

# FinTech: Disruption in Digital Currency

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# Today's Webinar Presenters



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- More than 2300 cryptocurrencies
- Over \$290 Billion in market cap
- Bitcoin represents more than 50% of the market cap

# Cryptocurrency – 2008 to 2019

**8/2008**  
Domain name  
bitcoin.org is registered

**1/2009**  
First Bitcoin  
transaction

**5/2010**  
Bitcoin used to buy 2  
pizzas from Papa  
John's

**6/2011**  
Mount Gox (online  
Bitcoin exchange) is  
raided

**2/2011**  
Bitcoin criticized  
for Silk Road  
connection

**2013**  
First Bitcoin  
fork

**2/2014**  
Mount Gox  
collapses

**7/2014**  
Dell and Newegg  
accept Bitcoin



**10/2008**

the bitcoin designer,  
publishes whitepaper,  
"Bitcoin: A peer-to-peer  
Electronic Cash System

**10/2009**

New Liberty  
Standard publishes  
first Bitcoin  
exchange rate

**8/2010**

Bitcoin is  
hacked

**2/2011**

Litecoin, Namecoin,  
and Swiftcoin launch

**6/2012**

Coinbase is  
founded

**10/2013**

First Bitcoin ATM  
launched in  
Vancouver

**8/2014**

Microsoft accepts  
Bitcoin for Xbox  
transactions

**12/2014**

BitPay sponsors St.  
Petersburg Bowl  
game

**1/2014**

Las Vegas hotels  
accept Bitcoin

**7/2016**

Uber accepts  
Bitcoin in  
Argentina

**5/2016**

Bidorbuy, a South African  
online market, accepts  
Bitcoin payments

**7/2017**

Bitcoin forks  
into BTC and  
BCH

**2017**

Skandiabanken  
recognizes Bitcoin as  
an investment asset

**2018**

Samsung  
announces chips  
to mine coins

**2/2018**

Lloyds Bank, Halifax, Bank  
of Scotland, and MBNA  
customers banned from  
buying cryptocurrencies  
with credit cards

**6/2019**

Facebook  
announces plan to  
launch Libra in 2020



**7/2015**

Ethereum launches  
and introduces smart  
contracts

**11/2016**

SBB (Swiss Railway)  
allows automated  
ticket machines to  
sell Bitcoin

**4/2016**

Steam accepts  
Bitcoin

**4/2017**

Japan legally  
recognizes Bitcoin as  
payment method

**12/2017**

CME Group and  
CBOE launch  
Bitcoin futures

**2/2018**

Venezuela  
announces oil-  
backed  
cryptocurrency

**1/2018**

Coincheck has \$534 million  
in NEM coins stolen

# Bitcoin v. Ethereum v. Libra

## Bitcoin

- Launched in 2009
- Transactions recorded anonymously
- Cap at 21 million Bitcoins (3-4 million left to be mined)
- Easy to liquidate compared other cryptocurrency
- Accepted more than other cryptocurrency
- Has nearly 50% of the cryptocurrency market
- Volatile
- Risk of displacement
- Still associated with dark web/crime

## Ethereum

- Launched in 2015
- Decentralized software platform
- Smart contracts and dApps (Distributed Applications)
- Ether is the token
- Users of dApps will always need ether
- New projects are being built on Ethereum
- Transactions are significantly faster than Bitcoin
- Unlimited ether coins

## Libra

- Transactions are permissioned
- Centralized structure governed by an unelected “association” composed exclusively of large institutions who have purchased their voting rights
- Reliance on a trusted issuer to hold and manage a fund of assets backing the currency
- Cross-border payments and money transfers
- Currency is tied to government-backed currencies and other assets

# Libra to the Rescue! (?)



“Crypto Currency to the Rescue – Facebook’s Libra could help the poor who lost credit after Dodd-Frank”

The Editorial Board, *The Wall Street Journal*, Friday, July 19, 2019

“Forget the Gold Standard and Make the Dollar Stable Again”

John H. Cochrane, senior fellow at Stanford University’s Hoover Institution, *The Wall Street Journal*, July 18, 2019

“Fed’s Powell Says Facebook’s Libra Raises ‘Serious Concerns’”

*The Wall Street Journal*, July 11, 2019





# What is the big deal?

- There are many “cryptocurrencies” already issued since Bitcoin in 2008-2009
- Libra is a type of “stable coin” – but there are already stable coins in existence
- Facebook:
  - Market cap >\$500M
  - Approx. 2.3 BN active monthly users
  - Facebook is not alone, establishing the Libra Association comprised of many companies with well-known names

