Blockchain Year-in-Review 2019

April 27, 2020

Following the ICO boom of 2017 and the burst of the bubble in 2018, the feel of the blockchain industry in 2019 might be characterized as one of greater pragmatism and a focus on identifying and developing sustainable use cases for the technology.

Following a record high in the market cap of all existing crypto assets in 2018 and a subsequent fall by over 70% by that year-end, 2019 saw some recovery and relative stabilization in the prices of core crypto assets (putting aside subsequent events in early 2020). As additional cryptocurrency exchanges came online and existing exchanges continued to mature and draw customers, trading volume in 2019 increased by nearly 600%.

Regulators in the United States and various other countries continued their focus on the blockchain industry. Meanwhile, efforts at high-profile projects—such as Libra—drew widespread attention from politicians and the public (even if mostly negative).

In this update, we have chosen a handful of jurisdictions and discussed selected regulatory and other developments in 2019. Regulatory responses to the fast-developing technology continue to vary significantly from nation to nation, though some areas—such as guidance on anti-money laundering regulations—have seen efforts at greater consistency across borders. With the COVID-19 pandemic having a drastic affect on global markets—including the crypto markets—as we release this update, 2020 promises to be an eventful year for blockchain as well.

European Union

Statement on Stablecoins by the Council of the EU and the European Commission

In December 2019, the Council of the EU and the European Commission published a joint statement on stablecoins.[1] The Council and the European Commission acknowledge that stablecoins present opportunities in terms of cheap and fast payments, especially cross-border payments. At the same time, the Council and the European Commission indicate that these arrangements pose multifaceted challenges and risks related, for example, to consumer protection, privacy, taxation, cyber security and operational resilience, money laundering, terrorism financing, market integrity, governance and legal certainty. In particular, the Council and the European Commission are concerned about risks to monetary sovereignty, monetary policy, the safety and efficiency of payment systems, financial stability, and fair competition when stablecoin initiatives reach the global scale. These initiatives should not undermine existing financial and monetary orders, as well as monetary sovereignty in the European Union, and should not come into operation until all such concerns are properly addressed. The Council and the European Commission also call on all stablecoins projects to provide full and adequate information to allow for a proper assessment under the applicable existing rules.

ECB's Paper on Risks Posed by Crypto-Assets

In May 2019, the European Central Bank's Crypto-Assets Task Force ("Task Force") published an Occasional Paper on implications of crypto-assets for financial stability, monetary policy, and payments and market infrastructures in the euro area.[2] The paper analyzes whether the current regulatory and financial oversight framework provides an adequate mechanism for the containment of risk posed by crypto-assets. According to the Task Force, crypto-assets do not currently have a significant impact on monetary policy given that they do not fulfill the traditional functions of money. However, monetary policy implications could materialize in the future if crypto-assets become more widely adopted and serve as a credible substitute for money.

The Task Force also concludes that crypto-assets do not currently pose a material risk to financial stability due to their relatively small size. Nevertheless, the Task Force identifies a regulatory gap and suggests that EU level regulation of crypto-asset

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1 *See* https://www.consilium.europa.eu/en/press/press-releases/2019/12/05/joint-statement-by-the-council-and-the-commission-on-stablecoins/https://www.consilium.europa.eu/en/press/press-releases/2019/12/05/joint-statement-by-the-council-and-the-commission-on-stablecoins/.

2 *See* https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdfhttps://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf.

businesses, such as crypto-asset custody and trading/exchange services, could help to address crypto-asset risks to avoid "disjointed regulatory initiatives" at the Member State level.

France

As reported by us last year, France has enacted a new piece of legislation entitled "*Plan d'Action pour la Croissance et la Transformation des Entreprises*", also known as the *Loi Pacte* (the "Pacte Law").[3] The broad spectrum of the law encompasses a variety of measures aimed at fostering entrepreneurship and innovation.

Under the Pacte Law, starting December 19, 2019, French-established companies that provide services of digital asset custody and/or buying or selling digital assets for legal tender in France are subject to mandatory licensing requirements. A one-year transition period is granted to existing companies to enable them to continue their operations. In order to obtain such a license, a digital asset service provider needs to file an application with the *Autorité des Marchés Financiers* ("AMF") which verifies whether such service provider complies with the regulations on Anti-Money Laundering and Combating the Financing of Terrorism. The AMF published guidance[4] summarizing the conduct of business rules and organizational requirements with which digital asset service providers are required to comply. The list of approved digital asset service providers will also be published on the AMF website. Additionally, an optional license is available for digital asset service providers that provide other digital assets-related services on behalf of third parties or operate a trading platform for digital assets.

