

Treasury Committee – Call for Evidence: The Crypto-Asset Industry

LINK's Response to the Treasury Committee's Call for Evidence on the Crypto-Asset Industry

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Introduction

1. Link Scheme Holdings Ltd (LINK) manages the UK's main cash dispenser (ATM) network and is central to the operation of the UK's cash infrastructure.
2. LINK's network connects the vast majority of ATMs (both free and charging) in the country and allows customers of banks and building societies (card issuers) that are LINK Members to make cash withdrawals and balance enquiries with their payment card at almost all ATMs. All major card issuers and ATM operators currently choose to become Members of LINK. This helps to ensure that consumers in the UK have the choice of using cash should they wish to.
3. Cash is in long term decline in the UK. Since the Government announced in March 2020 its intention to legislate to protect access to cash, that trend has accelerated as a result of COVID-19. Until the planned legislation is in force (likely in 2023), there are no requirements that give consumers the right to access cash (free or otherwise). LINK has therefore chosen to set itself the objective of ensuring that communities throughout the UK have satisfactory free access to cash while policymakers finalise a longer-term strategy.
4. Part of LINK's objective is to support the orderly transition of the UK from cash to digital payments. Hence, LINK is active in supporting digital transition and has a broad interest in the successful development of an inclusive digital payments approach, while ensuring access to cash remains available for consumers who remain reliant on cash for as long as possible.
5. LINK notes that crypto-assets (such as a sterling CBDC) may well play an important role in the future of retail digital payments and may replace elements of cash usage. LINK is therefore keen to ensure that policymakers are alert to the importance of following inclusive policies that ensure that all consumers can enjoy the benefits of digital payments.
6. LINK is regulated by the Payment Systems Regulator (PSR), and by the Bank of England as a systemically important payment system.
7. LINK works closely with the members of the Joint Authorities Cash Strategy (JACS) Group which is the Government's vehicle for developing a longer-term strategy.
8. LINK is also working with the industry's Access to Cash Action Group (CAG) to develop industry-led solutions while legislation is pending.

9. As part of that work, LINK has agreed to act as the “Co-ordinating Body” to support the retail banks in ensuring adequate provision of access to cash to communities across the UK. Further details of this initiative can be found on the UK Finance website¹. As part of this new commitment, LINK will independently review the impact of all changes to banking provision in communities. LINK will then commission new services where needed.

Executive Summary

(all definitions and references are in the main text)

10. There are currently some 10 million consumers reliant on cash and the rate of migration to digital alternatives is too low for this number to reduce sufficiently before lack of cash access becomes a serious problem.
11. Therefore, should the UK introduce a retail CBDC or “digital pound” with an effective inclusive design, this will give a valuable route to allow cash users to access digital payments should they need to.
12. This opportunity should be addressed as part of the design stage of a digital pound. A strategic approach that recognises the decline of cash, the introduction of a digital pound and the improvement of digital inclusion across the country would provide a safe “glide path” towards an end-goal of a financially inclusive digital society.
13. It may be that some aspects of an inclusive system will be best delivered through a collaborative industry approach. There are good examples of effective collaborative solutions such as basic bank accounts and the current approach to shared cash infrastructure (such as Shared Banking Hubs). Similar thinking should be extended into areas such as the provision of, for example, basic digital pound wallets available to all, and digital education (perhaps face-to-face via a high street shared bank facility or via local government locations) to support inclusive migration to digital services from cash.
14. In addition, with an appropriate balance of controls in place around privacy, LINK views the introduction of a digital pound as a potentially strong mechanism to restrict the proceeds of criminal acts while providing the law-abiding majority with the ability to hold and use digital currency in a manner similar to cash without dependence upon commercial banks or e-money institutions.
15. A key risk to highlight is that of operational resilience. Even in those parts of the country that are well served by existing infrastructure (power and digital communications), the storms experienced last winter left some communities without power or communications for several days. Digital payments (other than via offline deferred settlement) became impossible – a situation that was mitigated by the fact that most affected households held cash which local traders willingly accepted. Moving the clock forward several years to where a digital pound has been launched, cash usage has declined substantially and climate change means that Britain may be subject to more extremes of weather, it is likely that further investment will be required to strengthen the UK’s digital infrastructure.
16. The UK’s payment industry is about to go through a period of extensive change with Pay.UK’s development of a new retail payment architecture (NPA). It is envisaged that this new system will replace the majority of the functionality currently deployed through

