

Blockchain 2018 Year-in-Review

February 14, 2019

Since the introduction of blockchain¹ a decade ago, the pace of development, experimentation and application has continued to accelerate. In 2018, the market cap of all existing crypto-assets reached a record high in January, only to tumble by well over 70 percent by year-end. While initial coin offerings (“ICOs”) are still occurring, the earlier frenzy has largely dissipated. Even so, the estimated number of owners of crypto-assets increased globally, and more centralized exchanges and trading platforms came onto the scene, with a substantial increase in estimated trading volume.

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On the business front, the enterprise application of blockchain technology continued to rise, with more financial institutions and other commercial companies experimenting with the incorporation of blockchain into their existing business. In 2018, many enterprise use cases moved from the proof-of-concept stage to experimentation and beyond.

International and national regulators continued to struggle to catch up with the fast-developing technology and its application beyond the sphere of virtual currency. National regulators are drawing on both rule-making and enforcement action to protect customers and ensure market integrity. In so doing, many national and international regulators have acknowledged the inadequacy of the existing regulatory framework in addressing changes brought on by the technology, leading to surveys, consultation projects and proposed new rules.

In this update, we have reviewed key regulatory and other developments that took place in 2018 in a number of jurisdictions. As the following shows, regulatory responses to the relentlessly fast-developing technology vary significantly from nation to nation and even within a single nation like the United States. Indeed, it is possible that the global regulatory landscape for blockchain will become highly fractured in the near future.

¹ Blockchain is a subset of distributed ledger technology. There is no formal or widely agreed-upon definition of distributed ledger technology, but it generally refers to a technological system that creates a single, sequential record of transactions and other activities, secured by cryptography and consensus mechanism and that is distributed to and acted upon by all participants. In this report, we may use the term “blockchain” to refer to distributed ledger technology for purposes of convenience.

That would not be ideal for blockchain technology, which was created to transcend geographical and political borders.

European Union

The European Commission's FinTech Action Plan of 2018

On March 8, 2018, the European Commission published its FinTech Action Plan, intended as a starting point for a wide range of measures to improve Europe's position regarding new technologies in the financial sector.²

The Commission considers FinTech to be a key factor not only for the financial sector but also for its envisioned Capital Markets Union, a true single market for consumer financial services, as well as a Digital Single Market. To support the financial sector in its use of new technologies such as blockchain, artificial intelligence and cloud services, the Commission has prepared a FinTech Action Plan, encompassing three main objectives: (i) enabling innovative business models to scale up, (ii) supporting the adoption of new technologies and (iii) increasing cybersecurity and the integrity of the financial system. Specific initiatives within the plan include hosting a European Union ("EU") FinTech Laboratory, running workshops to improve the sharing of cybersecurity information and developing a best-practices blueprint for regulatory sandboxes. Most of the items discussed below are closely linked with the Commission's FinTech Plan or should be regarded in that context.

European Supervisory Authorities' Reports on ICOs, Crypto-Assets and Regulatory Sandboxes

In the first week of 2019, both the European Securities and Markets Authority ("ESMA") and the European Banking Authority ("EBA") issued reports advising EU legislators on the regulation of crypto-assets and ICOs. Concurrently, the European Supervisory Authorities ("ESAs"), issued a joint report on innovation hubs and regulatory sandboxes.³

² For the complete report please see: European Commission, "Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions" (Mar. 8, 2019), available at https://ec.europa.eu/info/sites/info/files/180308-action-plan-fintech_en.pdf.

³ For more information see our Client Update of January 22, 2019: <https://www.debevoise.com/insights/publications/2019/01/european-supervisory-authorities-recommend>. For the report please see: (i) ESMA, "Advice: Initial Coin Offerings and Crypto-Assets" (Jan. 9, 2019), available at https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf, (ii) EBA, "Report with advice for the European Commission: on crypto-assets" (Jan. 9, 2019), available at

ESMA's report reviews the current EU rules applicable to crypto-assets which qualify as financial instruments, as well as the gaps and issues in those rules. For crypto-assets that do not qualify as financial instruments, the report recommends considering a bespoke regime. EBA focuses on crypto-assets from the perspective of EU regulations on banking, payment services and electronic money, and recommends further analysis of the current regulatory environment to determine whether amendments are necessary. ESAs' report centers on a comparative analysis of regulatory sandboxes and innovation hubs within Europe, including best practices for their design and operation, and recommends promoting coordination and cooperation between innovation facilitators at the EU level in an EU network.

EU Blockchain Observatory and Forum

In February 2018, the European Commission launched the EU Blockchain Observatory and Forum.⁴

The objective of the EU Observatory is to accelerate blockchain innovation and the development of the blockchain ecosystem within the EU. It provides analysis and reports on a range of blockchain topics reflecting the priorities of the European Commission. During 2018, those reports included "Blockchain Innovation in Europe" in July 2018, "Blockchain and the GDPR" in October 2018 and "Blockchain for Government and Public Services" in December 2018.⁵

The report on blockchain and the EU General Data Protection Regulation ("GDPR") is particularly noteworthy. It identifies three main points of tension between blockchain and the GDPR: (i) difficulties in identifying data controllers and processors in the context of blockchain transactions, particularly when blockchain transactions are written by the data subjects themselves; (ii) a lack of consensus regarding what is required to anonymize personal data so that the result can be stored in a blockchain network; and (iii) challenges in rectifying or removing personal data once it has been recorded in a blockchain network.

The report offers general recommendations for using blockchain in the context of GDPR and in light of the number of important issues that remain unresolved. These recommendations include (i) assessing if it is essential to use blockchain in a given

<https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf>, and (iii) ESA, "Report FinTech: Regulatory sandboxes and innovation hubs" (Jan. 7, 2019), available at <https://eba.europa.eu/documents/10180/2545547/JC+2018+74+Joint+Report+on+Regulatory+Sandboxes+and+Innovation+Hubs.pdf>.

⁴ Further information can be found at: EU Blockchain Observatory and Forum, available at

<https://www.eublockchainforum.eu/>.

⁵ See the reports at: EU Blockchain Observatory and Forum: Reports, available at

<https://www.eublockchainforum.eu/reports>.

scenario; (ii) using encryption and aggregation techniques for storing personal data rather than storing such data directly on blockchain; (iii) avoiding the use of blockchain for the collection of personal data (or at a minimum using private, permissioned blockchain networks to do so); and (iv) continuing to innovate while being as clear and transparent as possible with users. These suggestions are in line with the approach taken by France's CNIL (see below).

European Blockchain Partnership

In April 2018, 21 Member States of the European Union and Norway signed a declaration creating the European Blockchain Partnership ("EBP").⁶

The EBP aims to develop a trusted, secure and resilient European Blockchain Services Infrastructure ("EBSI"), which would meet the highest standards for privacy, cybersecurity, interoperability and energy efficiency, and be fully compliant with EU regulations. The EBSI is intended to support digital services deployed by public authorities and to promote cooperation between public authorities with actors. Five additional countries have since joined the European Blockchain Partnership.

Securities and Markets Stakeholders Group's Report to ESMA

In October 2018, the Securities and Markets Stakeholders Group ("SMSG") issued its "Own Initiative Report on Initial Coin Offerings and Crypto-Assets," intended to provide advice to the ESMA.⁷ SMSG represents the interests of various financial markets stakeholders, including consumers, users of financial services, financial market participants, academics, employees in the financial sector and small and medium-sized enterprises and provides advice to ESMA on development of financial market policies.

The first part of the report provides definitions for the concepts used in connection with ICOs and crypto-assets. Building on the taxonomy of crypto-assets of the Swiss financial supervisory authority FINMA, SMSG differentiates between payment tokens, utility tokens, asset tokens and hybrids.

The second part of the report discusses whether and how to regulate ICOs and crypto-assets, with SMSG recommending that ESMA either issue level 3 guidelines or work toward supervisory convergence to clarify whether:

⁶ The Declaration on European Partnership on Blockchain can be found at: "DECLARATION: Cooperation on a European Blockchain Partnership" (Apr. 10, 2018), available at https://ec.europa.eu/newsroom/dae/document.cfm?doc_id=50954.

⁷ For the complete report please see: Securities and Markets Stakeholder Group, "ADVICE TO ESMA: Own Initiative Report on Initial Coin Offerings and Crypto-Assets" (Oct. 19, 2018) available at https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338_smsg_advice_-_report_on_icos_and_crypto-assets.pdf.

