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FUTURE FINANCE

Future of Crypto in Financial Services

How the nascent asset class could disrupt the financial ecosystem



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Future of Crypto in Financial Services



Milo Larkin,
Consultant and
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at MRM

It is fair to say that cryptoassets have captured the attention of many over the past 18 months. We've seen huge price fluctuations in the most popular assets such as Bitcoin and Ethereum - the former flew from \$6,600 in April 2020 to an all time high of \$60,000 in April 2021. You don't have to be an investment analyst to understand that's a meteoric rise.

But more so than the price movements, the real world applications of crypto, both in terms of their use cases (i.e., how the end consumer or businesses could use crypto) and their roles as investment assets have also come to the fore.

How is this nascent but rapidly changing industry affecting the life of the consumer, and how might we see crypto and other blockchain technology permeate the financial services sector?

To find out, MRM put together a panel of experts to discuss crypto as an investment asset, the real world uses of cryptoassets, and how the regulatory framework surrounding the industry should look.

It is worth noting that this discussion took place in April 2021, and therefore some of the responses reflect where crypto was at that time. I think they nevertheless hold up, and I hope you find the discussion as informative as I found hosting it.

Milo Larkin: We've seen a huge increase in popularity in cryptoassets over the past 12 months or so, for example Bitcoin has gone from \$6,600 to over \$50,000. Do we think people are using Bitcoin and other cryptoassets for their intended purposes, or are they mostly interested in them as investments?

Simon Peters: From my point of view speaking to clients at eToro, most are investing for the long term as opposed to using crypto for their utility. But it will be interesting to see how recent moves from firms such as PayPal [which announced users can pay with and hold crypto] changes things. Payment provider Square is also involved in the space, whilst Visa and Mastercard have taken positive steps too. People are holding for the long term in my opinion, but the groundwork has been laid to see crypto used more for their original purposes.

Alex Roy: While our research suggests that consumers are primarily focused on crypto as an investment asset, this is a fast-paced sector and the changes we see are occurring at such a rate that something may move from an investment into a mainstream payments instrument. It moves at such a

pace that from a regulatory standpoint we're having to work hard to understand how consumers are using their crypto, and how much they understand what they are using.

Anthony Morrow: Judging from my social media channels and conversations with my children, then I would imagine around 95% of people do consider crypto as an investment, as opposed to a currency alternative.

Scott Chipolina: One of the biggest factors we have seen in the last 12 months is that crypto, and Bitcoin in particular, has managed to attract quite a large amount of institutional investment. Looking back to previous bull runs, such as the Christmas 2017 run, these movements in price have been retail driven. But the market has diversified since then. Tesla [at the time of writing] invested \$1.5bn into Bitcoin, while firms such as MicroStrategy and their CEO Michael Saylor have been firm advocates for Bitcoin. I think this has informed investment decisions and captured Bitcoin specifically as an investment asset for people too.

However more people are using crypto for real world use cases, and while people do predominantly view the asset class as an investment, there are others out there trying to take advantage of the real world uses for crypto and make it easy to use in everyday capacities.



ML: We mentioned some firms are looking to push people into using crypto for their intended purposes. Tesla, as an example, recently decided to accept Bitcoin for car purchases, and WeWork will accept Bitcoin for their services too. Are these firms doing this as a marketing ploy, or are they genuinely interested in using cryptoassets to pay for goods and services?

SC: From my personal perspective, I think that it would be naive to suggest there's no marketing angle behind those very public moves. But I also believe that these companies see Bitcoin's appeal as 'digital gold', and this is playing into the thought process behind some of these moves. Some of these firms may be looking to get ahead of the curve, and in a fiercely competitive financial world they've realised that Bitcoin may be the way to do that.

This institutional investment hasn't all happened at one time, but rather in a continuous wave. I believe the reason they've done this is because they have taken the view that crypto is a long-term asset for them to hold. What will be telling is what these firms do with this Bitcoin later. Will ►

ROUNTABLE ATTENDEES



Anthony Morrow

Anthony Morrow is founder of OpenMoney. Working as a consultant for financial giants such as KPMG and Deloitte gave Anthony a broad view of the industry landscape before co-founding Tatton Asset Management plc (formerly Paradigm Group). All this experience helped him identify the 'advice gap', which OpenMoney was created to address.



