

2020: The Year of EU Regulation of Crypto-Assets?

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In June 2019, the attention of the world was drawn to crypto-assets when Facebook, Inc., announced that it planned to launch Libra, a “stable coin,” i.e., a cryptocurrency designed to be backed by a reserve of hard currencies (*fiat*), during the first half of 2020. The reaction of global regulators to Facebook’s plans and Libra’s possible impact on financial stability was quite vocal.

Although the Geneva-based Libra Association behind the project had asked the Swiss Financial Market Supervisory Authority (FINMA) for an assessment on how the authority would classify the project (including the issuance of a “stable coin”) and guidelines were issued on 11 September 2019,^[1] Facebook seems to have largely gone quiet on its plans for Libra since early October (when various major payment companies reportedly deserted the Libra Association). Regulators in Europe have continued to consider the issues raised by crypto-assets and the necessity of a response to address the legal, regulatory and oversight challenges and risks.

Against that background, we consider in this article the changes that 2020 will bring in the EU in terms of the regulation of crypto-assets.

National implementation of amendments to the Anti-Money Laundering Directive

Changes to crypto-currency regulation are anticipated in a number of Member States in early 2020 with the deadline for national transposition of changes to the Anti-Money Laundering Directive (“AMLD”) of 10 January 2020.

The amendments to the previous iteration of the AMLD include:

- A new definition of virtual currencies;^[2]
- The inclusion of virtual currency providers and custodian wallet providers as obliged entities (which means that they will be subject to the requirements of the AMLD, including the need to apply customer due diligence measures and the need to report suspicious transactions); and
- The requirement that exchange platforms and custodian wallet providers be registered.

At the time of writing [7 January 2020], only 11 of the 28 EU Member States had communicated to the European Commission that they have taken measures to transpose the requirements into national law.

The prospect of forthcoming changes to money laundering rules has caused a number of crypto firms to reconsider their operations, with crypto payments startup Bottle Pay, crypto mining pool Simplecoin and bitcoin gaming platform Chopcoin all closing their operations, citing the new rules as the catalyst for closure.

Public consultation on a directive/regulation establishing a European framework for markets in crypto-assets

On 19 December 2019, the European Commission launched a public consultation into a Directive/Regulation establishing a European framework for markets in crypto-assets (https://ec.europa.eu/info/law/better-regulation/initiatives/crypto-assets-2019/public-consultation_en).

The introduction to the consultation notes that crypto-assets have “the potential to bring significant benefits to both market participants and consumers” but also acknowledges the potential difficulties presented, including the challenge to financial stability that arises from the emergence of “stablecoins” as a new subset of crypto-assets.

The consultation builds on advice obtained from the European Banking Authority and the European Securities and Markets Authority^[3] on the applicability and suitability of the existing financial services regulatory framework to crypto-assets and will inform the Commission services’ ongoing work on crypto-assets. The consultation document notes that this includes a possible common regulatory approach at EU-level for crypto-assets that are not currently covered by EU legislation.

The consultation document seeks views on:

1. The uses and potential uses of crypto-assets,
2. The classification of crypto-assets,
3. Crypto-assets that fall outside the scope of EU financial services legislation, and
4. Crypto-assets that fall within the scope of EU legislation (i.e., as financial instruments under the Markets in Financial Instruments Directive and as e-money under the Electronic Money Directive).

The consultation document is a working document and does not constitute a formal proposal by the European Commission. However, the consultation document provides a useful indication of the main areas of focus for the Commission and areas identified for potential regulatory reform. Subject to feedback, the Commission appears to be considering the need for:

- Clarity (either by way of guidance, regulation, or a combination of the two) as to the classification of crypto-assets potentially distinguishing between “payment tokens”, “investment tokens”, “utility tokens”, and “hybrid tokens”;
- A bespoke regime for crypto-assets not currently covered by EU financial services legislation, which may or may not include certain types of crypto-assets (such as utility tokens);
- Greater regulatory requirements on crypto-asset service providers (issuers of crypto-assets, exchanges, trading platforms, wallet providers, etc.). These requirements are likely to vary depending on the type of service provider, but may include that the provider:
 - has a physical presence in the EU,
 - be subject to governance arrangements (i.e., in terms of operational resilience and ICT security),
 - be subject to rules on conflicts of interests,
 - be required to keep appropriate records, and
 - has adequate complaints and redress procedures;

- Requirements to ensure the proper identification of transacting parties in crypto-assets;
- A widening of the AMLD definition of virtual currency, classification of obliged entities and conditions for regulation and licensing of providers;
- Increased oversight and supervision of crypto-asset service providers; and
- Amendments to existing legislation (including, *inter alia*, MiFID, the Market Abuse Regulation and Short Selling Regulation) to ensure appropriateness for security tokens and the use of distributed ledger technology.

The deadline for responses to the consultation is 19 March 2020, with any proposal for legislation likely to come in the third quarter of 2020.

Basel Committee invites comments on the design of a prudential treatment for crypto-assets

With a remarkable coincidence in timing, the Basel Committee on Banking Supervision published on 12 December 2019 a discussion paper^[4] on the design of a prudential treatment for crypto-assets. The deadline for comments is 13 March 2020. The Basel Committee is comprised of 45 institutions from 28 jurisdictions. It is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

In its press release,^[5] the Basel Committee indicated that it is of the view that the growth of crypto-assets and related services has the potential to raise financial stability concerns and increase risks faced by banks. Crypto-assets are an immature asset class given the lack of standardisation and constant evolution. Certain crypto-assets have exhibited a high degree of volatility, and present risks for banks, including liquidity, credit, market, operational (including fraud and cyber), money laundering and terrorist financing, and legal and reputation risks. If banks are authorised, and decide to acquire crypto-assets or provide related services, the Committee is of the view that they should apply a conservative prudential treatment to such exposures, especially for high-risk crypto-assets.

The discussion paper seeks the views of stakeholders on a range of issues related to the prudential regulatory treatment of crypto-assets, including:

- i. the features and risk characteristics of crypto-assets that should inform the design of a prudential treatment for banks' crypto-asset exposures, and
- ii. general principles and considerations to guide the design of a prudential treatment of banks' exposures to crypto-assets, including an illustrative example of potential capital and liquidity requirements for exposures to high-risk crypto-assets.

The regulation of crypto-assets in the EU has, to date, consisted of a patchwork of national rules on issues related to crypto-assets, with EU regulation only applying where crypto-assets fell within existing legislative frameworks. The outcome of the European Commission's consultation and the response to that feedback remains to be seen, but it seems likely that 2020 will be an important year for the development of a more-harmonised approach to the regulation of crypto-assets.

^[4] <https://www.finma.ch/en/news/2019/09/20190911-mm-stable-coins/>

^[5] "Virtual currencies' means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically."

ESMA, “Advice on Initial Coin Offerings and Crypto-Assets”, January 2019; EBA report with advice for the European Commission on “crypto-assets”, January 2019

<https://www.bis.org/bcbs/publ/d490.htm>

<https://www.bis.org/press/p191212.htm>

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