# Legal landscape is confusing; and inconsistent use of terminology doesn't help



- Too many terms!
  - Cryptocurrency
  - Virtual currency
  - Digital currency
  - Digital assets
  - Tokens
  - Securities tokens
  - Utility tokens
- Generally, focus on digital assets that are meant to function like true “currency”

# Currency generally

- Medium of exchange to transfer value
- Currency “replaced” the barter system
  - Farmer trades wheat to blacksmith in exchange for a pitch fork
  - Farmer can’t always bring wheat with him/her to barter – too burdensome.

# United States Currency

# The USD is a “fiat currency”

- A “fiat currency” is generally government-issued currency that is not backed by a physical commodity, such as gold or silver.
- Congress has the power to regulate USD
  - Article I, Section 8 of the U.S. Constitution, “The Congress shall have power ... To coin money, regulate the value thereof”.
  - See also, 31 U.S. Code § 5103 Legal Tender
    - “United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues. Foreign gold or silver coins are not legal tender for debts.”

# What is the “value” of a USD



- Generally, until 1972, the USD was backed by gold.
- The “value” of the USD is “tied” to the stability of the U.S. government and like other goods and services, the value is also “tied” to supply and demand
  - If the U.S. economy is not doing well, the price of the USD decreases because people around the world would rather hold currency from a country with a stronger economy
  - If the amount of “money” in circulation increases, the price of money decreases

# How are USD created?

- Federal Reserve uses USD to purchase assets (U.S. government securities) from member banks which increases the amount of USD in circulation
  - E.g. a bank sells a treasury bond to the federal reserve for \$100,000. The amount of USD in circulation increased by \$100,000.
- Banks lend money on deposits which increases the amount of USD in circulation – fractionalized banking system
  - E.g. a person with \$100,000 deposits that money into a bank. The bank lends out \$80,000 and keeps \$20,000 as a reserve to fund withdrawals. The amount of USD in circulation increased by \$80,000.

# Cryptocurrency

There is no formal definition, but there are a few characteristics that people seem to agree on





# Cryptocurrencies:

- “Virtual currency” a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value, but does not have legal tender status in any jurisdiction”
  - This definition is generally consistent across the CFTC, SEC and the IRS
- Based on blockchain technology
- Cryptocurrencies use cryptography
  - cryptography provides additional functionality to a virtual currency by using mathematical equations and “keys” to encrypt and decrypt data

# Bitcoin

- Developed in 2008-2009 by Satoshi Nakamoto – real identity unknown!
- Approximately 17.75M in circulation with a *limited supply* of 21M
  - Smallest unit is a “satoshi”  $1/100000000$  or  $10^{-8}$
- Issued by “mining” – providing services to the network
  - People use computers to solve equations on the bitcoin blockchain
  - If you are successful, the program issues you 12.5 bitcoin per block. Every four years, the reward is halved until the reward is zero and all 21M bitcoins have been issued

# What is the value of Bitcoin?

- Price is established on markets/exchanges
  - Negative:
    - Not backed by a government – certainly not legal tender
    - Not backed by a gold, silver or other items with “real” value
  - Positive:
    - But it has limited supply
    - Most importantly, it has the faith of its users
- How comfortable are people using a currency with a value tied to “scarcity” and “faith”?
- Price fluctuation can make bitcoin unwieldy to use in commerce (among other issues)
  - The price of bitcoin can be very volatile
  - Bitcoin has conversion risk

# Stable Coins – How do they work?

- Developed in part to address concerns with “value” and price stability
- How do they work?
  - E.g. Purchaser of a stable coin contributes \$10 in exchange for 10 stable coins
    - The issuer takes the \$10 and deposits the money into a custody or trust account that holds cash, cash-like instruments and government securities
    - The holder of the stable coin can redeem the coin for USD or use it in commerce at a price of \$1 per coin
- Eliminates “value” risk - A stable coin bought with \$10 should always be worth \$10
  - Eliminates the need to take on conversion risk
- *Usually* eliminates conversion risk
  - Stable coins are typically backed by financial instruments denominated in the same currency that the coin represents
  - a stable coin can be “pegged” to a currency
- Stable coins theoretically can be backed by any currency