Simon Peters

Simon Peters is a cryptoasset analyst at eToro, with a detailed knowledge of crypto markets and the crypto industry. In his role at eToro, he also helps High Net Worth clients with their investments in cryptoassets. Simon has a degree from Brunel University London in Mechanical Engineering, and has a CFA UK Level 4 Certificate in Investment Management.



Alex Roy

Alex Roy leads the FCA's Consumer Investments Strategy. This joins up the work of the FCA developing a collective approach to financial advice, higher risk investments, redress and fraud within the consumer investments market. He also leads the policy department responsible for consumer investments, financial promotions, disclosure and our wider banking policy. He joined the FCA in 2014 and has been working in a variety of policy and strategy roles including leading the team developing the FCA's Mission. Alex started working life as an economist before moving to a policy focus at the Association of British Insurers.



Scott Chipolina

Scott Chipolina is an investigative journalist at Decrypt, a cryptoasset and blockchain news outlet. Scott has a background in regulation, having previously worked for the Gibraltar Financial Services Commission. Using his regulatory background, Scott has a keen focus on climate and green issues within the crypto and blockchain space.

OUR MRM CRYPTO SPECIALIST



Milo Larkin

Milo Larkin is consultant and head of crypto at MRM. Since joining MRM in 2017, Milo has worked with a number of investment, wealth manager, family office and crypto clients. He writes regular guides and opinion columns on crypto for personal finance blogzone Mouthy Money, and has subsequently delivered educational presentations on crypto and blockchain. In April 2021, Milo developed, organised and hosted the Future Finance roundtable on crypto in the financial services sector.

they continue to hold, or will they sell? That will really be telling on whether they think Bitcoin will be here to stay or they are just looking to benefit from Bitcoin being in a bit of a bubble. Ultimately it is interesting to see how these institutions are behaving, because that will have an influence on the consumer.

ML: We saw Tesla release their financial results and announced they subsequently had sold 10% of their Bitcoin, supposedly to test liquidity. What is your view on that?

SP: Given the events of last year and the amount of liquidity in the markets now, there is this increasing belief that Bitcoin could be seen as an inflation hedge, as protection against the depreciating dollar. But it could also be giving an option to the consumer too, as it will allow people to pay for products and services without having to convert back to dollars if they hold a large amount of crypto. These conversions can be as high as 4%. Giving consumers these options could make such a purchase a lot less expensive.

AM: What I found interesting was that recently in the US, Morgan Stanley and Goldman Sachs' private client houses were going to start introducing Bitcoin as a part of their clients' portfolios, but only for a very small percentage of the overall portfolio and only for customers with assets in excess of \$2 million.



The privacy and security features are going to be at the forefront of the UK Treasury and others' minds when they decide what they want to bring in and what they don't."

AR: I'm not an investment analyst, so it's up to you guys to decide whether it's a good investment or not. But from our perspective we think there's certainly some clear use cases, for example, on cross border payments, where crypto has a real potential benefit to the market and consumer, reducing the cost by taking out some of the middlemen that aren't required in the market.

I wanted to follow up on your point, Anthony, where Bitcoin forms part of a portfolio. That is different from individuals who do not have a diversified portfolio and are putting money in crypto they cannot afford to lose. It is not always clear what direction the market will go, as there isn't an underlying asset that sits behind it that gives you a sense of what it's really worth.

I think this creates a real challenge and I think the regulatory approach needs to be different where individuals are investing speculatively.

ML: We've discussed Bitcoin as an alternative payments system. In a similar vein, the Bank of England recently announced a consultation into a Central Bank Digital Currency, or CBDC. Do you think that we might see that people become more interested in crypto as a result of this consultation?

SC: I think inevitably there will be an increase in interest in cryptocurrencies whenever they read a headline about CBDCs in the UK, but it's important to distinguish between a CBDC and a cryptocurrency, with the latter being divorced from any central authority. The story of the UK looking at a CBDC is also interesting in a wider geopolitical context.

