



## Regulation of crypto-assets in Ireland - **FAQ**

November 2020

**As is the case in many jurisdictions, the Irish regulatory landscape relating to crypto-assets remains at a developmental stage.**

At the date of writing, there is no Irish or EU framework that either specifically regulates crypto-assets and their issuers or prohibits their use.

However, this is set to change by 2024 following the publication on 24 September 2020 of the EU's Digital Finance Strategy 2020 which contains a proposed legislative framework for Markets in Crypto-Assets (Proposed Framework). Click [here](#) to read our William Fry Fintech Group/Financial Regulation Unit FAQ on that Proposed Framework.

Until the Proposed Framework enters into force, existing financial services regulatory regimes may be relevant to crypto-asset issuers and service providers, depending on the characteristics of the particular crypto-asset and business model.

The William Fry Fintech Group/Financial Regulation Unit has designed this FAQ to answer some essential regulatory questions relating to crypto-assets and help firms navigate this often complex, and continually evolving, regulatory landscape.

### **WHAT IS A "CRYPTO-ASSET"?**

Whilst there is no universally accepted definition of a "crypto-asset", the European Banking Authority (**EBA**) defines a crypto-asset as having the following three properties:

- it depends primarily on cryptography and distributed ledger technology or similar technology as part of its perceived or inherent value;
- it is neither issued nor guaranteed by a central bank or public authority; and
- it can be used as a means of exchange and/or for investment purposes and/or to access a good or a service.

The Proposed Framework reflects these properties and defines a crypto-asset as "a digital representation of value or rights which may be transferred and stored electronically using distributed ledger technology or similar technology". Crypto-assets are not recognised in Ireland or by the European Central Bank as fiat money (i.e. value designated as legal tender).

## WHAT ARE THE VARIOUS TYPES OF CRYPTO-ASSETS?

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Broadly speaking, there are three categories of crypto-assets although some crypto-assets span more than one of the below three categories and different regulatory regimes classify crypto-assets according to different criteria.

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**Cryptocurrencies** (also known as virtual currencies or digital currencies), such as Bitcoin, Ethereum and Litecoin, are used as a means of exchange (i.e. to enable the buying or selling of goods or services offered by someone other than the issuer of the cryptocurrency) or for investment purposes or for the storage of value.

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**Investment tokens** typically provide the holder with rights (e.g. ownership rights and/or entitlements similar to dividends) akin to investments.

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**Utility tokens** typically enable the holder to redeem the token in exchange for a specific product or service but are not accepted as a means of payment for other products or services.

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## IS THERE A SPECIFIC REGIME REGULATING CRYPTO-ASSETS IN IRELAND?

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At the time of writing, there is no Irish framework specifically designed to either regulate crypto-assets and their issuers or to prohibit their use.

However, some existing regulatory regimes may be relevant to crypto-assets depending on the characteristics of the particular crypto-asset and business model. For example:

- **Investment services regulatory regime:** Some crypto-assets may fall within the scope of the definition of a “financial instrument” (including but not limited to a “transferable security”) under Irish laws implementing the second Markets in Financial Instruments Directive (**MiFID2**). Where a firm carries out “investment services or activities” in relation to “financial instruments” it may require authorisation as a MiFID investment firm, unless an exemption is available.

- *Electronic money regulatory regime:* A crypto-asset will qualify as “electronic money” only if it satisfies all elements of the definition of “electronic money” as set out in the second Electronic Money Directive (**EMD2**) namely “electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in [the second Payment Services Directive], and which is accepted by a natural or legal person other than the electronic money issuer”. Where a business model involves the issuance of electronic money, the issuer may require authorisation as an electronic money institution under EMD2, unless an exemption is available.
- *Payment services regulatory regime:* Some services that may be provided in connection with cryptocurrencies may be regulated payment services (e.g. execution of payment transactions or money remittance) or money transmission (e.g. where the operator of a cryptocurrency platform settles payments of fiat currency between buyers and sellers of the cryptocurrency) under Irish laws implementing the second Payment Services Directive (**PSD2**) or Irish laws governing money transmission. An entity carrying out regulated payment services may require authorisation as a payment institution under PSD2 (or depending on the business model as an electronic money institution under EMD2), unless an exemption from regulation is available.
- *Data Protection / General Data Protection Regulation (GDPR) regime:* cryptocurrency exchanges and blockchains may be subject to data protection/GDPR compliance because, although any personal data may be encrypted as well as pseudonymised, true anonymity is becoming less frequent due to the increased application of customer due diligence and anti-money laundering requirements. Also, while a blockchain may not contain names, addresses, telephone numbers, or any other personally identifiable information (that might directly identify an individual) studies have shown that it may still be possible, without too much effort, to indirectly identify an individual on a blockchain from an internet protocol address.