- transferable asset tokens which have features typical of transferable securities are subject to the Markets in Financial Instruments Directive (“MiFID II”), and the Prospectus Regulation;
- depending on the interpretation of the MiFID definition of “commodities,” asset tokens with features typical of derivatives are MiFID financial instruments;
- the organization of a secondary market in asset tokens which qualify as MiFID financial instruments is a multilateral trading facility (“MTF”) or an organized trading facility (“OTF”);
- issuers of asset tokens are to be considered to organize an MTF or an OTF, and consequently, whether the Market Abuse Regulation (“MAR”) applies to such MTFs and OTFs;
- persons giving investment advice on asset tokens that are to be considered MiFID financial instruments or persons executing orders in such asset tokens are to be considered investment firms, and thus required to have a license (unless they qualify for an exemption under MiFID II).

Based on its conclusion that transferable payment tokens and utility tokens currently do not fall into the scope of MiFID II but are increasingly used as investment products, SMSG suggests adding transferable tokens to the MiFID II list of financial instruments.

Finally, SMSG suggests that ESMA provides guidelines with minimum criteria that national authorities can use regarding sandboxes or innovation hubs. Some of these suggestions seem to have been considered by ESMA in its report to EU Institutions on regulation of ICOs and crypto-assets (see above).

European Parliament’s Resolution on Blockchain: A Forward-Looking Trade Policy

In December 2018, the European Parliament passed a resolution on “Blockchain: A Forward-Looking Trade Policy.”⁸

In its resolution, the European Parliament calls on the European Commission to develop a set of guiding principles for the adoption of blockchain in international trade, which the European Parliament believes would lead to cost reduction and improved

⁸ The complete resolution can be found at: European Parliament, “Resolution of 13 December 2018 on Blockchain: a forward-looking trade policy” (Dec. 13, 2018), *available at* <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2018-0528&format=XML&language=EN>.

transparency and traceability throughout the supply chain, as well as improved EU trade policies. In addition, the Parliament called on the European Commission, the European Union and the Member States to work together with all stakeholders to develop the technology and the necessary legal framework and to address any challenges that arise.

Fifth Money Laundering Directive Targets Virtual Currencies

In July 2018, the fifth EU Anti-Money Laundering (“AML”) Directive entered into force with the aim, among others, to regulate virtual currency service providers.⁹

The fifth Anti-Money Laundering Directive modifies the fourth Anti-Money Laundering Directive (2015) and extends the AML regime to, among others, providers of exchange services between virtual currencies and fiat currencies and custodian wallet providers. The directive defines “virtual currency” to mean 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. The directive clarifies that local or complementary currencies that are used in very limited networks such as a city or a region and among a small number of users should not be considered to be virtual currencies. “Custodian wallet provider” means an entity that provides services to safeguard private keys on behalf of its customers, to hold, store and transfer virtual currencies.

As a consequence of these definitions, exchange services providers and custodian wallet providers fall within the definition of the directive of entities obliged to comply with requirements of the AML regime, including conducting due diligence when establishing and performing business relationships and identifying and reporting suspicious activity. In addition, the directive requires Member States to require exchange services providers and custodian wallet providers to register with the financial supervisory authorities. The EU Member States are required to implement the fifth Anti-Money Laundering Directive in their national laws by January 2020.

Separately, in October 2018, the Financial Action Task Force (“FATF”) announced that it is updating its guidelines to require jurisdictions worldwide to license or regulate cryptocurrency exchanges and firms that provide either encrypted wallets or financial services for issuances of new cryptocurrencies. The updated guidelines are expected to

⁹ The complete directive can be found at: European Parliament And of the Council, “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 2009/138/EC and 2013/36/EU” (May 30, 2018), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>.

be issued by June 2019. FATF will periodically review the implementation of these rules by each of its member countries; countries falling short may be added to an FATF blacklist that restricts access to the global financial system.

France

French legislator adopts law on ICOs

In October 2018, the French Parliament adopted the “Action Plan for Business Growth and Transformation” (*Plan d’ Action pour la Croissance et la Transformation des Entreprises*), known as “*loi PACTE*,” which will become law once it is approved by the Senate.

Once it is approved, *loi PACTE* will provide for a legal framework for ICOs intended to increase consumer and investor protection. It will create an optional regime through which otherwise non-regulated crypto-assets can seek regulatory approval for offerings. Issuers of crypto-assets established in France may choose to have their offering documentation approved by the *Autorité des Marchés Financiers* (“AMF”), the French regulator, to demonstrate compliance with certain information requirements. The AMF will approve the offering documentation if the requirements for investor protection are met regarding the disclosure of certain information and the implementation of a system to monitor and safeguard investor funds. Following the offer, the issuer will have to inform the investors of the amounts raised and of the existence, if any, of a secondary market.

An issuer authorized under the new regime will be registered on a public “white list” and the AMF may publish violations of the law. Credit institutions must open bank accounts for the authorized issuers. *Loi PACTE* also provides for an optional license regime for various service providers in the secondary market such as digital asset custodians and trading platforms.

CNIL Issues Guidance on Blockchain and GDPR¹⁰

The EU General Data Protection Regulation was drafted in the context of centralized data governance. European data protection authorities and practitioners still struggle with the application of the regulation to personal data stored on a decentralized blockchain. It is unclear, for example, whether every user of a blockchain is a data controller and has to grant data subject rights to natural persons whose personal data

¹⁰ CNIL, “Blockchain and the GDPR: Solutions for a responsible use of the blockchain in the context of personal data” (Nov. 6, 2018), available at <https://www.cnil.fr/en/blockchain-and-gdpr-solutions-responsible-use-blockchain-context-personal-data>.

reside on the blockchain. Nor is it clear how to reconcile the right to erase personal data with a technology that necessarily stores all information.

As a step toward resolving these issues, the French data protection authority, *Commission Nationale de l'Informatique et des Libertés* (“CNIL”), proposed guidance to users of the blockchain technology. The guidance, issued in November 2018, states that every participant determining the purposes and means of data processing qualifies as a data controller. It also observes that it is technically impossible to grant the right to erasure mandated by the GDPR within current blockchain technology and suggests implementing technology that will produce results that are substantially similar to data erasure.

The guidance suggests that application developers carefully assess whether blockchain technology is essential for their needs and choose, if possible, more GDPR-friendly solutions.

Germany

BaFin’s Advisory Letter on the Regulatory Categorization of Tokens

In February 2018, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, “BaFin”) issued an advisory letter on the regulatory categorization of tokens and cryptocurrencies issued in initial coin offerings.¹¹

The letter suggests that tokens can, depending on their design, qualify as regulated instruments, and capital market regulations may govern initial coin offerings and certain services in connection with token transactions. Specifically, tokens may constitute (i) a financial instrument within the meaning of the German Securities Trading Act or MiFID II, (ii) a security within the meaning of the German Securities Prospectus Act, (iii) a capital investment within the meaning of the German Capital Investment Act, (iv) a unit in a collective investment undertaking within the meaning of the German Capital Investment Act or MiFID II or (v) an underlying asset for derivative contracts within the meaning of the German Securities Trading Act or MiFID II.

BaFin considers a token a security if it (i) is transferable, (ii) is negotiable on financial or capital markets (including trading platforms), (iii) represents certain rights such as

¹¹ BaFin, “Initial Coin Offerings: Advisory letter on the classification of tokens as financial instruments” (Mar. 28, 2018), available at https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl_hinweisschreiben_einordnung_ICOs_en.html.

shareholder or creditor rights and (iv) does not constitute an instrument for payment within the meaning of the German Securities Trading Act or MiFID II. BaFin considers a token as certificated, which triggers the prospectus requirements, if the token is documented by means of blockchain or other distributed ledger technology.

Once a token qualifies as a regulated instrument, capital market regulations may impose duties on market participants including prospectus and licensing duties.

BaFin points out that an assessment as to whether a token is a security can only be made on a case-by-case basis and invites market participants to consult BaFin prior to launching a project when there is uncertainty.

BaFin Issues Article on Regulation of Blockchain Technology

In the August 2018 edition of BaFin's biannual *BaFinPerspectives*, BaFin's Division for Innovations in Financial Technology published an article discussing the various kinds of tokens and their regulatory relevance.¹² This article responded to criticism of the February guidance letter for lacking criteria to determine whether a particular token is regulated or unregulated. In the article, BaFin discusses the following three types of tokens:

- **Payment tokens:** tokens that have no intrinsic value and are primarily used as means of payment. They have no or only limited function other than this;
- **Security tokens** (equity and other investment tokens): tokens that confer membership rights or contractual claims involving assets, similar to equities and debt instruments; and
- **Utility tokens:** tokens that can only be used in the issuer's network to purchase goods or services.

In BaFin's long-standing view, payment tokens are "units of accounts" and therefore financial instruments, and certain services relating to payment tokens are regulated banking or financial services. BaFin maintains the definition of security token established in its February guidance. BaFin acknowledges that "pure" utility tokens should not be subject to any requirements under the regulatory regimes applicable to payment or security tokens. However, BaFin warns that hybrid forms of tokens may be considered financial instruments, if, for instance, a utility token is designed to also function as means of payment.

