

# DIGITAL ASSETS AND BLOCKCHAIN UPDATE



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### AIMA Work

#### *Digital Assets and Blockchain Core Group Priorities*

There have been two calls of the AIMA DAB Core Group to date. The most recent of which was held on Wednesday 6 June. These calls have agreed the immediate priorities of AIMA to be: (i) the development of a global AIMA Position Paper on digital assets and blockchain, and (ii) an AIMA Educational Guide to digital assets and blockchain. The focus of the AIMA Position Paper, amongst other things, will be to propose an AIMA solution for the current difficulties around digital assets and custody. Once complete, AIMA will focus on maximising its engagement with policymakers and regulators globally. The Educational Guide will provide a detailed introduction to AIMA members on digital assets and, importantly, the underlying distributed ledger technology. It will include a glossary of terms and hopefully help to answer the most frequently asked questions by investment managers relating to the space. It is intended to be launched in the EU, US and APAC with three AIMA member events later this year. Following the completion of these projects AIMA's work will then look towards regulatory and operational guidance, with the potential development of DDQs and a regulatory guide relevant to digital assets funds and trading, and blockchain technology.

#### *AIMA Cryptoasset Tax Group*

AIMA's Cryptoasset Tax Group has met for the first time and agreed upon an approach on the application of fund tax relief for AIFs invested in cryptocurrencies and other digital assets, including the application of the UK investment management exemption. A draft letter is being developed to be sent to HMRC to this end requesting a clear classification of the new assets for the UK tax regime.

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# Regulatory Updates

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## EU

### *ESMA – Product intervention limiting leverage through cryptocurrency CFDs (March 2018)*

ESMA in March used its product intervention powers in the retail CFD space to limit leverage by retail clients for cryptocurrencies to 2:1 (from 30:1), as well as other restrictions such as risk warnings and restricted incentives to trade CFDs. This followed a consumer warning issued jointly by all three European Supervisory Authorities on the risks of buying virtual currencies. The restriction document also made clear ESMA's and EU NCAs' overarching concerns about the integrity of the price formation process in underlying cryptocurrency markets.

### *European Commission - Action Plan on FinTech (March 2018)*

In March, the European Commission released its Action Plan on FinTech. Among other things, the plan references crypto-assets, confirming the Commission's position that the assets and underlying blockchain technology hold promise for financial markets and infrastructures. It, nonetheless, highlights the many risks of cryptocurrency investments and trading, and notes the agreement of the EU legislative institutions to extend the Anti-money laundering Directive to virtual currency exchanges and wallet providers. However, the Commission at this stage notes the case for broad legislative or regulatory action or reform at EU level at this stage is limited.

### *Legislative Institutions - EU Anti-Money Laundering Directive V (December 2017)*

The amended AMLD V was agreed by the European Legislative Institutions in December 2017 and is due to be published in the Official Journal of the European Union imminently. Member States will then have 18 months to transpose it before it becomes effective. Importantly, AMLD V has further broadened the scope of obliged entities to include virtual currencies, anonymous prepaid cards and other digital currencies such as bitcoin exchanges and wallet services to the list of activities carrying the risk of money laundering and terrorist financing.

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## Gibraltar

### *Announcement of Gibraltar token legislation (March 2018)*

HM Government of Gibraltar has published proposals for the regulation of token sales, secondary token market platforms, and investment services relating to tokens (Token Regulation). The Token Regulation is proposed to regulate the following activities conducted in or from Gibraltar:

- the promotion, sale and distribution of tokens by authorised sponsors;
- operating secondary market platforms trading in tokens; and
- providing investment and ancillary services relating to tokens.

The desired outcomes are to protect customers, to protect Gibraltar's reputation, and to support the safe use of token-based crowd financing. It is made clear that the rules are not intended to regulate the technology itself, individual tokens or the promoters and issuers of tokens – instead focusing on service providers. Persons that receive proceeds from the sale of tokens will nonetheless be subject to AML and terrorism financing rules. The Token Regulation will be in addition to the Financial Services (Distributed Ledger Technology Providers) Regulations 2017 published last year.

