K2 Integrity

DOLFIN
DEDICATED ONLINE FINANCIAL INTEGRITY NETWORK

Regulatory Roundup – Q2 2021
Special Virtual Asset Edition

Click on a jurisdiction name to go to its page in the document

This special edition covers regulatory developments related to virtual assets across the world for the three months ending June 30, 2021

Regulatory Roundup – Q2 2021
Special Virtual Asset Edition

The DOLFIN *Regulatory Roundup* is a quarterly curation of key regulatory developments of interest to the financial integrity community, which includes financial institutions, compliance professionals, jurisdictional authorities, and others involved in countering illicit finance and mitigating financial crimes risk. Information has been distilled from dozens of financial regulatory websites and other publicly available English-language sources. Beginning on page three, this special edition contains information on virtual currency-related developments for the three months ending June 30, 2021, in global financial centers and countries of special interest to DOLFIN subscribers.

The Regulatory Landscape

by Gabriel Hidalgo, K2 Integrity Managing Director

As demonstrated during the second quarter of 2021, market pricing and regulatory perspective on retail applications of virtual assets became more focused on the downside risks of a purely market-based pricing structure. While the supply-and-demand dynamics of cryptocurrencies continue to fluctuate, pressure on governments to regulate the purchase and trading of cryptocurrencies has grown. Gray-market crypto exchanges operate on the premise that either they are in a jurisdiction that does not have a framework for virtual asset regulation or that they can operate in a decentralized manner where no single jurisdiction can oversee their operations. However, these entities are learning quickly that countries will not allow them to access their citizens as customers without some prudential oversight. Business incorporation in the Cayman Islands or the Seychelles is no longer a safe haven for avoiding regulatory oversight.

Meanwhile stable coins—cryptocurrency tokens backed by fiat currency reserves or their equivalent—are facing headwinds from jurisdictions looking to possibly launch their own versions of stable coins, or central bank digital currencies (CBDCs). China is testing its digital renminbi and the European Union has discussed its launch of a digital euro as part of a five-year plan. The United States, not to be left behind, addressed digital payments and CBDC in a speech by Lael Brainard, member of the Board of Governors of the Federal Reserve, entitled "Private Money and Central Bank Money as Payments Go Digital: an Update on CBDCs." These efforts point to a desire to usher in a digital age where consumers and businesses can harness available technologies to facilitate faster and more efficient methods of sending and receiving value. Governments across the globe are realizing that private efforts in the creation of digital currency have moved past the point of no return.

As we move ahead in 2021, additional clarity on regulations surrounding the oversight of virtual assets is expected as regulatory agencies around the world acknowledge that the total asset value of the cryptocurrency marketplace continues to eclipse the gross annual output of many countries and that their citizens are actively investing in this new asset class. Additionally, more countries are expected to announce their own CBDC efforts as they try to join the chorus of nations embracing change and seeing the benefits of a digital version of their own fiat currency. Lastly, certain areas of the world likely will expand their bans on the usage or ownership of cryptocurrency because they lack the frameworks in place to protect their citizens from some of the negative aspects seen in the marketplace such as money laundering, scams, and the absence of certain consumer protections.

Australia

In June, the Australian Securities and Investments Commission (ASIC) released a consultation paper seeking public comment on exchange-traded products proposals and other investment products that give retail investors access to crypto assets. With the unique and changing aspects of these products, ASIC said that values receiving insight from a multitude of parties on the issue and hopes to finalize and issue best practices for operators and product issuers in this market. The comment period ends July 27, 2021.

Argentina

In May, Argentina's Central Bank (BCRA) and National Securities Commission (CNV) issued a joint statement warning of the risks and implications of using and investing in crypto assets. The regulators urged caution to mitigate a potential source of vulnerability for users and investors. The statement emphasized that crypto assets are not legal tender in Argentina and that individuals who trade in them or invest in related products should understand and assess the associated risks. These risks include operational disruptions and cyber attacks, lack of institutional safeguards, fraud and lack of transparency, risk of money laundering and terrorist financing, potential breach of forex regulations, and cross-border transactions that can be outside of the jurisdiction of courts and authorities in Argentina.