¹² BaFin, "BaFinPerspectives Issue 1 | 2018" (Sept. 21, 2018), available at https://www.bafin.de/SharedDocs/Downloads/EN/BaFinPerspektiven/2018/bp_18-1_digitalisierung_en.html.

Higher Regional Court of Berlin's (*Kammergericht*) Decision on Bitcoin as a Financial Instrument

In September 2018, the Higher Regional Court of Berlin (*Kammergericht*) ruled that Bitcoin is not a financial instrument within the meaning of the German Banking Act. This decision contradicts the view and administrative practice of BaFin.¹³

In December 2011, BaFin became one of the first supervisory authorities in Europe to have taken the position that Bitcoin is a financial instrument (in the form of a unit of account (*Rechnungseinheit*) within the meaning of the German Banking Act). In December 2013, BaFin extended this position to include all cryptocurrencies. As a consequence, certain services relating to cryptocurrencies, such as financial commission business, the operation of a multilateral trading system (e.g., trading platform for cryptocurrencies), investment brokerage services and proprietary trading require a financial services license under the German Banking Act.

In September 2018, the Higher Regional Court of Berlin disagreed with BaFin in a decision in a criminal proceeding against an operator of an online trading platform for Bitcoins. The Court concluded that Bitcoin is neither a unit of account nor another financial instrument under the German Banking Act. As consequence, the defendant did not require a financial services license for the operation of the Bitcoin trading platform. In the Court's view, Bitcoin fails to meet essential requirements of financial instruments as it is neither issued by a central bank nor by a public authority and it lacks general recognition and predictable stability of value required for financial instruments. Given that this decision was rendered in a criminal case, the judgment is not binding on BaFin. Market participants offering regulated services for cryptocurrencies thus may still be required by BaFin to obtain a financial services license or face BaFin's enforcement.

In response to an inquiry by a member of the German Parliament, the German Government in November 2018 stated that while the decision of the Higher Regional Court of Berlin does not affect BaFin's administrative practice regarding cryptocurrencies, the Government is assessing the need for legislative measures to affirm those practices.¹⁴ In addition, the Government stated its support for appropriate

¹³ Higher Regional Court of Berlin, "Bitcoins als Rechnungseinheit" (Sep. 25, 2018), available at [http://www.gerichtsentcheidungen.berlin-brandenburg.de/jportal/portal/t/279b/bs/10/page/sammlung.phtml?pid=Dokumentanzeige&showdoccase=1&jspeid=Trefferliste&documentnumber=1&numberofresults=1&fromdoctodoc=yes&doc.id=KORE223872018&doc.part=L&doc.price=0.0#focuspoint](http://www.gerichtsentscheidungen.berlin-brandenburg.de/jportal/portal/t/279b/bs/10/page/sammlung.phtml?pid=Dokumentanzeige&showdoccase=1&jspeid=Trefferliste&documentnumber=1&numberofresults=1&fromdoctodoc=yes&doc.id=KORE223872018&doc.part=L&doc.price=0.0#focuspoint).

¹⁴ Deutscher Bundestag, "Antwort der Bundesregierung auf die Kleine Anfrage der Abgeordneten Frank Schäffler, Christian Dürr, Dr. Florian Toncar, weiterer Abgeordneter und der Fraktion der FDP: Die Rolle der Bundesanstalt für Finanzdienstleistungsaufsicht bei Kryptowährungen und Token" (Nov. 27, 2018), available at <https://dip21.bundestag.de/dip21/btd/19/060/1906034.pdf>.

regulation of cryptocurrencies and tokens on a European and international level given that they are being issued worldwide.

Enforcement Actions Against Blockchain Projects

Although BaFin generally takes a cautious approach with respect to blockchain projects, the past year saw an increasing number of enforcement actions and warnings against blockchain projects.

- In January 2018, the Higher Regional Court of Hamm upheld a judgment against IMS International Marketing Services GmbH (“IMS”), a German payment processor providing payment services to Onecoin Ltd, the issuer of “OneCoin,” a digital currency investment scheme. IMS’s services included receiving payments of German customers who purchased OneCoin and forwarding such payments on behalf of Onecoin Ltd to third parties based outside of Germany. The court concluded that receiving and forwarding such payments constitutes a money remittance business within the meaning of the Payment Services Supervision Act and therefore the payment processor would require a license as a payment service provider. In April 2017, BaFin had issued an order against IMS to cease and wind down its unauthorized money remittance business. At the same time, BaFin issued cease and desist orders against OneCoin entities in Dubai and Belize, to dismantle their internet-based OneCoin’s trading system and to end all sales promotion activities in Germany immediately.
- During 2018, BaFin has issued a number of cease and desist orders against blockchain projects based on the view that such projects were providing banking or financial services without the required license, including:
 - In January, against Crypto.exchange GmbH, a Berlin-based cryptocurrency trading platform, offering to sell cryptocurrencies for customers on various trading platforms in its own name but for the account of the customers and transfer the proceeds to the customers, and in June, against the sponsor of Crypto.exchange GmbH;
 - In August, against Cry Trade Capital Ltd., the operator of a platform which allowed the trading of Bitcoin and other cryptocurrencies; and
 - In October and November, against the cryptocurrency trading firm Finatex Ltd. and its trading platforms “Crypto-Capitals” and “UB4TRADE” which offered cryptocurrency-focused trading products.

- In addition, BaFin issued a number of warnings advising consumers and investors of projects providing banking or financial services without the required license, including:
 - In October, against Polarstern Capital GmbH, the operator of a “crypto-fund” claiming that it is the first “crypto-fund” regulated by BaFin;
 - In November, against Platincoin Genesis DMCC, a “crypto-fund” claiming to be approved by BaFin;
 - In December, against “Bitcoin Victory” (de.btc-victory.net), a platform for automated margin trading of cryptocurrencies.

Russia

A U-turn from complete prohibition to a search for regulatory solutions for blockchain, tokens and cryptocurrencies, and President Putin’s directive of October 2017 to provide a regulatory framework for blockchain, crypto-assets, smart contracts, ICO and mining by July 2018,¹⁵ led to the introduction of several bills addressing the legal framework for crypto-assets and their circulation in Russia. The Digital Financial Assets Bill (the “DFA Bill”) and the Bill on Digital Rights were both introduced to the State Duma, Russia’s lower legislative chamber, in March 2018 and were adopted by it in the first reading on May 22, 2018.¹⁶ In addition to these legislative initiatives, there was also an encouraging development in Russian case law. On May 15, 2018, the Ninth *Arbitrazh* (Commercial) Appellate Court ruled in a bankruptcy case that Russian civil law does not contain an exhaustive list of objects of civil law rights and that cryptocurrency must be treated as “other property” under Russian civil law. The court reasoned that even if the civil law cannot be applied to cryptocurrency by analogy, the legal treatment of cryptocurrency can be inferred from the general principles of law or the principles of good faith, reasonableness and fairness.¹⁷ This means that even in the absence of clear legal

¹⁵ For more details see *Byungkwon Lim, Dmitri V. Nikiforov, Anna V. Maximenko, Elena Klutchareva*, “Cryptocurrency in Russia: Regulatory Framework on Its Way,” available at https://www.debevoise.com/~media/files/insights/publications/2017/11/20171110%20english_cryptocurrency_in_russia.pdf.

¹⁶ To become a law, the bills are to be adopted in three readings by the State Duma, approved by the Council of Federation and signed by the President of the Russian Federation.

¹⁷ For more details see *Byungkwon Lim, Dmitri V. Nikiforov, Anna V. Maximenko, Elena Klutchareva*, “Russian Court Holds That Cryptocurrency Constitutes Property,” available at https://www.debevoise.com/~media/files/insights/publications/2018/06/20180620_client_update_re_russian_court_holds_that_cryptocurrency_is_property_english.pdf

guidelines, Russian courts may still recognize crypto-assets as objects of civil law rights and may grant protections to their holders based on general civil law provisions.

DFA Bill

The DFA Bill was developed by the Ministry of Finance and the Bank of Russia.¹⁸ It establishes requirements for information memorandum (*i.e.*, white paper) disclosures to be made by token issuers, circulation and exchange of tokens and cryptocurrencies and recording of transactions. The DFA Bill recognizes cryptocurrencies and tokens as so-called “digital financial assets” constituting “other property” under Russian civil law. However, the DFA Bill does not recognize tokens or cryptocurrencies as a method of payment. It allows their conversion to rubles or foreign currency only via exchanges run by operators acting as special professional securities market participants or trading institutions and does not permit the direct exchange of tokens to cryptocurrency or other types of tokens. The DFA Bill leaves a substantial number of important issues regarding circulation of tokens and cryptocurrencies to the Bank of Russia, which has yet to promulgate the rules addressing those issues. This will limit the immediate impact of the DFA Bill, if adopted as is.