¹ <https://www.ukfinance.org.uk/area-of-expertise/personal-finance/access-cash-action-group>.

the Faster Payments System (FPS) which handles the vast majority of consumer/SME same day payments in the UK. Pay.UK is also due to produce a plan in the coming months with regards to developing the future long-term strategy for BACS (which takes care of the majority of future dated payments such as direct debits and credits). For a future digital currency (either systemic stablecoin or CBDC) to be able to operate effectively within the UK, it will be essential that the country's payment systems are able to accommodate the use of such digital payment forms and that work should commence as soon as practically possible around the planning for this. To illustrate the requirement, a transaction should not fail if a party wishes to pay with a CBDC but the recipient wishes to receive traditional fiat currency. This is where both the UK payment systems and the banking infrastructure need to be aligned via relevant standards and rules to maximise the chance of payment success.

Related Publications and Consultations

17. LINK notes that, both prior to and since the Treasury Committee launched its Call for Evidence, a number of key related papers have been published:
 - a. HMT's consultation (31st May 2022) on Managing the failure of systemic Digital Settlement Asset (including stablecoin) firms².
 - b. The Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organisation of Securities Commission (IOSCO) guidance confirming the application of the Principles for Financial Market Infrastructures (PFMI) to systemically important Stablecoin arrangements (13th July 2022)³. *[The specific relevance to this Call for Evidence being that the PFMI form the basis of supervision by the Bank of England over the UK's payment system providers such as LINK and Pay.UK and other systemically important Financial Market Infrastructures (FMIs)⁴ which would likely also apply to systemic stablecoin operators following the proposed extension of the 2009 Banking Act.]*
 - c. The UK Government's draft Financial Services and Markets Bill (20th July 2022) where Schedule 6 covers Digital Settlement Assets⁵.
 - d. HMT's consultation on Payments Regulation and the Systemic Perimeter (22th July 2022)⁶.
 - e. The Law Commission's consultation (28th July 2022) on Digital Assets⁷.

Collectively, these documents provide substantive input into some of the themes raised in the Call for Evidence. We therefore presume the Committee will also be taking these into consideration as part of its inquiry.

LINK's Feedback on the Issues Raised in the Call for Evidence

² <https://www.gov.uk/government/consultations/managing-the-failure-of-systemic-digital-settlement-asset-including-stablecoin-firms>.

³ <https://www.bis.org/cpmi/publ/d206.pdf>.

⁴ <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>.

⁵ <https://bills.parliament.uk/bills/3326>.

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091941/Payments_Regulation_and_the_Systemic_Perimeter_-_Consultation_and_Call_for_Evidence.pdf.

⁷ <https://www.lawcom.gov.uk/law-commission-proposes-reforms-for-digital-assets-including-crypto-tokens-and-nfts/>.

To what extent are crypto-assets when used as digital currencies (such as Stablecoin) likely to replace traditional currencies?

18. LINK's view is that no crypto-asset (including a systemic stablecoin and/or a Central Bank Digital Currency (CBDC)) is likely to replace an existing fiat currency. However, the closer in design, safety and security that a crypto-asset gets to a "traditional" currency, the stronger the likelihood is that it could augment and sit alongside that currency at the mainstream level. Sir Jon Cunliffe's (Bank of England Deputy Governor for Financial Stability) recent speech on the so-called "crypto-winter"⁸ clearly highlights the risks associated with crypto-assets such as Bitcoin and Terra USD, which are not underpinned by both strong regulation and a strong and stable asset-base. For any crypto-asset to be acceptable and run in parallel with an existing currency, these two attributes must be met.

