

Cryptocurrency: a regulatory challenge

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IBUY / TRIPK

BITCOIN PRICE: FRAUDSTERS USING SURGE IN CRYPTOCURRENCY TO TRICK PEOPLE INTO SCAMS, FINANCIAL REGULATOR WARNS

INDEPENDENT

Twitter says it will stop cryptocurrency scams by removing manipulative accounts

THE VERGE

Why bitcoin fraud suspect Alexander Vinnik looks set to be extradited to the US **THE CONVERSATION**

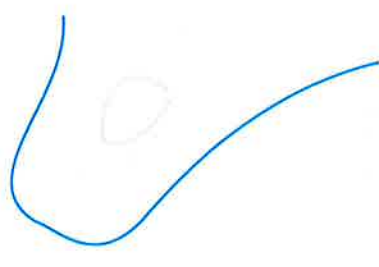
Cryptocurrencies opening fraud gates **FRAUD MAGAZINE**

Bee Token ICO Stung by \$1 Million Phishing Scam **coindesk**

Telegram ICO: Scam Among Cryptocurrency Scams **Forbes**

Regulatory challenges

- Instantaneous transfer of currency across jurisdictions
- No centralised authority to control or monitor such transfers
- Highly volatile and speculative in nature
- Appeal to unsophisticated investors
- Disconnect between an individual's crypto and real life identities: to what extent does this guarantee anonymity?
- Potential to be misused in fraud - especially in ICOs - with risk of consumers sustaining massive losses

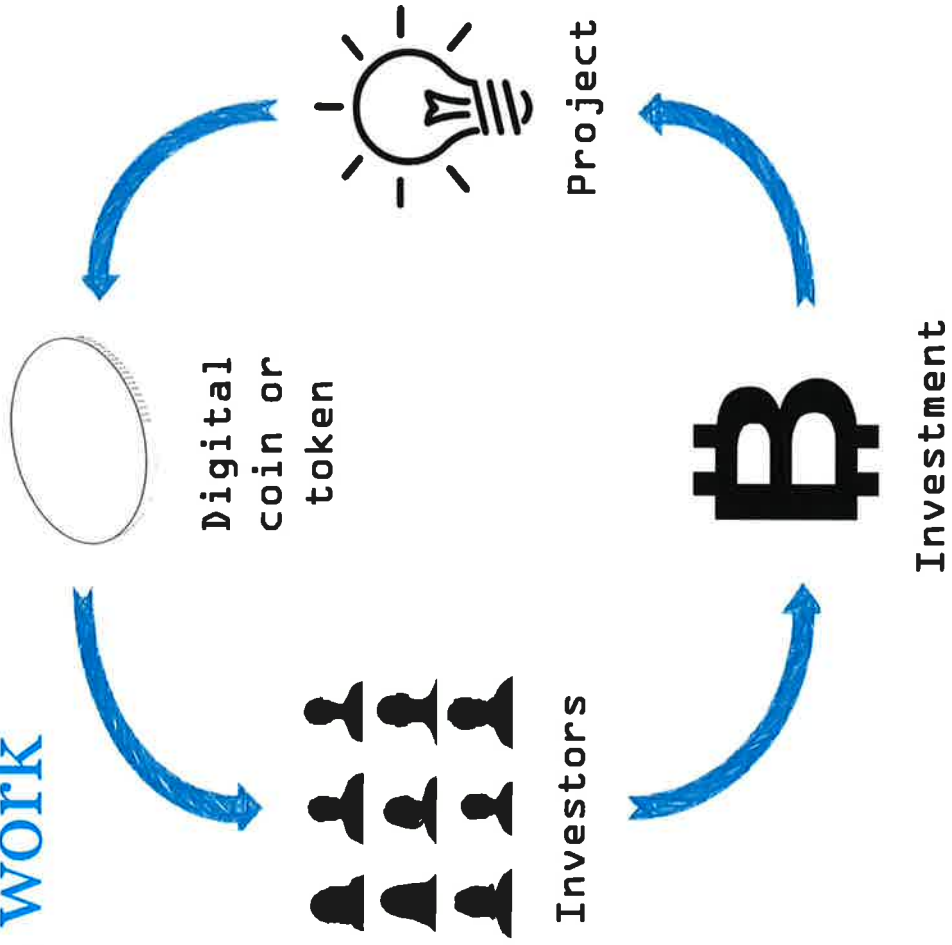


Initial Coin Offerings

- A type of fund-raising mechanism for cryptocurrency-related business ventures
- Combines aspects of a traditional IPO with crowd-funding
- Favoured by start-ups who wish to avoid regulatory requirements associated with traditional capital fund-raising
- Depending on how structured, may fall partly or wholly within regulated perimeter
- First ICO was in 2013. Around \$6bn raised by ICOs in 2017.