## HOW ARE CRYPTO-ASSETS ADDRESSED UNDER THE AML/CTF REGULATORY REGIME IN IRELAND?

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To reduce the risk of crypto-assets being used to facilitate financial crime, the fifth Anti-Money Laundering Directive (**MLD5**) requires EU Member States to treat “*virtual currency exchange platforms*” and “*custodian wallet providers*” as “*designated persons*” subject to AML/CTF obligations including customer due diligence, identifying suspicious activity and monitoring customer transactions with respect to possible money laundering or terrorist financing activity.

Although the deadline for transposition of MLD5 into national law was 10 January 2020, these provisions of MLD5 have not yet been implemented in Ireland. Draft implementing legislation was published by the Irish Government in August 2020.

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For this purpose:

- “*Virtual currency exchange platforms*” are service providers which facilitate the trading of cryptocurrencies with fiat currencies (note that crypto to crypto exchanges are excluded from the scope of MLD5, but some EU Member States, such as the UK, have opted to “gold plate” this provision and include such exchanges in their transposing legislation).
- “*Custodian wallet providers*” are service providers which offer services of safeguarding/storing private cryptographic keys granting rights to access/transfer crypto-assets.

## WHAT ARE INITIAL COIN OFFERINGS (ICOS) AND WHICH REGULATORY REQUIREMENTS APPLY TO ICOS IN IRELAND?

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An ICO is an innovative method of raising funds by issuing digital tokens or coins in exchange for fiat currencies or other cryptocurrencies. The coins or tokens may enable the holder to access goods or services that the issuer develops using the proceeds of the ICO or may grant the holder voting rights or shares in the revenue of the issuing venture. Some coins or tokens may be traded or exchanged for traditional currencies or cryptocurrencies. As each ICO is different, any application of existing regulatory regimes to an ICO may only be determined on a case-by-case basis.

In November 2017, the European Securities and Markets Authority (**ESMA**) issued a statement alerting firms involved in ICOs to the need to meet any applicable regulatory requirements or risk the consequences of regulatory breaches. While noting that, depending on how they are structured, some ICOs may fall outside the regulatory sphere, ESMA observed that, where coins or tokens qualify as “financial instruments”, it is likely that firms involved in ICOs may be involved in regulated investment activities such as placing, dealing in or advising on financial instruments or managing or marketing collective investment schemes. The non-exhaustive list of regulatory regimes which ESMA advised firms involved in ICOs to consider include:

- the Prospectus Directive, which requires inter alia the publication of a prospectus before the offer of transferable securities to the public unless exemptions apply,
- MiFID2,
- the Alternative Investment Fund Managers Directive (**AIFMD**), noting that, depending on how it is structured, an ICO may amount to an alternative investment fund to the extent that it is used to raise capital from a number of investors with a view to investing it in accordance with a defined investment policy, and
- the AML/CTF regime.

In December 2017, the Central Bank of Ireland’s ‘Alert on Initial Coin Offerings’ warned of the risks of investing in ICOs including vulnerability to fraud and illicit activity connected with lack of regulation, the high risk of losing all invested capital, lack of exit options, extreme price volatility, inadequate information and flaws in technology.

## WHAT ARE THE KEY RISKS IN RELATION TO CRYPTO-ASSETS IDENTIFIED BY REGULATORS?

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Both the Central Bank of Ireland and European regulatory authorities have drawn attention to various risks relating to crypto-assets.