# What is Libra?

# What is Libra's mission?



- On June 18, 2019, Facebook announced its plans with respect to a new crypto currency – Libra
- “Libra’s mission is to enable a simple global currency and financial infrastructure that empowers billions of people.” – See White Paper <https://libra.org/en-US/white-paper/>
- “1.7 billion adults globally remain outside of the financial system with no access to a traditional bank, even though one billion have a mobile phone and nearly half a billion have internet access” – Libra White Paper

# Libra – a Global Crypto Currency



- Libra is meant to be a digital representation of value that functions as a medium of exchange – a “virtual currency”
- Libra will be based on blockchain technology
- Libra will use cryptography
- Stable coin
  - Libra will be backed by financial instruments – will have intrinsic value
  - Libra will not be “pegged” to one currency – will have conversion risk
    - Libra will be backed by financial instruments issued in different currencies

# Will the SEC and the CFTC regulate Libra?



# SEC

- To date, the SEC does not have (or is not asserting) jurisdiction over bitcoin (and Ethereum)
  - The SEC told us they didn't
    - “Applying the disclosure regime of the federal securities laws to the offer and resale of Bitcoin would seem to add little value.”
    - “And, as with Bitcoin, applying the disclosure regime of the federal securities laws to current transactions in Ether would seem to add little value.”
    - Remarks at the Yahoo Finance All Markets Summit: Crypto, June 14, 2018, William Hinman, Director of the SEC's Division of Corporation Finance

# SEC (cont'd)

- The SEC analyzes cryptocurrencies under the 1946 case, SEC vs. Howey, which “generally” has 4 elements:
  - 1) Is there an investment of money?
  - 2) In a common enterprise?
  - 3) With a reasonable expectation of profit?
  - 4) Derived from the entrepreneurial or management efforts of others?
    - See generally, Framework for “Investment Contract” Analysis of Digital Assets published by the SEC Strategic Hub for Innovation and Financial Technology on April 3, 2019. See also Report of Investigation Pursuant to Section 21(A) of The Securities Exchange Act of 1934: the DAO dated July 25, 2017

# SEC (cont'd)

- “Staff at the Securities Exchange Commission are looking at whether Libra’s structure effectively makes it an exchange-traded fund, according to people familiar with the matter.”
  - “SEC Weighs Whether to Regulate Facebook’s Libra”, *The Wall Street Journal*, July 12, 2019

# CFTC

- CFTC has asserted jurisdiction over Bitcoin (BTC) and is asserting jurisdiction over other virtual currencies
  - The CFTC has jurisdiction over and regulates commodity futures, options and other derivatives that are within the definition of a “swap.”
  - The CFTC does not directly regulate commodity “spot” markets *but has the authority to bring anti-fraud and anti-manipulation cases* in respect thereof.
- In 2015, the CFTC first asserted its interpretation that virtual currencies were within the definition of “commodity.” [In the Matter of Coinflip, Inc.](#), CFTC Docket 15-29 (Sept. 17, 2015).
- The United States District Court for the Eastern District of New York agreed with the CFTC’s interpretation in granting a preliminary injunction order against defendants in an enforcement case. [CFTC v. Patrick K. McDonnell and Cabbagetech, Corp. d/b/a Coin Drop Markets](#), No. 18-CV-361 (E.D.N.Y. March 6, 2018).

# Cryptocurrency – the good and the bad

# FATF 2-22-19 – Public Statement – Mitigating Risks from Virtual Assets

- Recommendation 15 – interpretive note –
- Members should identify, assess, and understand ML and TF risks posed by virtual assets
- Based on risk assessment, Members should implement processes so that VASPs identify, assess, and take effective action to mitigate their ML and TF risks
- Registration/Licensing Requirement for VASPs
- VASPs must be monitored
- CDD at USD/EUR 1,000

# FATF Interpretive Note cont.,

- Originating VASPs must obtain and hold accurate originator information and required beneficiary information; must be available to regulators
- Sanctions laws and regulations apply to VASPs (R. 16)
- Members should exchange information on VASPs (R 37 & 40)
- SARs must be filed
- Record keeping and retention policies and procedures apply

# FATF Guidelines – VASPs – June 2019

- VASPs must be registered/licensed (1) where they are created; and potentially (2) where they conduct business
- VASPs are regulated by competent authorities; not self regulatory bodies
- Members must be able to conduct inspections, compel production of information, impose sanctions
- Members must cooperate with each other on VASPs
- Relevant authorities should coordinate to ensure AML rules are applied consistent with national data protection and privacy rules



