

3x3 FinTech lecture series

Inaugural event

BITCOIN AND REGULATION

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Uni.lu

FinTech

FinTech = Finance & Technology

Two trends:

- compete with banks
- provide services to banks



Examples

- Payments
- Compliance solutions (Risk, AML)
- Crowdfunding
- Lending
- Correspondant banking system
- Smart contracts
- Transfer of value (ownership)

TODAY: BITCOIN AND REGULATION

I. Why regulate

II. How to regulate

III. How to apply regulation

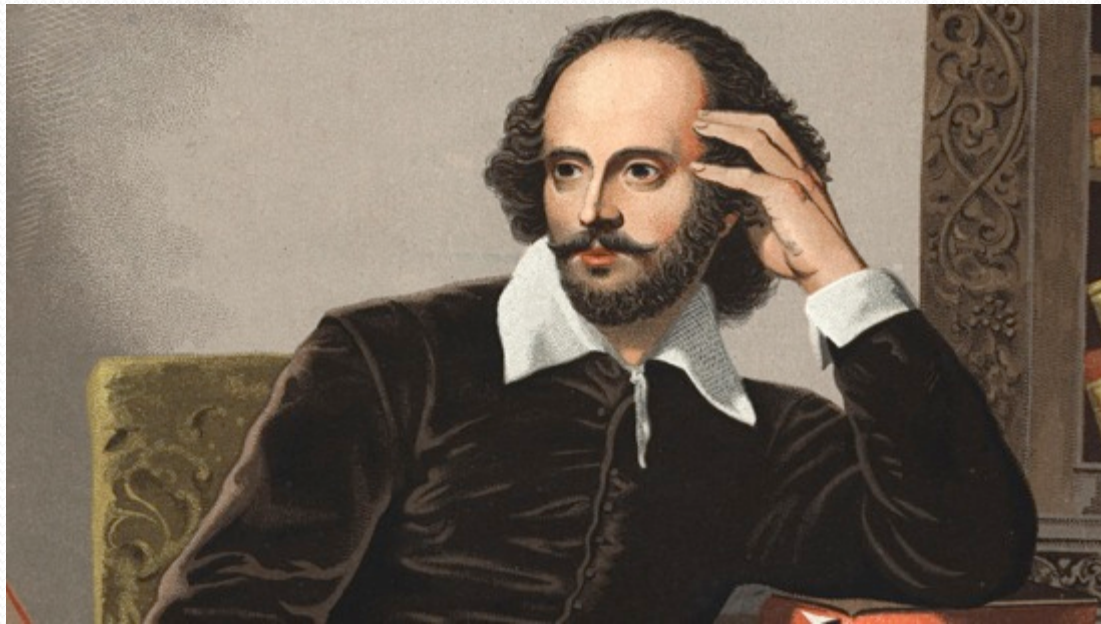
IV. A little note on tax

V. Developments at EU level

VI. What's next?



To regulate or not to regulate ?



William Shakespeare

Photograph: Leemage/Getty Images/Universal Images Group

Will Regulation Dictate the Location of the World's Bitcoin Hub?

Jean-Louis Schiltz | Published on August 9, 2015 at 15:00 GMT

OPINION

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Jean-Louis Schiltz is a guest professor at the University of Luxembourg and legal advisor to several virtual currency companies (since his first involvement with bitcoin through MIT Media Lab). He is also a former Cabinet minister in Luxembourg. In this article, he examines whether it is possible for one place to emerge as the world's bitcoin hub and whether regulation will have a hand in this.



Bitcoin and its regulation have been hot topics in and around the financial industry for some time now.

I. Why regulate

=> Some advantages of regulation



Some advantages of regulation

➤ Predictable framework



Some advantages of regulation

➤ Partners like (banking partners f. ex.)



Some advantages of regulation

➤ Consumer protection



Some advantages of regulation

➤ Mitigate risks



Example of risk mitigation: AML / CTF risk !

- **Apply AML / CTF rules of financial sector**



II. How to regulate

=> Apply existing rules or invent new ones?

=> Luxembourg: PI / EMI

=> France-Japon



Apply existing rules or invent new ones?

- Existing rules are more predictable
- Huge advantage: « passporting » = one license for 28 countries and half a billion potential consumers



Luxembourg: Regulatory approach

Commission de Surveillance du Secteur Financier

COMMUNIQUE

VIRTUAL CURRENCIES

The financial sector regulators are increasingly confronted with the phenomenon of virtual currencies. At the level of the European Union, the supervisory authorities EBA and ESMA deal with this subject.