### RISKS TO CONSUMERS IN RELATION TO CRYPTOCURRENCIES

In February 2018, the Central Bank of Ireland issued a 'Consumer Warning on Virtual Currencies' highlighting risks for consumers relating to virtual currencies including their extreme price volatility, the absence of regulatory protections and the fact that information given to consumers in relation to virtual currencies is often incomplete, difficult to understand and does not properly disclose the risks to consumers.

### RISKS TO INVESTORS IN RELATION TO ICOS

In November 2017, ESMA issued a statement alerting investors to the risks of ICOs, describing ICOs as highly risky, speculative investments. ESMA's statement highlighted that investors may not benefit from the protection that comes with regulated investments where ICOs are structured in a way which brings them outside the regulated sphere, that some ICOs may be used for fraudulent or illicit activities, that there is a high risk of losing all of the invested capital given that the vast majority of ICOs are launched by companies at a very early stage of development, the lack of exit options for investors, extreme price volatility of coins or tokens issued to investors, inadequate information for investors and that there may be flaws in the technology used to create, transfer or store coins or tokens leaving them vulnerable to becoming inaccessible or being stolen.

### RISKS RELATING TO CUSTODIAN WALLET PROVIDERS AND VIRTUAL CURRENCY EXCHANGE PLATFORMS

In January 2019, the EBA issued a report on crypto-assets which identified risks relating to custodian wallet providers and virtual currency exchange platforms including absent or inadequate conduct of business requirements (e.g. for the disclosure of risks, provision of information and advertising/marketing practices), suitability checks (i.e. regarding riskiness of a crypto-asset activity relative to the consumer's risk appetite), governance arrangements (i.e. to ensure that risks are appropriately managed and mitigated) and complaints handling/redress procedures and compensation schemes and the lack of a legal framework determining the rights and obligations of each party, including in relation to liability. The Proposed Framework aims to mitigate many of these risks by bringing certain crypto-asset service providers, including custodian wallet providers and virtual currency exchange platforms, in scope of the Proposed Framework as regulated entities with obligations including consumer protection and governance requirements.

### RISK RELATING TO USE OF CRYPTO-ASSETS TO FACILITATE FINANCIAL CRIME

A major concern of regulators regarding crypto-assets is how their perceived relative anonymity facilitates their use for the purposes of money laundering and terrorist financing and other financial crime.

## ARE THERE ANY PROPOSALS FOR THE FUTURE REGULATION OF CRYPTO-ASSETS?

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### EU REGULATORY FRAMEWORK FOR MARKETS IN CRYPTO-ASSETS

Since the publication of the EU Fintech Action Plan in March 2018, the European Commission has been closely monitoring the opportunities and challenges raised by crypto-assets. Analysis published in response to the EU Fintech Action Plan by the EBA and ESMA assessing the suitability of existing financial services regulatory regimes to cover crypto-assets found that while some crypto-assets fall within existing regimes, effectively applying the regulations to these assets is not always straightforward and in some instances EU legislation hinders the use of technologies such as distributed ledger technology/blockchain in financial services. The European Commission subsequently launched a consultation on a legislative proposal for a future EU Framework for Markets in Crypto-Assets and invited stakeholders to respond to a series of questions aimed at determining whether EU legislative intervention is required. As stated above, on 24 September 2020, the European Commission published that Proposed Framework in the form of a proposed regulation and it will now advance through the EU legislative process.

### IRISH DEPARTMENT OF FINANCE 2018 DISCUSSION PAPER ON VIRTUAL CURRENCIES AND BLOCKCHAIN TECHNOLOGY

To date, Ireland, like many other jurisdictions, has exercised caution and refrained from developing a specific domestic regulatory regime for crypto-assets, preferring to wait and see whether a common EU approach emerges. In 2018, the Irish Department of Finance published a discussion paper on virtual currencies and blockchain technology and established an Intra-Departmental Working Group to monitor developments in this area. The discussion paper does not contain any proposal for an Irish regulatory regime specific to crypto-assets. Instead, it outlines the potential benefits and known risks of virtual currencies and the notes the intention of the Department of Finance to keep abreast of developments at the EU level and to assess any potential economic opportunities for Ireland.

## OUR FINANCIAL REGULATION UNIT

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