Germany

BaFin's Second Advisory Letter on Prospectus and Authorisation Requirements in Connection with the Issuance of Crypto Tokens

In August 2019, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "BaFin") issued the second advisory letter on prospectus and authorisation requirements in connection with the issuance of crypto tokens.[5] The purpose of the second advisory letter is to provide guidance on (i) information and

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[3] *See* Debevoise Update, "Loi PACTE: French Regulator Implements an Innovative Legal Framework for ICOs" (Jul. 8, 2019), *available* here.

[4] AMF Instruction DOC-2019-23, *available* here.

[5] *See* https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl_wa_merkblatt_ICOs_en.pdf;jsessionid=422764812F8A6B5FBA0164A44AB76EBE.1_cid393?__blob=publicationFile&v=4
We have also reported on the first advisory letter in our 2018 update *available* here.

documentation required by BaFin in order to respond to inquiries in the run-up to ICOs with respect to possible prospectus and authorisation requirements, (ii) classification of a token as a security under the prospectus regulations and the obligation to prepare a prospectus in connection with an ICO and (iii) potential authorisation requirements under the German Banking Act (*Kreditwesengesetz* – "KWG"), the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* – "ZAG") or the Investment Code (*Kapitalanlagegesetzbuch* – "KAGB").

Blockchain Strategy and Digital Securities

On 18 September 2019, the German government published a blockchain strategy that identifies the German government's objectives and principles in connection with blockchain to take advantage of the opportunities that blockchain technology offers.[6] The strategy has been developed after a public consultation process that took place in spring 2019.

One of the key elements of the German blockchain strategy is the opening of the German law to electronic, dematerialised securities. Currently, mandatory requirements that securities must be represented by physical certificates prevent German securities from being issued on the blockchain. According to the blockchain strategy, the German government will propose a new law to lift such restrictions, however initially limited to electronic debt securities/bonds (*Schuldverschreibungen*). By the end of 2020, the German government intends to examine possible further applications of blockchain in companies and corporate law. The end result could be a "blockchain company" whose shareholders, and their voting rights, would be determined by means of a virtual register.

New Law Regulating Crypto Custody and Crypto Assets

In November 2019, the German Parliament passed a new law that subjects crypto custody services to licensing requirements in accordance with the German Banking Act (*Gesetz über das Kreditwesen*).[7] The new law was intended to implement the EU 5th AML Directive as well as the recommendations of the Financial Action Task Force ("FATF") for the approach to virtual assets and virtual asset service providers ("FATF Guidance").

While the FATF Guidance only requires the licensing or registration of virtual asset service providers for purposes of AML, the German lawmakers decided to go beyond

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[6] *See* https://www.bundesfinanzministerium.de/Content/DE/Pressemitteilungen/Finanzpolitik/2019/09/2019-09-18-PM-Block-Anlage.pdf;jsessionid=A837255B7FF038CEC9BBD648066BB740.delivery2-master?__blob=publicationFile&v=3.

[7] *See* https://www.bgbl.de/xaver/bgbl/start.xav?startbk=Bundesanzeiger_BGBl&start=//*[@attr_id=%27bgbl119s2602.pdf%27]#__bgbl__%2F%2F*%5B%40attr_id%3D%27bgbl119s2602.pdf%27%5D__1585729591911.

this and to subject crypto custody service providers to the same regulations, and consequently, the same licensing requirements that apply to regulated financial service providers.

In addition to designating crypto custody service providers as financial service providers, the new law provides that "crypto assets" (*Kryptowerte*) constitute financial instruments within the meaning of the German Banking Act. Crypto assets (*Kryptowerte*) are defined as digital representations of an asset which are neither issued nor guaranteed by any central bank or public entity, and which do not have the statutory status of a currency or money, but which, based on agreements or actual practice, are accepted by natural or legal persons as means of exchange or payment or serve investment purposes and which can be transferred, stored or traded electronically. Electronic money within the meaning of the German Payment Services Supervisory Act (*Zahlungsdiensteaufsichtsgesetz*) does not constitute a crypto asset. Such definition covers all cryptocurrencies as well as all security tokens. As consequence, a number of services relating to crypto assets are now considered financial services and require a financial services license. The new law also introduces a grandfathering mechanism for service providers already safekeeping crypto assets in Germany. Such service providers are required to notify BaFin by end of March 2020 and to submit an application for a license at latest by end of November 2020.