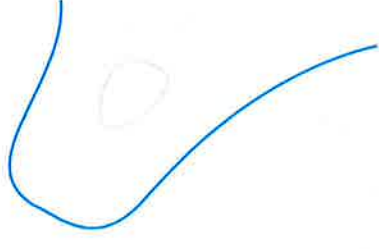


How ICOs work



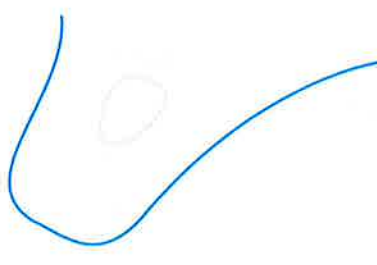
FCA approach to technology

- 'Technologically-neutral' approach
- Recognition that underlying DLT technology has vast potential impact on financial services sector, beyond cryptocurrency – has taken a cautiously welcoming approach
- See FCA Discussion Paper 17/3 (April 2017) and Feedback Statement 17/4 (December 2017)
- Recognition of regulatory benefits of DLT technology – for example, resilience, security, improved transparency and data quality, ease of auditing and meeting regulatory reporting requirements



FCA approach to technology

- Published warning in September 2017 as to risks of investing in ICOs:
 - Unregulated space
 - No investor protection
 - Price volatility
 - Potential for fraud
 - Inadequate documentation
 - Early stage projects
- Feedback Statement 17/4: FCA signalled intent to gather evidence on ICOs and assess whether regulatory action is required

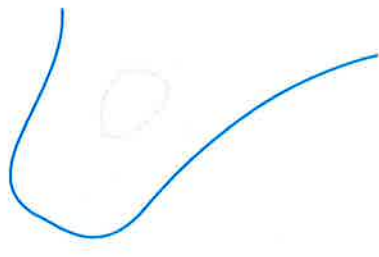


“ICOs are very high-risk, speculative investments. You should be conscious of the risks involved...and fully research the specific project if you are thinking about buying digital tokens. You should only invest in an ICO project if you are an experienced investor, confident in the quality of the ICO project itself (e.g. business plan, technology, people involved) and prepared to lose your entire stake.”

Financial Conduct Authority warning, 12 September 2017

US SEC approach

- Recent focus on targeting ICO fraud – has taken first enforcement cases against what it considers to be fraudulent securities offerings masquerading as ICOs
- Wide definition of ‘security’ in US, encompassing any tradeable financial asset, has made it easier for US authorities to categorise ICO tokens as securities which fall to be regulated and thus subject to federal securities laws
- SEC has also issued strong warnings to investors as to risks of investing in ICOs

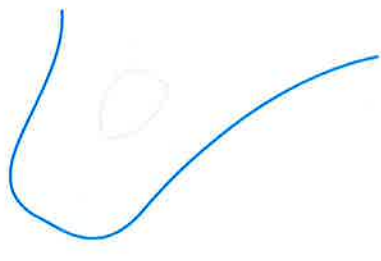


“...Any such activity that involves an offering of securities must be accompanied by the important disclosures, processes and other investor protections that our securities laws require. A change in the structure of a securities offering does not change the fundamental point that when a security is being offered, our securities laws must be followed...replacing a traditional corporate interest recorded in a central ledger with an enterprise interest recorded through a blockchain entry on a distributed ledger may change the form of the transaction, but it does not change the substance.”

Jay Clayton, SEC Chairman, 11 December 2017

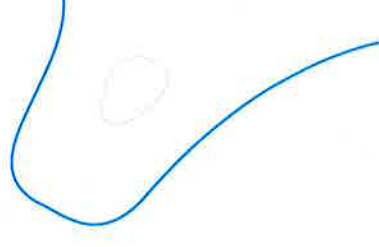
Scope for increased UK regulation

- Tightening processes for exchanging funds from fiat currency to cryptocurrency and back to fiat. For example, requiring digital currency exchange platforms to use similar KYC/AML requirements as mainstream banks – amendments being made to EU 4th Anti-Money Laundering Directive
- Seeking to bring ICOs within regulated perimeter. Some aspects of arranging, dealing or advising on ICOs may constitute regulated activities. Depending on how they are structured, some schemes may in fact constitute collective investment schemes, which fall to be regulated. Creation of a new category of regulated activity to capture ICOs?



Future trends

- Recent clampdowns and regulatory warnings in almost every jurisdiction likely to herald increase in regulation, including in the UK
- Related trend towards self-regulation and adoption of voluntary standards within the crypto-community
- Is regulation now a matter of when and how, rather than if?



Questions

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