In May, Argentina's Federal Administration of Public Revenue (AFIP) announced a policy that will require crypto exchanges to file monthly customer transaction data. *BitCoin Insider* reported that AFIP introduced the policy through Form 8126, which mandates that crypto exchanges and payment aggregators and processors submit the required data by the 15th day of the subsequent month. *BitCoin Insider* noted AFIP is seeking to gain "some control over the crypto sector in the country, which has exploded over a short span due to raging inflation, which became worse after the onset of the COVID-19 pandemic."

In June, the BRCA announced it had begun to inspect a group of FinTech companies that finance crypto asset investment projects. The inspections are intended to help the securities commission determine if the companies are conducting unlicensed financial intermediation. The commission said the inspection involves nine companies that take deposits, which are then invested in crypto assets—especially cryptocurrency—to finance projects that yield returns.

Canada

In mid-May, the Bank of Canada included the monitoring of the crypto asset market and its emerging vulnerabilities as part of its annual Financial System Review. The bank said it is developing its regulatory response and faces key challenges associated with crypto assets, including investor protection issues related to crypto asset trading platforms and the use of crypto assets in illicit transactions such as money laundering and terrorist financing. The bank noted that classification of crypto assets and corresponding regulatory responses are also a challenge because of their unique features and the rapid pace at which they are evolving.

Canada's Financial Transactions and Reports Analysis Centre previously issued regulations and guidance for the treatment of crypto assets and virtual asset service providers. On June 1, 2021, amendments to certain regulations under Canada's Money Laundering and Terrorist Financing Act (PCMLTFA) came into force, creating or changing obligations for reporting entities subject to the PCMLTFA.

In June, the Ontario Securities Commission (OSC) published a Statement of Allegations against Bybit Fintech Limited (Bybit), a cryptocurrency derivatives exchange, for failing to comply with Ontario securities law. The OSC said that Bybit, which is incorporated in the British Virgin Islands, is operating an unregistered crypto asset trading platform,

(Canada continued on next page)

encouraging Ontarians to use the platform, and allowing Ontario residents to trade crypto asset products that are securities and derivatives. Weeks earlier, on March 29, the OSC had warned crypto asset trading platforms offering trading in derivatives or securities in Ontario that they must contact OSC staff or face potential regulatory action. Platforms were given until April 19, 2021, to discuss how to bring their operations as a dealer or marketplace into compliance.

China

Throughout May and June, the government and financial industry groups in China escalated their statements and actions against virtual currencies and related activities. In mid-May, China's key financial industry groups banned financial institutions and payment providers from using, underwriting, or providing services related to virtual currencies due to their risk and potential ability to be exploited. According to the Shanghai Securities News, the statement from three financial industry associations—the China Internet Finance Association, the China Banking Association, and the China Payment and Clearing Association—noted that "crypto currency prices have skyrocketed and plummeted, and speculative trading of cryptocurrency has rebounded, seriously infringing on the safety of people's property and disrupting the normal economic and financial order."

A few days later, Reuters reported that the State Council's Financial Stability and Development Committee said it planned to crackdown on bitcoin mining and trading activities in an effort to disrupt the potential financial risks. The news outlet said the country "will also clamp down on illegal activities in the securities market, and maintain the stability of stock, bond and forex markets."

In June, China's central bank announced that it had called on certain banks and payment firms, including China Construction Bank and Alipay, urging them to further restrict cryptocurrency trading, according to CNBC. The People's Bank of China (PBOC) encouraged institutions to conduct thorough checks on clients' accounts to identify anyone involved in cryptocurrency transactions, and to sever their payment channels. "Speculative trading in virtual currencies roils economic and financial order, spawns the risks of criminal activities such as illegal asset transfers and money laundering, and endangers people's wealth," the PBOC said in a statement.

European Union

In June, the EU said it would designate the National Securities Market Commission (CNMV) and the Bank of Spain to supervise and regulate bitcoin and cryptocurrencies. Nasdaq and other news outlets recirculated a story initially reported by the Spanish publication *Cinco Días* that a draft revision of the EU's proposed regulation of markets in crypto assets, known as "MiCA," designates the two entities to oversee crypto activity in Spain alongside the European Central Bank, citing a working document it had access to. *Cinco Días* noted that the goal is for the proposed regulation to be ready by the end of 2021 or the beginning of 2022. *Bitcoin News* reported that "cryptocurrency-based companies offering services to Europeans must be located in the region to offer their services. With this measure, the EU wants to bring protection to its users by having service providers within its jurisdiction." The draft revisions to MiCA exclude non-fungible tokens (NFTs) from regulation "because, unlike cryptocurrencies, they are not used as a medium of exchange, an indication of how the EU needs to be clear about the definition of crypto assets," Nasdaq reported.