Bill on Digital Rights

The bill on amendments to the Civil Law of the Russian Federation (the “Bill on Digital Rights”) was developed by a group of deputies of the State Duma. In contrast to the DFA Bill, the Bill on Digital Rights is more focused on questions of private law that arise with tokens and cryptocurrencies like transfer of rights to themselves and rights to objects of civil law rights that they represent, and provides some regulation for smart contracts. According to the Bill on Digital Rights, tokens and cryptocurrencies are “digital rights” and “digital money,” respectively, existing only in decentralized information systems. A digital right, in comparison to digital money, represents a right to an object of civil law rights (rather than non-material value), while digital money does not have such attribution and is used for payment. The transfer of title represented by a digital right occurs solely by making an entry to the relevant information system on the same terms and conditions as the underlying object of civil law rights, *e.g.* requiring state registration in certain cases.

The Bill on Digital Rights views smart contracts as a means of automatic performance of transactions and recognizes their enforceability. However, it limits the remedies available to the parties to such transactions allowing them to be challenged only in cases

¹⁸ For more details see *Byungkwon Lim, Dmitri V. Nikiforov, Anna V. Maximenko, Elena Klutchareva*, “First Russian Bills on Cryptocurrencies, ICO and Crowdfunding,” available at https://www.debevoise.com/~media/files/insights/publications/2018/02/20180226%20cryptocurrency_and_crowdfunding_bills_in_russia.pdf.

where there is evidence that one of the parties or a third party has interfered in the process of performance.¹⁹

Current Status

There has been no significant development with either bill since their adoption by the State Duma in the first reading in May 2018. Both bills have been criticized by the expert and business community for inconsistent terminology, delegation of numerous matters to future regulations of the Bank of Russia, burdensome regulatory requirements for participants in the crypto-assets market (e.g., for an operator of DFA as mentioned above) and failure to take into consideration existing market practices. These deficiencies caused different industry associations, including the Russian Association of Cryptocurrency and Blockchain (“RACIB”) and the Russian Union of Industrialists and Entrepreneurs, to develop and advocate their own bills on crypto-assets. The dialog between the state authorities and the industry is ongoing.

Switzerland

In 2018, Switzerland undertook a wide range of actions and initiatives aimed at establishing itself as a jurisdiction favorable to crypto-assets. The Swiss Financial Market Supervisory Authority (“FINMA”), the Federal Assembly and the Federal Council were at the forefront of these actions, welcoming technical invocation and maintaining an open dialogue with industry. FINMA issued a number of guidelines focusing mainly on how to conduct ICOs in Switzerland. The Swiss Federal Council proposed amendments to existing laws to promote distributed ledger technology (“DLT”) and blockchain, and the Federal Assembly enacted amendments to the Swiss Banking Act to create a licensing alternative for FinTech projects (i.e., FinTech license).

Current Regulatory Framework and Clarification Opportunities

In its 2018 guidelines, FINMA mainly focused on the application of existing rules to ICOs and crypto-assets, as well as the risks associated with them. FINMA noted that ICOs raise a variety of legal issues for which there is no case law or consistent legal doctrine, requiring each project to be considered holistically. It echoed its Guidance of 2017,²⁰ stating that while there are no requirements specific to ICOs in Swiss law, ICO

¹⁹ For more details see *Byungkwon Lim, Dmitri V. Nikiforov, Anna V. Maximenko, Elena Klutchareva*, “Amendments to the Russian Civil Code: Blockchain Tokens, Cryptocurrencies and Smart Contracts,” available at https://www.debevoise.com/~media/files/insights/publications/2018/05/20180517_amendments_to_the_russian_civil_code_blockchain_tokens_cryptocurrencies_and_smart_contracts_eng.pdf.

²⁰ See FINMA Guidance 04/2017 “Regulatory treatment of initial coin offerings” at: <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/4dokumentation/finma-aufsichtsmittelungen/20170929-finma-aufsichtsmittelung-04-2017.pdf?la=en>.

projects may be covered by existing financial market regulation, including the Banking Act, the Collective Investment Schemes Act, the Anti-Money Laundering Act and the Financial Market Infrastructure Act.²¹ In addition, prospectus requirements of the Financial Services Act, which is expected to come into effect on January 1, 2020, may also be applicable. Depending on the substance of the project and applicable laws, ICO projects such as professional underwriting and offering of tokens constituting securities of third parties publicly on the primary market may be subject to licencing requirements.²²

To help market participants understand the applicability of financial market regulation to ICOs and the existence of licensing requirements, FINMA established a procedure for inquiries by market participants, including specifying the minimum information needed to obtain FINMA's response and setting forth principles for addressing specific inquiries.

One of the most important of these principles is FINMA's categorization of tokens based on their underlying economic function. FINMA categorizes tokens as follows:

- **payment tokens (cryptocurrencies):** Used as a means of payment for acquiring goods or services or as a means of money or value transfer, and not treated as securities and give rise to no claim on their issuer;
- **utility tokens:** Intended to provide access digitally to an application or service in a blockchain-based infrastructure, and are not treated as securities (unless they have an additional or sole investment purpose at the time of their issue);
- **asset tokens:** Represent assets such as a debt or equity claim on the issuer and promise, such as a share in future company earnings or future capital flows, and are treated as securities; and
- **hybrid tokens:** Falling within more than one of the above categories above based on their economic features.

Required Regulatory Amendments

The blockchain/ICO working group established by the Swiss Department of Finance conducted a thorough analysis of the current Swiss legislative framework for DLT and blockchain, primarily in the financial sector. Based on this analysis, the Swiss Federal

²¹ See FINMA Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs) dated February 16, 2018 at: <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitung-ico.pdf?la=en>.

²² *Ibid.*

Council concluded in its 2018 report²³ that the Swiss legal system is generally well-suited for the regulation of new technologies, but identified a number of modifications to civil, banking, anti-money laundering, financial market and insolvency laws to better address the legal issues posed by the development of blockchain and DLT. The proposed modifications include, among others:

- **Transfer of rights by means of digital registers:** For tokens qualifying as securities to be validly recorded and transferred on decentralized registers, Swiss securities law may need to be amended to abolish the current requirement for the written form of transfer of uncertificated securities;
- **Handling DLT-based assets in the event of bankruptcy:** Currently, if the custodian of crypto-assets becomes bankrupt, Swiss legislation does not provide for a clear solution to the problem of segregation of clients' crypto-assets from the bankruptcy estate of the custodian. In this regard, amendments may need to be made to Swiss bankruptcy law explicitly establishing the procedure for such segregation. This may also require amendments to the corresponding provisions of banking and other legislation;
- **Additional license categories and possible extension of the scope of the FinTech license:** Laws may need to be amended for infrastructure providers of blockchain and DLT-based services, such as crypto exchanges, to obtain the relevant license to, among other things, permit non-intermediated trading with securities tokens without the involvement of the securities dealer. In addition, a FinTech license (see below) may also allow its holder in the future to operate an OTF, thus permitting it to arrange for the exchange of crypto-assets qualifying as financial instruments on the OTF;
- **Anti-money laundering clarifications:** Currently, non-custodian wallet providers and certain decentralized platforms for trading crypto-assets do not fall within the scope of the Swiss Anti-Money Laundering Act ("AMLA"). The Swiss Federal Council suggests that the issue be addressed on the international level under the supervision and guidance of the FATF, and the current practice be more explicitly tailored so that decentralized trading platforms are subject to AMLA.

Based on the Report, the Swiss Federal Department of Finance and the Swiss Federal Department of Justice and Police are to draw up a consultation draft in the first quarter of 2019 to address the issues raised in the Report.

²³ See the Swiss Federal Council report "*Legal framework for distributed ledger technology and blockchain in Switzerland. An overview with a focus on the financial sector*" dated December 14, 2018 at: <https://www.news.admin.ch/news/message/attachments/55153.pdf> (the "Report").

FinTech License

Under previous Swiss law, the only persons authorized for the professional acceptance of public deposits were banks regulated in accordance with the Swiss Banking Act. Following the adoption of the FinTech license regime in 2018 (effective January 1, 2019), non-banking institutions are allowed to accept public deposits of up to CHF 100,000,000 provided that such deposits are not invested and no interest is paid on them. This regime allows companies with a FinTech license (primarily those operating in the FinTech sphere) to accept such deposits, subject to less strict authorization requirements. In addition, such companies are able to hold asset-tokens qualified as securities in custody for their clients without obtaining an additional license as a securities dealer or securities firm solely for such purpose.²⁴

Eligible applicants for the FinTech license, which is issued by FINMA, include companies limited by shares, corporations with unlimited partners or limited liability companies that have a registered office and conduct business activities in Switzerland.²⁵

United Kingdom

Although the United Kingdom (“UK”) is not yet a major market for crypto-assets trading, the UK Government has recognized the potential benefits of DLT and crypto-asset technology²⁶ and has indicated that it is prepared to give the Financial Conduct Authority (“FCA”) greater power to oversee the industry,²⁷ holding that the existing UK regulatory approach to DLT and crypto-assets developments is adequate and can adapt to related contemporary FinTech developments. Likewise, the UK’s Financial Stability Board was not of the opinion that crypto-assets pose a risk to global financial stability.