German Federal Office for Information Security–Guideline on Blockchain Technology

In May 2019, the German Federal Office for Information Security ("BSI") issued a guideline providing for a comprehensive and in-depth analysis of blockchain technology and the related risks to information security. The BSI concludes that the mere use of blockchain does not solve IT security issues. On the contrary, well-known issues relating to hardware and software security continue to exist. In addition, new blockchain-specific risks arise. This may include attacks on the consensus mechanisms and the smart contracts as well as external interfaces.

In light of the above, the BSI emphasizes that the security of a blockchain technology strongly relies on the cryptographic algorithms used. In order to attain the desired security level, these algorithms should be selected carefully. The BSI points out the necessity to have at one's disposal measures for replacing cryptographic algorithms which are no longer secure.

BSI further identifies the lack of standards in the blockchain area as a security issue.

Russia

Russia followed the course on digital transformation that was established in previous years. The most significant development of 2019 was the adoption of the first Russian laws on virtual assets introducing relevant definitions, clarifying the legal status of smart contracts and providing for regulation of the first type of digital tokens and related information systems. In addition, for the first time, Bitcoin was contributed to the charter capital of a Russian company.[8]

Digital Rights

On October 1, 2019, the Law on Digital Rights,[9] introducing amendments to Russian Civil Code, came into force. It defines the legal status of digital tokens ("digital rights") and clarifies the legal force of smart contracts.[10]

- Digital Rights. Digital rights are obligations or other rights specifically named as such by law, the essence and terms for exercising of which are provided for by the rules of an information system meeting the requirements set forth by the law. Digital rights qualify as civil law proprietary rights. Exercise, disposition (including transfer, pledge or encumbrance in any other way) or a restriction on disposition of a digital right can be conducted solely within the information system without applying to a third party. Creation of digital rights, including tokenization, requires the adoption of special laws on the types of digital rights and requirements for information systems where digital rights can circulate.

- Smart Contracts. The requirement for a written form of a transaction is deemed to be satisfied if the transaction is executed through electronic or similar technical means, and the terms of the transaction can be reproduced intact on a tangible medium. Signature requirements are deemed to be fulfilled if the parties use an instrument allowing for credible identification of a person who expressed the requisite intent. The performance of a contractual undertaking may not require a separate expression of intent of the parties if software or other technology agreed upon between the parties is used. All these provisions contributed to establishing the legal validity and enforceability of smart contracts.

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8 *See* https://www.rbc.ru/crypto/news/5ddbc3779a7947b7a56880cb.

9 Federal Law No. 34-FZ dated March 18, 2019 (the "Law on Digital Rights"). The Law on Digital Rights came into force on October 1, 2019.

10 For more details on the Law on Digital Rights, please see Debevoise Update "Russian State Duma Adopts Bill on Digital Rights in Third Reading" *available* here.

Crowdfunding

On January 1, 2020, the Crowdfunding Law[11] adopted in 2019 came into force. It is the first law providing requirements as to the first information system for digital rights circulation and introduces the first type of digital rights—digital utility rights.[12] The Bank of Russia was empowered to regulate this activity.

- Digital Utility Rights. Digital utility rights include the right to demand transfer of tangible property, the right to demand transfer of exclusive rights to intellectual property and/or the right to use intellectual property, and the right to demand performance of work and/or provision of services. However, digital utility rights may not constitute a right to demand property subject to state registration and/or transactions that are subject to state registration or notary certification.

- Investment Platform. A digital utility right can be created, exercised or transferred only on an investment platform. An investment platform is an online information system that allows investment agreements to be made using the information technologies and technical facilities of such information system.

- Investment Platform Operator. An investment platform operator operates the investment platform. The investment platform operator is subject to various requirements and regulations. The investment platform operator must be included on a register maintained by the Bank of Russia, comply with specified capital requirements, and comply with a number of other regulatory restrictions, including a prohibition on the conduct of any other financial activity.

Shareholders of the investment platform operator are also subject to various requirements. In particular, a shareholder of an investment platform operator cannot be a legal entity that is registered in offshore jurisdictions or that had its credit or non-credit financial institution license revoked, or be an individual who was subject to the administrative penalty of disqualification (unless the individual's administrative disqualification has expired).

- Issuers and Investors. The Crowdfunding Law imposes limitations on digital utility token issuers and investors. In particular, the Crowdfunding Law limits the amount of investments that can be raised through investment platforms by a particular issuer to one billion Russian rubles within one calendar year. An investor who is an

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[11] Federal Law No. 259-FZ on Raising Investments via Investment Platforms and on the Amendments to Certain Legislative Acts of the Russian Federation dated August 2, 2019 (the "Crowdfunding Law").

