

Virtual Currencies: Regulators' Concerns and Responses, by Edith Rigler

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There isn't a day now that you open a newspaper and don't find a Bitcoin story. Partly this has to do with the fact that Bitcoin's shine has been tarnished lately: the price of Bitcoin recently dropped again; it is now priced at around \$380, a two-thirds decline from its high of more than \$1,130 in December 2013. Obviously this volatility begs the question whether Bitcoin can be a sound investment. A second reason for Bitcoin's media attraction is that on a daily basis more and more retailers and merchants announce their readiness to accept Bitcoin as payment. Thus we read human interest stories about people paying their children pocket money in Bitcoin, or paying college admission fees in Bitcoin, and so on. But another reason for Bitcoin's media appearances is that one country after another announces plans to regulate Bitcoin – or not.

The regulatory conundrum

As Bitcoin, the most popular among a whole host of virtual currencies (VCs), is gaining momentum, many government authorities are now focusing on how these VCs can be used and misused. The questions raised are not simply ones such as "should Bitcoin be regulated or not". Rather, the fundamental questions start with an **exact definition of a VC**. Are VCs legal currency? Are they an "asset", a "property", a "financial unit"? If they are an asset, is it taxable? If so, does capital gains tax apply?

Beyond trying to define what VCs actually are, regulators have been looking at the **participants** in the VC market. Typically there are three participants:

- an "administrator" (who issues VC and has the authority to withdraw VC from circulation)
- an "exchanger" (who is involved in the exchange of a VC for traditional, hard currency or for other virtual currency), and
- the "user" (who obtains convertible VC and uses it to purchase real or virtual goods or services).

Each type of participant may fall into one or another already existing law or regulation. For example, in some jurisdictions, VC "administrators" and "exchangers" are considered "money transmitters" and are thus subject to regulation, while "users" are not. As a money transmitter, a VC administrator or an exchanger is required to register as a money services business and is subject to regulations as would any ordinary money transmitting service dealing in traditional currency. Those who use VCs exclusively for common personal transactions like receiving payments for services or buying goods online would qualify as "users" and are thus not regulated.

In some countries (e.g. the US), VC "administrators" and "exchangers" are also subject to numerous other regulations, including complying with the requirements that they implement an antimoney laundering / know your customer (AML/KYC) programme, as well as record keeping requirements and reporting obligations. Failure to register as a money transmitting business is punishable by civil penalty, and operating as a money transmitting business without registering is a criminal offense.

Beyond the definition of whether someone is an "administrator", "exchanger" or "user" additional legal questions arise: if a user "mines" a convertible VC solely for his or her own purposes, is the user then a money transmitter or not? Is a company that purchases and sells convertible VCs as an investment exclusively for its own benefit, and that produces and distributes software to facilitate such purchases, a money transmitter or not?

Criminals are not waiting for regulatory definitions

Clearly, VC regulation is a hugely complex area and novel legal questions arise continuously. In the meantime, VC usage has started to take off, even though many jurisdictions have yet to fully define what a VC is and how it should be regulated. Some of these early VC adopters are possibly criminals. According to law enforcement authorities, VCs' high degree of anonymity have induced criminals to use VCs and particularly Bitcoin, to commit crimes, launder money, and evade law enforcement, and a number of cases are now coming before the courts.

Regulation around the globe

Unfortunately regulation typically starts on a national rather than regional or even global level. Therefore, multiple countries around the world have reviewed VCs and in some cases passed legislation.

Simplistically speaking, regulatory responses fall into roughly three distinct groups:

1. Some countries have prohibited banks and payment institutions from dealing in Bitcoin altogether. Examples are Japan, China, Thailand, India.
2. Some countries have been setting strict rules where using Bitcoin for purchases is permitted, but trading, creating a market or operating an exchange etc. requires a license from the national regulator (examples are Germany, the US).
3. Some countries have not passed regulation yet, but are monitoring and investigating the Bitcoin market (examples include Canada, the UK, and France).
4. And for some countries we simply do not have sufficient information yet on their regulatory plans.

Before you start a VC business – think again!

At present, VCs represent a miniscule amount of transactions globally. However, many retailers and small businesses are sufficiently attracted by the perceived advantages of Bitcoin (lower transaction fees, speed, anonymity, no charge-back) so that they are considering doing business in Bitcoin. Depending on the jurisdiction in which the retailer or small business operates, entering the VC market will have significant implications. In addition to registration and AML/KYC compliance, businesses that operate as VC brokers must consider consumer protection obligations.

Conclusion

Currently VCs are not widely used or understood yet. The current volume of VC transactions around the world is minimal, compared to the volumes which banks and payment systems handle. But Bitcoin's 6-year history has clearly demonstrated its extremely high volatility, its risk of manipulation and that it is vulnerable to hacking or electronic system failures. Central banks in several jurisdictions are not concerned about the impact of VCs on the financial stability or monetary policy of the market they regulate – yet. However, should VCs become more widespread as alternative payment means, central banks will be highly interested in determining the likely consequences on their economies and respective national currencies, and of course on domestic consumers ... the constituency whom they ultimately must protect.

This blog post is written by guest blogger and freelance consultant Edith Rigler. She has over 25 years experience in senior positions at global banks. It is the second blog in a series of three posts on Bitcoin. The first blog was "[Virtual Currencies: Are They for Real?](#)".