China is widely credited as leading the way on CBDCs, having begun in earnest in looking at them in 2014. Jerome Powell from the Federal Reserve said, 'it's better to be right than first.' I'm reminded of this phrase when thinking about the Bank of England and the UK's own ventures into CBDCs.

What I find particularly interesting is how governments deal with some of the potential risks that CBDCs present. We are all aware of some of the benefits to CBDCs in an ever-digitising economy. But there are also threats with regards to cybersecurity and potential stability issues that a government should be aware of before they dive headfirst into the concept of a CBDC.

Even though they are very different, I do think there will be a big jump in crypto interest whenever the UK does formally adopt a CBDC.

AM: China is clearly quite ahead of everyone else in adopting a CBDC, and I think largely that's to try and put some pressure on the dollar and usurp the US Dollar as the primary currency of the world.

Do you think that as governments develop their own [digital] currency, will that move one of the use cases for Bitcoin as its own currency?

SC: Potentially, I think it's very hard to speculate on the future as to where Bitcoin might sit. One of the biggest appeals of Bitcoin as a currency is that it appeals to people who have some ideological or political position that's very anti-state. We mentioned China's own CBDC, and while it is true that a very large chunk of the pie for China is to put pressure on the dollar, another chunk of the pie is that it enables a lot of financial surveillance and gives states some very handy tools to keep track of where the native currency is being spent, what it is being spent on and by whom it is being spent.

While Bitcoin is often based on a public ledger on the blockchain, some of those anonymising features that people know cryptocurrency for will persist. If CBDCs take off, not only in China but also in the UK, there will still be a place for cryptocurrencies. And not just Bitcoin, but privacy-oriented coins such as Zcash and Monero. People may turn to these cryptocurrencies if they feel that the more mainstream ones are not scratching their financial privacy itch.

AM: I think that the privacy side is where the pressure from regulation will come. The benefits of anonymous usage brings with it all the stories we hear about crypto's popularity on the darker side of the world because of those very characteristics.

If we do move into a world where crypto is regulated, then one would imagine a quid pro quo of regulation is that those privacy characteristics would no longer be available.

FOLLOW-UP QUESTIONS



Anthony Morrow is founder of OpenMoney

Q1: What theme or event do you think will most impact the crypto sector over the next 12 months?

By a wide margin, the key theme will be regulation. The FCA's recent commentary about its struggle to regulate crypto exchange Binance shows the huge challenge facing regulators.

Regulators have been struggling, and this in turn threatens crypto as a whole. If firms such as Binance continue to handle the threat of regulation with such a laissez-faire attitude, a strong reaction from the regulator could be an existential threat to the whole crypto sector.

Overbearing regulation, combined with governments developing their own CBDCs could act as a pincer movement on the crypto sector.

Q2: What recent move in the crypto space took you by surprise?

PayPal's recent decision to allow UK users to buy, sell and hold crypto feels like a watershed moment. Although they are only acting as a wallet, in and of itself a relatively low risk business move, it does signal another step into the mainstream.

We may see the threat of regulation affect decisions like this, however. If the inevitable regulation is all encompassing, firms that have ventured into crypto recently could end up beating a hasty retreat.

The threat of regulation looms large, and I can't see how a properly regulated crypto sector could exist in the shape and size that it does now, especially when taking into account the ideologies of both the creators and fans of some of the major cryptocurrencies.

AR: It's not clear right now what will be regulated. Once it's decided what is regulated, then it becomes a matter of discussion which parts will fall under the scope of regulation. But certainly, the privacy and security features are going to be at the forefront of the UK Treasury and others' minds when they decide what they want to bring in and what they don't.

ML: One of the consistent criticisms of Bitcoin and other proof of work protocol coins is that they are very energy intensive. What are your views on the energy intensity of Bitcoin, and do you think we're going to move towards more renewable sources used in mining? Will this energy intensity be a detriment to it as an investment asset given the continued focus on sustainability?