What opportunities and risks would the introduction of a Bank of England Digital Currency bring?

19. The Bank of England's publication (March 2022)⁹ of responses to its earlier discussion paper on CBDCs represents a good summary of the various themes which LINK will not repeat here. Instead, we shall limit ourselves to those areas where we believe LINK's input can add value to the Committee's inquiry.
20. The decline in cash usage in the United Kingdom is well known to the Treasury Committee and continues to feature extensively in the mainstream press. At the moment, cash is the only form of "central bank money" available to consumers. Should cash usage continue to decline, it is plausible that its use as a medium of exchange and store of value will eventually become minimal. This could happen within a 5–10-year period, should the pre-COVID decline of cash usage for payments of around 10% each year continue.
21. "Commercial bank money" or other forms of "e-money" will then be the sole viable form of medium of exchange and store of value. Commercial and technology developments means that provision of this money may not be restricted, as now, predominantly to banks. It may be that this does not matter, but there are implicit risks and challenges around customer acceptance [by these financial institutions] and deposit protection limits that arise.
22. Therefore, there may come a time when both the Bank of England (and other central banks) wish to enhance the public's ability directly to access "central bank money" both as a medium of exchange and as a store of wealth via a CBDC or "digital pound".
23. Should this be the case, then it will be vital that the design of the digital pound is inclusive. Otherwise, the people in the country who are unbanked and/or cash-dependent could experience significant challenge at the point that cash usage declines to a point of no-return. There are currently some 10 million consumers reliant on cash

⁸ . <https://www.bankofengland.co.uk/speech/2022/july/jon-cunliffe-speech-on-crypto-market-developments-at-the-british-high-commission-singapore>.

⁹ <https://www.bankofengland.co.uk/paper/2022/responses-to-the-bank-of-englands-discussion-paper-on-new-forms-of-digital-money>.

and the rate of migration to digital alternatives is too low for this number to reduce sufficiently before lack of cash access becomes a serious problem.¹⁰

24. A strategic approach that recognises the decline of cash, the introduction of a digital pound and the improvement of digital inclusion across the country would provide a safe “glide path” towards an end-goal of a financially inclusive digital society.
25. In addition to this inclusion opportunity, the anonymous nature of cash means it is often associated with the so-called “black economy” as well as with proceeds of crime (the latter also being true of certain crypto-assets). It is widely accepted that no CBDC/systemic regulated stablecoin can replicate the anonymity of cash given the digital trail that its usage would provide. However, with an appropriate balance of controls in place around privacy, we view the introduction of a digital pound as a potentially strong mechanism to restrict the proceeds of criminal acts while providing the law-abiding majority with the ability to hold and use digital currency in a manner similar to cash without dependence upon commercial banks or e-money institutions.
26. A key risk to highlight to the Committee is that of operational resilience. Even in those parts of the country that are well served by existing infrastructure (power and digital communications), the storms experienced last winter left some communities without power or communications for several days. Digital payments (other than via offline deferred settlement) became impossible – a situation that was mitigated by the fact that most affected households held cash which local traders willingly accepted. Moving the clock forward several years to where a digital pound has been launched, cash usage has declined substantially and climate change means that Britain may be subject to more extremes of weather, it is likely that further investment will be required to strengthen the UK’s digital infrastructure.

What impact could the use of crypto-assets have on social inclusion?