[12] For more details on the Crowdfunding Law please see Debevoise InDepth "Russia Adopts Crowdfunding Law" *available* here.

individual can invest only up to 600,000 Russian rubles through investment platforms during one calendar year.

Going Forward

The State Duma of the Russian Federation is still considering the Bill on Digital Financial Assets that was adopted in the first reading in May 2018. If finally adopted, the bill will provide for a regulatory framework for circulation of security tokens in Russia, including in particular, ICO procedures and the requirements for issuance of tokenized shares. There is an expectation that this bill will be adopted in 2020.

Following the issuance of the FATF Guidance (as discussed in the update on Germany above), the State Duma of the Russian Federation announced plans for the regulation of cryptocurrencies that incorporate FATF recommendations. The details of such regulation are yet to be released.

Switzerland

Switzerland remains a jurisdiction favorable to crypto-assets and innovation. As an indicator of such positive approach, the Swiss Financial Market Supervisory Authority ("FINMA") granted banking and securities dealer licenses to two financial services firms focused on operations with digital assets.[13] Following the release of a report of the Swiss Federal Council on the legal framework for distributed ledger technology ("DLT") and blockchain in Switzerland, the Swiss Federal Council developed a draft law concerning DLT and blockchain (the "DLT Draft Law"). In addition, following the publication of new FATF Guidance (as discussed in the update on Germany above), FINMA provided additional guidance on AML and KYC for blockchain payments. FINMA also supplemented its ICO guidelines published in 2018[14] to address issues connected with the circulation of stablecoins.

DLT Draft Law

The DLT Draft Law is intended to address the legal issues posed by the development of blockchain and DLT identified in the abovementioned report of the Swiss Federal Council.[15] Its first draft was published by the Federal Council in March 2019 for public consultation. Following the consultation, in November 2019, the Federal Council

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[13] https://www.seba.swiss/news/FINMA-licence-received; https://www.insights.sygnum.com/post/sygnum-digital-asset-technology-group-receives-finma-banking-and-securities-dealer-licence.

[14] For more details see Debevoise InDepth "Blockchain 2018 Year-in-Review" available here.

[15] For more details on the report please see Debevoise InDepth "Blockchain 2018 Year-in-Review" available here.

published the final draft that had to be submitted to the Parliament. The main provisions of the DLT Draft law are the following:

- "Uncertificated Register Securities": Contractual rights or participatory interests can be tokenized in the form of "uncertificated register securities" ("URS"). Under the classification of tokens provided by FINMA, asset tokens, utility tokens and hybrid tokens can be issued as URS. In order to create URS, a token issuer and token holders shall enter into a registration agreement, according to which the underlying right is recorded in a Register of Uncertificated Securities (the "Register"). Existence of URS may thereafter be confirmed purely on the basis of an entry in the Register. Transfer of URS is possible only by means of the Register. The Register must meet certain statutory requirements.

- Shares as URS: Shares can be issued in the form of URS. In this case, other registers where information on the issuing company's shares is recorded shall be incorporated into the Register.

- DLT-Securities: The DLT Draft Law addresses DLT-Securities, which are securities suitable for public circulation and having either the form of URS or other uncertificated securities that are held in distributed electronic registers and that grant the creditor the right of disposal over the securities.

- DLT Trading Venue: The DLT Draft law addresses DLT Trading Venues, which are trading venues that allow for simultaneous exchange of offers between several participants and the conclusion of contracts based on standard rules and that provide for (a) admission of unregulated companies or individuals; (b) custody of DLT-Securities based on standard rules; or (c) clearing and settlement of transactions in DLT-Securities based on standard rules. In general, the licensing requirements applicable to DLT Trading Venues are similar to requirements for traditional trading venues. The Federal Council or FINMA will have the authority to establish additional requirements for certain DLT Trading Venues or to exempt certain DLT Trading Venues from some of the requirements.

- Crypto-Assets in Insolvency: Crypto-assets held in custody must be segregated from the custodian's own assets and be protected during insolvency proceedings against the custodian. However, in order to enable such segregation, certain requirements must be met. In particular, crypto-assets must be capable of being allocated to a particular creditor.

FINMA AML and KYC Guidelines

In its guidance on payments on the blockchain as of August 2019, FINMA stressed its technically neutral approach to applicability of AML requirements. Swiss AML laws apply to blockchain service providers, especially given high money laundering and terrorism financing risks connected with anonymity of blockchain transactions. In particular, blockchain service providers must transmit information about the client and the beneficiary with token transfers in the same way as for bank transfers, but not necessarily on the blockchain. FINMA also mentioned that Swiss AML law, unlike FATF standards, does not exempt payments involving unregulated wallet providers from AML requirements.