## Malta

### *Malta discussing three legislative Bills intended to cover the crypto-assets industry (ongoing)*

The Maltese parliament are currently considering three legislative bills: (i) Digital Innovation Authority Bill, (ii) Innovate Technology Arrangements and Services Bill; and (iii) Virtual Financial Assets Bill. The first bill provides for establishment of an Authority to be known as the “Malta Digital Innovation Authority” (MDIA), among other things to develop and support relevant guiding principles, exercise regulatory functions and to adopt measures regarding DLT and related services and ancillary matters. The second covers the regulation of designated innovative technology arrangements and for the exercise of powers by the MDIA. The Third is intended to regulate initial digital asset offerings and digital assets and to make provisions for other ancillary matters. These are further to the Maltese push to attract greater cryptofund and DLT business to the island.

## Switzerland

### *FINMA Guidelines on ICOs (February 2018)*

The Swiss Financial Market Supervisory Authority (FINMA) has published new guidelines regarding the supervisory and regulatory framework for initial coin offerings (ICOs). The Guidelines supplement earlier FINMA guidance and respond to the submission of various enquiries regarding ICOs and the categorisation of tokens. FINMA clarifies that it will focus on the economic function and purpose and transferability of the token, on a case-by-case basis. Whether anti-money laundering (AML) and securities regulations apply to ICOs will depend on whether the tokens are classified as securities. In absence of international terminology, FINMA classifies three types of token – payment, asset and utility. It may publish a circular in the future to provide further guidance. FINMA classifies tokens as follows overleaf:

- payment tokens are not treated as securities for ICOs where the token is intended to function as a means of payment and can already be transferred. FINMA will require compliance with AML requirements nonetheless;
- utility tokens are not treated as securities if their sole purpose is to confer digital access rights to an application or service and if the token can be used in this way at the point of issue. The contrary will be the case if the token functions solely or partially as an investment in economic terms; and
- asset tokens are regarded as securities, therefore securities law requirements and civil law requirements under the Swiss Code of Obligations will apply to the trading of such tokens.

## UK

### *FCA - Dear CEO Letter on Cryptoassets and Financial Crime (June 2018)*

The FCA has issued a Dear CEO letter regarding good practice for how banks handle financial crime risks posed by cryptoassets - including reasonable and proportionate measures to lessen the risk of facilitating financial crimes enabled by cryptoassets. The letter, although relating largely to banks and customers, is informative of the FCA's view of the assets as high-risk and speculative investments or as a means of funding technological innovation, and also represents the FCA beginning to move to regulate the space.

The Dear CEO letter recommends steps including:

- developing staff knowledge and expertise to identify risks;
- ensuring existing financial crime frameworks adequately reflect crypto-related activities in which the firm is involved;
- carrying out due diligence on key individuals and, for crypto-exchange clients, assessing the adequacy of the exchange client's own due diligence arrangements; and
- for ICO tokens, firms should consider the issuances' investor-base, organisers, the functionality of tokens and the jurisdiction.

The FCA notes that the firms should assess the risks posed by a customer whose wealth or funds derive from the sale of cryptoassets, or other cryptoasset-related activities, using the same criteria that would be applied to other sources of wealth or funds.

#### ***FCA - Statement on virtual currency derivatives and cryptocurrencies (April 2018)***

The FCA in April published a statement on cryptocurrency derivatives which confirms that cryptocurrencies are capable of being financial instruments under MiFID2, even though the FCA does not view cryptocurrencies as either currencies or commodities for regulatory purposes under MiFID2. This means that any firms conducting regulated activities in cryptocurrency derivatives must comply with all applicable rules in the FCA's Handbook and directly applicable EU regulations. It is likely that dealing in, arranging transactions in, advising on or providing other services that amount to regulated activities in relation to derivatives that reference either cryptocurrencies or tokens issued through an ICO will require authorisation by the FCA.

