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| Committee(s) | |
| 1) Port Health & Environmental Services Committee 2) Economic Crime Board of the Police Committee 3) Safer City Partnership Strategy Group | 1) 6 March 2018 2) 27 April 2018 3) 31 May 2018 |
| Subject: Cryptocurrencies and the City of London | Public |
| Report of: Director of Markets & Consumer Protection | 1) For Decision |
| Report author: Steve Playle, Trading Standards Manager | 2) For information 3) For information |

Summary

Operation Broadway is a partnership approach to tackling the problem of investment fraud associated with the City of London that has been operating successfully since 2014. Fraudsters selling non-regulated investment products to consumers across the UK such as wine, diamonds, property bonds and car parking spaces want an association with addresses in the 'Square Mile' to give credibility to their marketing literature and sales pitches.

The latest trend with potential investment fraud is based around what are termed cryptocurrencies. The most well-known such cryptocurrency is called Bitcoin. The landscape with cryptocurrencies is changing on almost an hourly basis but the imagination of the nation has been captured by the prospect of making large sums of money through buying and selling in a relatively short period of time. To illustrate the point, during 2017, the price of one Bitcoin rose from £830 and peaked at £14,800 just before Christmas. The price has fallen back significantly since then. Since Autumn 2017, the media has been full of stories about cryptocurrencies.

Trading Standards believes that criminals will start to exploit the current cryptocurrency frenzy and seek to establish businesses that will defraud consumers and businesses of money. The concern is that, just like with binary options, these criminals will try and associate their fraudulent cryptocurrency businesses with the 'Square Mile'. For this reason, Trading Standards intend to undertake a piece of work and try and ensure that the reputation of the 'Square Mile' is protected as far as possible.

The purpose of this report is to inform Members about this important piece of work and seek Members' endorsement on the proposed way forward.

Recommendations

Members are asked to:

1. note the contents of this report; and
2. endorse the proposal for Trading Standards to take a proactive and innovative approach to dealing with a potential future problem.

Main Report

Background

1. Operation Broadway seeks to identify investment fraudsters as early as possible in their operational life cycle and disrupt their activities before they have had the chance to become fully established and defraud large numbers of consumers. Trading Standards works very closely with serviced offices and mail forwarding businesses (MFBs) to disrupt criminal activity and protect the reputation of the 'Square Mile'.
2. During 2017, Trading Standards identified issues with a large rogue element in the Binary Options sector and ran a project to identify any binary business that had a footprint within the 'Square Mile'. Out of around 120 such businesses identified, around 90 were found to be 'cybersquatting' and the remainder were visited during the highly successful, high profile Operation Mass in October.
3. Since then, the Financial Conduct Authority (FCA) have taken over responsibility from the Gambling Commission for the regulation of Binary Options and have continued this work, most recently naming and shaming on their website, a list of 90 or so Binary Options businesses right across the UK that have failed to register as required.
4. Investing money safely is one of the most important things that consumers can do. However, there are determined criminals who are dedicated to actively pursuing and persuading consumers to invest in schemes that, on the surface, appear to be great opportunities offering highly attractive rates of return.
5. The reality is that they are nothing but fraudulent scams that will result in consumers losing most, if not all, of their money. Cryptocurrencies are currently completely unregulated, being outside the remit of the FCA or the Bank of England. As a result, if cryptocurrencies are mis-sold, consumers have no recourse to the Financial Services Compensation Scheme and no route to the Financial Ombudsman Service.
6. To give an air of respectability to cryptocurrency scams, it is anticipated that these criminals will associate themselves with an address in the City of London by using the services of a MFB or by renting space from a serviced office provider. This prestigious City address is then used on web sites, in social media or in glossy brochures to help persuade victims that they are dealing with a seemingly reputable business, based in the 'Square Mile'.
7. Most people have now heard of cryptocurrencies but do not quite fully understand them but it is not the intention of this report to do that in any detail. However, cryptocurrencies are hot news now and the media is full of stories virtually every day¹. There are, at the time of writing this report in mid-February

1 BBC Panorama - "**Who Wants to be a Bitcoin Millionaire?**" - BBC One, 12 February, 20:30 - <http://www.bbc.co.uk/news/technology-43025787>

2018, around 3000 different types of cryptocurrency. The most well-known is called Bitcoin and anyone who purchased in 2013 would have seen their investment increase 100-fold by the end of 2017. Other popular cryptocurrencies are called Ethereum, Litecoin, Ripple and Monero.