2018 Initiatives

The FCA and the Bank of England (“BoE”) have maintained a technologically neutral approach to regulating crypto-assets, so that packaging a “specified investment” in the form of a token generally would not change the regulatory outcome. For example, tokens that grant a holder some or all of the rights that would typically be enjoyed by a

²⁴ See pp. 85, 89 of the Report.

²⁵ See FINMA Guidelines for FinTech license applications pursuant to Article 1b of the Banking Act at: https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/w_be_willigungfintech_20181203_de.pdf?la=en.

²⁶ House of Commons Treasury Committee, Government and Financial Conduct Authority Responses to the Committee’s Twenty-Second Report: Crypto-assets (19 December 2018), available at: <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/1845/1845.pdf>.

²⁷ *Ibid.*

shareholder are likely to fall within the regulatory perimeter and activities involving such tokens would thus be subject to FCA authorization.

However, in 2018 the FCA noted that crypto-assets were not contemplated in the initial design of the regulatory perimeter. This was followed with a plan to reassess the regulatory perimeter in 2019 and the launch of a public consultation on whether and how exchange tokens and related firms, such as exchanges and wallet providers could be regulated. The FCA has also stated that it will not authorize or approve the listing of transferable securities that reference exchange tokens (for example, exchange-traded funds).²⁸ On a similar note, the FCA supported ESMA's restrictions on the sale of contracts for difference ("CFDs") that reference crypto-assets, to retail customers²⁹ and has indicated that it will consult on a prohibition of the sale to retail consumers of all derivatives referencing exchange tokens such as Bitcoin, including CFDs, futures, options and transferable securities.³⁰

Additionally, in 2018:

- A Taskforce consisting of HM Treasury, FCA and Bank of England (the "Crypto-assets Taskforce") was launched to investigate the impact of crypto-assets and their interaction with the existing regulatory framework.³¹
- The Government supported the development of, amongst other things, DLT by investing more than £10 million through Innovate UK and research councils³² and expressed its readiness to expand the regulatory perimeter to encompass all crypto-assets that are akin to securities.

²⁸ *Ibid.*

²⁹ The restrictions, among other things, limit leverage on cryptocurrencies to 2:1. The ESMA restrictions were renewed on 1 November 2018. See European Securities and Markets Authority, "ESMA to renew restriction on CFDs for a further three months" (28 September 2018), available at: <https://www.esma.europa.eu/press-news/esma-news/esma-renew-restriction-cfds-further-three-months>.

³⁰ Financial Conduct Authority, "CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products", available at: <https://www.fca.org.uk/publications/consultation-papers/cp18-38-restricting-contract-difference-products-sold-retail-clients-and-discussion-other-retail>.

³¹ HM Treasury, Financial Conduct Authority and the Bank of England, "Cryptoassets Taskforce: final report" (October 2018), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf.

³² Innovate UK, "Support for game-changing ideas: apply for an innovation loan" (27 June 2018), available at: <https://www.gov.uk/government/news/support-for-game-changing-ideas-apply-for-an-innovation-loan>.

- The UK joined the EU Blockchain Partnership to help develop cross-border Blockchain projects in the public sector;³³
- The Bank of England set up a FinTech Hub to consider the policy implications of FinTech and completed work with 18 firms via proofs of concept to explore the adoption of new technologies (including DLT) in the public sector.³⁴
- The FCA issued a letter to all bank CEOs, setting out general practice guidelines for managing crypto-asset related financial crime risks.³⁵
- The Bank of England has established a program to deliver a renewed Real-Time Gross Settlement (“RTGS”) service with the intention for future forms of settlement, including those based on DLT, to be able to plug into the renewed RTGS service.³⁶

Last year also saw a rise in the use of DLT by firms participating in the FCA Sandbox³⁷ with more than one third of 89 firms that have been accepted into the Sandbox thus far seeking to test the application of DLT and/or blockchain technology.³⁸

Tax

HM Revenue and Customs set out its position regarding the taxation of crypto-assets held by individuals in a policy paper published on December 19, 2018.³⁹ Key points include:

- Individuals will be liable to pay either Capital Gains Tax (“CGT”) or Income Tax depending on the type of cryptocurrency transactions in which they are involved.

³³ European Commission, “European countries join Blockchain Partnership” (2018), available at: <https://ec.europa.eu/digital-single-market/en/news/european-countries-join-blockchain-partnership>.

³⁴ Bank of England, “Open to Fintech – speech by Dave Ramsden” (22 March 2018), available at: <https://www.bankofengland.co.uk/speech/2018/dave-ramsdens-speech-hm-treasury-international-fintech-conference>.

³⁵ Financial Conduct Authority, “Dear CEO – cryptoassets and financial crime” (2018), available at: <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-cryptoassets-financial-crime.pdf>.

³⁶ Bank of England, “RTGS renewal programme proof of concept: supporting DLT settlement models” (23 July 2018), <https://www.bankofengland.co.uk/news/2018/july/rtgs-renewal-programme-proof-of-concept-supporting-dlt-settlement-models>.

³⁷ See our client update on the FCA Regulatory Sandbox at: https://www.debevoise.com/~media/files/insights/publications/2018/03/20180306_thinking_inside_the_box_client_update.pdf.

³⁸ The latest list of FCA’s regulatory sandbox firms is available here: Financial Conduct Authority, “Regulatory sandbox cohort 4” (3 July 2018), available at: <https://www.fca.org.uk/firms/regulatory-sandbox/regulatory-sandbox-cohort-4-businesses>.

³⁹ HM Revenue & Customs, “Policy paper: Cryptoassets for individuals” (19 December 2018), available at: <https://www.gov.uk/government/publications/tax-on-cryptoassets/cryptoassets-for-individuals>.

- Employees who receive their salaries in cryptocurrencies would also have to pay social security contributions (also known as National Insurance).
- In case of loss or theft of cryptocurrency, victims retain their CGT obligations until it becomes apparent that the allegedly stolen cryptocurrencies are forever inaccessible.
- Individuals who do not receive the crypto-assets they pay for may not be able to claim a capital loss.

Anti-Money Laundering and Counter-Terrorism Financing

The Crypto-assets Taskforce Report published in October stated that the Government intends to address Anti-Money Laundering and Counter-terrorism financing (“AML/CTF”) risks by imposing regulation that is significantly more stringent than the requirements set out in the EU Fifth Anti-Money Laundering Directive (which modifies the fourth Anti-Money Laundering Directive to apply to virtual currency exchange service providers and electronic wallet providers).⁴⁰

The Government has also expressed its intention to consult on, amongst other things, the following within the context of AML/CTF regulations:

- Exchange services between different crypto-assets, to prevent anonymous “layering” of funds to mask their origin.
- Platforms that facilitate peer-to-peer exchange of crypto-assets, which could enable anonymous transfers of funds between individuals; and
- Non-custodian wallet providers that function similarly to custodian wallet providers, which may otherwise facilitate the anonymous storage and transfer of crypto-assets.

⁴⁰ HM Treasury, Financial Conduct Authority and the Bank of England, “Cryptoassets Taskforce: final report” (October 2018), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf.

United States

Deeper Scrutiny of Cryptocurrency Activities by the SEC

In addition to continuing its crackdown on unregistered initial coin offerings and fraudulent offerings, the Securities and Exchange Commission (“SEC”) expanded the scope of its investigations into cryptocurrency activities.

Trading Platforms. In March 2018, the SEC issued a statement that platforms serving as venues for trading digital assets must register as a national securities exchange or operate under an exemption from registration (such as the exemption for alternative trading systems) if the assets being traded are securities.⁴¹ This was followed in November 2018 by the SEC’s announcement of its settlement of charges against the founder of EtherDelta, its first enforcement action based on findings that a platform for secondary market trading of digital “tokens” was operating as an unlicensed national securities exchange. The SEC indicated that the EtherDelta platform facilitated trading in millions of ERC20 tokens, many of which constituted securities. The SEC indicated that EtherDelta functioned as an online marketplace for buyers and sellers of digital asset securities through the combined use of an order book, a website that displayed orders, and a smart contract that ran on the Ethereum blockchain and provided validation and execution of paired orders.⁴²

Crypto-funds, Valuation and Custody. In March 2018, the SEC acknowledged that it was examining certain business practices of hedge funds investing in digital assets.⁴³ Among other things, the SEC examinations were focused on issues such as valuation and custody. From a valuation perspective, the SEC is interested in understanding the manner in which digital assets are priced and whether such pricing is fair and reasonable. From a custody perspective, the SEC is interested in understanding the manner in which digital assets are held and whether such methods comply with applicable

⁴¹ See SEC Divisions of Enforcement and Trading and Markets, Statement on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), available at <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

⁴² See SEC Press Release 2018-258, *SEC Charges EtherDelta Founder with Operating an Unregistered Exchange* (Nov. 8, 2018), available at <https://www.sec.gov/news/press-release/2018-258>. The SEC has also stated that an entity that facilitates the issuance of digital asset securities in ICOs and secondary trading in digital asset securities may be acting as a “broker” or “dealer” that is required to register with the SEC and become a member of FINRA—even if they do not meet the definition of an exchange. See SEC Divisions of Enforcement and Trading and Markets, Statement on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), available at <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>; see also *In the Matter of TokenLot LLC, Lenny Kugel, and Eli L. Lewitt*, SEC Release No. 33-10543 (Sep. 11, 2018), available at <http://www.sec.gov/litigation/admin/2018/33-10543.pdf>.