27. As highlighted above, there is the potential for crypto-assets to benefit social inclusion, particularly in the context of the ongoing decline in cash usage in the UK and the challenges that some consumers experience when attempting to set up bank or e-money accounts. However, the degree to which this takes place will likely be dependent upon whether it is a private or public sector arrangement. Private sector crypto-assets (which are profit-driven behind the scenes) are far less likely to be geared towards social inclusion (unless forced by regulation to do so) than a public-sector crypto-asset such as a CBDC. Similarly, we believe the associated widespread challenge of digital exclusion is less likely to be collectively addressed by individual private-sector arrangements than an integrated government/regulatory-led plan which interleaves with the population’s increasing dependence on digital payment mechanisms.
28. This issue should be addressed as part of the design stage. There are good examples of effective industry shared solutions such as basic bank accounts and the current approach to shared cash infrastructure that demonstrate how inclusive services can be developed. Similar thinking should be extended into areas such as the provision of basic digital pound wallets available to all, and digital education (perhaps face-to-face via a high street shared bank facility or local government locations) to support migration to digital services from cash.

¹⁰ [The cash census - RSA \(thersa.org\)](https://www.thersa.org/).

Are the Government and regulators suitably equipped to grasp the opportunities presented by crypto-assets, whilst at the same time mitigating against the risks?

29. Regulation has lagged behind the technical developments that have led to the international proliferation of crypto-assets. Over the past twelve months, there have been co-ordinated efforts between regulators (both domestic and international) to arrive at an approach that can formally recognise and regulate certain crypto-assets. The latest draft legislation published in the UK represents a significant step towards this with the proposed extension of the Banking Act and Electronic Money Regulations plus the new draft Financial Services and Markets Bill to regulate stablecoins and other digital settlement assets.

30. However, as was demonstrated by the recent collapse of Terra USD, certain forms of crypto-asset can be extremely volatile and are more representative of speculative investment than a stable monetary instrument and can therefore represent significant financial risk to uninformed consumers and businesses. While accepting the balance between competition and regulation, LINK believes that further work will be required from the regulatory community to define and determine how the risks that can arise from certain forms of crypto-assets can be best managed (or made publicly known) in order to minimise risk to the end-consumer. Some form of definition may be required to distinguish between those crypto-assets that are designed to be used for payment purposes (where stability at par to the existing fiat currency in that country should be an innate requirement), as opposed to other crypto-asset classes (including NFTs) which are perhaps more representative of other forms of “investable” asset which are not normally used as a medium of exchange.

What opportunities and risks could the use of crypto-assets—including Non-Fungible Tokens—pose for individuals, the economy, and the workings of both the public and private sectors?

31. In terms of opportunities, LINK believes that a well-regulated, nationally available and inclusive stablecoin or CBDC could represent a significant opportunity given declining cash usage (with, as stated above, a CBDC enabling the continuation of the ability for the general public to hold “central bank money”). A well-designed stablecoin/CBDC should enable consumers that are unbanked to be able to continue to transact in the absence of cash thereby protecting financial inclusion.

32. However, the nationwide use of crypto-assets carries with it an implicit requirement for digital inclusion. Alongside the decline of cash, an increase in crypto-asset usage without an associated programme aimed to improving digital inclusion could substantially increase the risk of financial exclusion to those who are currently cash dependent.

33. One additional risk that has been widely aired is that of commercial banks being disintermediated in the event of the introduction of a national CBDC. Putting aside the potential for commercial banks to be involved as part of the issuing CBDC infrastructure, LINK would draw attention to a recent speech¹¹ by an Executive Board member of the ECB which talked to a future euro digital currency being potentially limited to an amount commensurate to the current holdings of banknotes in circulation. A similar approach

¹¹ <https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220615-0b859eb8bc.en.html>.

here in the UK could mitigate risk to the commercial banking sector and therefore allay concerns with regards to financial stability in the wider economy.

How can distributed ledger technology be applied in the financial services sector?

34. LINK has no views with regards to the “how” in this question (which would be best answered by technology companies). We would, however, highlight that certain crypto applications (such as CBDCs) are agnostic as to whether they run on a centralised or distributed ledger (DLT) basis (a point highlighted in the Bank of England’s original discussion paper on CBDCs published in March 2020¹²). If implemented correctly, DLT can provide stronger resilience than traditional data centres (given each node on the distributed network processes and verifies every item). However, it should be noted that this does not provide protection against software bugs and defects (given these would proliferate equally given the software at each node would contain the same defect). Furthermore, for wider distributed networks, there is the question of data security at country level and how this can be maintained.