8. Cryptocurrencies started back in 2008 when Bitcoin was created as a reaction to the banking crisis. Bitcoin is decentralised which means that there is no central bank anywhere in the world that controls it. The currency is entirely virtual and, more recently, it has been possible to use it to pay for goods and services from a small number of businesses. There is even a growing network of Bitcoin cash points where the currency can be purchased or Bitcoin code exchanged for cash. Cryptocurrencies are considered to have value because they are considered, rightly or wrongly, to be valuable. It is this public confidence in how valuable they are that causes the price to fluctuate.
9. In relation to traditional bank accounts, your bank has a record of all the names of its customers and how much money they have. With cryptocurrencies, there are multiple identical copies of that record with details of every transaction made available for all to see. This data has to be protected from those that might tamper with it and this is achieved by allowing people to act as the currency's bankers by earning rewards if they get their computers to verify transactions. This is called 'mining'. Once verified, each transaction is stored in blocks of data, called the 'blockchain'.
10. There are many ways that ordinary people can be drawn into the cryptocurrency frenzy. They may wish to acquire cryptocurrency by purchasing some from a dealer (known as a cryptocurrency platform) in exchange for cash, normally through payment via bank account transfer or by debit or credit card. The currency would then be stored in a digital wallet and the purchaser would then hope that the price rises so it can be sold for a profit.
11. Such transactions are completely unregulated, and anyone can set up a cryptocurrency platform. Another route into cryptocurrency is through betting on the price movements. This is called a 'contract for difference' (CFD) and the consumer does not actually acquire any of the currency but can speculate on the price rising or falling. Businesses engaged in CFDs need to be authorised and regulated by the Financial Conduct Authority, one of the partners of Operation Broadway. Another way for consumers to be involved is through investing in what is called an initial coin offering (ICO). This is similar to a traditional share offering but the product being offered is a new cryptocurrency and the issue is not regulated by anybody.
12. There are businesses involved in the cryptocurrency sector that are entirely reputable. There is one platform that is established in the City and meetings have already taken place between Trading Standards and its senior management.
13. However, Trading Standards are already aware of a trickle of complaints about other cryptocurrency businesses that clearly seem to have fraudulent intentions. Issues are also starting to be raised with the City of London Police

via Action Fraud. One of the simplest frauds that is likely to occur, based on our experience of the binary sector, is for a fraudulent cryptocurrency platform to offer to sell currencies, take the money and run.

14. There are several recent indicators that tend to show how potentially dangerous an investment in cryptocurrencies might be. In November 2017, the FCA issued a public warning about the risks of investing in cryptocurrency CFDs. Theresa May at the end of January 2018 said that Britain was looking “very seriously” at cryptocurrencies being used by criminals.
15. In February 2018, both Lloyds and Virgin banks said that they would stop their credit cards being used to purchase cryptocurrencies. Also in February 2018, Facebook has decided to ban Bitcoin and other cryptocurrency advertising and on 12 February 2018, Europol, the European Union Agency for Law Enforcement Cooperation, said it estimates that about 3-4% of the £100bn in illicit proceeds in Europe are laundered through cryptocurrencies.
16. Closer to home in the City, Jon Cunliffe, deputy governor for financial stability at the Bank of England, has said that Bitcoin is too small to pose a risk to the global economy. However, he warned that investors should “do their homework” before backing the currency.

What are Trading Standards planning to do?

17. Trading Standards has already started to compile a list of cryptocurrency businesses that have a footprint within the ‘Square Mile’. This is a very difficult task because the cryptocurrency landscape seems to be changing literally by the hour. So far, a list of around 40 possible businesses has been identified based on open source research. We are looking to work closely with Action Fraud and see what reports are being received from consumers who have concerns or complaints about other businesses based in the City.
18. Trading Standards Officers have wide ranging powers of entry that allows access to business premises without the need for a Magistrate’s warrant. The intention is to visit all the premises identified and find out exactly who is there. If a business is legitimately present, Trading Standards will consider their trading activity and take the opportunity to examine their trading terms and conditions for fairness. Marketing literature and websites can also be checked to ensure that they are not misleading.
19. Inevitably, as with the binary options sector, there will be a large number of businesses that are squatting at a City address. A visit will provide real evidence of a fraudulent claim of being associated with the ‘Square Mile’ and action can then be initiated to try and take down websites and deal with false information that is stored at Companies House.
20. There is a real opportunity for Trading Standards in the City of London to take a lead dealing with cryptocurrency businesses. We are very well placed to do this due to our Operation Broadway connections with the City of London Police and the Financial Conduct Authority. Ultimately, one potential outcome could

be the development of a code of practice for the legitimate cryptocurrency traders and this would give consumers confidence that they are dealing with a business that will treat them fairly. Clearly, the issues around the volatility of cryptocurrencies will always remain and consumers need to be made aware that this is a very high-risk investment.

21. Ultimately, Trading Standards believes that the Government will introduce a regulatory regime to cover the cryptocurrency sector. However, in the meantime, it is forward thinking, responsive and innovative for the Trading Standards Service to step into the current regulatory vacuum.

Corporate & Strategic Implications

22. The proposal by Trading Standards to carry out work in the cryptocurrency sector fits well with the City of London Corporation's strategic aim to protect the reputation of the Square Mile and also to be of benefit beyond its own boundaries and this is another opportunity to contribute positively to the economic well-being of consumers across the whole of the UK.

Conclusion

23. Trading Standards has identified the potential threats posed by cryptocurrencies. Whilst it is recognised that there will be entirely reputable businesses engaged in this sector, it is inevitable that a significant rogue element will attempt to jump on the bandwagon and try and exploit consumers right across the UK and also try and exploit the reputation of the Square Mile.

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