At this stage, as regards the situation in Luxembourg, the CSSF deems it useful to provide the following answers to the most frequently asked questions of general nature.

a) On the one hand, "virtual" currencies are considered as money, since they are accepted as a means of payment of goods and services by a sufficiently large group of people.

More specifically, they are scriptural money as opposed to cash in the form of banknotes and coins. The scriptural nature does not require a tangible writing, similarly to electronic documents or signatures that do not require paper. Virtual currencies may thus be electronic money, but not necessarily within the meaning of the European Directive 2009/110 which provides for a definition of electronic money limited to its own scope.

The issuing of virtual currencies is not regulated from a monetary point of view. The methods for its issuing and the definition of its relation with other monies may vary from one type of virtual currency to another. Virtual currencies are obviously not legal tender and they entail risks for their holders. These risks were subject to a public warning issued by the EBA and ESMA.

b) On the other hand, the CSSF reminds that nobody can be established in Luxembourg to carry out an activity of the financial sector without an authorisation by the Minister of Finance and without being subject to the prudential supervision of the CSSF (Article 14 of the law of 5 April 1993 on the financial sector).

Therefore, the potential interested persons who would like to establish themselves in Luxembourg in order to carry out an activity of the financial sector (as, for instance, the issuing of means of payments in the form of virtual or other currencies, the provision of payment services using virtual or other currencies, the creation of a market (platform) to trade virtual or other currencies) shall define their business purpose and their activity in a sufficiently concrete and precise manner to allow the CSSF to determine for which status they need to receive the ministerial authorisation.

Luxembourg, 14 February 2014

Luxembourg: Regulatory approach

« virtual » currencies are considered as money



Luxembourg: Regulatory approach

The issuing of virtual currencies is not regulated from a monetary point of view.



Luxembourg: Regulatory approach

The CSSF reminds that nobody can be established in Luxembourg to carry out an activity of the financial sector without an authorisation



Luxembourg: Regulatory approach

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**CSSF's press release « Virtual currencies »,
Luxembourg, 14 February 2014.**

Luxembourg: Regulatory approach

Licenses

Payment services provider

« Authorisation requirement » , Article 6 of the Law of 10 November 2009 on payment services :

No person may provide payment services as a payment institution without holding a written authorisation by the Minister responsible for the CSSF

Electronic money institution

« Authorisation requirement » , Article 24-2 of the Law of 10 November 2009 on payment services :

No person may issue electronic money without holding a written authorisation by the Minister responsible for the CSSF.

Luxembourg: Regulatory approach Licenses

➤ *La constitution des établissements de monnaie électronique dans un contexte européen et luxembourgeois*, J.- L. Schiltz, Recueil ALJB, 2014.

5

La constitution des établissements de monnaie électronique dans un contexte européen et luxembourgeois

Jean-Louis SCHILTZ

Avocat à la Cour

Professeur invité à l'Université de Luxembourg

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Other regulatory approaches

Examples of France and Japan



France

Position de l'ACPR*, 29 janvier 2014 :

L'activité d'intermédiation consistant à recevoir des fonds de l'acheteur de Bitcoins pour les transférer au vendeur de Bitcoins relève de la fourniture de services de paiement.

➤ agrément de prestataire de services de paiement



*Autorité de contrôle prudentiel et de résolution

France

AMF*:



Les crypto-monnaies sont « *des monnaies non régulées et numériques, émises et contrôlées par ses développeurs et utilisées et acceptées par les membres des communautés virtuelles.* »

- ne peuvent pas entrer dans le champ d'application des réglementations connues
- propose comme piste de définir le bitcoin comme «*bien divers*»

* Autorité des marchés financiers

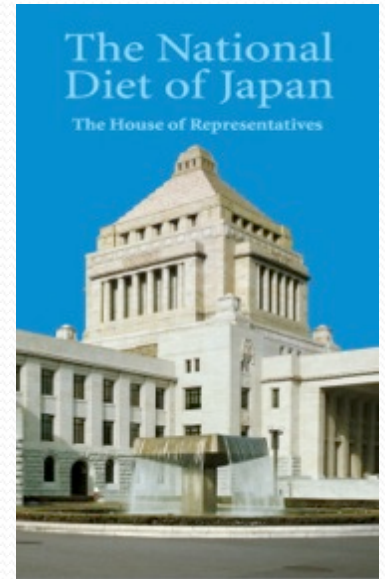
France



Rapport de la Commission des finances du Sénat, 15 février 2014:

« L'attention accordée presque exclusivement aux risques revient à ignorer les multiples opportunités qu'ouvrent les monnaies virtuelles. Ce n'est pas parce qu'une innovation vient mettre au défi nos conceptions traditionnelles de l'économie et de la souveraineté qu'il faut les rejeter en bloc, d'autant qu'il serait très difficile d'empêcher les particuliers d'en faire usage sur les plateformes offshore, hébergés à l'étranger. »

Japan



Diet: a bill passed on May 25th 2016 mandates the regulation of bitcoin and virtual currency exchanges by the Financial Services Agency (FSA) in Japan.

Details to be worked out – entry into force in 1 year

III. How to apply regulation?

- => Risk mitigation (in general)
- => AML/CTF rules
- => Customer protection
- => Capital base and own funds
- => IT (?)



Risk mitigation in general

- > Risk policy
- > Risk procedures



(cf. EBA–risk paper: to follow)



AML / CTF

➤ Recent report of a EU-Treasury

- *The money laundering risk associated with digital currencies is low.*
 - *Intelligence drawn from a limited number of recent cases indicates there is criminal use of digital currencies predominantly on the online market-place for the sale and purchase of illicit goods and services. [i.e. firearms and drugs]*
- => AML / CTF rules of the financial sector enable to mitigate these risks**

AML / CTF

- non face-to-face
- risk based approach: f. ex. low amount exception for B to C solutions
- tracking on the blockchain = easy
- camera onboarding



Customer protection

➤ Consumer (customer) protection



Customer protection

Examples:

- transparency on charges (art.79 2009 EMI/PI law)
- consent in the form agreed (art. 81 2009 EMI/PI law)
- rules re. unauthorized transactions (art. 85 2009 EMI/PI law)
- liability and refunds (art.87-90 2009 EMI/PI law)

Capital base and own funds



Capital base and own funds

Own funds methods A – B – C – D
(2009 EMI/PI law)

Capital base: 600.000 / 1.000.000.



IT

IT Systems & Security + virtual currencies

Start ups and a banking type IT

- Control
- Segregation

Cloud?





IV. A little note on tax



A little note on tax

Tax + virtual currencies

- VC = money -> No (direct) tax
- VC \neq money -> tax
- VAT -> CJEU - case



V. Developments at EU level

=> EBA

=> EU-Council

=> EU-Commission

=> AMLD 4

=> EU-Parliament



European Union (1)

04.07.2014



➤ (1) EBA opinion on virtual currencies, 4 July 2014:

- aims at a comprehensive regulatory regime
- focus on risks and disadvantages
- but ok for banks to maintain accounts for virtual currency actors



European Union (1)

04.07.2014

- *Until a comprehensive regulatory regime is developed, (if it is developed at all) (...) the EBA recommends that national supervisory authorities discourage credit institutions, payment institutions, and e-money institutions from buying, holding or selling VCs, thereby 'shielding' regulated financial services from VCs (§177)*
- *The EBA also recommends that EU legislators consider declaring virtual currency exchanges as 'obliged entities' that must comply with anti-money laundering and counter terrorist financing requirements set out in the EU Anti Money Laundering Directive (§178)*
- *Other things being equal, this immediate response will allow VC schemes to innovate and develop outside of the financial services sector, including the development of solutions that would satisfy regulatory demands of the kind specified above. The immediate response would also still allow financial institutions to maintain, for example, a current account relationship with businesses active in the field of VCs (§181)*

European Union (2)

20.11.2015

- (2) Council of the European Union and the Member States:
- Virtual currencies should be subject to AML/CTF regulations



European Union (2)

20.11.2015

Conclusions of the Council of the European Union and the Member States meeting within the Council on Counter-Terrorism, 20 November 2015:

8. The Council:



a) invites the Commission to present proposals to strengthen, harmonise and improve the powers of, and the cooperation between Financial Intelligence Units (FIU's), notably through the proper embedment of the FIU.net network for information exchange in Europol, and ensure their fast access to necessary information, in order to enhance the effectiveness and efficiency of the fight against money laundering and terrorist financing in conformity with Financial Action Task Force (FATF) recommendations, to strengthen controls of non-banking payment methods such as electronic/anonymous payments, money remittances, cash-carriers, virtual currencies, transfers of gold or precious metals and pre-paid cards in line with the risk they present and to curb more effectively the illicit trade in cultural goods,