What work has the Government (and its associated bodies) done to understand, prepare for and, where relevant, encourage changes that may be brought about by increased adoption of crypto-assets?

35. While the Bank of England continues to consult extensively with industry with regards to the potential introduction of a CBDC, we are not aware of a parallel level of work being done within the wider UK payment system environment to accommodate either CBDCs or systemic stablecoins (should one be introduced). In order for a digital asset to be acceptable as a payment medium, the end-to-end payment chain (from issuing party through to end merchant acceptance) needs to be in a position to accommodate fungibility between digital currency and fiat currency. Such interoperability will be essential (particularly during the early transition phase) for a digital currency to operate effectively. To illustrate this, a transaction should not fail if a party wishes to pay with a CBDC but the recipient wishes to receive traditional fiat currency. This is where both the UK payment systems and the banking infrastructure need to be aligned via relevant standards and rules to maximise the chance of payment success.
36. The UK’s payment industry is about to go through a period of extensive change with Pay.UK’s development of a new retail payment architecture (NPA)¹³. It is envisaged that this new system will replace the majority of the functionality currently deployed through the Faster Payments System (FPS) which handles the vast majority of consumer/SME same day payments in the UK. Pay.UK is also due to produce a plan in the coming months with regards to developing the future long-term strategy for BACS¹⁴ (which takes care of the majority of future dated payments such as direct debits and credits). For a future digital currency (either systemic stablecoin or CBDC) to be able to operate effectively within the UK, it will be essential that the country’s payment systems are able to accommodate the use of such digital payment forms and that work should commence as soon as practically possible around the planning for this.

¹² <https://www.bankofengland.co.uk/paper/2020/central-bank-digital-currency-opportunities-challenges-and-design-discussion-paper>.

¹³ <https://www.wearepay.uk/programmes/new-payments-architecture-programme/>.

¹⁴ <https://www.psr.org.uk/publications/general/specific-direction-2/>.

How might the Government's processes – for instance the tax system - adapt should crypto-assets be adopted more widely?

37. LINK has no view on this question.

How effective have the regulatory measures introduced by the Government - for instance around advertising and money laundering - been in increasing consumer protection around crypto-assets?

38. While progress has been made in recent months, more will be required in this area (particularly around the differentiation between crypto-asset classes, the differing risks that can arise from these and, consequently, the differing levels of regulatory engagement and public awareness required around them).

Is the Government striking the right balance between regulating crypto-assets to provide adequate protection for consumers and businesses and not stifling innovation?

39. See our answer above.

Could regulation benefit crypto-asset start-ups by improving consumer trust and resilience?

40. LINK has no view on this question.

How are Governments and regulators in other countries approaching crypto-assets, and what lessons can the UK learn from overseas?

41. LINK has no view on this question.

The environmental and resource intensity of using crypto-asset technology.

42. While LINK is not aware of any detailed studies in this area, the OMFIF¹⁵ has already pointed to the potential environmental benefit of a CBDC vs cash. Bank notes are costly to produce and transport in energy terms (coin more so) but then carry zero energy costs when they are stored. ATMs are energy intensive to build and require energy expended to keep them replenished and operational. While a CBDC will continue to use energy all the time it is stored (similar if not identical to the energy costs of running computers at commercial banks to keep track of customer balances) and for consumers to transact electronically, it is arguable that these costs will be less in the long term for a well-designed approach.

43. For example, a ledger-based (centralised or decentralised) CBDC/Stablecoin should be far less energy intensive than some of the other forms of crypto-asset (such as bitcoin) that use extremely energy intensive mechanisms for new coins to be “mined” and validated via the consensus mechanisms on their respective blockchains.

¹⁵ [CBDC standards needed for wide-spread adoption - OMFIF.](#)