This includes:

- cryptocurrency futures – a derivative contract in which each party agrees to exchange cryptocurrency at a future date and at a price agreed by both parties.
- cryptocurrency contracts for differences (CFDs) – a cash-settled derivative contract in which the parties to the contract seek to secure a profit or avoid a loss by agreeing to exchange the difference in price between the value of the cryptocurrency CFD contract at its outset and at its termination; and
- cryptocurrency options – a contract which grants the beneficiary the right to acquire or dispose of cryptocurrencies.

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## **US**

#### ***SEC – Director Hinman Remarks on digital assets categorisation (June 2018)***

William Hinman, SEC Director in the Division of Corporation Finance gave industry an updated SEC position on the classification of cryptoassets during a recent speech at the Yahoo Finance All Markets Summit. He confirmed his view of the application of the Howey test to coin and token offerings and his view that both Bitcoin and Ether are not securities. He noted that the decentralised nature of Bitcoin in practice means that profits are not generated by the efforts of a third-party for the purposes of the Howey Test and that federal securities law disclosure regimes to the offer and resale of Bitcoin would add little value.

Similarly for Ether, Director Hinman also offers insight into the fact that an asset originally offered as a security could potentially move outside the definition of a security where there is no longer a central enterprise being invested in, or the asset is sold only to purchase a good or service available through the network.

### ***NASAA – Operation cryptosweep heralded as a success (May 2018)***

The North American Securities Administrators Association (NASAA) regulatory probe into potentially fraudulent digital assets programmes – otherwise known as ‘Operation Cryptosweep’ – was announced in May. The large coordinated enforcement action by US and Canadian state and provincial securities regulators is intended to crack down on fraudulent ICOs, cryptocurrency investment products and the firms/individuals behind them. Nearly 70 inquiries and investigations and 35 pending or completed enforcement actions have resulted since. The NASAA President described the actions to date as ‘the tip of the iceberg’ as the recent spike in the price of Bitcoin has attracted many of the 30,000 crypto-related domain name registrations.

### ***CFTC – Backgrounder on oversight and approach to virtual currency futures markets (April 2018)***

In April, the CFTC published a “Backgrounder” which is intended to provide clarity regarding: federal oversight of and jurisdiction over virtual currencies; the CFTC’s approach to regulation of virtual currencies; the self-certification process generally, as well as specifically regarding the recent self-certification of new contracts for bitcoin futures products by DCMs; the background on the CFTC’s “heightened review” for virtual currency contracts; and a discussion of the constituencies the CFTC believes could be impacted by virtual currency futures. This follows a Federal Court ruling in March that the CFTC is able to assert jurisdiction over fraud that does not directly involve the sale of futures or derivatives contracts but instead involves the underlying asset of those contracts.

### ***SEC – Statement on potentially unlawful online digital assets platforms (March 2018)***

The SEC’s most recent statement on digital assets issued in March covers the risks posed by both coins and token exchanges. It confirms that any platform that offers trading in a token that meets the definition of a security and operates as an ‘exchange’ must be regulated by the SEC and either register as a national securities exchange, or have an exemption. Platforms may also need to register as an ATS or broker-dealer. The statement gives considerations for market participants using online platforms, as well as for the platforms themselves. The SEC reiterates concerns that platforms hold themselves out as regulated “exchanges” when they are not. Risks exist regarding listing standards, as well as trading protocols which may be as robust as national securities exchanges and not give equal access to all users. A list of diligence questions is provided. The statement also sets out the requirements for regulated exchanges which, in addition to compliance with federal securities laws, must have rules to prevent fraudulent and manipulative acts, rules and procedures governing the discipline of its members and associated persons, and be able to enforce compliance regarding the exchange’s rules and federal securities law. Requirements for ATSS are also elaborated upon, as well as potential for platforms to trigger other registration requirements by virtue of digital wallet or transaction services, including broker-dealer, transfer agent or clearing agency registration. These rules are in addition to the issuer itself which may be subject to laws on the offering of securities. SEC Chair Jay Clayton’s previous statement on cryptocurrencies and ICOs can be found [here](#).

