# Comment: Cryptoassets and the case for regulation

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**Over the past year, regulators around the globe finally woke up to the potential dangers of cryptoassets. *Anna Gaudoin* asks what progress, if any, as been made and looks at what the future might hold for regulation of this nascent yet rapidly evolving market.**

Amid increasing international scrutiny of digital currencies, the UK government and Financial Conduct Authority (FCA) have faced mounting pressure to impose some form of regulation on the industry. Several damning reports last year drew attention to the urgent need for regulation of cryptoassets.

In September, the Treasury Select Committee highlighted the lack of market oversight, dubbing the industry the "Wild West", while the New York Attorney-General's office criticised "pervasive" conflicts of interest and the lack of sufficient measures to prevent market abuse.

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Shortly afterwards, the UK's Cryptoasset Taskforce - which comprises representatives of the FCA, HM Treasury and the Bank of England - identified three major risks associated with cryptoassets. Firstly, harm to consumers, who, in purchasing highly volatile and potentially unsuitable digital assets, are exposed to

large losses without traditional safeguards such as compensation. Secondly, the potential harm to market integrity, caused by opaque market practices and widespread misconduct; and finally, the risk of financial crime, stemming from concerns that anonymously-held cryptoassets are used to launder money, fund illicit activities such as terrorism and human trafficking, and defraud consumers. The taskforce concluded that decisive action must be taken.

**How should regulation be approached?**

The Treasury Select Committee's report suggested that rather than creating a new framework specifically to regulate digital assets, it would be quicker to bring them within the scope of existing regulation. But quicker is not necessarily better.

Trying to shoehorn cryptoassets, with their unique challenges and rapid development, into rules designed for more traditional financial instruments could well be a recipe for disaster: indeed, the FCA acknowledged in its most recent consultation that "new business models don't always map neatly into our regulatory framework" and that the complexity of some cryptoassets makes it difficult to determine whether they do in fact fall within its remit. A situation where the existing framework is not fit for purpose, with a mishmash of old and new rules, may be even more dangerous than no regulation at all and risks creating loopholes that can be exploited all too easily.

If the FCA is to develop a new regulatory framework for cryptocurrencies, it must not do so in isolation. By their very nature, cryptoassets and associated blockchain technology are decentralised and difficult to pin to a particular jurisdiction or regulator. A globally co-ordinated, consistent approach would eradicate any weak links in the chain. Indeed, in responding to the Treasury Committee's report, the Government and the FCA acknowledged the need for international co-ordination and will hopefully take this forward into 2019.

Steps have already been taken to map out new international standards, with the Financial Action Task Force ("FATF") agreeing amendments to its Standards and Recommendations to help prevent the misuse of what it terms "virtual assets" in money laundering and terrorist financing. The FATF plans to update its guidance to help countries implement these changes and, given the speed of innovation in the sector, will revisit the issue later this year to ensure that the Standards remain

relevant. Similarly, the European Banking Authority has called for the feasibility of pan-European rules on the regulation of cryptoassets to be considered by the European Commission.

**What might 2019 have in store?**

The UK Government has previously indicated that it is willing and able to give the FCA greater powers to oversee cryptoassets; 2019 may be the year these powers actually materialise. The FCA has already launched a consultation on guidance in an attempt to provide clarity to firms about which cryptoassets fall within its existing regulatory perimeter.

The consultation sets out the FCA's assessment of how the current regulations apply to different types of cryptoassets, inviting views from stakeholders by early April, with final guidance due in summer 2019. A further consultation by the FCA later this year will consider a possible ban on cryptocurrency derivatives, while HM Treasury intends to explore the possibility of expanding the FCA's remit to cover additional types of cryptoassets.

In the meantime, the FCA is keeping itself busy. As of 12 November 2018, the FCA had opened investigations into 67 companies involved in cryptocurrency business. Of these, 49 investigations were discontinued, with 39 resulting in consumer alerts - which warn the public that a company could be operating without proper authorisation and may be a scam. It is striking that so many investigations have been closed in such a short period of time.

This may be representative of the FCA's decisive approach in closing cases which do not merit further scrutiny. However, it is possibly symptomatic of a wider problem: the FCA simply lacks the clarity and tools needed to police this new landscape. Enforcement action cannot be taken in the absence of a clear regulatory framework. Until a coherent, comprehensive strategy for regulating the cryptoassets market is agreed, the FCA's hands are effectively tied.

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