⁴³ See, e.g., Benjamin Bain, Olga Kharif and Matt Robinson, “Hedge Funds Draw Scrutiny in Crypto Coin Review,” Bloomberg.com (Mar. 14, 2018), available at <https://www.bloomberg.com/news/articles/2018-03-14/hedge-funds-are-said-to-draw-sec-scrutiny-in-crackdown-on-crypto>.

safeguards, such as the SEC's custody rule, intended to prevent theft by advisers and others.⁴⁴ In November 2018, the SEC signaled that it was expanding its probe of investment advisers with investments in the digital asset space.⁴⁵ In addition to these more general examinations, in September 2018, the SEC found that the manager of a hedge fund formed for the purpose of investing in digital assets (and which invested more than 40 percent of the fund's assets in digital asset securities) had improperly failed to register the fund as an investment company and had violated antifraud provisions of the Investment Advisers Act of 1940 by making misleading statements to investors.⁴⁶

Additional Certainty on Ether. Speaking at a Yahoo Finance All Markets Summit in June 2018, William Hinman, Director of the Division of Corporation Finance at the SEC, confirmed his view that Ether is not a security. Focusing on key aspects of decentralization, Mr. Hinman discussed how a digital asset that was initially sold as a security can cease being a security. In this context, he noted that “[i]f the network on which the token or coin is to function is sufficiently decentralized—where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts—the assets may not represent an investment contract...[and] when the efforts of the third party are no longer a key factor for determining the enterprise's success, material information asymmetries recede.”⁴⁷

First Orders Imposing Civil Penalties Solely on the Basis of ICO Securities Offering Registration Violations. Until recently, decisions of the SEC in the ICO space imposed fines for fraudulent activities or required that unregistered ICOs cease activities and return monies raised to investors. In November 2018, however, the SEC announced its first settlements with ICO issuers in which civil fines were imposed solely on the basis of registration violations. In each case, the respective issuer consented to a civil money penalty in the amount of \$250,000, agreed to cease and desist from committing further unregistered offering activities, agreed to compensate investors who purchased tokens in the illegal offerings if an investor makes a claim and undertook to register the tokens

⁴⁴ For an extensive discussion regarding the SEC's custody rule and its application in the digital asset space, see our recent article on this subject, available at <https://www.debevoise.com/insights/publications/2018/12/custody-of-digital-assets>.

⁴⁵ See, e.g., Patrick Temple-West, “SEC expands cryptocurrency crackdown with nationwide sweep,” Politico.com (Nov. 1, 2018), available at <https://www.politico.com/story/2018/11/01/sec-cryptocurrency-910135>.

⁴⁶ See *In the Matter of Crypto Asset Management, LP and Timothy Enneking*, SEC Release No. 33-10544 (Sep. 11, 2018), available at <http://www.sec.gov/litigation/admin/2018/33-10544.pdf>; see also SEC Division of Corporation Finance, Division of Investment Management, and Division of Trading and Markets, Statement on Digital Asset Securities Issuance and Trading (Nov. 16, 2018), available at <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>.

⁴⁷ William Hinman, Dir., SEC Div. of Corp. Fin., Remarks at the Yahoo Finance All Markets Summit: Digital Asset Transactions: When Howey Met Gary (Plastic) (Jun. 14, 2018), available at <https://www.sec.gov/news/speech/speech-hinman-061418>.

as securities under the Exchange Act and to file periodic reports with the SEC.⁴⁸ In a separate statement summarizing the SEC's views on various developments concerning the issuance and trading of digital assets, the SEC pointed to these cases as demonstrating a path to compliance with the federal securities laws, even for issuers that have conducted an illegal unregistered offering of digital asset securities.⁴⁹

Innovation Hub Launches While ETFs Remain Grounded. In October 2018, the SEC announced the launch of FinHub, its new strategic hub for Fintech innovation. “The FinHub will serve as a resource for public engagement on the SEC’s Fintech-related issues and initiatives, such as distributed ledger technology (including digital assets), automated investment advice, digital marketplace financing, and artificial intelligence/machine learning.”⁵⁰ The FinHub consolidates many of the SEC’s various working groups dealing with Fintech issues under a single umbrella. Meanwhile, over the course of 2018, the SEC refused to rule on—if not outwardly rejected—many bitcoin ETF proposals. On August 22, for example, the SEC issued three orders denying proposals from ProShares, Direxion and GraniteShares.⁵¹ The SEC claimed that the rules of these ETFs would not sufficiently prevent fraudulent and manipulative acts and practices.

Stay Tuned—More to Come. Speaking at the D.C. Fintech Week conference in November 2018, SEC director Hinman announced that the SEC intends to release more guidance for market participants planning digital asset token offerings. He said the guidance will serve as a “plain English” guide to determining when a token offering is a security offering. The guidance is also intended to have sections on the registration process and the conduct of exempt offerings for those tokens that are determined to be

⁴⁸ See *In the Matter of CarrierEQ, Inc., d/b/a Airfox*, SEC Release No. 33-10575 (Nov. 16, 2018), available at <http://www.sec.gov/litigation/admin/2018/33-10575.pdf>; *In the Matter of Paragon Coin, Inc.*, SEC Release No. 33-10574 (Nov. 16, 2018), available at <http://www.sec.gov/litigation/admin/2018/33-10574.pdf>.

⁴⁹ See SEC Division of Corporation Finance, Division of Investment Management, and Division of Trading and Markets, Statement on Digital Asset Securities Issuance and Trading (Nov. 16, 2018), available at <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>.

⁵⁰ See SEC Press Release No. 2018-240, *SEC Launches New Strategic Hub for Innovation and Financial Technology* (Oct. 18, 2018), available at <https://www.sec.gov/news/press-release/2018-240>.

⁵¹ *Self-Regulatory Organizations; NYSE Arca, Inc.; Order Disapproving a Proposed Rule Change to List and Trade the Shares of the ProShares Bitcoin ETF and the ProShares Short Bitcoin ETF*, SEC Release No. 34-83904 (Aug. 22, 2018), available at <https://www.sec.gov/rules/sro/nysearca/2018/34-83904.pdf>; *Self-Regulatory Organizations; NYSE Arca, Inc.; Order Disapproving a Proposed Rule Change Relating to Listing and Trading of the Direxion Daily Bitcoin Bear 1X Shares, Direxion Daily Bitcoin 1.25X Bull Shares, Direxion Daily Bitcoin 1.5X Bull Shares, Direxion Daily Bitcoin 2X Bull Shares, and Direxion Daily Bitcoin 2X Bear Shares Under NYSE Arca Rule 8.200-E*, SEC Release No. 34-83912 (Aug. 22, 2018), available at <https://www.sec.gov/rules/sro/nysearca/2018/34-83912.pdf>; *Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Disapproving a Proposed Rule Change to List and Trade the Shares of the GraniteShares Bitcoin ETF and the GraniteShares Short Bitcoin ETF*, SEC Release No. 34-83913 (Aug. 22, 2018), available at <https://www.sec.gov/rules/sro/cboebzx/2018/34-83913.pdf>.

securities. No announcement has been made as to when the guidance will be published.⁵²

Developments in the Courts and the CFTC

Virtual Currencies Continue to Be Treated as Commodities in the Federal Courts. In a series of actions brought by the Commodity Futures Trading Commission (“CFTC”), federal judges continued to treat virtual currencies as commodities, giving the CFTC jurisdiction to pursue fraudulent transactions in the virtual currency market. In August 2018, Judge Jack B. Weinstein of the United States (“U.S.”) District Court for the Eastern District of New York found in favor of the CFTC and against Patrick K. McDonnell and CabbageTech, Corp. for a fraudulent virtual currency scheme.⁵³ McDonnell and CabbageTech induced customers to pay virtual currency for “expert” virtual currency trading advice and to facilitate virtual currency purchases and trades. In reality, they allegedly misappropriated the funds received for their own purposes. In September 2018, Senior Judge Rya W. Zobel of the U.S. District Court for the District of Massachusetts ruled against My Big Coin Inc.’s motion to dismiss an action brought by the CFTC.⁵⁴ The motion challenged the CFTC’s authority to pursue the action, claiming that virtual currencies are not commodities. In dismissing the action, the judge noted that the existence of futures contracts for virtual currency signals that virtual currencies are commodities as intended under the Commodity Exchange Act.

