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Russia: Trends & Developments

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Trends and Developments

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Less than four years after the U-turn from complete prohibition of blockchain, cryptocurrencies and other crypto-assets to a search for regulatory solutions applicable to them, in 2021, Russia substantially finalised its legal framework for the issuance and circulation of digital assets. The main developments that were discussed in this respect in 2020 and that will be further considered in 2021 are the newly adopted Law on Digital Financial Assets, the regulation of digital currency, and the digital rouble concept presented by the Central Bank of Russia.

Digital Financial Assets

Federal Law No 259-FZ on Digital Financial Assets, Digital Currency and Amendments to Certain Legislative Acts of the Russian Federation dated 31 July 2020 (the DFA Law), which came into force on 1 January 2021, had been under discussion since the beginning of 2018, but was enacted later than other laws regulating digital assets (or “digital rights” in Russian legal terminology) in Russia. The main concerns related to an interaction between digital financial asset regulation, on the one hand, and, on the other, securities markets law, the necessity of enhanced investor protection and the mitigation of money laundering risks. The DFA Law completed the system of digital rights by defining and regulating digital financial assets (DFAs) and allowing the creation of hybrid digital rights.

DFAs are digital rights that include monetary claims, the ability to exercise rights attached to issuable securities, interest in the capital of a non-public joint stock company (digital shares), or the right to require transfer of issuable securities. Issue, circulation and recording of DFAs

are carried out by means of making or amending entries in an information system, including a distributed ledger.

Information system operators and DFA exchange operators

The infrastructure for issuance and circulation of DFAs includes operators of information systems where DFAs are issued and maintained (the information system operator) and DFA exchange operators. Only Russian legal entities can be information system operators or DFA exchange operators. They need to be included in the registers of information system operators and DFA exchange operators, maintained by the Central Bank of Russia, and have the rules of the information system and the DFA exchange rules approved by the Central Bank of Russia prior to the start of their activities. During review of the rules of the information system and the DFA exchange rules, the Central Bank of Russia takes a rigorous approach to the compliance of these rules with the law and conducts on-site inspections of the functionality of each information system.

In order to ensure financial stability, both the information system operator and the DFA exchange operator need to comply with statutory requirements to obtain their respective status. In particular, members of their management bodies shall comply with qualification (eg, education and work experience in the respective area) and reputation (eg, no convictions or administrative disqualifications) requirements. Shareholders holding 10% or more of the shares of an information system operator or a DFA exchange operator are subject to reputation requirements as well. In addition, a DFA exchange operator shall have sufficient

share capital and net assets. Regulated entities, like credit institutions, have a relative advantage in obtaining the status of an information system operator or DFA exchange operator, as some of the requirements (eg, those relating to qualification and reputation of management and shareholders, and to share capital and net assets) are not applicable to these entities.

Though none of the information system operators or DFAs exchange operators are currently registered with the Central Bank of Russia, according to public sources the regulator is now considering several applications from major Russian companies.

Uses of DFAs

The DFA Law has raised interest in the Russian business community. Though its practical application still needs to be tested, the DFA Law provides for the opportunity to establish a “digital” non-public joint stock company with digitalised corporate governance, transfer/acquisition rights attached to traditional shares, including dividend rights and voting rights, without selling/acquiring the shares themselves. The DFA Law provides the basis for tokenisation of assets and improvement of business processes by digitalising contracts to expedite transactions and reduce transactional costs. Businesses may also use DFAs as a way to attract financing by acquiring new financial products (eg, digital derivatives or digital settlement instruments) or as a way to diversify investment instruments and investor base (eg, by offering assets to new categories of investors who do not have access to traditional investment vehicles).

However, the use of the DFAs for any business purpose, especially for raising investment, must comply with the restrictions imposed by the Central Bank of Russia on acquisition of DFAs by non-qualified investors. By way of example, only qualified investors may purchase DFAs issued

pursuant to foreign law, and DFAs representing the ability to exercise rights attached to issuable securities can be acquired only by qualified investors. The amount of annual investments in DFAs made by individuals who are not qualified investors is also limited. This limit, however, does not apply to investments in certain types of DFAs, such as DFAs representing monetary claims with an amount equal to the value of a certain precious metal.