SP: The last Coinshares report on Bitcoin mining estimated that it is already using 70% renewable energy. I think there are two components to understand with Bitcoin mining electricity and consumption. You have the electricity consumption itself but also how that electricity is generated. If we have the majority of electricity generated from renewables does that mean consumption isn't an issue? You could always argue that the electricity could be better used elsewhere. Whilst Bitcoin is ultimately one of many cryptos that use proof of work, there are other algorithms and consensus mechanisms that are less energy intensive. I think the ecosystem as a whole will be moving towards a more efficient way of generating energy.

SC: I just want to push back slightly on the Coinshares point Simon. Yes, the report put the Bitcoin network's renewable energy share at 78%. From my perspective as a journalist covering Bitcoin mining and Bitcoin's envi- ►



FOLLOW-UP QUESTIONS



Simon Peters is a cryptoasset analyst at eToro

Q1: What theme or event do you think will most impact the crypto sector over the next 12 months?

There are a number of themes which I feel will be prominent over the next 12 months, it's difficult to pinpoint one exactly. Non-Fungible Tokens, mining energy consumption, cryptocurrency as legal tender, CBDCs, regulation KYC/AML (particularly centralised exchanges and stablecoins), cryptoassets as an inflation hedge given continued stimulus by central banks globally are the ones I'd say will be the main talking points.

Q2: What recent move in the crypto space took you by surprise?

I would probably say the news from Tesla - that they'd purchased \$1.5 billion worth of Bitcoin and that the company was accepting Bitcoin as payment. Expected from large institutional investors in the space and hedge funds etc, but a significant purchase from one of the most valuable companies listed on the NASDAQ caught me by surprise.



My only worry at the moment is that some of the marketing we are seeing around crypto could lead to people investing in the asset class when they really can't afford to."

ronmental impact more broadly, we have to be aware of where some of these reports are coming from. We need to understand whether some of these reports' authors have skin in the game with regards to downplaying Bitcoin's environmental impact. One other study that I've tended to use before is Cambridge University's own report on Bitcoin's total share of renewable energy, and they put the figure at a much lower 39%.

What we can look at which may help us peer behind the curtain a little more is a recent coal mine flood in China's Xinjiang region. The flood immediately sucked Bitcoin's hashrate [the difficulty at which miners can process transactions on the blockchain] down to levels not seen since November 2020. I think that proves, at least anecdotally, that Bitcoin is still largely dependent on fossil fuel energy.

I recently spoke with the president of Bitfarms, one of the largest Bitcoin mining operations in North America, and he told me that if it makes sense financially, there may be a future for them to pivot towards energy that's not renewable.

The Cambridge University study also has a report that says Bitcoin currently uses around 120-130 terawatt hours per year, which puts it on par with the consumption of Argentina, one of the top 30 most energy-intensive countries in the world. Naturally people will see that stat and their jaw will hit the floor, but it's important to contextualise such a figure to get an estimate to what percentage is consumed via fossil fuels and what is consumed via renewable energy. Only then can we estimate Bitcoin's carbon footprint and then that can equip us with the knowledge to be able to decide whether this energy usage is worth it.

ML: Let's return to crypto as an investment asset. We've seen a handful of larger investment companies look at Bitcoin, and some of them have included the cryptoasset in their multi-asset funds, an example being Ruffer Investment Management. We also have vehicles like the Greyscale Bitcoin Investment Trust which currently stands at an enormous \$36 billion [at the time of the discussion]. Do you think we will see Bitcoin or another crypto form a regular part of an investor's portfolio, in the same way that we see equities and bonds?

SP: In the conversations I have with my clients, many users on the eToro platform join for stocks and then diversify into crypto, or vice versa. I definitely think that investors' portfolios will be a mix of, crypto, equities and possibly fixed income in the future.

AM: I believe it will. As we've already highlighted, firms such as Goldman Sachs are starting to introduce crypto into their portfolios. You can certainly see that becoming a common event for investment advisors to do. I think the key point to make is that any crypto is being allocated at an appropriate level, and that customers for whom it is being allocated are fully aware of the risk that they're taking. Anything that brings with some diversionary behaviour should be encouraged, as well as anything that is innovative and moves the financial services sector into doing new things.

My only worry at the moment is that some of the marketing we are seeing around crypto could lead to people investing in the asset class when they really can't afford to.