# Hearing Before Senate Banking – July 16, 2019



- Statement by Caitlin Long – Wyoming Blockchain Coalition
  - Digital currencies are here to stay
  - They can be regulated so they compliant with AML laws and regulations
  - Wyoming is a model, having implemented 13 laws and regulations
  - Concerns for Libra – privacy
  - Stablecoins are a result of U.S. regulations making it difficult for banks to trade in digital currency
    - Banks have de-risked and created the unbanked because of the way Bank Examiners score during regulatory reviews
    - The U.S. banking system has been weaponized – jurisdiction through USD clearing
    - Compliance burdens are a barrier to illicit and licit activity
  - Digital currency is an innovation to be embraced – and kept within the U.S. (and the U.S. has already lost Libra to Switzerland)

# Hearing Before Senate Banking – Member Statement – Chairman Mike Crapo (R- ID)

- Concerns relate to:
  - how the payment system will work
  - How it will be managed
  - How each component interacts
  - Consumer protections
  - Implications for consumers if there is financial loss
  - Data protection
  - Individual privacy protection
  - Interaction with the Bank Secrecy Act
- Goals are “commendable” as according to the World Bank, 1.7 billion adults are unbanked but 2/3rds of those own a phone or have access to the internet



# Hearing Before Senate Banking – Member Statement – Sherrod Brown (D- OH)

- “Facebook is dangerous.”
- “Like a toddler who has gotten his hands on a book of matches, Facebook has burned down the house over and over, and called every arson a learning experience.”

# Libra Association

- The Libra Association is now comprised of 28 members
- Each member contributed \$10 million and has one vote in the Association
- The Libra Association oversees
  - development of the token
  - The Reserve or real world assets (a basket of currencies)
  - Governance rules
- Every payment is written into the Libra Blockchain – a public online ledger that can handle 1,000 transactions/second
- Transactions cannot be reversed
- Libra has no plans to scrutinize developers of Libra wallets



# Calibra

- Calibra is a subsidiary of Facebook
- Separate for “data privacy”
- The Calibra Wallet will launch alongside Libra currency on iOS and Android within Facebook Messenger, WhatsApp and a stand alone group
- Customers –
  - Subject to KYC
  - Must provide government issued ID
  - Other verification methods
  - Subject to SAR/STR filing and due diligence

# The Regulators

- Financial Action Task Force – Recommendations
- Financial Crimes Enforcement Network
- Swiss Financial Markets Supervisory Authority (FINMA)



# FinCEN – May 9, 2019 Interpretive Guidance

- The BSA applies to Convertible Virtual Currencies (CVCs)
- The Guidance consolidates and does not create new requirements
- Whether a business is an MSB is fact specific
- The term “money transmission services” is defined to mean the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. The term “other value that substitutes for currency” encompasses situations in which the transmission does not involve currency, or funds but instead involves something that the parties to a transaction recognize has value . . .



# BSA Requirements for MSBs

- Written AML Program reasonable designed to prevent the MSB from being used to facilitate money laundering and terrorist financing.
- Must:
  - incorporate policies, procedures, and internal controls to assure ongoing compliance
  - designate an individual responsible for day to day compliance with the BSA
  - provide training for appropriate personnel
  - provide for independent review
  - be approved by the owner of the FI
  - register with FinCEN
  - comply with recordkeeping, reporting, and transaction monitoring obligations



# CVC Wallets – BSA rules are fact specific

- FinCEN's regulatory treatment depends on four criteria:
- (1) who owns the value;
- (2) where the value is stored;
- (3) whether the owner interacts directly with the payment system where the CVC runs; and
- (4) whether the person is acting as intermediary has total independent control over the value.

# Cryptocurrency's Bad Side

- On July 15, Treasury Secretary Mnuchin commented that cryptocurrencies have the potential to be used by criminals.
- Venezuela and the “Petro”
  - In December 2017, President Maduro announced plans to launch the Petro – a “cryptocurrency” backed by the nation’s gasoline, gold, and diamond reserves.
  - January 2018: Maduro ordered the issuance of the first 100 million Petros– pegging each Petro to one barrel of Venezuelan oil
  - Parliamentary Deputy Jorge Millan immediately responded by describing the Petro as a “forward sale of Venezuelan oil” and not a cryptocurrency.
  - On March 19, 2018, President Trump issued Executive Order 13827 prohibiting dealings in digital currency, digital coin, or digital token issued by/on behalf of the GoV



# Thank You



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