Stablecoins

In September 2019, FINMA supplemented its guidance on ICOs and provided its view on the most common types of stablecoin projects in accordance with Swiss law.

FINMA noted that particular designs of stablecoins can vary in legal, technical, functional and economic terms. As such, a specific assessment of each individual stablecoin use case is required. However, FINMA provided for the following classifications and qualifications of stablecoins:

- if a token is linked to a specific fiat currency, it can be qualified either as a deposit under banking law or a collective investment scheme, depending on the type of redemption claim (fixed or dependent on price development) and the person for the account and risk of which the underlying assets are managed;

- if a token is linked to a commodity and evidences an ownership right of the token holder, it does not qualify as security, and its regulation is outside the scope of the financial market laws;

- if a token is linked to a commodity and evidences a contractual claim on "bank precious metals", it can be qualified as a deposit under banking law; if a token is linked to other assets, the token generally qualifies as a security or a derivative; and if a token is linked to a basket of commodities with redemption claims dependent on price development, it can be qualified as a collective investment scheme;

- if a token is linked to individual properties or a real estate portfolio, and a token holder has a redemption claim dependent on price development, the token can be qualified as a collective investment scheme; and

- if a token is linked to a security, it can be qualified as a security as well; and if a token is linked to a basket of securities with redemption claims dependent on price development, it can be qualified as a collective investment scheme.

Depending on the qualification of a token, the respective licensing and regulatory requirements will apply.

United Kingdom

There has been some clarification of the nature of cryptoassets over the past year, including separate consultations by the UK Financial Conduct Authority ("FCA") on the regulatory implications of cryptoassets and by the UK Jurisdiction Taskforce ("UKJT") on the legal nature of cryptoassets and smart contracts under English law. The implementation in the UK of the Fifth EU Money Laundering Directive means that cryptoasset exchanges and custodian wallet providers now fall within the scope of UK anti-money laundering and counter-terrorism financing legislation.

2019 Initiatives

In January 2019, the FCA issued a consultation paper[16] on Guidance on Cryptoassets. The consultation paper focused on where cryptoassets interact with the FCA's regulatory 'perimeter'. In particular, it looked at where cryptoassets would be considered 'Specified Investments' under the UK's Regulated Activities Order ("RAO"), 'Financial Instruments' such as 'Transferable Securities' under the Markets in Financial Instruments Directive II, or captured under the Payment Services Regulations, or the E-Money Regulations. It also covered where cryptoassets would not be considered 'Specified Investments' under the RAO.

For the purposes of the consultation paper the FCA categorised cryptoassets into three types of tokens: Exchange tokens, designed to be used as means of exchange for goods and services—generally considered to be outside the regulatory perimeter; Security tokens, with specific characteristics that mean that they meet the definition of a Specified Investment such as a share or debt instrument and are therefore within the perimeter; and Utility tokens, which grant holders access to a product or service but do not grant holders rights similar to those granted by Specified Investments. However, the FCA considered that Utility tokens might meet the definition of e-money in certain circumstances, in which case activities in relation to them might be within the perimeter.

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[16] Financial Conduct Authority, "CP19/3: Guidance on Cryptoassets," available here.

The FCA provided feedback and final Guidance on Cryptoassets in a policy statement issued in July 2019.[17] As a result of feedback, the FCA reframed its taxonomy of cryptoassets to help market participants better understand whether tokens are regulated, and where they fall outside the FCA's remit. The FCA divided tokens into two broad categories: Unregulated tokens, Exchange tokens and Utility tokens; and Regulated tokens, Security tokens and E-money tokens. The FCA also considered that 'stablecoins' might fall into different categories, depending on how they were structured. Ultimately, this could only be determined on a case-by-case basis.

The UKJT is one of six task forces established by the LawTech Delivery Panel[18] for the purpose of achieving the objective of promoting the use of technology in the UK's legal sector. In May 2019, the UKJT issued a public consultation on the status of cryptoassets, distributed ledger technology and smart contracts under English private law. The objective was to demonstrate that English law and the jurisdiction of England and Wales together provided a state-of-the-art foundation for the development and use of distributed ledger technology, smart contracts and associated technologies. In November 2019, the UKJT issued a legal statement on cryptoassets and smart contracts.[19] In relation to cryptoassets, the legal statement made the following general points:

- Cryptoassets have all of the indicia of property;
- The novel or distinctive features possessed by some cryptoassets—intangibility, cryptographic authentication, use of a distributed transaction ledger, decentralisation, rule by consensus—do not disqualify them from being property;
- Nor are cryptoassets disqualified from being property as pure information, or because they might not be classifiable either as things in possession or as things in action; and
- Cryptoassets are therefore to be treated in principle as property.