G7 Finance Ministers and Central Banks

Following a meeting in the United Kingdom in early June, the Group of Seven (G7) Finance Ministers and Central Bank Governors issued a communiqué that addressed central bank digital currencies (CBDCs) and stablecoins. The report, published by HM Treasury, called for greater coordination on CBDCs, and emphasized the public benefits of greater financial innovation, competition, and inclusion. "We note that any CBDCs, as a form of central bank money, could act as both a liquid, safe settlement asset and as an anchor for the payments system. Our objective is to ensure that CBDCs are grounded in long-standing public sector commitments to transparency, the rule of law and sound economic governance," the report said, noting that CBDCs "should be resilient and energy-efficient" and could enhance cross-border payments. The G7 Finance Ministers and Central Bank Governors said they "will work towards common principles and publish conclusions later in the year."

The June 5 communiqué reiterated the group's position that "no global stablecoin project should begin operation until it adequately addresses relevant legal, regulatory, and oversight requirements through appropriate design and by adhering to applicable standards." The G7 Finance Ministers and Central Bank Governors emphasized their commitment to international cooperation to ensure common standards for CBDCs and stablecoins, "including by supporting international standard setting bodies in reviewing existing regulatory standards," and highlighted the need to address "any identified gaps."

Germany

In April, Germany's financial regulator, BaFin, warned investors that Binance, one of the world's biggest cryptocurrency markets, had likely violated German securities rules with the company's launch of trading in stock tokens, one of several government crackdowns on the crypto industry during the second quarter of 2021. In a note published on its website, BaFin said that tokens "tracking the movement of shares in Tesla, Coinbase and MicroStrategy represent securities" required a prospectus. As the prospectuses were not issued, BaFin noted that such a violation represents a criminal offense that can be punished with a fine of up to €5m, or 3 percent of the issuer's last annual revenue. The *Financial Times* reported that the move follows European financial regulators' examination of Binance's launch of a service to allow investors to trade fractions of shares through products that use a German broker as an intermediary.

In late May, the German Ministry of Finance published a draft bill that would require the recording of information relating to crypto asset transactions, a proposal that was expected to be finalized this summer and incorporated into the ministry's German Anti-Money Laundering Act. According to media reports, the draft bill is consistent with Financial Action Task Force (FATF) guidelines for crypto transactions involving centralized exchanges and other services that hold crypto assets in custody for customers, known as the travel rule.

In late June, BaFin granted the cryptocurrency exchange Coinbase permission to provide crypto custody services and proprietary trading, Reuters reported. The news outlet said the license was the first BaFin had issued for such business in Germany and that it allows Coinbase Germany GmbH to conduct proprietary trading of crypto assets.

India

On April 1, the Indian Ministry of Corporate Affairs (MCA) began mandating that companies disclose crypto trading and investments during the financial year, BitCoin.com reported. A notification issued by MCA said that every company that "has traded or invested in cryptocurrency or virtual currency during the financial year" must disclose "profit or loss on transactions involving cryptocurrency or virtual currency," the "amount of currency held as at the reporting date," and "deposits or advances from any person for the purpose of trading or investing in cryptocurrency or virtual currency." The news outlet reported that crypto companies in India welcomed the new government requirements, believing that they legitimize cryptocurrency transactions. It also said that the Indian government is continuing to develop a cryptocurrency bill.

Indonesia

In June, multiple news outlets reported that Bank of Indonesia Governor Perry Warjiyo announced at a virtual seminar that the central bank will not allow cryptocurrencies to be used for payments. *CoinTelegraph* reported that Warjiyo said crypto assets are "not legitimate payment instruments under the constitution, Bank Indonesia Law, and Currency Law," noting that "field supervisors will be sent out to ensure that local financial institutions adhere to the policy" of the ban on crypto assets as a means of payment. The news outlet also noted that the country is currently "severely curtailing crypto-related activities," and has forced three crypto trading platforms to shut down. Another publication, PYMNTS.com, noted that "moves by various countries to crack down on cryptos may come in part as a way to get CBDCs—digital fiat—out into the field" and that "Indonesia is reportedly in the midst of exploring its own CBDC."