Furthermore, the Central Bank of Russia has displayed its negative attitude toward DFAs used as a means of settlement within an ecosystem or a group of companies. According to the Central Bank of Russia, such DFAs in fact replace money and create unlawful competition with state currencies. Potentially, such units of settlement may also hinder the implementation of a digital rouble, which is discussed in more detail below.

Digital Currency

Prior to the enactment of the DFA Law, in the absence of specific regulation, Russian state authorities and courts started to recognise digital currency as a type of asset – for example, in 2018, a Russian court concluded that digital currency as an asset that can be included in a bankruptcy estate, and in 2019, Bitcoin contributed to the charter capital of a Russian company. However, the regulators, including the Central Bank of Russia, have articulated concerns over the potential competition between digital currency and state currencies, including the Russian rouble, and any related money laundering and tax evasion risks.

The DFA Law introduced the basic definitions relating to digital currency in Russia. Digital currency is defined as a series of digital data contained in an information system that can be used either as a means of payment or as an investment and, contrary to digital rights, in respect of which there is no obligor liable to its holder.

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Digital currency is not a legal means of payment in Russia, and the Russian rouble remains the only official monetary unit.

In addition to these definitions, the DFA Law provides for a prohibition on Russian legal entities and individuals residing in Russia for not less than 183 days within 12 consecutive months (residents) accepting digital currency as consideration for goods, works or services. Claims of such entities related to digital currency are enforceable only if tax authorities are notified of the possession of the digital currency and transactions with it.

The notification procedure is considered by Russian regulators as mandatory, not voluntary. On 17 February 2021, the State Duma of the Russian Federation adopted, in the first reading, a bill establishing the reporting requirements of residents in respect of digital currency (the Tax Reporting Bill). The Bill obliges residents to inform tax authorities of the acquisition of digital currency, including through third parties, and submit reports on transactions with digital currency and its balances. The reporting obligation will apply if the amount of digital currency received or spent by the resident within one calendar year exceeds RUB600,000. Failure to submit reports or provision of false reports may lead to the imposition of a fine in the amount of 10% of the rouble equivalent of the digital currency received or spent by the resident (depending on which sum is larger) that was not reported.

In order to become law, the Tax Reporting Bill will need to pass the three readings in the State Duma, obtain the Council of Federation's approval, and the President's signature. The date of its further consideration is not yet available.

Other specifics of the legal treatment of digital currency are to be set forth in a separate law. This law has not been enacted yet. However,

the basic concepts of this law demonstrate an over-restrictive approach to digital currency, even including the complete prohibition of its circulation, and, together with the Tax Reporting Bill, have been heavily criticised in the business community.

Digital Rouble

In line with initiatives of central banks of various jurisdictions and following the feedback received from market participants, in April 2021, the Central Bank of Russia presented the concept of the digital rouble. The digital rouble will be issued by the Central Bank of Russia and will become the third form of Russian national currency in addition to cash and non-cash money. Advantages of the digital rouble include easy accessibility through any financial institution, reduction of transaction costs by establishing unified commissions, increased level of security, and possibilities for development of innovative services and products.

The Central Bank of Russia chose the retail two-tier model for implementation of the digital rouble. This model provides that the Central Bank of Russia issues digital rouble and serves as the operator of the digital rouble platform. Financial institutions will open wallets in digital currency for their clients and carry out transactions on the digital rouble platform. This model, according to the Central Bank of Russia, ensures that assets are safeguarded and at the same time improves customer experience as operations with the digital rouble will be accessible through the mobile applications of any financial institutions that the client uses.

The Central Bank of Russia plans to launch the pilot digital rouble platform in December 2021 and start its testing in the first quarter of 2022 together with financial market participants. On the basis of the testing results, a roadmap for implementation of digital rouble will be adopted.

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industries as diverse as financial services, investment management, supply chain management and shipping. The group's representative services include (i) blockchain token launches, IPOs, debt and equity offerings, crowdfunding offerings, venture capital investments, private placements, and follow-on offerings; (ii) regulatory compliance, exchange regulation, adviser regulation, privacy, information technology, data protection and cybersecurity; (iii) anti-money laundering and sanctions compliance; and (iv) technology implementation projects and development of systems.

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