AR: Just to build on Anthony's point, I think it's still early days, but given the direction of travel I believe it is



Photo by Executium on Unsplash

here to stay. The real key is, is it an investment? And if it is, who is being induced to invest in it? How much do they understand about the nature of the investment? How does it fit with their broader portfolio? But if they understand the investment and the risks associated, and have a suitable time horizon then I can see how it could form part of an investor's portfolio. You could draw comparisons with assets such as fine wine, which can form part of a sophisticated investor's portfolio, but might seem rather strange for your average retail investor.

The worry I have is that there is a perception with many retail investors that the market only moves one way and the size of returns available are substantially above the size of returns for real assets. I think this is a challenge.

We know that consumers aren't rational decision makers, and that they aren't normally sitting there weighing up all those risks and making informed decisions. It's therefore about how we then provide the information and put in place the right friction for consumers that actually helps them make better decisions, so that any investments they do make genuinely fit as part of their portfolio.

It's a real challenge. As a regulator we want to promote innovation, and help competition shape the market. But you have to make sure consumers understand what the choices they have and impact of decisions they take.

SC: I'm interested in delving a little bit more into the FCA's position here. The FCA published a bit of a warning on cryptoassets a few months back and one of the things highlighted is that some investors might not understand cryptoassets sufficiently to be able to invest in them safely.

What would satisfy you as the regulator that an investor understands cryptoassets sufficiently to be able to safely invest in them?

AR: Well, it's still early days. We do a lot of work on financial promotions and find promotions are difficult, irrespective of whether they're on a common asset that everyone's used to or a more niche asset like crypto which is emerging into market.

I think the problem we have with crypto is that the understanding on the technology that sits behind the assets, how the value is created and how it will move in the future is very uncertain for consumers.

We then look at what the disclosures are that are given to the customers. What do they see about these assets? What are they told about them? What are they told about likely returns? We've given out a lot of information, highlighting that the past is no guide to the future. Indeed, if we could forecast the future then we would all be a lot richer than we are today!

Ultimately, it's about getting across to the consumer the uncertainty that is involved in investing in cryptoassets, the pricing mechanisms, the technology behind the asset class and how it might sit in a portfolio.

We don't regulate crypto, so we haven't yet been put in a position where we have to actually think in that level of detail about precisely what information we'd expect consumers to be given. But we are aware of some of the practices we have seen on the market that would cause us concern, such as the inducements for consumers to invest and the messaging around the pricing. ►



I think the continuous news flow we're seeing now, which carries a series of messaging focusing on daily price increases and high returns, is often the sort of environment where we do see consumers begin to make mistakes that they later come to regret. And these types of investments for many consumers are ones they can't afford to lose.

For many of these people who are investing in crypto this is about retirement, or about saving for a house, as opposed to other investors who have a strong understanding of risk and large portfolios.

Therefore, we put out our consumer messaging to make clear to people that with these assets you can lose everything.

AM: At OpenMoney we are regulated and as such we fall under the existing financial promotions regulation, which means we have to talk in a certain way to promote our products. If we promoted in the way that some of the crypto companies are promoting their products, we wouldn't get away with it for long as some of Alex's colleagues would be waiting in our reception.

As Alex said, it's important that the people who are investing in crypto fully understand it, as a lot of these people aren't [professional] investors.

ML: We've discussed the importance of people understanding what they are investing in. I would be interested in hearing your opinions on how many people you think understand how US Treasuries work as an investment asset, for example. Perhaps an investor has a fund that holds Treasuries, at what point do we decide that investors need to have a deep understanding of various investment assets?

AR: It's an interesting point, as a fund investing across a range of Treasuries and other assets are a way of mitigating some of the risks of individual assets. But a concern for us is people who don't understand the market investing in a

single asset, without an understanding of what is behind it and don't have a diversified portfolio. These consumers would therefore be taking on much more risk than if they had invested through funds or other products.

Now that isn't to say that people don't invest in individual Treasuries, stocks or crypto. But it's important that we know who these customers are, and whether they know the risks associated with such investments and what their overall portfolios look like.

