European Regulators Set Sights On Cryptocurrencies

Regulators across Europe have been discussing possible oversight of cryptocurrencies even though the region only represents a small share of global trading volumes.

Mark Carney, governor of the Bank of England, gave a speech on 2 March on the future of money and how the UK central bank can help manage the potential risks, as well as realise the promise of, more than a thousand virtual or cryptocurrencies.

He said the cryptocurrencies have to be judged against the entire ecosystem – including the exchanges on which they are traded, the miners who create new coins, verify transactions and update ledgers, and the wallet providers who offer custodian services.

Mark Carney, BoE & Financial Stability Board

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"The long, charitable answer is that cryptocurrencies act as money, at best, only for some people and to a limited extent, and even then only in parallel with the traditional currencies of the users," added Carney. "The short answer is they are failing."

He noted that the daily standard deviation of Bitcoin was ten times that of sterling over the last five years and the average volatility of the top ten cryptocurrencies by market capitalisation was more than 25 times that of the US equities market last year.

"This extreme volatility reflects in part that cryptocurrencies have neither intrinsic value nor any external backing," added Carney.

In addition, in the UK no major high street or online retailer accepts Bitcoin as payment, and the Bank of England is not aware of any business that accepts Bitcoins in payments that also maintains its accounts in Bitcoin.

The Bank of England's Financial Policy Committee is currently considering the risks posed to UK financial stability. As a part of this exercise the global Financial Stability Board will report to the G20 in Argentina later this month on the financial stability implications of cryptoassets. Carney said: "At present, in my view, cryptoassets do not appear to pose material risks to financial stability."

Cryptoassets are small, relative to the financial system and in addition, major

Ed Oliver, VP, Finance Sales at Dataminr

European Commission
@EU_Commission

"Today's roundtable focused on three main topics: the implication of #cryptocurrency for financial markets, the risks and opportunities of their use and recent developments on initial coin offerings" VP @VDombrovskis #blockchain

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UK financial institutions have minimal exposures to the cryptoasset ecosystem.

"Looking ahead, financial stability risks could rise if retail participation significantly increased or linkages with the formal financial sector grew without material improvements in market integrity, anti-money laundering standards and cyber defences," added Carney.

Carney continued that some jurisdictions have banned cryptoassets, such as China, which had been one of the most active markets. He recommended that the cryptoasset ecosystem should be held to the same standards as the rest of the financial system.

"In my view, holding cryptoasset exchanges to the same rigorous standards as those that trade securities would address a major underlap in the regulatory approach," he added.

If any such regulation is introduced, this will lead to more volatility and price movements in cryptocurrencies. Furthermore, the news is often broken on social media before traditional news sources.

Carney noted that US derivatives exchanges have begun trading bitcoin futures. When the CME announced on 31 October last year that they were planning to launch bitcoin futures, Dataminr for Finance sent clients an urgent alert. Dataminr highlights that in the hours following this alert Bitcoin went on to rise approximately 2% and more than 4% overnight as the news hit Asian markets. Since then, Nasdaq has also said it intends

to launch Bitcoin futures this year.

"Having derivatives traded and cleared on exchanges could, in time, raise standards in them and mean that regulators have better information about how the underlying markets function," said Carney. "The discussions at the FSB and the G20 will be valuable given the diversity of possible approaches and the decentralised and cross-border nature of crypto-assets."

On 26 February the European Commission held a roundtable focused on the implication of cryptocurrency for financial markets, the risks and opportunities of their use, and recent developments on initial coin offerings.

Valdis Dombrovskis, Commission Vice-President in charge of Financial Stability, Financial Services and Capital Markets Union, said after the roundtable: "Cryptoasset markets are global, with worldwide transactions between investors, consumers and intermediaries. On its own, Europe represents only a small share of global cryptocurrency trading, so we need to work together with our partners in the G20 and international standard-setters."

Ed Oliver, Vice President, Finance Sales at Dataminr, told Markets Media that the firm has noticed an increase from European firms in gaining early insights into events impacting cryptocurriencies. He said: "There is clearly growing interest. Foreign exchange professionals are starting to trade on their accounts and so are some smaller firms."

For example, in February seven UK cryptocurrency companies – BlockEx; CEX.IO; Coinbase; CoinShares; CommerceBlock; CryptoCompare; and eToro – launched CryptoUK, a self-regulatory trade body, to improve industry standards by publishing a code of conduct and to engage policy makers.

Iqbal Gandham, UK managing director of eToro, has been elected chair for the first year. He said in a statement: "The code of conduct is at the heart of everything we do. It is not finished. It will be improved and refined, in collaboration with industry, policy makers and others. We hope it can form the blueprint for what a future regulatory framework will look like".

One of the conclusions from the roundtable was that the European Commission needs to assess how cryptocurrencies and related services are covered by existing regulation. "Based on the assessment of risks and opportunities and the suitability of the existing regulatory framework for these instruments, the Commission will determine if regulatory action at EU level is required," said Dombrovskis.

The day after the roundtable Dombrovskis gave a speech at the Afore Consulting's 2nd Annual Fintech and Digitalisation Conference stressing that Europe represents only a small share of global blockchain developments, and cryptocurrency trading. "When it comes to blockchain, borders are almost irrelevant, so we need to work together with our international partners, including in the G20," he added.

Steven Maijoor, chair of the European Securities and Markets Authority also gave a speech at the same conference. He noted that the extreme price volatility of cryptocurrencies raises risks for investors so Esma has issued warnings.

"In recent months we have seen virtual currencies themselves as the building block for further innovation, in the form of Bitcoin futures contracts in the US," Maijoor added. "We see virtual currencies as an unstable building block, however, as they generally lack the key characteristics of a currency and are unregulated under EU law."

Economist Heike Mai at Deutsche Bank said in a report, Why would we use crypto euros?, that it is hard to see a compelling reason for consumers to switch voluntarily to crypto euros for the time being. He continued that cryptocurrencies have not yet fulfilled the three basic functions of money: means of payment, unit of account, and store of value. Instead the main reasons for growth of private cryptocurrencies have been passion for technology, avoidance of bank payment systems, and financial speculation.

"Unless its use was strongly pushed by regulation, digital cash would need to convince users by offering better and more convenient payment solutions than other payment systems," added Mai. "In particular, it would need to match current low fee levels and high safety standards for regulated consumer payments."

However he argued that if fundamental trust in monetary and political stability were lost, people would probably turn away from any form of the sovereign currency in favour of other alternative assets or private cryptocurrencies.

"Nevertheless, despite starting from a low level as compared to sovereign currencies like euro or dollar, private cryptocurrencies are growing strongly, be it by number of transactions, number of tokens ("coins") in circulation or value measured in US dollar or euro," said Mai. "Given the early stage of this financial innovation, it is hard to foretell its future success."