Ethereum, SROs and Smart Contracts. While the CFTC continued to bring actions against fraudulent virtual currency business activities, it also took steps to support legitimate activities and improve its understanding of popular virtual currencies. In December, the CFTC asked for information on virtual currencies beyond Bitcoin, naming Ethereum specifically.⁵⁵ This could suggest that the CFTC is cautiously considering allowing futures contracts in Ethereum.⁵⁶ The CFTC also supported the

⁵² See Nikhilesh De and Aaron Stanley, “SEC Official Says ‘Plain English’ Guidance on ICOs is Coming,” CoinDesk.com (Nov. 5, 2018), available at <https://www.coindesk.com/sec-official-says-plain-english-guidance-on-icos-is-coming>.

⁵³ See *Commodity Futures Trading Commission v. Patrick K. McDonnell & CabbageTech, Corp. d/b/a Coin Drop Markets*, 18-CV-361 (E.D.N.Y. Aug. 28, 2018) and *CFTC Wins Trial against Virtual Currency Fraudster*, CFTC Release No. 7774-18 (Aug. 24, 2018), available at <https://www.cftc.gov/PressRoom/PressReleases/7774-18>.

⁵⁴ See *Commodity Futures Trading Commission v. My Big Coin Pay, Inc. et al.*, Civil Action No. 18-10077-RWZ (E.D. Mass. Sep. 26, 2018), available at <https://www.cftc.gov/sites/default/files/2018-10/enfmybigcoinpayincmemorandum092618.pdf>; *Court Denies Defendants’ Motion to Dismiss in Commodity Fraud Case Involving the Virtual Currency My Big Coin*, CFTC Release No. 7820-18 (Sep. 26, 2018), available at <https://www.cftc.gov/PressRoom/PressReleases/7820-18>.

⁵⁵ *CFTC Seeks Public Comments on Crypto-asset Mechanics and Markets*, CFTC RELEASE No. 7855-18 (Dec. 11, 2018), available at <https://www.cftc.gov/PressRoom/PressReleases/7855-18>.

⁵⁶ There are already futures contracts in bitcoin, which have garnered some criticism for their potential for manipulation. The National Futures Association released new disclosure requirements in May 2018 in an effort to prevent uninformed investors from being manipulated. National Futures Association, *Disclosure*

Winklevoss twins' company, Gemini, in its recommendation of a virtual commodity self-regulatory organization ("SRO"). In a press release, CFTC commissioner Brian Quintenz said, "Ultimately, a virtual commodity SRO that has the most independence from its membership, the most diversity of views, and the strongest ability to discover, reveal, and punish wrongdoing will add the most integrity to these markets. I encourage Gemini (or any other market participant, advocacy group, platform, or firm) to be aggressive in promoting these qualities within any SRO construct."⁵⁷ In addition, the CFTC released a primer on smart contracts, explaining how they work and their risks, again indicating their efforts to understand the industry.⁵⁸

The Treasury Looks to Facilitate Fintech Innovation

The Treasury Looks to Facilitate Fintech Innovation. On July 31, 2018, the U.S. Department of the Treasury (the "Treasury") released "Nonbank Financials, Fintech, and Innovations." The report makes nearly 80 recommendations for improvements to the regulatory landscape to help nonbank financial institutions, embrace financial technology and foster innovation.⁵⁹

The OCC Creates the Fintech Charter and States Sue. On July 31, 2018, the Office of the Comptroller of the Currency ("OCC") announced that it will begin accepting national bank charter applications from financial technology companies.⁶⁰ These "Fintech charters" would not allow the companies to accept deposits, but it might allow Fintech companies to bypass the task of complying with 50 separate state agencies. The establishment of Fintech charters came as part of the OCC's support for the industry under its Office of Innovation, which "serves as the central point of contact and clearing house for requests and information related to innovation."⁶¹ In response to the proposal, the Conference of State Bank Supervisors and the New York Department of Financial Services sued the OCC, claiming the OCC lacks the authority to create such a charter

Requirements for NFA Members Engaging in Virtual Currency Activities, Interpretive Notice No. 9073 (May 17, 2018), available at <https://www.nfa.futures.org/rulebook/rules.aspx?Section=9&RuleID=9073>.

⁵⁷ CFTC Speeches & Testimony, Statement of CFTC Commissioner Brian Quintenz on a Proposal by Cameron and Tyler Winklevoss for a Virtual Commodity SRO (Mar. 13, 2018), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement031318>.

⁵⁸ *CFTC's LabCFTC Releases Primer about Smart Contracts*, CFTC Release No. 7847-18 (Nov. 27, 2018), available at <https://www.cftc.gov/PressRoom/PressReleases/7847-18>.

⁵⁹ *A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation*, U.S. Dept. of the Treasury, Report 2018-04417 (Jul. 31, 2018), available at https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf.

⁶⁰ *OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies*, OCC NR 2018-74 (Jul. 31, 2018), available at <https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html>.

⁶¹ *Responsible Innovation*, U.S. Dept. of the Treasury and OCC, available at <https://www.occ.treas.gov/topics/responsible-innovation/index-innovation.html>.

without Congressional action and did not follow proper procedure in releasing the rule.⁶²

The IRS Keeps Virtual Currency on Its Radar. Throughout 2018, the Internal Revenue Service (“IRS”) has pushed for further compliance with the tax guidance it released in 2014 regarding the taxation of virtual currency. In that guidance, the IRS said it would treat virtual currencies as property and thus any gain realized from trading them was taxable. In March 2018, the IRS released a reminder to taxpayers to report virtual currency transactions in their upcoming tax returns in accordance with the 2014 guidance, stressing the consequence of not reporting income accurately.⁶³ In July 2018, the IRS announced it would begin five large business and international compliance campaigns, one of which would be aimed at noncompliance with the 2014 release and which will encourage taxpayers to correct any mistakes in their returns promptly.⁶⁴ On the same day, the IRS announced the formation of the Joint Chiefs of Global Tax Enforcement, a new operational alliance among the leaders of tax enforcement authorities from Australia, Canada, the Netherlands, the United Kingdom and the United States.⁶⁵ In the announcement, some authorities specifically called out cryptocurrency as enabling cybercrime and threatening tax administration.

FinCEN Proposes Guidance on ICOs and MSBs. In a February 2018 letter to Senator Ron Wyden, the Financial Crimes Enforcement Network (“FinCEN”) outlined its approach to ICO token distributors required to register as Money Service Businesses (“MSBs”). In the letter, FinCEN reiterated past guidance describing how cryptocurrency exchanges are money transmitters subject to registration. It went on to say that an ICO distributor will be an MSB based on a facts and circumstances analysis, noting “generally, under existing regulations and interpretations, a developer that sells convertible virtual currency, including in the form of ICO coins or tokens, in exchange for another type of value that substitutes for currency is a money transmitter.”⁶⁶

⁶² CSBS Sues OCC Over Fintech Charter, CSBS (Oct. 25, 2018), available at <https://www.csbs.org/csbs-sues-occ-over-fintech-charter>; https://www.dfs.ny.gov/banking/dfs_occ_complaint_with_exhibits_9_2018.pdf.

⁶³ IRS Reminds Taxpayers to Report Virtual Currency Transactions, IR-2018-71 (Mar. 23, 2018), available at <https://www.irs.gov/newsroom/irs-reminds-taxpayers-to-report-virtual-currency-transactions>.

⁶⁴ IRS Announces the Identification and Selection of Five Large Business and International Compliance Campaigns, IRS (Jul. 2, 2018), available at https://www.irs.gov/businesses/irs-announces-the-identification-and-selection-of-five-large-business-and-international-compliance-campaigns?utm_source=7-10-18+Member+List&utm_campaign=04042b3121-EMAIL_CAMPAIGN_2018_01_19_COPY_01&utm_medium=email&utm_term=0_0b2740a0bd-04042b3121-344951547.

⁶⁵ Available at <https://www.irs.gov/pub/irs-utl/j5-media-release-7-2-18.pdf>.

⁶⁶ Drew Maloney, Letter to Senator Ron Wyden, U.S. Dept. of The Treasury (Feb. 13, 2018), available at <https://coincenter.org/files/2018-03/fincen-ico-letter-march-2018-coin-center.pdf>.