It's also important to know what these investors are investing for. If they're investing for a bit of fun and understand they understand they could lose it all, but it's something they want to do, then that's fine. But that's very different from someone who invests in crypto, or any other asset, believing that it has a guaranteed 20% return and will help them pay for their house.

ML: Let's move on to crypto as a competitor to financial services institutions. Bitcoin enables users to send money without a financial intermediary, whilst the Ethereum platform hosts a range of 'Decentralised Finance' services such as decentralised investment exchanges or direct lending. To what extent do you think that crypto poses a threat to financial services institutions?

SP: I personally don't see it as a threat, I think it's the next evolution of the financial services sector. Take sending money abroad for example, which can take an extended number of working days. Crypto can allow for instant sending and receiving of money. There are certain issues that we have in the current financial system that crypto can solve, and it's about transitioning to this next phase. That's what crypto and distributed ledger technology is there to do.

SC: I would agree with Simon. I don't think it needs to be painted as a threat to existing financial institutions. We've seen many institutions that have pre-dated crypto trying to



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Only recently has the crypto industry managed to turn some heads and prompt some of these big financial players to take notice.”

incorporate crypto into their business model. I think that that will continue to a high degree in the future.

There are some practical advantages that many pre-existing financial institutions will want to take advantage of if they see it as a viable option for their business model more generally.

The biggest challenge with crypto becoming more mainstream is public understanding. There are many facets of the wider crypto industry that are very complicated even for those in the sector. This is a battle that I think crypto will be fighting for a long time. Another challenge is the wide array of use cases. Crypto is only as applicable as it is useful for wider society. If any one of us as individuals have a major belief in the future of crypto and the future of finance being very crypto-oriented, that might be true for us and our subjective outlook on the world, but if the rest of the world doesn't follow in our opinion, then we are going to have a lot of crypto to spend. But as Alex has mentioned several times, it's still early days.

AR: The financial services sector has been innovating for centuries. I suspect crypto and distributed ledger technology are going to be very important for many aspects of financial services. In terms of the front line, I think it's a very simple equation: 'what is the value to the consumer, and what does the consumer want from this?' If what they want is a new asset that's a bit of speculation and a bit of fun, that's fine. But as Simon mentioned, there are also genuine use cases such as cross-border payments that reduce the cost of financial services to the consumer, help the consumer out, and provide a profit for the firms involved. We're looking at the business case for crypto – what value does crypto add? And from that perspective, I think crypto and the technology behind it can offer long term benefits to the market.

ML: We seem to be in agreement that crypto is here to stay. Banks such as BNY Mellon will be offering crypto services, whilst other financial institutions have been looking at rolling out Bitcoin funds, for example. Are these businesses now waking up to crypto?

SC: From my perspective, it goes back to the point I made earlier about the wave of crypto adoption we've seen over the past year. A lot of this adoption has been fuelled not only by institutional investments from firms such as Tesla and MicroStrategy, but also some significant developments in real world crypto use cases. For example, in November PayPal announced that it was going to allow US customers to transact and trade crypto, and in many ways that changed the game.

Big financial institutions always have their ears to the ground to find out what the next emerging technology is. I think these big entities have spotted that there has been a growth in crypto adoption and crypto awareness and use cases for the wider industry.

I think it's broadly a reaction to that. Crypto has clearly been around for a lot longer than the last 12 months, but I don't think that, until recently, any particular cryptoasset has said that it could be a mainstay in an investment portfolio or seriously provide an alternative to currency.

That's not to say it's a done deal by any means, but I think only recently has the crypto industry managed to turn some heads and prompt some of these big financial players to take notice. I think that we're seeing that pretty much every week. ►

AR: There are a range of regulated firms which are starting to shift their views on crypto. I don't think that's surprising. They have to find ways to use the technology that can benefit them and benefit their customers. The shift to having crypto in portfolios is about testing the market and making sure these firms are making sensible decisions that do benefit customers. I'd expect to see more use of crypto and distributed ledger technology over time, and I'd expect to see use cases for crypto that we may not even have thought about.

Currently, the FCA's role is limited given we don't regulate crypto, but our approach to firms and innovation is led by our own objectives, which is to promote competition in the interest of customers.