Japan

In early April, Japan's Financial Services Agency (FSA) announced in a press release its adoption of the FATF "travel rule" for crypto assets to address potential money laundering risks. Virtual asset service providers will be required by April 2022 to collect and share transaction data of cryptocurrency senders and recipients in order to limit the use of virtual assets as a means to engage in money laundering or the finance of terrorism.

In June, the Bank of Japan published a report on standardization in information technology related to digital currencies. The paper, which is a part of the bank's study on the topic of standardization of IT relating to digital currency, was identified as an issue in the country's exploration of the possible design of a CBDC. The report notes that the benefits of standardization in financial services, such as ensuring interoperability and reliability, also apply to digital currencies and that existing international financial services standards can serve as a useful reference. In addition, the report said, the Bank of Japan "recognizes the need for cooperation and collaboration with a wide range of stakeholders, including private-sector businesses and experts, as well as for leveraging the cooperative efforts among central banks, in its ongoing consideration of CBDC."

In late June, FSA warned that cryptocurrency exchange Binance was operating in Japan without permission. *Coindesk* reported that Binance was warned by the FSA in March 2018 for the same reason and that in May 2021 the FSA issued a similar warning concerning Bybit about offering crypto services in the country despite not being registered to do so.

Kuwait

In May, like other central banks around the world, the Central Bank of Kuwait issued a statement on crypto assets and their risks warning the public about volatility in cryptocurrency markets. The central bank said that crypto assets "can in no way be compared to real currency." According to the statement, only a lawful state can issue real currency as a symbol of sovereignty. "The real currency is regulated by state authorities such as central banks or monetary institutions. It is considered and accepted as a store of value and legal tender. It serves as a reliable medium for exchange." The bank's statement cautioned against dealing in crypto assets, which "come at a high risk and with an array of negative consequences for dealers in view of the nature of these assets and the high fluctuation in their prices. These assets are not subject to regulation or supervision by any authority in the State of Kuwait, which could mean great losses for speculators and increased risk of fraud."

Mexico

In June, Mexico's central bank, its finance ministry, and banking regulator jointly issued a warning about cryptocurrencies, saying that crypto assets are not legal tender in Mexico and are not considered currencies under current laws. It also warned that financial institutions that operate with cryptocurrencies are subject to sanctions. In their statement, the financial authorities reiterated earlier warnings issued since 2014 "on the risks inherent in the use of so-called 'virtual assets' as a means of exchange, as a store of value or as another form of investment." The statement said that "the country's financial institutions are not authorized to carry out and offer to the public operations with virtual assets, such as bitcoin, ether, XRP and others in order to maintain a healthy distance between them and the financial system."

Russia

In May, Russia's Central Bank affirmed that it is setting in motion the infrastructure and required environment for testing of the digital ruble, according to Global Finance. During a press conference, the Central Bank's deputy governor, Alexey Zabotkin, stated that the bank hoped to release the digital ruble in 2023.

The Russian central bank announced in June that it is conducting research related to the risks of crypto investing. The study, titled "Assessment of Risks of Using Cryptocurrencies" is part of the Bank of Russia survey program for the second half of 2021. The central bank said the objective of the survey is to "obtain information on trends to assess systemic risks in connection with investments of Russian individuals and legal entities in cryptocurrency," The regulator will be surveying financial market participants, including 15 banks such as VTB, Tinkoff, Alfa-Bank, Raiffeisenbank, and the state-owned banking giant SberBank.

Singapore

In an April reply to a member of Parliament's question about the country's crypto asset market, the Monetary Authority of Singapore (MAS) outlined steps it has taken to address money laundering and terrorism financing (ML/TF) risks associated with cryptocurrencies. MAS noted that digital payment token service providers, which are entities involved in providing cryptocurrency-related services, must be licensed by MAS, and comply with anti-money laundering (AML)/countering the financing of terrorism (CFT)requirements, such as obligations to perform customer due diligence and transaction monitoring. They are also required to file suspicious transactions reports with the Commercial Affairs Department. MAS also noted that it has "stepped up surveillance of the cryptocurrency sector, to identify suspicious networks and higher risk activities for further supervisory scrutiny."