European Union (3)

02.02.2016

➤ (3) European Commission:

- address AML/CTF questions -> AMLD 4
- also in favour of applying PSDs to VC actors (platforms in particular)





European Union (3)

02.02.2016

EU, Communication from the Commission to the European Parliament and the Council on an action Action Plan for strengthening the fight against terrorist financing, COM(2016) 50 final, 2.2.2016:

- Innovation in financial services and technological change, for all its benefits, creates new opportunities which may sometimes be abused to conceal terrorist financing. New financial tools such as virtual currencies create new challenges in terms of combatting terrorist financing. Highly versatile criminals are quick to switch to new channels if existing ones become too risky. For innovative financial tools, it is critical to be able to manage the risks relating to their anonymity, such as for virtual currencies. Critical to this question is less the forms of payment themselves, but rather whether they can be used anonymously. For this reason, the Commission has already started to carry out periodic assessments of known but also emerging risks related to money laundering and terrorist financing. This work allows the EU to continuously assess and mitigate emerging risks which affect the internal market, but also the EU's security (see point 1 - Preventing the movement of funds and identifying terrorist funding)*

As regards virtual currency exchange platforms, the European Commission states that:

- Virtual currency exchange platforms: There is a risk that virtual currency transfers may be used by terrorist organisations to conceal transfers, as transactions with virtual currencies are recorded, but there is no reporting mechanism equivalent to that found in the mainstream banking system to identify suspicious activity. Virtual currencies are currently not regulated at EU level. As a first step the Commission will propose to bring anonymous currency exchanges under the control of competent authorities by extending the scope of the AMLD to include virtual currency exchange platforms, and have them supervised under Anti-Money Laundering / countering terrorist financing legislation at national level. In addition, applying the licensing and supervision rules of the Payment Services Directive (PSD) to virtual currency exchange platforms would promote a better control and understanding of the market.*

European Union (4)

12.02.2016

➤ (4) Council of the European Union:

- endorses the Commission's action plan
- calls for rapid action



The Council of the European Union in its press release of 12 February 2016 states that:

The Council: (...)

3. *WELCOMES the Commission's Action Plan to strengthen the fight against the financing of terrorism of 2 February 2016, which takes into account responses of Member States to a Commission's questionnaire and contains both legislative and non-legislative actions and initiatives, which should be implemented in full respect of the Treaties;*
4. *UNDERLINES: the importance of achieving rapid progress on legislative actions identified by the Commission, in particular in, but not limited to: the field of virtual currencies, (...).*

(Press Release 50/16, 12/02/2016 « Council conclusions on the fight against the financing of terrorism ». Doc. 5782/16 + ADD1.)

European Union (5)

05.07.2016

- (5) Amendments to the fourth anti-money laundering directive:
 - VC exchanges to be subject to AMLD 4





European Union (5)

05.07.2016

Amendments to the proposal for a directive of the European parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC, 5.7.2016, extract from the EXPLANATORY MEMORANDUM:

In respect of designing providers of exchange services between virtual currencies and fiat currencies as obliged entities, the proposed amendments respect the proportionality principle. In order to allow competent authorities to monitor suspicious transactions with virtual currencies, while preserving the innovative advances offered by such currencies, it is appropriate to define as obliged entities under the 4AMLD all gatekeepers that control access to virtual currencies, in particular exchange platforms and wallet providers. The proposed measure takes into account, on the one hand, the fragmentation of financial information, and, on the other, the lack of direct, swift access to this information by FIU's and AML/CFT competent authorities. Furthermore, information that will be available must be accurate (i.e. the information should be precise enough in order to avoid targeting the wrong person) and limited to what is necessary (proportionality) to enable FIUs and AML/CFT competent authorities to match all the bank and payment accounts with their corresponding accountholders, proxy holders, and beneficial owners.