ML: We've discussed the FCA's warning at the start of the year that investors in crypto 'should be prepared to lose all their money.' Where do you think the balance lies in allowing consumers the freedom to invest in whichever assets they choose to, whilst also protecting consumers from themselves?

AR: It's a difficult question and always subject to a lively debate. Whilst we don't regulate crypto, from an FCA perspective it goes back to the basics of how we can think about the information we give customers to help them make good decisions.



Within the crypto sphere we see a fear of regulation because, at a very high level at least, regulation is an anathema to what crypto is supposed to be"

What we want are informed people who make choices that are in their long-term interest. In areas that we do regulate, in places we have rules that limit the proportion of a portfolio that certain consumers can invest in certain asset classes. This is because we have taken the view that for certain retail customers who are not sophisticated or high-net-worth investors the risk that they may put too much money in high-risk products and lose their savings is too great.

In other areas such as binary options we have actually banned the promotion and sale of them. For speculative illiquid securities we've banned the promotion of them to retail customers. We've taken a variety of different approaches, depending on the risks we've seen.

In terms of allowing investors to take risk, the starting point of the FCA has always been to allow them to do so and to allow them to have a wide variety of investments.

But in addition to this we look at how various products are promoted and the extent to which customers can mitigate the risk of individual assets in their portfolio. It is a complicated area to which I don't think there is a simple answer to.

SC: I think the wider discussion that governs this conversation is a political one, ultimately. Whether or not people are free to make their own financial decisions, essentially. Within the crypto sphere we see a fear of regulation because, at a very high level at least, regulation is an anathema to what crypto is supposed to be. Crypto is supposed to be divorced from the state, it's supposed to be decentralised, and it's supposed to put the onus on the buyer and the seller to make their own decisions with the total absence of a third party. With that in mind, regulation has negative connotations for a lot of people in crypto.

However there are others who believe that regulation serves as a legitimising factor for a lot of these business and assets, and without it they can't see crypto laying down its flag as being a mainstay in the wider world of financial services. I'm tempted to agree with that line of thought. But it's an interesting dynamic that we see in the crypto sphere, which is ultimately populated by a lot of libertarian thinking.

AM: It's a balance. There is a backdrop where it's widely recognised that financial literacy amongst the general public is at a very low level. We've been talking about funds for example, and a large portion of the public won't even know what a fund is. At OpenMoney we deal with either novice investors, or those who aren't investors at all because they have debts and very low levels of financial literacy. In fact, a staggering amount of people in this country have less than £100 in savings.

When we're talking about moving products into the mainstream and making them available for everyone, then there has to be some protection. It's great to say 'we want people to make informed decisions', but you have to manage their expectations. We see stories in newspapers almost every week of gloomy looking people who have seen something offering 10-12% return, invested their whole savings, and subsequently discovered that their investment wasn't covered and they have no recourse for getting that money back. That's the sad reality, and as long as those instances continue then consumer protection has to come ahead of consumer choice. Or at least the balance needs to become a bit more equal.

ML: Simon I want to bring you in here quickly. We've had discussions previously where you've highlighted that you accept regulation as it would be conducive to seeing more people use crypto for its intended purpose. Do you still feel that's the case?

SP: From my perspective and the conversations I have with clients on the eToro platform, regulation is very appealing, with the safeguarding aspects that regulation brings. There's obviously a fine balance between regulation and giving consumers freedom of choice. From a consumer's point of view they might be looking for freedom of choice... until it all goes wrong. But when we're dealing with consumers' own assets and money, it should probably lean slightly more towards the regulation side. This would protect both the consumers but also the companies involved in the crypto and blockchain space, which would give them the opportunities to innovate and push things forward.

FOLLOW-UP QUESTIONS



Milo Larkin is consultant and head of crypto at MRM

Q1: What theme or event do you think will most impact the crypto sector over the next 12 months?

The most important theme is going to be regulation, and how that affects both crypto businesses and innovation in the sector.

Crypto businesses listing publicly is also going to be one to watch. With public listings come additional responsibilities to regulators and individual investors, and it's going to be intriguing to see how this affects how crypto firms operate. Imagine Binance's share price movements if it was public!