In relation to smart contracts, the legal statement explained that there is a contract in English law when two or more parties have reached an agreement, intend to create a legal relationship by doing so, and have each given something of benefit. A smart contract is capable of satisfying these requirements just as well as a more traditional or natural language contract, and a smart contract is therefore capable of having

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17 Financial Conduct Authority, "PS19/22: Guidance on Cryptoassets", available here.

18 The LawTech Delivery Panel was established by the UK government, the Judiciary and the Law Society of England and Wales.

19 UK Jurisdiction Taskforce: "Legal statement on cryptoassets and smart contracts", available here.

contractual force. Whether the requirements are in fact met in any given case will depend on the parties' words and conduct, just as it does with any other contract.

Anti-Money Laundering and Counter-Terrorism Financing

The Fifth EU Money laundering Directive ("5MLD")[20] entered into force on 10 July 2018 and was required to be implemented by EU Member States by 10 January 2020. In April 2019, HM Treasury issued a consultation on the transposition of 5MLD into English law[21] and the relevant amending Regulations[22] were made on 19 December 2019.

As a result of the Regulations, "providers engaged in exchange services between cryptoassets and fiat currencies" and "custodian wallet providers" will be required to fulfil customer due diligence obligations, assess money laundering and terrorist financing risks they face, and report any suspicious activity they detect. They will also be required to register with the relevant UK supervisor. The UK government asked the FCA to take on the role of supervision of cryptoasset exchanges and custodian wallet providers in fulfilling their AML/CTF obligations, and the FCA assumed this role with effect from 10 January 2020.

United States

Continuing Scrutiny of Cryptocurrency Activities by the SEC and Other Regulators, and Some Guidance

- SEC Enforcement Actions. The U.S. Securities and Exchange Commission ("SEC") continued to bring enforcement actions against certain market participants. Fraudulent activities and unregistered initial coin offerings ("ICOs") remained one primary focus of enforcement efforts. On June 4, 2019, the SEC announced that it had filed a complaint against Kik Interactive Inc. for its alleged offer and sale of Kin tokens constituting unregistered securities.[23] On September 30, 2019, the SEC announced that it had settled charges against Block.one for its alleged unregistered securities offering of EOS tokens.[24] Block.one agreed to pay a $24 million fine without admitting or denying the SEC's allegations. In October 2019, the SEC

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[20] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 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 Directives 2009/128/EC and 2013/36/EU, available here.

[21] HM Treasury: Transposition of the Fifth Money Laundering Directive (April 2019), available here.

[22] The Money Laundering and Terrorist Financing (Amendment) Regulations 2019, available here.

[23] *See* SEC Press Release, SEC Charges Issuer With Conducting $100 Million Unregistered ICO (Jun. 4, 2019), available here.

[24] *See* SEC Press Release, SEC Orders Blockchain Company to Pay $24 Million Penalty for Unregistered ICO (Sep. 30, 2019), available here.

announced that it had filed an emergency action and obtained a temporary restraining order against Telegram Group Inc. and its wholly owned subsidiary, TON Issuer Inc., based on its alleged ongoing unregistered securities offering of TON tokens.[25] Court proceedings in the case were ongoing as of the end of 2019.

- SEC Framework. In April 2019, the SEC released staff guidance on analyzing the federal securities law status of digital assets (the "Framework").[26] The Framework lists a variety of factors that are relevant when analyzing whether a particular digital asset constitutes an investment contract, and thus a security, for purposes of the U.S. federal securities laws. The Framework focuses on the application of the so-called Howey test and, in particular, on whether the offer and sale of a particular token is made to an investor with an expectation of profit based on the efforts of a sponsor or other active participant.

- SEC No-Action Letters. The SEC also released its first no-action letters in the digital asset space in 2019. On the same date that it released the Framework, the SEC announced its no-action letter with respect to TurnKey Jet, Inc.[27] In July 2019, the SEC released its no-action letter with respect to Pocketful of Quarters, Inc.[28] Both no-action letters are somewhat limited in scope, involving tokens that may only be used on the issuer's fully functional platform upon issuance and that may not be sold or traded outside of the issuer's platform-based wallets.