### ***FinCEN – Confirms 2013 Guidance that virtual currencies activities are within AML rules (February 2018)***

FinCEN in February confirmed in a letter responding to a request for information from Senator Rob Wyden that virtual currency exchangers and administrators are likely subject to the Bank Secrecy Act and AML requirements of FinCEN, the SEC and CFTC – reiterating its own 2013 guidance that such administrators and exchangers are money transmitters. The latter must therefore: register as a money service business (MSB) with FinCEN; have a written AML compliance programme in place; and file all required reports under the Bank Secrecy Act (including suspicious activity reports and currency transaction reports) and, to the extent they are US persons, comply with financial sanctions obligations required by the Office of Foreign Assets Control.

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## Political Updates

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### China

#### ***Chinese Government to establish blockchain standardisation technical committee (March 2018)***

The Chinese Ministry of Industry and Information Technology in March announced the intention to launch a technical committee to form a complete standardised blockchain system as soon as possible to promote the development of the industry. This comes alongside the concerted effort China is taking to position itself at the forefront of the nascent blockchain sector and is additional to the International Organisation for Standardisation TC307 initiative which is focusing on blockchain to use in authentication and smart contracts. President Xi Jinping has also recently noted the “breakthrough” technology and China’s intention to become a world leading technology centre, although China has imposed a ban on domestic cryptocurrency trading and ICOs.

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### International

#### ***Bank of International Settlements - Cryptocurrencies: looking beyond the hype (June 2018)***

BIS have included a chapter in their 2018 Annual Report on cryptocurrencies. Chapter V sets out the BIS’s thinking which appears still relatively sceptical. It notes that cryptocurrencies promise to replace trusted institutions with distributed ledger technology, yet, looking beyond the hype, it is hard to identify a specific economic problem which they currently solve. The report notes that transactions are slow and costly, prone to congestion, and cannot scale with demand. The decentralised consensus behind the technology is also fragile and consumes vast amounts of energy. Still, the report admits that distributed ledger technology could have promise in other applications. It concludes that policy responses need to prevent abuses while allowing further experimentation.

#### ***G20 agree that cryptocurrencies lack the attributes of sovereign currencies (March 2018)***

The G20 group of nations in its Communiqué from Finance Ministers and Central Bank Governors in March made a statement relating to crypto-assets. Although acknowledging the technical innovation and potential benefits to the financial system, the G20 group noted concerns around consumer and investor protection, market integrity, tax evasion, money laundering and terrorist financing. They also confirmed the position that crypto-assets lack the key attributes of sovereign currencies. The body recommended ongoing monitoring with multilateral responses as needed.

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### Ireland

#### ***Discussion Paper on Virtual Currencies and Blockchain Technology (April 2018)***

The Irish Department of Finance in April issued a paper presenting an introduction to key elements of blockchain technology and virtual currencies. It includes: use-cases as examples; considerations of commercial impacts; considerations of data protection, tax, contract and consumer protection law; recommendations for an intra-departmental working group be set up; recommendations to monitor future developments and to instigate further research by engaging with industry regulators and professional bodies if and as required, and to further raise awareness of the possible risks to consumers and investors. The paper caveats that it is not a policy-paper or endorsement of cryptocurrencies as a replacement for central bank currencies.

## UK

### ***Government “Cryptoassets Task Force” (May 2018)***

The UK Government “Cryptoassets Task Force”, consisting of the FCA, HM Treasury and the Bank of England, announced by Chancellor Phillip Hammond earlier in 2018 met for the first time in late May 2018. The meeting agreed the Task Force’s objectives, including exploring the impact of cryptoassets, the potential benefits and challenges of the application of distributed ledger technology in financial services, and assessing what, if any, regulation is required in response. AIMA intends to engage with the Task Force, in particular in advance of the publication of its report in Q3 2018.