➤ (6) Report on virtual currencies, Jakob von Weizsäcker:

- Pro virtual currencies (=money)
- Pro regulation
 - => smart regulation:
 - foster innovation
 - safeguard integrity



European Parliament

European Union (6)

03.05.2016

European Parliament, Plenary sitting, REPORT on virtual currencies (2016/2007(INI)) Committee on Economic and Monetary Affairs, Rapporteur: Jakob von Weizsäcker, 3 May 2016 (A8-0168/2016):

- *A. whereas a universally applicable definition is not yet established, but virtual currencies (VCs) are sometimes referred to as digital cash, and the European Banking Authority (EBA) regards them as being a digital representation of value that is neither issued by a central bank or a public authority nor necessarily attached to a fiat currency, but is accepted by natural or legal persons as a means of payment, and can be transferred, stored or traded electronically; whereas VCs are most notably based on distributed ledger technology (DLT), the technological basis for more than 600 VC schemes, which facilitates 'peer-to-peer' exchange, the most prominent of which to date is Bitcoin; while it was launched in 2009 and currently holds a market share among DLT based VCs of almost 90 %, with a market value of the outstanding Bitcoins of around EUR 5 billion¹, it has not yet reached systemic dimensions;*
- *Opportunities and risks of VCs and DLT in the rapidly evolving technological landscape of payment, point 4:*

Points out, however, that if a regulation is adopted at a very early stage, it may not be adapted to a state of affairs which is still in flux and may convey a wrong message to the public about the advantages or security of virtual currencies;
- *Smart regulation towards fostering innovation and safeguarding integrity, point 21:*

Observes that several virtual local currencies have been created in Europe, not least as a response to the financial crisis and the related credit crunch problems; urges particular caution when defining virtual currencies, in the context of any future legislative proposals, with a view to taking proper account of the existence of 'local currencies' of a not-for-profit nature, often having limited fungibility and providing significant social and environmental benefits, and to preventing disproportionate regulation in this area, as long as taxation is neither avoided nor circumvented;

European Union (7)

26.05.2016

➤ (7) European Parliament:

- endorses the views of Jakob von Weizsäcker report





European Parliament

European Union (7)

26.05.2016

European Parliament resolution of 26 May 2016 on virtual currencies (2016/2007(INI)) (P8_TA-PROV(2016)0228):

A. whereas a universally applicable definition is not yet established, but virtual currencies (VCs) are sometimes referred to as digital cash, and the European Banking Authority (EBA) regards them as being a digital representation of value that is neither issued by a central bank or a public authority nor necessarily attached to a fiat currency, but is accepted by natural or legal persons as a means of payment, and can be transferred, stored or traded electronically; whereas VCs are most notably based on distributed ledger technology (DLT), the technological basis for more than 600 VC schemes, which facilitates 'peer-to-peer' exchange, the most prominent of which to date is Bitcoin; while it was launched in 2009 and currently holds a market share among DLT-based VCs of almost 90 %, with a market value of the outstanding Bitcoins of around EUR 5 billion , it has not yet reached systemic dimensions;

4. Points out, however, that if a regulation is adopted at a very early stage, it may not be adapted to a state of affairs which is still in flux and may convey a wrong message to the public about the advantages or security of virtual currencies;

21. Observes that several virtual local currencies have been created in Europe, not least as a response to the financial crisis and the related credit crunch problems; urges particular caution when defining virtual currencies, in the context of any future legislative proposals, with a view to taking proper account of the existence of 'local currencies' of a not-forprofit nature, often having limited fungibility and providing significant social and environmental benefits, and to preventing disproportionate regulation in this area, as long as taxation is neither avoided nor circumvented;



VI. What's next?



What's next?

at EU level



=> VCs and PSD2



What's next?

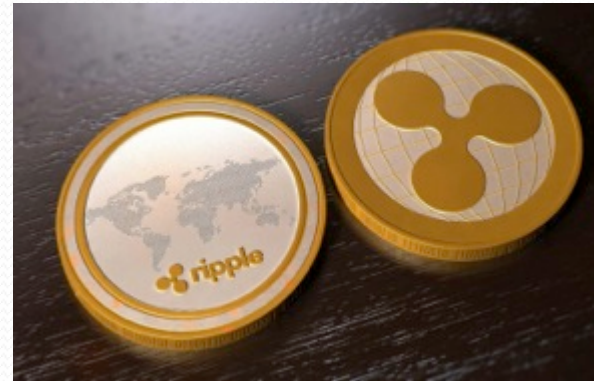
VC to VC exchanges
-> AML/CTF!



What's next?

New currencies

- Ethereum
- XRP



What's next?

Sophistication of VC products

=> new regulatory challenges

Margin trading for example
-> MiFiD?



Thank you - Merci - Danke

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