to digital tokens can pose to those firms: to both their conduct, and their prudential soundness.

## Conclusion

Good financial regulation supports innovation, productivity and economic growth. In regulating the online world, we need to strike the right balance between fostering innovation, providing an appropriate level of protection and allowing individuals freedom to take decisions for which they are responsible.

We also have to recognise that effective regulation of a digital world requires international cooperation and common standards. As we said in [our recent Business Plan](#), the most harmful behaviour, like fraud, often occurs across jurisdictions and sectors beyond financial services. Only by working with our partners – many of which are in this room – can we have the greatest impact in disrupting misconduct.

The digital world will continue to produce a lot of problematic content. But stables can produce winners too, so we must be careful not to scare the horses.