

## LEGAL UPDATE

### Developments in cryptoland (i)

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On 25 May 2018 we wrote about (the lack of) regulation in the field of cryptocurrencies and a call from the House of Representatives for a more active approach. Last Friday the Minister for Finance sent a [letter](#) to the House of Representatives explaining how he has dealt with last year's motions and commitments regarding cryptocurrencies. The Minister also sent the House the investigation and recommendations of the regulators, the Dutch Authority for the Financial Markets ("**AFM**") and De Nederlandsche Bank ("**DNB**"), regarding the regulation of cryptocurrencies. This Legal Update focusses on the investigation and recommendations of the regulators. In a next Legal Update we will discuss how the Minister follows (or has followed) up on these recommendations.

#### Investigation by regulators

The AFM's and DNB's investigation outlines the (general) developments around cryptos. In addition, the regulators discuss market developments, with the general trend being that after the first quarter of 2018 there was considerably less interest in (investing in/purchasing of) cryptos.

When it comes to risks, the regulators mainly identify two risks: the risk of financial and economic crime and the risk to which consumers are exposed. The latter risk is then divided into a significant market risk (e.g. the speculative nature of cryptos, which (often) leads to high price volatility and immaturity of the cryptographic markets) and a significant risk of fraud (e.g. the risk of price manipulation of cryptos or the vulnerability to deception and fraud due to the highly technical nature of cryptos, the international dimension and the pseudo-anonymity of transactions). In terms of consumer risk, the regulators point out the following. The decline in popularity of cryptos may result in fraudsters becoming less interested in using cryptos for fraud purposes. Moreover, research has shown that most Dutch crypto owners are aware of the risks they run.

In addition to highlighting the risks of cryptos, regulators explicitly address the opportunities that cryptos (can) offer. Firstly, the regulators mention the functional use of blockchain applications using (payment) cryptos. Examples include market places for admission tickets or decentralised cloud storage. Subsequently, corporate financing is also mentioned as a complement to the existing forms of capital market financing. The advantage of corporate financing using cryptos is the absence of a third (central) party, resulting in efficiency gains and lower costs. Finally, the regulators also see an opportunity when it comes to cross-border retail payments. The advantages here are (also) cost reduction and a faster and more transparent service (cryptos have the potential to be transferred faster, according to the regulators).

#### Current regulations not sufficient

The regulators hold the view that effective application of the existing regulations on investment cryptos (for corporate financing) is not sufficient for two reasons. Firstly, the rules are not proportionate. The regulators draw a parallel with crowdfunding here. Moreover, the current rules require that the activities of clearing, settlement and custody are separate activities. In this sense, the benefits of blockchain technology – the merging of clearing, settlement and custody in the supply chain – cannot be sufficiently enjoyed.

Secondly, providers can easily circumvent the rules because their scope does not sufficiently take into account the new forms of funding that have emerged from ICOs. A token (the crypto often used in ICOs) usually bears the most similarities with a security. The current concept of securities is not based on the

activity (attracting risk-bearing capital), but on the form (a title of ownership or debt). The qualification of security can therefore be avoided (relatively simply).

## Recommendations

The regulators come up with two recommendations, namely (i) the introduction of a Money Laundering and Terrorist Financing (Prevention) Act licensing regime for fiat crypto exchange platforms and providers of crypto wallets, aimed at combating money laundering and terrorist financing in crypto exchange and storage, and (ii) advocating a European amendment to the regulatory framework for corporate financing and aligning the national definition of 'security' with European legislation.

The first recommendation relates to the implementation of the [Fifth Anti-Money Laundering Directive](#) (AMLD5). By introducing the aforementioned licensing system, parties are tested at the gate to see whether they (are able to) meet the AMLD5 requirements. The parties may also lose their licence (and hence their access to the market) if the set (AMLD5) requirements are not met. According to the regulators, other changes to national regulations (in the field of consumer protection) do not make a significant contribution to reducing the risks to consumers in the Netherlands, one of the reasons being the international character of the cryptos. Regulators therefore expect the costs of supervision to outweigh the benefits and, accordingly, advocate an international approach. The regulators conclude that the need to quickly come up with additional rules has decreased because of the waning interest of Dutch consumers in cryptos and the fact that consumers are aware of the risks they run with cryptos.

The second recommendation relates to a European regulatory framework where the regulators recommend a more proportionate approach to corporate financing rules in order to avoid disproportionately burdensome requirements. Moreover, they advise not to create unnecessary barriers to the application of blockchain technology and recommend that the concept of securities be adjusted to create sufficient scope for regulators to apply a content-over-form approach in qualifying (new) activities aimed at corporate financing. In order to do something about the 'concept of securities' in the Netherlands, the regulators recommend aligning the national definition with the definition of the European regulatory framework, because it contains a non-exhaustive list of securities as the wording 'such as' suggests. In the Netherlands, however, there is an exhaustive list of securities (due to the absence of the words 'such as'). The Dutch Authority for the Financial Markets considers it desirable to have the same freedom of interpretation as other European regulators.

The report makes it clear that regulators are struggling with the regulation of cryptos. The regulators want to encourage technological innovation, but not without creating guarantees for financial market players (especially investors/consumers). The regulators are realistic: the case for a European regulatory framework continues to prevail. Until then, the regulators wish to have the means to intervene. The recommendations on the licensing regime and changing the definition of 'security' are concrete steps in this direction. Whether the Minister of Finance follows up on these recommendations will be discussed in our next Legal Update.

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