30 July 2019

Consultation on the Transposition of 5MLD
Sanctions and Illicit Finance Team (2/27)
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
London

Dear Sir or Madam

Transposition of the Fifth Money Laundering Directive: Consultation

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In 2018, Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the "Fifth Money Laundering Directive" or "5MLD") came into force in the E.U. In April 2019, HM Treasury published a consultation on the transposition of 5MLD in the U.K. (the "Consultation"), inviting responses by 10 June 2019. The FMLC regrets that it was unable to send its response by that deadline. It would be grateful, nonetheless, to be permitted to raise an issue in relation to the regulation of cryptoassets under 5MLD in the U.K.

Article 1(2)(d) of 5MLD provides the following definition of virtual currencies:

"virtual currencies" means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.

The Consultation notes that, in the U.K., the Cryptoassets Taskforce, comprising representatives from HM Treasury, the Financial Conduct Authority and the Bank of England, have adopted the following non-legislative definition in a policy paper published last year:

a cryptoasset is a cryptographically secured digital representation of value or contractual rights that uses some type of distributed ledger technology and can be transferred, stored or traded electronically.


Ibid at paragraph 2.10; see also paragraph 2.21 of the Consultation.
This policy paper further categorises cryptoassets into three broad types: (1) exchange tokens, which are used as a means of exchange or for investment; (2) security tokens, which provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits; and (3) utility tokens, which can be redeemed for access to a specific product or service, typically provided using a digital ledger technology platform.

The Consultation asks, in Question 12, whether the 5MLD definition is appropriate or whether it needs to be amended in order to capture the framework articulated in the policy paper.

The FMLC is concerned that the definition of virtual currencies in 5MLD is limited to those cryptoassets which “do not possess a legal status of currency or money”. In July 2016, the FMLC published a Report analysing how established virtual currencies may fit into the traditional categories of property and personal rights established at Common Law (the “Virtual Currencies Report”). The Virtual Currencies Report examined the legal aspect of virtual currencies and addressed issues of uncertainty in the context of their development as a medium of exchange. It concluded that, in some circumstances:

> the cases of bank deposits and e-money lend strong support to the view that virtual currencies which have become a medium of exchange and which are capable of “passing in currency” should, in their legal aspect, be viewed as money.

The Virtual Currencies Report acknowledged that virtual currencies are not standardised and that their legal characterisation is both fact-dependent and a question which is independent of the optimal regulatory approach.

The definition of virtual currencies in 5MLD seems inadvertently to have excluded those cryptoassets which may be used as, and therefore share the characteristics of, money. Media reports suggest that market participants often and increasingly use cryptoassets as a form of money in commercial practice. The regulation of such activities in cryptoassets seems therefore necessary to prevent market disruption.

The FMLC suggests that the following definition of virtual currencies may better reflect the presumed legislative intention to capture paradigmatic and well-established exchange tokens such as Bitcoin.

> “virtual currencies” means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of sovereign fiat currency or money, but is accepted by natural or

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legal persons as a means of exchange and which can be transferred, stored and traded electronically.]

The Committee notes, however, that not only does there remain a great deal of overlap and redundancy between the three exceptions in this definition, but also there is inherent regulatory underlap in that the definition would still exclude those virtual currencies which are pegged to a sovereign fiat currency or to a basket of such currencies (such as CAD-coin and Libra—in the latter case, yielding a surprising policy result).

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins
FMLC Chief Executive

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6 A fiat currency is, by translation ("let it be"), a currency which is accepted to have certain value in terms of its purchasing power which is unrelated to the material from which it is made. In theory at least, or in a limited context, a non-sovereign currency could achieve this status, and so "sovereign" has been used as an additional qualifier. The FMLC has taken the view in proposing this definition that the euro is a sovereign currency but understands that there may be a lack of certainty in this regard. In that context, a more precise, albeit cumbersome definition, might read "does not possess a legal status of fiat currency issued by a government or inter-governamentally".


