

Virtual currencies and the regulatory environment

A look around the globe

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Virtual currencies and the regulatory environment: a look around the globe

Today's discussion

- What is cryptocurrency?
- Major regulatory issues and key differences from around the globe:
 - EU developments
 - UK developments
 - US developments

Cryptocurrency 101

Why do people care about virtual currency?

— Built on blockchain

- Blockchain was a genuinely new invention, with potential to solve some hard problems in a new way without centralized authority or control
- Distributed ledger technology or DLT
- Many use cases and applications beyond virtual currency

— New asset class

- Virtual currency is being viewed as a new speculative asset class
- Can be used to diversify portfolio, seen as having low correlation to other asset classes
- Value based on usability, low processing costs, scarcity
- Maturing and evolving market
- Highly volatile
- Each currency has different features/characteristics

Jargon dictionary

- Virtual currency vs. digital asset
- **Wallet:** software for storing keys and facilitating transactions
- **Private key:** secret code that proves ownership and grants control over an address
- **Block:** group of transactions processed and confirmed by the network
- **Network:** network of computers that process and validate transactions
- **Mining:** process by which transactions are processed and validated, and new bitcoin (BTC) is minted
- On-chain vs. off-chain
- **Smart contract:** automation for blockchain; neither smart, nor a contract

Bitcoin vs. Blockchain

What is the difference?

Bitcoin

- The first “cryptocurrency”
- A distributed electronic payment system that does not rely on central banks or other counterparties
- Enables global peer-to-peer payment with no single central depository or processor
- Powered by the first-ever blockchain

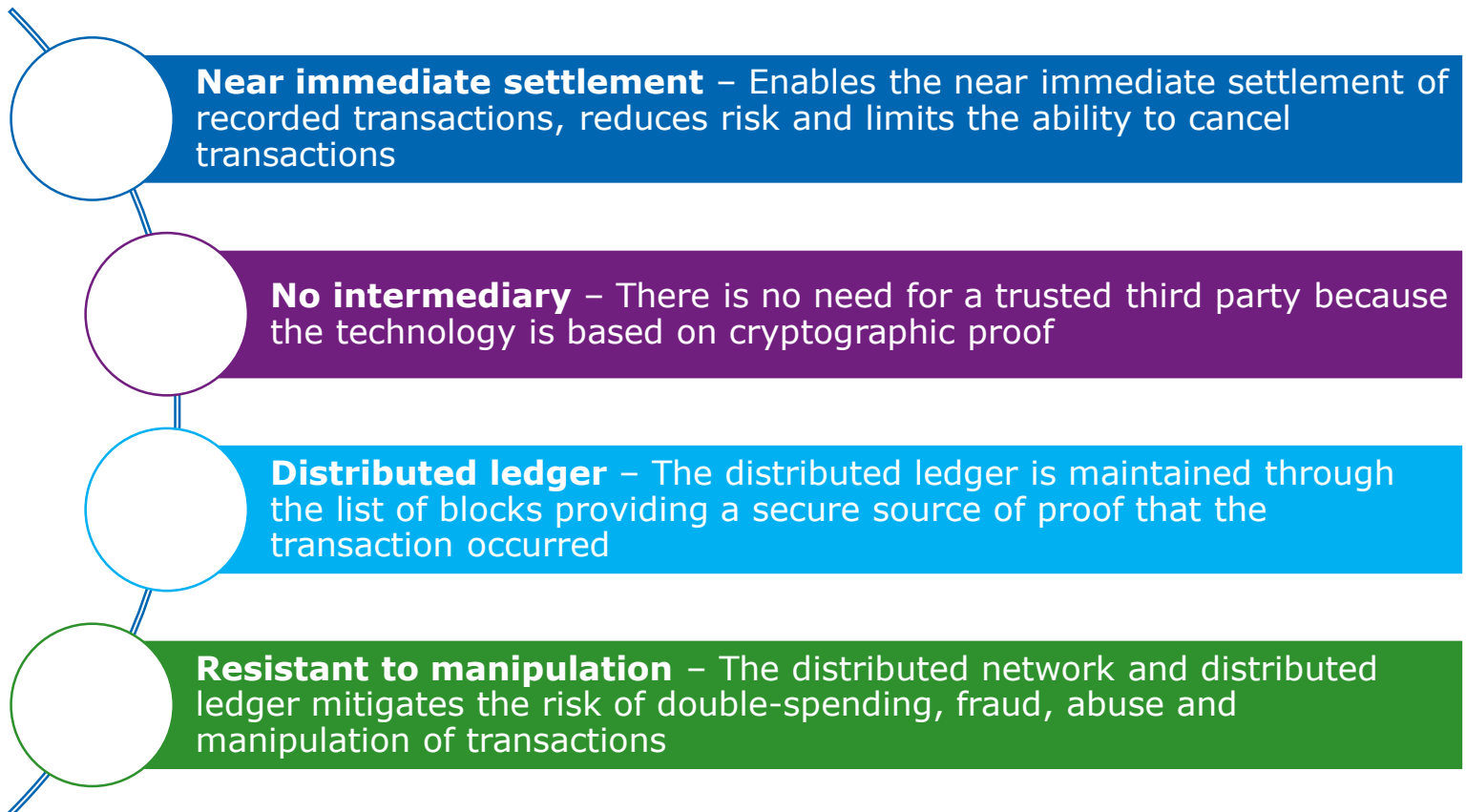
Blockchain

- The technology underlying bitcoin and many other projects
- A new system to arrange, process, store, and share information electronically
- Leverages existing and widely used cryptography
- Just one kind of “distributed ledger technology”