- Possible Steps Toward a Safe Harbor. SEC Commissioner Hester Peirce, referred to by some in the blockchain industry as 'crypto mom', made a number of statements during 2019 indicating her belief that the SEC's unwillingness to introduce a regulatory framework for offerings and sales of digital assets has harmed innovation in the space.[29] These statements may have foreshadowed the recent introduction by Commissioner Peirce of a proposed three-year safe harbor for network developers that fund the development of their network in whole or in part through the sale of blockchain tokens, so long as certain disclosure and other requirements are met and the network reaches a required level of decentralization and/or functionality by the end of such three-year period.[30]

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[25] *See* SEC Press Release, SEC Halts Alleged $1.7 Billion Unregistered Digital Token Offering (Oct. 11, 2019), available here.

[26] *See* Framework for 'Investment Contract' Analysis of Digital Assets (Apr. 3, 2019), available here.

[27] *See* SEC No-Action Letter, Turnkey Jet, Inc. (Apr. 3, 2019), available here.

[28] *See* SEC No-Action Letter, Pocketful of Quarters, Inc. (Jul. 25, 2019), available here.

[29] *See*, e.g., Hester M. Peirce, SEC Commissioner, Speech, Broken Windows: Remarks before the 51st Annual Institute on (Nov. 4, 2019), available here.

[30] *See* Hester M. Peirce, SEC Commissioner, Speech, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization (Feb. 6, 2020), available here.

- Custody Remains a Hot Issue. On March 12, 2019, the SEC issued a statement soliciting feedback questions on its Custody Rule under the Investment Advisers Act, as well as other related matters (such as "delivery versus payment" concepts).[31] On July 8, 2019, the SEC and Financial Industry Regulatory Authority ("FINRA") published a joint statement on the custody of digital asset securities by registered broker-dealers, acknowledging challenges but reiterating that considerations under relevant federal securities laws and FINRA rules need to be addressed when a broker-dealer considers engaging in the custody of digital assets.[32]

- FinCEN and Anti-Money Laundering Considerations. On May 9, 2019, the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") published guidance on the application of FinCEN's regulations to certain virtual currency business models.[33] Building on earlier guidance, including its 2013 guidance on the application of FinCEN's regulations to administrators, exchangers and users of virtual currencies, the 2019 guidance provides a summary of the regulatory framework as applied to convertible virtual currencies and considers that application under a number of specified business activities involving the transmission of convertible virtual currencies (including, for example, wallet providers, crypto ATMs, dApps and payment processors). The Financial Action Task Force, of which the United States is a member, also published guidance for a risk-based approach to virtual assets and virtual asset service providers in mid-2019,[34] including an indication that obligations commonly referenced as the "travel rule" should apply to virtual asset service providers.[35]

- IRS Tax Guidance on Virtual Currencies. On October 9, 2019, the U.S. Internal Revenue Service ("IRS") published new guidance on the application of tax laws to persons who engage in transactions involving virtual currency.[36] Although it may be difficult to implement in practice and there are aspects that may require further

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[31] *See* Paul G. Cellupica, Deputy Director and Chief Counsel, SEC Division of Investment Management, Letter to Karen Barr, President & Chief Executive Officer, Investment Adviser Association, "Engaging on Non-DVP Custodial Practices and Digital Assets" (Mar. 12, 2019), available here.

[32] *See* SEC Division of Trading and Markets and Office of General Counsel, Financial Industry Regulatory Authority, Public Statement, "Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities" (Jul. 8, 2019), available here.

[33] FIN-2019-G001, "Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies" (May 9, 2019), available here.

[34] *See* Financial Action Task Force, "Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers" (Jun. 2019), *available* here.

[35] The "travel rule" generally requires that a transmitter of virtual currency (or other funds) obtains, holds and transmits required originator and beneficiary information along with the transmittal. Compiling and transmitting such information in the blockchain context can present challenges.

[36] *See* IR-2019-167, News Release, "Virtual currency: IRS issues additional guidance on tax treatment and reminds taxpayers of reporting obligations" (with accompanying Revenue Ruling and FAQs) (Oct. 9, 2019), available here.

clarification (such as treatment of forks and airdrops), the basic gist of the guidance is not surprising given the IRS's prior conclusion that virtual currency is to be treated as property. A seller of virtual currency must recognize any capital gain or loss on the sale, subject to applicable limitations on the deductibility of capital losses.

The Libra Saga

Announced in June 2019, the Libra project proposed the issuance of a new "stablecoin" backed by a basket of international currencies and U.S. Treasuries.[37] Led by Facebook and initially supported by a consortium of more than two dozen founding members, the project faced a great deal of scrutiny from regulators and legislators and a number of early consortium members backed out of the project by the fourth quarter of 2019. Despite the headwinds, indications late in the year were that Facebook and the Libra Association still planned to move forward with Libra, with an expected launch date in 2020. While regulators and the public have expressed varying views on Libra, the project has certainly drawn more attention to blockchain and its potential uses.