(Singapore continued on next page)

In June, MAS issued a notice setting forth AML/CFT requirements for digital payment token service providers. Notice PSN02, on Prevention of Money Laundering and Countering the Financing of Terrorism—Digital Payment Token Service, notes that digital payment token service providers are required to establish robust controls to detect and deter the flow of illicit funds through Singapore's financial system. "Such controls include the need for financial institutions to identify and know their customers (including beneficial owners), to conduct regular account reviews, and to monitor and report any suspicious transaction," the notice says. MAS also recently published an infographic illustrating its supervisory expectations on AML/CFT controls for the digital payment token (DPT) sector that is intended to raise industry awareness about the ML/TF risks in the sector, and provide additional supervisory information to help DPT service providers implement effective policies, procedures, and controls to deal with the ML/TF risks.

Switzerland

In June, the Switzerland-based Bank for International Settlements published a report that unconditionally backed development of CBDCs, citing their numerous benefits, including their ability to modernize finance and ensure 'Big Tech' does not take control of money. "Like the latest generation of instant retail payment systems, retail CBDCs could ensure open payment platforms and a competitive level playing field that is conducive to innovation," the report said. The BIS report also highlighted the need to ensure open technology platforms to preserve access. "The ultimate benefits of adopting a new payment technology will depend on the competitive structure of the underlying payment system and data governance arrangements. The same technology that can encourage a virtuous circle of greater access, lower costs and better services might equally induce a vicious circle of data silos, market power and anti-competitive practices." The report also touted the ability of CBDCs "to improve cross-border payments and limit the risks of currency substitution" but said that multi-CBDC arrangements will require international cooperation.

South Africa

In early June, South Africa's Financial Sector Conduct Authority (FCSA) stated that it plans to bring crypto exchanges under regulatory oversight. As part of its announced plans, the country's Intergovernmental Fintech Working Group (IFWG), through its Crypto Assets Regulatory Working Group, released a position paper on the necessity of bringing crypto assets within the regulatory regime. The paper includes recommendations to apply current AML/CFT obligations to crypto asset service providers (CASPs), establish ways to monitor cross-border flows, and institute risk limitations to avoid financial system damage due to inherent crypto asset risks. The IFWG said the country's national policy position of 2014—that crypto assets are largely unregulated in South Africa and that parties engaging in crypto-related activities do so at their own risk and without any regulatory recourse—has been revised to bring crypto assets under regulations in "a phased and structured manner."

Later in June, Bloomberg News reported that South Africa was moving "with more urgency to stiffen oversight of cryptocurrency assets after a proliferation of scams." The news outlet said the regulatory timeline foresees finalizing a framework in three to six months, according to Kuben Naidoo, chief executive officer of South Africa's banking regulator, the Prudential Authority. "We are trying to put in place the regulatory framework quickly," Naidoo told Bloomberg. "Our view is that crypto is a financial product and should be regulated as a financial product."

Turkey

In April, the Central Bank of the Republic of Turkey banned the use of crypto assets in payments because they involve significant risks, including volatile market values and irrevocable transactions, and "are used in illegal actions due to their anonymous structures." The central bank said crypto assets are "neither subject to any regulation and supervision mechanisms nor a central regulatory authority, among other security risks." The bank's statement said further, "It is considered that their use in payments may cause non-recoverable losses for the parties to the transactions due to the above-listed factors and they include elements that may undermine the confidence in methods and instruments used currently in payments."

In late April, Bloomberg News reported that Turkey is planning to regulate its cryptocurrency market by establishing a central custodian bank. According to the report, the plans were in response to the collapse of two local exchanges, with senior officials indicating the change would seek to eliminate counterparty risk. Bloomberg reported authorities, including the Treasury and Finance Ministry, the Capital Markets Board, and financial crime watchdog Masak, are involved in the effort, which includes "pondering a capital threshold for exchanges, among other requirements."