Blockchain

Capabilities

Blockchain is a digital ledger system for recording business transactions and events



Cryptocurrency payments in Europe

Regulatory implications and AML requirements

Cryptocurrencies, stablecoins and e-money coins

- The regulatory implementations may vary due to the respective classifications of **cryptocurrencies**:
 - e.g. Bitcoin, Ether
 - Stablecoins: e.g. USD Coin, Paxos, Tether, DAI
 - E-Money coins: Fiat-backed stablecoins may qualify as e-money
 - In none of the EU27 countries is it prohibited to accept payments in cryptocurrency currencies, stablecoins or e-money coins as a consideration for a service
 - Fiat-backed stablecoins may qualify as e-money under certain conditions. Acceptance of e-money as a payment is, however, not regulated
 - In the event that e-money coins are transferred from a payer to a payee via a third party, such a third party may require a license as a payment service provider. Reception of e-money from such a third party does, however, not require a license
- ➔ There is no license requirement for just accepting cryptocurrencies, stablecoins or e-money coins as a means of payment

How do you store cryptocurrencies?

Things to consider...

Decisions to make:

- How to store cryptoassets:
 - Through a crypto custody provider (at an exchange or a crypto custodian);
 - Implement a self-custody solution for each cryptocurrency
- Crypto custody provider due diligence:
 - Proper Anti-Money Laundering (AML) compliance management
 - Licensed crypto custody provider
- In case of self custody: wallet screening

How do you implement proper risk management with regard to AML requirements?

Things to consider...

- Crypto exchanges and custodial wallet providers are subject to AMLD5
- Corporations should implement proper risk management as there are reputational risks, criminal law provisions etc. to be taken into account (incriminated cryptocurrencies)
 - Detection of incriminated coins by engaging AML service providers (e.g. Coinfirm, Chainalysis, CipherTrace)
 - Tracking mechanisms of transactions from hosted to hosted wallets, hosted to unhosted wallets, unhosted to unhosted wallets

Further points to consider...

- Reception of payments in cryptocurrencies or Fiat?
 - Conversion risk
 - Third party acceptance of payments in cryptocurrencies
 - Participation in market developments and generation of other crypto income streams (e.g. lending and staking opportunities)
- Tax implications
 - VAT treatment
 - Booking in the annual financial statement

EU Member States that require a license/registration for crypto exchanges

EU MS that require a license/registration	EU MS that <i>do not</i> require a license/registration
Austria, Belgium, Croatia, Cyprus, Czech Republic, Estonia, Finland, France, Germany, Greece, Gibraltar, Ireland, Latvia, Luxembourg, Poland, Romania, Slovakia, Slovenia	Bulgaria, Italy, Lithuania, The Netherlands, Portugal, (UK)

UK developments

UK regulatory developments

- AMLD5
- MiCA will not apply
- Cryptoassets Taskforce report (HMT, FCA and BoE) and subsequent reports on consumer usage
- FCA CP19/22 and PS20/10 – investment products that reference cryptoassets and retail clients
- FCA CP19/3 and PS19/22 – guidance on cryptoassets
- HMT consultation and call for evidence on UK regulatory approach to cryptoassets and stablecoins
- CBDC

US crypto developments

US Federal securities regulation of cryptocurrencies

- **Securities and Exchange Commission (SEC):** May qualify as securities under the Securities Act of 1933
 - Virtual currencies or tokens constitute a security to the extent they meet the Howey Test as to what qualifies as an investment contract
 - Investment of money
 - Common enterprise
 - Reasonable expectation of profits
 - Derived from efforts of others
 - Companies buying and selling these assets may be regulated as securities broker/dealers and exchanges
 - Investment companies holding cryptocurrencies may be subject to registration as a 1933 Act fund or 1940 Act fund
 - Crypto ETFs vs. 40-Act crypto futures contract ETFs
 - SEC request for comment regarding custody of digital asset securities

- **FINRA**
 - Regulatory Notice 21-25
 - CMA approval
 - OBA and PST rules

US Anti-Money Laundering Regulation of Cryptocurrencies

- FinCEN
 - AML Act of 2020
 - Federal regulation as a “financial institution”
 - KYC/CIP
- OFAC
 - Money laundering and OFAC sanctions
 - Be aware that OFAC sanctions apply to all US persons
 - Prohibited from doing business with foreign nationals who are on the Specially Designated Nationals and Blocked Entities List published by OFAC
 - Violations can result in civil and criminal penalties
- State money transmitter licensing requirements

State laws on blockchain and virtual currencies

Some states have passed laws or regulations referencing blockchain

- **Arizona:** first regulatory sandbox for Fintech/blockchain firms
- **Delaware:** passed a law allowing Delaware corporations to track stockholders and outstanding stock through blockchain
- **New York:** “bitlicense” requires licensing of entities engaged in “virtual currency business activity”
- **Tennessee:** records on blockchain are electronic records; signatures on blockchain are e-signatures; and smart contracts are valid contracts
- **Vermont:** authorizes “blockchain-based limited liability company” or BLLLC
- **Wyoming:** permits corporate records to be kept on blockchain, including voting of shares on blockchain; also exempt from some state securities laws
- **State Money Transmitter Licenses:** e.g. Texas Department of Banking – Supervisory Memorandum 1037



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