Federal Legislative Efforts

Partly driven by reactions to the Libra announcement, blockchain remained an active focus of certain legislative efforts. Although these proposals have generally stalled before the end of the legislative session, they demonstrate increasing awareness and (in some cases) concerns about the blockchain industry and its participants.

By way of example, in April 2019, Rep. Warren Davidson reintroduced the Token Taxonomy Act of 2019, aimed at amending the securities laws to exclude certain digital tokens from the definition of a security.[38] In October 2019, Rep. Patrick McHenry reintroduced the Financial Services Innovation Act, which would establish within financial-related agencies (such as the Federal Reserve, the SEC and the Commodity Futures Trading Commission) a Financial Services Innovation Office tasked with supporting the development of financial innovations.[39] Less friendly measures introduced in 2019, in some cases seemingly in reaction to the Libra project, include the Keep Big Tech Out of Finance Act,[40] which would preclude the involvement of large technology companies in the establishment, maintenance or operation of a digital asset intended to function as a medium of exchange, unit of account or store of value and place limits on certain such companies being affiliated with a financial institution, and

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[37] *See*, e.g., Mike Isaac & Nathanial Popper, "Facebook Plans Global Financial System Based on Cryptocurrency", The New York Times (Jun. 18, 2019).

[38] Token Taxonomy Act of 2019, H.R. 2144, 116th Congress (2019).

[39] Financial Services Innovation Act of 2019, H.R. 4767, 116th Congress (2019).

[40] Keep Big Tech Out of Finance Act, H.R. 4813, 116th Congress (2019).

the Managed Stablecoins are Securities Act,[41] which would amend the definition of security in relevant federal laws to include "managed stablecoins."

State Developments

A number of states remained active in the blockchain space—both in terms of enforcement actions and legislative developments. Texas, New Jersey and other states brought enforcement actions for fraud and violation of state securities laws in connection with token offerings and similar projects. Focusing on a couple of states with broader activity, New York and Wyoming are highlighted below.

- New York. New York remained active with its consideration of BitLicense applications. In April 2019, the New York Department of Financial Services ("DFS") announced both the grant of a license to Bitstamp USA[42] and the denial of an application of Bittrex,[43] both token trading platforms. With respect to Bittrex, DFS indicates that Bittrex failed to meet a number of licensing requirements, primarily due to deficiencies in its BSA/AML/OFAC compliance program, deficiencies in meeting capital requirements, and deficient due diligence and control over its token and product launches. Although DFS continued to consider BitLicense applications actively, it also took steps indicating that it may look to modify the licensing regime or the review process in some respects. On July 23, 2019, DFS announced the creation of a Research and Innovation Division, which would be tasked with supporting internal transformation and market innovation and would, among other things, house the DFS division responsible for licensing and supervising virtual currencies.[44] On October 22, 2019, speaking at Georgetown University's Institute of International Economic Law during DC Fintech Week, DFS Superintendent Linda Lacewell indicated that DFS was reviewing the BitLicense regulations to consider whether any adjustments might be warranted based on the current market and changes in the industry.[45]

- Wyoming. Wyoming introduced and passed a number of blockchain-related laws in 2019. These include measures focusing on the definition of blockchain-based assets

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41 Managed Stablecoins are Securities Act of 2910, H.R. 5197, 116th Congress (2019).

42 New York Department of Financial Services, Press Release, "DFS Grants Virtual Currency License to Bitstamp USA, Inc." (Apr. 9, 2019), available here.

43 New York Department of Financial Services, Press Release, "DFS Denies the Applications of Bittrex, Inc. for New York Virtual Currency and Money Transmitter Licenses" (Apr. 10, 2019), available here.

44 New York Department of Financial Services, Press Release, "DFS Superintendent Linda A. Lacewell Announces Newly Created Research and Innovation Division, New Executive Appointments" (Jul 23, 2019), available here.

45 *See*, e.g., Nikhilesh De, "New York's Financial Regulator Is Reviewing the Controversial BitLicense," CoinDesk.com (Oct. 22, 2019), available here.

(i.e., digital securities, digital consumer assets and virtual currencies), the property status of digital assets, and the custody of digital assets.[46]

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Please do not hesitate to contact us with any questions.

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[46] *See*, e.g., CleanApp, "Into to Wyoming Crypto Law," medium.com (Feb. 23, 2019), *available* here.