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Banking and Credit Team
Floor 1, Red
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Re: Digital Currencies – Call for Information

Dear Sir or Madam,

CFA Institute appreciates the opportunity to respond to HM Treasury's Call for Information on digital currencies.

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 127,000 members in 150 countries and territories, including 120,000 Chartered Financial Analyst® charterholders, and 144 member societies.

Summary

CFA Institute broadly welcomes financial innovation that may allow greater access to the financial system at lower cost for investors and consumers. We believe crypto-currencies are an interesting financial innovation that may facilitate these goals. However, CFA Institute believes there is scope for greater investor and consumer protection in some areas of crypto-currencies, particularly in custodial activities such as wallets and exchanges.

We have responded to selected questions in this call for information as set out below.

Specific Comments

Question 1: What are the benefits of digital currencies? How significant are these benefits? How do these benefits fall to different groups e.g. consumers, businesses, government, the wider economy? How do these benefits vary according to different digital currencies?

CFA Institute supports financial innovation in its capacity to provide benefits to investors, consumers and the broader economy. We believe digital currencies[1] have potential to provide benefits to these groups in several ways.

For consumers and businesses, digital currencies may result in lower international transaction costs and transfer fees compared to existing payments systems. These lower fees are the result of the

[1] We use the term "digital currencies" and "crypto-currencies" interchangeably throughout.

disintermediation of the payments system with funds being transferred directly between recipients. These benefits are likely to increase as more merchants begin accepting digital currencies and as related infrastructure, like digital currency ATMs, become more common. For the wider economy, digital currencies have encouraged entrepreneurship and created new-knowledge jobs in the technology sector, something which the UK Government has previously committed to encouraging.

Although there are hundreds of digital currencies, Bitcoin is by far the largest and most widely accepted digital currency to-date. Alternative digital currencies (known as altcoins) are typically more volatile in terms of their value and fewer if any merchants currently accept them as payment.

Question 2: Should the government intervene to support the development and usage of digital currencies and related businesses and technologies in the UK, or maintain the status quo? If the government were to intervene, what action should it take?

CFA Institute believes the current status of digital currencies in the UK does not provide sufficient clarity for investors, consumers or businesses. In particular, we would like to see the government clarify the issue of whether digital currencies should be considered a currency, a commodity, an asset class, or other form of property as soon as practicable to provide needed certainty to potential investors regarding taxation treatment and other legalities.

CFA Institute believes that in order to encourage the development and usage of digital currencies and related businesses in a legal, responsible and productive direction, the government may wish to formalize its position on digital currencies in certain ways. For investors, it must be made clear that digital currencies are very high risk and have few if any investor protections. As such they are unlikely to be suitable for all but the most experienced or risk-seeking investors.

Question 3: If the government were to regulate digital currencies, which types of digital currency should be covered? Should it create a bespoke regulatory regime, or regulate through an existing national, European or international regime? For each option: what are the advantages and disadvantages? What are the possible unintended consequences (for instance, creating a barrier to entry due to compliance costs)?

CFA Institute believes there is scope for government to regulate digital currencies to ensure protection for investors and other users and to limit the scope for fraud. In general, CFA Institute believes that common minimum standards at the international level are preferable to a patchwork of potentially divergent national regimes in order to minimise scope for regulatory arbitrage.

The difficulty for authorities when considering regulation arises in the dynamic nature of this fledgling technology, its borderless nature, and ultimately the extent to which it may be integrated with payment and settlement systems. Moreover, the development and application of national, European or international regulatory regimes must be considered with caution so as not to create excessive barriers to entry due to compliance costs.

Further, there are significant differences in the types of digital currency businesses so a one-size-fits-all approach within a given jurisdiction is unlikely to be desirable. This has been the experience of the New York Department of Financial Services in consulting on its BitLicence proposals. The BitLicence proposals initially proposed extensive anti-money laundering (AML) and know your customer (KYC) obligations on any crypto-currency-related business operating in or dealing with persons in New York. These were criticized as unworkable due to the myriad types of businesses involved with crypto-currencies.

CFA Institute believes that businesses providing wallet, custodian, transfer and exchange services for digital currencies for investors and other users should adhere to standards that afford investors and consumers greater levels of protection and recourse than currently available. We acknowledge there may be exceptions where such services can be technically provided without the service provider ever taking custody of the digital currency holdings, instead merely facilitating such transactions.