### ***Bank of England response to HM Treasury call for evidence setting out their thinking on digital currencies (May 2018)***

The Bank of England response to the Treasury Select Committee Inquiry on Digital Currencies has now been published. The response stresses the importance of distinguishing between privately-issued crypto assets and the DLT upon which many rely – highlighting the underlying technologies have significant potential and, over time, could have material benefits, including for the efficiency and resilience of the financial system. It also notes that crypto assets are highly unlikely to replace commonly used payment systems due to their volatility, capacity constraints, high transaction costs, speed and energy usage. The response also notes the cyber risks of widespread adoption of crypto-assets. It nonetheless, notes that such assets do not pose a material threat to financial stability due to their small stock and use in payments, and small exposure of systemically important UK institutions. The Bank’s approach to DLT is technology neutral, rather focusing on outcomes. It notes that it has undertaken work to understand DLT, the impact on PRA regulated firms and the Bank’s own operations. To this end, the Bank is open minded about the possibility of introducing a central bank digital currency in the long term and will continue researching the topic.

# 04

## Other Updates

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### ***SEC – Launch of fake ICO website (May 2018)***

The SEC has recently launched a fake ICO website, intended to draw attention to how easy it is to create a fraudulent ICO offering and the typical misrepresentations made. The website for HoweyCoins can be found [here](#).

### **US - Self-regulatory organisation for virtual currency exchanges (March 2018)**

Gemini, the virtual currency exchange, has proposed the creation of an SRO for US virtual commodity exchanges – the Virtual Commodity Association (VCA). It would aim to create a set of industry-sponsored standards, best practices and oversight that would promote price discovery, efficiency and transparency in virtual currency markets. It would also require conformity with the VCA's sound practices regarding responsible financial management, transparency and conflicts of interest, rules-based markets, cyber and information security and recordkeeping, surveillance, information sharing and cooperation with regulators. This would initially be purely virtual currency related, not for tokens or token markets.

### **Japan - Self-regulatory body established by digital assets exchanges (April 2018)**

Japanese exchanges have established a new self-regulatory body – the “Japanese Cryptocurrency Exchange Association” in response to the publicised exchange hacks and to improve the regulatory standing of the unregistered Japanese cryptocurrency exchange sector. The JCEA will set the standards and the expectations of those exchanges that currently are not registered and compliant with FSA exchange rules. It hopes to alleviate customers’ anxieties and to help the development of the market. The intention is for the JCEA to be supported by law and to be given powers to create rules and punish companies that damage public trust in the industry.

### **Japan - FSA Push back against anonymous cryptocurrency trading (May 2018)**

the Japan Financial Security Agency (FSA) has pushed local exchanges to remove private coins from their platforms. It is the intention that the rules become effective today (18 June 2018). The move comes, despite Japan being the largest cryptocurrency trading jurisdiction by volume, in response to the publicised hacking of Japanese exchange CoinCheck and further to the FSA's intention to combat illicit activity in the space. The FSA website makes no reference, however the initiative has been reported by various sector news sites.

### **UK - Bank of England Working Papers on central bank digital currencies (May 2018)**

The Bank of England in May published two papers further to its investigation of the possibilities of digital currencies for central banks Broadening narrow money: monetary policy with a central bank digital currency and Central bank digital currencies – design principles and balance sheet implications. The first paper discusses central bank digital currency (CBDC) and its potential impact on the monetary transmission mechanism. It concludes that monetary policy would be able to operate much as it does now, by varying the price or quantity of central bank money, and that transmission may even strengthen for a given change in policy instruments. The second paper sets out three models of CBDC that differ in the sectors that have access to CBDC. It studies sectoral balance sheet dynamics at the point of an initial CBDC introduction, and of an attempted large-scale run out of bank deposits into CBDC. It finds that if the introduction of CBDC follows a set of core principles, bank funding is not necessarily reduced, credit and liquidity provision to the private sector need not contract, and the risk of a system-wide run from bank deposits to CBDC is addressed. These papers come in addition to a paper of the BoE's vision for a renewed Real Time Gross Settlement (RTGS) service supporting DLT settlement models.