

EU Moves Toward Regulating Virtual Currencies, Blockchain

By Mark Taylor

Law360, London (May 26, 2016, 1:52 PM ET) -- The European Parliament on Thursday took a big step toward regulating virtual currencies like Bitcoin and backed the creation of a new task force to study the technology that could transform financial services.

The Parliament also voted to approve a “hands off” oversight of blockchain, or “distributed ledger technology,” the digital network system which underpins Bitcoin and is being replicated and tested internally for other uses by the world’s biggest banks.

“Some of these changes may come very rapidly and then they may require regulation,” said Jakob von Weizsacker, a German member of Parliament involved in the project. “The potential applications of the underlying technology goes far beyond virtual currencies.”

Blockchain has taken financial services by storm with potential to revolutionize almost every aspect from cross-border payments to post-trade settlement. It could act as a tamper-proof method of handling and storing sensitive government data.

The backing of EU lawmakers clears the way for the European Commission, the EU’s executive arm, to set budget and draw the task force from a pool of public and private enterprise, legal and political experts.

“This is pragmatic, and sensible,” said Sian Jones, head of Brussels-based think tank the European Digital Currency and Blockchain Technology Forum, “It is a fantastic result and a huge boost to the industry, and unprecedented in that we have a Parliament supportive and sympathetic to innovation, allowing it to flourish instead of concentrating solely on risks and harm.”

Blockchain’s ability to log every participant in a system is seen as a key factor in fighting money laundering and helping central authorities in fields of data sharing, data security, bolstering transparency and helping relations between government and citizens. And the EU believes the technology could help plug a €168 billion (\$188 billion) VAT gap if utilized by government and regulatory



The EU took steps Thursday to regulate virtual currencies like Bitcoin as well as blockchain, the digital network system that underpins the cryptocurrency. (Credit: AP)

agencies, von Weizsacker said.

Applications are likely to emerge in areas where reliability, proof of identity and ownership and standardization are important, such as smart contracts, intellectual property transfers, supply chain management and a number of government services.

The EU's new task force was originally sketched to focus on blockchain alone. But EU financial stability commissioner Jonathan Hill hinted this week that a much wider group with a larger remit is to be formed to cover several other areas of fintech. Overseen by the commission and consisting of technical and regulatory experts, it would monitor developments globally and feedback to officials various benefits and risks as they are uncovered.

The EU's fintech task force would also look at existing European legislation including the steps taken after the financial crisis of 2008 to consider how fintech can aid financial stability. Stress tests, should virtual currencies and blockchain develop sufficient transaction, would also be developed by the group.

Understanding the reach of blockchain is not limited to EU shores is imperative for regulators to grasp, said Sue McLean, of counsel at Morrison & Foerster LLP. "It goes beyond borders, and this is a positive step for the industry but also encouraging that the regulators seem to be in tune with what is going on elsewhere in the world," she said.

Virtual currencies such as Bitcoin are a much more hotly contested issue, however. The commission is currently mulling plans to bring virtual currency exchange platforms within the scope of the existing EU anti-money laundering laws, with an update expected in the coming weeks. Included are measure requiring platforms to undertake due diligence when customers exchange virtual currencies for real ones.

The anonymous nature of cryptocurrency Bitcoin is still a concern for regulators and the "potential for 'black market' transactions, money laundering, terrorist financing, tax fraud and evasion and other criminal activities" was noted by officials. However creating an alternative digital currency for use in a closed blockchain system where each of the participants is known to each other would remove the anonymity aspect.

Internal testing is taking place at several central authorities to test this theory. The Bank of England is working on its own settlement coin, and a privately built and managed blockchain which would enable it to authenticate all participants..

"One of the special aspects of the technology is that you get a complete record of every transaction that has ever taken place," von Weizsacker said. "With a little forensic talent, it tends to be much easier to trace illicit transactions with virtual currencies than with cash. So in terms of transparency, it stands in the middle between a normal bank transfer and cash, which is truly anonymous."

--Editing by Rebecca Flanagan.