Question 4: Are there currently barriers to digital currency businesses setting up in the UK? If so, what are they?

We are not able to comment.

Question 5: What are the potential benefits of this distributed ledger technology? How significant are these benefits?

The distributed ledger technology may ostensibly be used to disintermediate any property right. It is currently unclear whether the digital currency application of the distributed ledger will continue to be the most used and widespread application in the future. Any potential benefits will likely come in the form of reduced transaction costs and greater market efficiency due to disintermediation. An example of this may be that distributed ledger technology may facilitate the use of crowdfunding by allowing small- and medium-sized firms to issue digital equity without incurring large issuance costs.

Question 6: What risks do digital currencies pose to users? How significant are these risks? How do these risks vary according to different digital currencies?

CFA Institute believes that the most significant risk that digital currencies pose to users is the lack of investor or consumer redress. Specifically, there is no systematic way to recover misappropriated funds, which is a significant concern for wider adoption of digital currencies by investors or other users. It is also difficult for investors and other users to ascertain the credibility and trustworthiness of digital currency businesses like wallets and exchanges in the first place. Typically, these concerns increase exponentially when dealing with digital currencies other than Bitcoin.

Question 7: Should the government intervene to address these risks, or maintain the status quo? What are the outcomes of taking no action? Would the market be able to address these risks itself?

CFA Institute is aware of several market-based solutions to the issue of investor and consumer protection, such as insured custodian firms. However, we believe the lack of a systematic approach to this issue of investor and consumer redress is still a major impediment to the wider adoption of digital currencies. Indeed, experience in other markets suggests market-based solutions may be unlikely to completely solve these issues. We would welcome the opportunity to comment on government proposals to address issues of investor and consumer protection.

Question 8: One of the ways in which the government could take action to protect users is to regulate. Should the government regulate digital currencies to protect users? If so, should it create a bespoke regime, or regulate through an existing national, European or international regime?

For each option: what are the advantages and disadvantages? What are possible unintended consequences (for instance, creating a barrier to entry due to compliance costs)? What other means could the government use to mitigate user detriment apart from regulation?

Please refer to our response to question 3; we have no further comments.

Question 9:What are the crime risks associated with digital currencies? How significant are these risks? How do these risks vary according to different digital currencies?

We are not able to comment.

Question 10: Should the government intervene to address these risks, or maintain the status quo? What are the outcomes of taking no action?

We are not able to comment.

Question 11: If the government were to take action to address the risks of financial crime, should it introduce regulation, or use other powers? If the government were to introduce regulation, should it create a bespoke regime, or regulate through an existing national, European or international regime? For each option: what are the advantages and disadvantages? What are possible unintended consequences (for instance, creating a barrier to entry due to compliance costs)?

What has been the impact of FinCEN's decision in the USA on digital currencies?

We are not able to comment.

Question 12: What difficulties could occur with digital currencies and financial sanctions?

We are not able to comment.

Question 13: What risks do digital currencies pose to monetary and financial stability? How significant are these risks?

Digital currencies are a nascent innovation; as such, their issuance and usage represents only a tiny fraction of the financial system. To provide some perspective, Bitcoin, the largest digital currency by some distance, has a market capitalisation of approximately USD 5 billion at the time of writing. The next largest digital currency is Ripple with a market capitalisation of approximately USD 400 million, followed by Litecoin with a market capitalization of approximately USD 120 million. Consequently, at this stage in their development, we do not consider digital currencies to pose significant risks to monetary and financial stability.

Concluding Remarks

CFA Institute welcomes the initiative to better understand and take advantage of the potential benefits of crypto-currencies while minimising the risks posed to investors and consumers. For further information on the facts, issues, and policy considerations associated with digital currencies, HM Treasury may wish to refer to the CFA Insitute policy brief on crypto-currencies available on our website.[2] Please do not hesitate to contact us should you wish further elaboration of the points raised.

Yours faithfully,

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[2] CFA Institute, *Crypto-currenices: Intellectual Curiosity or the Future of Finance?* October 2014, available at http://www.cfainstitute.org/learning/products/publications/contributed/Pages/policy_brief__crypto-currencies___intellectual_curiosity_or_the_future_of_finance_.aspx