The CFPB Also Dips Its Feet in the Sandbox

In September 2018, the Consumer Financial Protection Bureau's ("CFPB's") Office of Innovation proposed a Disclosure Sandbox to help Fintech companies using the Bureau's trial disclosure program.⁶⁷ The sandbox would offer limited no-action letters and exemptions, typically of two-year duration, for qualifying companies. In December, the CFPB released a proposed rule implementing parts of its September proposal, including a streamlined process for receiving no-action letters.⁶⁸

Federal Legislative Proposals Take Shape

Several legislative proposals were introduced in Congress in support of blockchain technology and cryptocurrencies. In the final few months of the year, U.S. Representative Tom Emmer introduced three bills in Congress. The first bill expresses support for the development of digital currencies and blockchain technology and encourages a light touch and consistency in regulating the space. The second would provide that cryptocurrency miners do not need to register as money transmitters given that at no point do they take control of consumer funds. The last would create a safe harbor for taxpayers with cryptocurrencies resulting from a hard fork of a network.⁶⁹ Another bill, introduced by U.S. Representatives Doris Matsui and Brett Guthrie, proposes the creation of a working group to study blockchain technology and create a consensus-based definition of blockchain for use by the government.⁷⁰ In December, U.S. Representatives Warren Davidson and David Soto introduced the "Token Taxonomy Act," aimed at exempting cryptocurrencies and certain other digital assets from the scope of the federal securities laws.⁷¹

⁶⁷ BCFP Office of Innovation Proposes "Disclosure Sandbox" for Fintech Companies to Test New Ways to Inform Consumers, CFPB Blog (Sep. 13, 2018), available at <https://www.consumerfinance.gov/about-us/blog/bcfp-office-innovation-proposes-disclosure-sandbox-fintech-companies-test-new-ways-inform-consumers/>.

⁶⁸ Policy on No-Action Letters and the BCFP Product Sandbox, 83 FR 64036 (Dec. 13, 2018), available at <https://www.federalregister.gov/documents/2018/12/13/2018-26873/policy-on-no-action-letters-and-the-bcfp-product-sandbox>.

⁶⁹ See, e.g., Nikhilesh De, "U.S. Congressman Drafts Bills to Aid Blockchain Development," CoinDesk.com (Sep. 21, 2018), available at <https://www.coindesk.com/us-congressman-drafts-bills-to-aid-blockchain-development>. Similar bills have been reintroduced in the new congress of 2019. See To Promote Fair and Transparent Virtual Currency Markets by Examining the Potential for Price Manipulation, H.R. 922, 116th Cong. (2019) and To Promote United States Competitiveness in the Evolving Global Virtual Currency Marketplace, H.R. 922, 116th Cong. (2019).

⁷⁰ See, e.g., Nikhilesh De, "U.S. Lawmakers Push for 'Blockchain' Definition in New Congressional Bill," CoinDesk.com (Oct. 3, 2018), available at <https://www.coindesk.com/us-lawmakers-introduce-bill-to-define-blockchain>.

⁷¹ See, e.g., Stan Higgins, "U.S. Lawmakers File Bill to Exempt Cryptocurrencies from Securities Laws," CoinDesk.com (Dec. 20, 2018), available at <https://www.coindesk.com/us-lawmakers-file-bill-to-exempt-cryptocurrencies-from-securities-laws>.

States Take Different Approaches to Virtual Currencies

NASAA Takes Aim at ICO Fraud. In May 2018, the North American Securities Administrators Association (“NASAA”), comprising state and provincial regulators from more than 40 jurisdictions in the United States and Canada, announced “Operation Cryptosweep,” a large swath of actions to combat fraud in the ICO market, including nearly 70 inquiries and investigations and 35 pending or completed enforcement actions.⁷² NASAA members identify ICOs nearing their public launch and analyze whether any of the ICOs requires further investigation or enforcement action.

Texas and New York Crack Down on Virtual Currency Fraud. Texas and New York are two examples of states that took aggressive steps to crack down on virtual currency risks in 2018. In April 2018, Texas released an investor alert, warning against the risks of fraud in the virtual currency space.⁷³ Since December 2017, the Enforcement Division of the Texas State Securities Board had opened 32 investigations in virtual currency fraud. The release lists enforcement actions from January to April against BitConnect, R2B Coin, Davor Coin, Investors in Crypto, LeadInvest and Freedom Financial Club Inc. and Mark J. Moncher, *et al.* LeadInvest, for example, fraudulently claimed its business was advised by Supreme Court Justice Ruth Bader Ginsburg and three former U.S. Solicitors General.⁷⁴ New York has also taken a harsh stance on virtual currencies, most visibly in the state Attorney General’s publication of its Virtual Markets Integrity Initiative in September 2018.⁷⁵ The report summarized six months of investigations, identifying problems with virtual currency platforms, such as deficiencies in detecting conflicts of interest, preventing market manipulation, ensuring market integrity and protecting consumer funds. The report followed an outright rejection of recommendations in July 2018 from the U.S. Treasury regarding the development regulatory sandboxes. In response to the recommendation, Superintendent Maria Vullo of the New York Department of Financial Services said, “Toddlers play in sandboxes. Adults play by the rules.”⁷⁶

⁷² *State and Provincial Securities Regulators Conduct Coordinated International Crypto Crackdown*, North American Securities Administrators Association (May 21, 2018), available at <http://www.nasaa.org/45121/state-and-provincial-securities-regulators-conduct-coordinated-international-crypto-crackdown-2/>.

⁷³ *Widespread Fraud Found in Cryptocurrency Offerings*, Texas State Securities Board (Apr. 10, 2018), available at <https://www.ssb.texas.gov/sites/default/files/CRYPTO%20SWEEP%20report%20April%2010%202018%20FINAL.pdf>.

⁷⁴ *In the matter of LeadInvest*, Texas State Securities Board Order No. ENF-18-CDO-1760 (Mar. 5, 2018), available at <https://www.ssb.texas.gov/sites/default/files/ENF-18-CDO-1760.pdf>.

⁷⁵ Barbara Underwood, *Virtual Markets Integrity Initiative Report*, Office of the N.Y. A.G. (Sep. 18, 2018), available at <https://virtualmarkets.ag.ny.gov/>.

⁷⁶ *Statement by DFS Superintendent Maria T. Vullo on Treasury’s Endorsement of Regulatory Sandboxes for Fintech Companies and the OCC’s Decision to Accept Fintech Charter Applications*, N.Y. Sept. of Fin. Serv. (July 31, 2018), available at <https://www.dfs.ny.gov/about/statements/st1807311.htm>.

Some States Invest in Virtual Currencies. Other states, including Colorado, Arizona and Wyoming, took steps to foster innovation in the development and use of virtual currencies and other digital assets. In May 2018, Colorado's governor created a Council for the Advancement of Blockchain Technology Use to create a legal framework for safely developing the Blockchain.⁷⁷ It also passed a law to help encourage the study of blockchain by providing scholarship grants and other incentives.⁷⁸ In March 2018, Arizona passed a bill to create the first Fintech regulatory sandbox, giving companies in the space the ability to launch on a limited basis without having to incur regulatory burdens.⁷⁹ Also in March, Wyoming passed a bill that exempted cryptocurrencies from property tax, and, in December 2018, Overstock.com announced that it is partnering with Wyoming to put its land registry on a distributed ledger.⁸⁰

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Please do not hesitate to contact us with any questions.

⁷⁷ See *Creating the Council for the Advancement of Blockchain Technology Use*, Col. Exec. Order No. B 2018-002 (May 2, 2018), available at https://www.colorado.gov/governor/sites/default/files/executive_orders/b_2018-002_blockchain.pdf.

⁷⁸ See *Cyber Coding Cryptology for State Records*, SB 18-086, 72nd Gen. Assemb. Reg. Sess. 2018 (Col. May 30, 2018), available at <https://leg.colorado.gov/bills/sb18-086>.

⁷⁹ See HB 2434 53rd Leg. 2nd Reg. Sess. 2018 (Ariz. March 22, 2018), available at <https://legiscan.com/AZ/text/HB2434/id/1688717>. Also, importantly, the U.S. Department of the Treasury announced that it will be encouraging these regulatory sandboxes going forward. *A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation*, U.S. Dept. of the Treasury Report No. E.O. 13772 (Jul. 31, 2018), available at <https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf>.

⁸⁰ See *Property Taxation-Digital Currencies*, WY SB 0111, 64 Leg. Budget Sess. 2018 (Wyo. Mar. 3, 2018), available at <https://www.wyoleg.gov/Legislation/2018/SF0111>; Overstock.com Inc., *Overstock.com Subsidiary Medici Land Governance to Develop Blockchain-Based Property and Land Information Platform with Teton County, Wyoming*, Overstock.com (Dec. 20, 2018) available at <https://investors.overstock.com/mobile.view?c=131091&v=203&d=1&id=2381345>.

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