Q2: What recent move in the crypto space took you by surprise?

I think the hype around NFTs this year was a bit of a shock. I wasn't surprised by the huge increase in interest in 2020, but for it to die down and subsequently resurge genuinely caught me off guard. And since that resurgence it's not yet subsided, and I'm interested in seeing where we're going to head next. Imagine if we saw NFTs as actual pieces of artwork, for example. Wait a minute...

ML: I started off this discussion highlighting the explosion of interest we've seen in Bitcoin and other cryptoassets. What do you think makes Bitcoin and crypto so appealing? Is it the potential for huge financial gains, or does it appeal because of its simplicity? Why do you think it's captured the imagination of so many people recently?

SP: I think there are a variety of things, as opposed to one aspect that makes it appealing. Of course, there is the upward price action we've seen in years gone by and that we've seen recently which is gaining more and more media attention.

But the anonymity of Bitcoin and the nature of its creation, with the mystique of who Satoshi Nakamoto, also contributes to why people may find Bitcoin interesting.

AR: To add to that, we're in a very low interest rate environment at the moment which is making many people look for ways to get higher returns. Put that together with very easy access to crypto and the broader online investment market exploding, meaning many people are seeing advertisements to invest alongside the widespread endorsement of crypto and you can see the appeal. With the higher returns we've seen, the increase in appeal doesn't surprise me at all. With our own research we have seen crypto take off among consumers.

For us, despite not regulating crypto, it's still concerning. These are still people's lives, so if the people getting involved are doing it for good reasons and understand the risks involved then that's fine. But it's worrying when you end up in a world where there is exuberance within a market that we've seen on many occasions in history, then we might see many more gloomy faces staring out at us from newspapers.

AM: I'm just grumpy because every time I think I'm going to have a go at crypto I've come to the conclusion that it's passed its peak!

SC: I'd agree with pretty much everything that's just been said. I think that over the last year, since we've seen Bitcoin jump to over \$55,000, what we see on the surface on

social media is that its biggest appeal has been its price volatility, or more precisely its upward trajectory.

I don't think there has been a decline in interest in the other aspects of Bitcoin, whether for privacy or political reasons, but I think over the last year people have been watching the upwards trajectory and have thought 'I want to get a slice of that pie'. Whether that be retail investors or the larger financial institutions such as BNY Mellon as we've already mentioned.

ML: Let's bring this discussion to a close. Warren Buffett famously once said 'investors should be fearful when people are greedy and greedy when people are fearful'. Should we be fearful right now?

SP: I think in fairness you always need to approach crypto with an element of caution. Even if things are looking positive in terms of price action, it only takes an event such as the recent drop in hashrate to change the complexion of the market going forward. Whilst the market may seem hunky-dory right now, anything can happen.

SC: In Coinbase's S1, ahead of its public listing, one of the risks that the firm highlighted going forward was negative media coverage of crypto, and the potential for that coverage to drive cryptoasset prices down.

And I think that's an important point to add to Simon's. We always have to exercise an element of caution when you're investing in these assets. To borrow one of Alex's phrases from earlier, the past is not a guide to the future.

AR: From our perspective, there are so many changes in the market with so many new firms entering and large businesses investing in crypto, this is a huge change in the investment area.

With these changes and the very high prices we're seeing at the moment, there is always the chance of a market correction. Anyone investing in crypto has to make sure they understand the risks and how it fits with their wider investments.

FUTURE FINANCE

This roundtable from MRM is the latest in a series known collectively as Future Finance. Whether it be investments, fintech, crypto, mortgages, pensions or any other area of finance, our aim is simple: to gather the industry's leading minds to discuss the future of their respective markets.

Crypto is a growing industry that will one day affect all aspects of financial services. With a whole range of sectors being disrupted by technological advancements, MRM will be at the forefront of these changes through the Future Finance series.

If you would like to discuss any of the themes in the above roundtable or hear more about MRM's work in the crypto space please get in touch with **Milo Larkin** at milo.larkin@mrm-london.com or **020 3326 9900**.



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