In May, Turkey added cryptocurrency trading platforms to the list of firms covered by AML/CFT regulation via a presidential decree published early on a Saturday. The Block reported that the decision to regulate crypto exchanges "took effect immediately," spurred by the belief of Turkey's central bank that digital assets pose "significant risks."

United Arab Emirates

In late March, the Dubai Financial Services Authority (DFSA) published "Consultation Paper No. 138: Regulation of Security Tokens," a comprehensive regulatory framework for regulating security tokens. The DFSA noted in its announcement that it "was actively engaged with stakeholders in Dubai and around the world on the future of finance and the rapidly growing area of financial technology, including various distributed ledger technology (DLT) applications." The announcement said that security tokens "create rights and obligations that are the same as, or are substantially similar to, conventional investment instruments," but the framework "goes beyond typical securities to cover derivatives as well." The DFSA is seeking to update its regulatory framework to facilitate DLT-based activities such as the offer of security tokens to the public, as well as their trading; the admission to trading of security tokens on trading facilities; and the provision of other financial services, such as providing custody relating to digital wallets holding security tokens.

United Kingdom

The UK was one of three regulators around the world to clamp down on Binance during the second quarter, joining Japan and Germany in issuing stark warnings to the company. In June, the Financial Conduct Authority (FCA) ruled that Binance Markets, part of the Binance Group, cannot conduct any "regulated activity" in the UK. Binance and the cryptocurrency industry in general are largely unregulated but government entities around the world continue to raise questions—and take actions—related to Binance's business operations. The company is incorporated in the Cayman Islands but says it has no corporate headquarters. The FCA's action warned investors to be wary of high returns promised on crypto asset investments. "No other entity in the Binance Group holds any form of UK authorisation, registration or licence to conduct regulated activity in the UK," the FCA said. *TechMonitor* noted that growing regulatory scrutiny and efforts to prohibit or regulate the cryptocurrency exchange reflect "concerns that Binance's platform is being used by cybercriminals to launder the proceeds of attacks."

United States

In May, Bloomberg reported that the U.S. Justice Department and the Internal Revenue Service (IRS) were investigating Binance Holdings Ltd., “ensnaring the world’s biggest cryptocurrency exchange in U.S. efforts to root out illicit activity that’s thrived in the red-hot but mostly unregulated market.” According to “people with knowledge of the matter” who spoke with Bloomberg, federal money laundering and tax offense investigators “have sought information from individuals with insight into Binance’s business.” Bloomberg’s coverage noted that Chainalysis Inc., a blockchain forensics firm, “concluded last year that among transactions that it examined, more funds tied to criminal activity flowed through Binance than any other crypto exchange.” A Binance spokeswoman said in an emailed statement that the company takes its legal obligations “very seriously” and engages with regulators and law enforcement “in a collaborative fashion.”

In May, the Federal Deposit Insurance Corporation (FDIC) announced it was soliciting comments about U.S. federally insured depository institutions’ current and potential digital asset activities, noting the “novel and unique” considerations related to digital assets as well as their rapid expansion and innovation in recent years. With banks increasingly “exploring the emerging digital asset ecosystem,” the FDIC seeks to inform its understanding of industry and consumer interests in digital assets, and said it was “laying the foundation for the next chapter of banking by ensuring [it has] a regulatory framework that allows responsible innovation to flourish.” Comments were due by July 16, 2021.

In May, the Treasury Department released “The American Families Plan Tax Compliance Agenda,” which includes a new requirement for tax reporting when businesses receive more than $10,000 in crypto assets. In addition, it notes that the Biden administration seeks to provide additional resources for the IRS so that the tax agency may fully address the growing crypto asset usage.

In June, the Texas Department of Banking announced that Texas state-chartered banks can provide customers with virtual currency custody services, “so long as the bank has adequate protocols in place to effectively manage the risks and comply with applicable law.” A statement issued by the department said that “while custody and safekeeping of virtual currencies will necessarily differ from that associated with more traditional assets, the Texas Department of Banking believes that the authority to provide these services with respect to virtual currencies already exists pursuant to Texas Finance Code § 32.001.” The statement said that the virtual currency custody services that a bank chooses to offer will depend on the bank’s expertise, risk appetite, and business model.