

The
**Bitcoin &
Blockchain**
Leadership Forum




Bitcoin &
Blockchain
Regulation
Monday 28th Sept

With contributions from



Hosted by

ALLEN & OVERY



Navigating the world's evolving Blockchain technologies. Together.

FOUNDER [JUSTIN HUNT]

The purpose of the Bitcoin & Blockchain Leadership Forum is to act as a key global innovation lab to enhance your understanding of the possibilities and challenges presented by Bitcoin & Blockchain.

We will monitor and share key Blockchain developments and provide access to interactive knowledge-sharing meetings; hackathons; and developer initiatives.

We are exploring the impact Blockchain will have for money and payments and how many other kinds of assets beyond currency can be transferred using the Blockchain.

The Bitcoin & Blockchain Leadership Forum has been set up by the founders of the Digital and Social Media Leadership Forum and is bringing together large organisations and leading edge bitcoin and Blockchain start ups; VCs; academics; analysts; commentators; freelance developers and thought-leading authors.



AT A GLANCE

BITCOIN & BLOCKCHAIN REGULATION



Obi Nwosu

CTO

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Coinfloor was set up to address the lack of trust in the bitcoin space in the UK. Our main focus has been on being pre-emptively regulatory compliant.

Right now we're 100% focused on bitcoin. 'Blockchain' (without bitcoin) is considered exciting and interesting, but it won't last.

We deal with brokers who are working with consumers rather than large traders. The UK banking sector is risk

averse when it comes to bitcoin, which doesn't exist in the framework they're used to.

We're less concerned with what banks and regulators want than what our customers want – regulation that helps facilitate their use of bitcoin.

We're seeing a proliferation of brokers on the ground. We have launched a platform called Coinfloor Market, a peer-to-peer exchange that enables 'mini-preneurs' to provide an exchange service in a decentralised manner.



Claire Harrop

ASSOCIATE

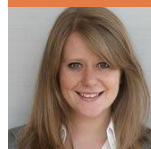
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Global bitcoin regulation covers a wide spectrum, from full regulation to semi-regulation with a light touch. Iceland, Thailand and Vietnam have been particularly anti-bitcoin, and the position is also quite unclear in Russia and China.

In the UK, the Financial Conduct Authority and Bank of England have said bitcoin doesn't affect enough people, so there's no call for regulation at present.

The most progressive approach has been in the state of New York with its BitLicense approval process, which aims to ensure the soundness of bitcoin businesses and protect consumers. This has been very controversial, but other jurisdictions could well follow the same route.

OLSWANG



Hannah Netherton

SENIOR ASSOCIATE

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Some organisations in North America are interested in making bitcoin available as a staff benefit. Some want to extend their existing use of bitcoin. Technology businesses and workers see a certain cashé in using bitcoin for staff pay.

A third category consists of organisations that have many international contractual payments and benefit from cutting annual transaction costs.

But mostly it's seen as a recruitment incentive, to be able to hire a certain type of person who is likeminded.

In the UK, the idea of setting up a bitcoin payroll system is starting to strengthen, especially among technology start-ups, even if it's significantly more heavily regulated than in the US.

AT A GLANCE

BITCOIN & BLOCKCHAIN REGULATION



SIÂN JONES

REGULATORY COMPLIANCE CONSULTANT

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Some jurisdictions have taken a view that bitcoin is like money, others that it's more like a commodity. Most are waiting for clarification from court judgements.

The European Court of Justice is deciding a case over whether the mark-up margins of a one-man bitcoin exchange are taxable in Sweden for VAT. A preliminary decision ruled that it was more like a currency and therefore ought to be exempt.

In the UK, banks aren't prevented from dealing in virtual currencies, but steer clear because of the reputational risk. The high risk of letting something go through that they shouldn't have, through not understanding the issues, is not perceived to be worth the small reward.



DR NICOLAS COURTOIS

LECTURER

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I've been focusing on the question of source code regulation. Each time you connect to the Wi-Fi network somebody can potentially break into your computer. Bitcoin is even worse than open source, with nobody to blame if things go wrong. I advocate that we know who the author of the code is, and that they be held liable.

You don't have to regulate the market, you just have to be sure there's a place where you can put your money that's safe.

I don't see the bitcoin community solving the security problem. Expecting a bitcoin government to magically emerge out of nowhere just won't work.

“In terms of third parties, I’d want as little regulation as possible.”



Obi Nwosu

CTO, COINFLOOR

Coinfloor was set up to address the lack of trust in the bitcoin space in the UK. It’s now the UK’s most liquid bitcoin exchange, carrying out £2 millions worth of transactions last month. We were really regulation-focused from the beginning, and have stayed that way, having had multiple conversations with respect to regulation with the UK Digital Currency Association, the British Standards Institute, HMRC, and many banks. The main focus has been on being pre-emptively regulatory compliant; however, we also understand the pressures on bitcoin. At the moment, ‘blockchain’ (without bitcoin) is considered exciting and interesting, but it won’t last, and in a few years’ time there’ll be many disappointed people.

JUSTIN HUNT: ARE YOU FOCUSING SOLELY ON BITCOIN, OR WOULD YOU CONSIDER TAKING OTHER VIRTUAL CURRENCIES?

Right now we’re 100% focused on bitcoin. There are various exchanges that focus on trading, with a small number of traders probably responsible for most of the volume. By contrast, we deal with brokers who are working with real consumers, trying to get



“We’ve been empowered by our board to become more focused on what our customers want, as opposed to what regulators want.”

them to buy bitcoin, as opposed to other platforms that do higher volumes, but are more geared towards large traders buying and selling from each other.

JH: HAS IT BEEN DIFFICULT WORKING WITH THE BANKS?

We hold conversations with the banks in the UK every few months. The UK banking sector is very risk averse when it comes to bitcoin, and wants to understand it by fitting it into their existing framework. But that’s the core problem; bitcoin doesn’t exist in this framework - it was designed from the outset to be an alternative.

JH: AS AN EXCHANGE, WHAT WOULD BE YOUR IDEAL BITCOIN REGULATION SCENARIO?

Over the last year or two we’ve been empowered by our board to become more focused on what our customers want, as opposed to what regulators, market makers and banks want. A study about bitcoin in the UK a few months ago showed that customers want a different

type of regulation, one that understands the fundamental properties of bitcoin and what it allows, and that helps facilitate that. So in terms of third parties, I’d want as little regulation as possible.

JH: THERE ARE HUNDREDS OF BITCOIN EXCHANGES AROUND THE WORLD. DO YOU FORESEE A SHAKEOUT AT SOME POINT?

Actually I think it’s going to go the other way, you’re going to see a few very large exchanges that will effectively over time turn into banks, or be subsumed by a banking organisation. Coinbase is an example of that: you’ll also see it moving from hundreds of exchanges to thousands of exchanges.

An exchange is a mechanism that allows people to buy and sell the currency. We’re seeing a proliferation of brokers on the ground. We have launched a platform called Coinfloor Market, a peer-to-peer exchange that enables ‘mini-preneurs’ to provide an exchange service in a decentralised manner.

“Bitcoin doesn’t affect enough people, so there’s no consumer protection imperative for it to impose regulation at this moment.”

Claire Harrop

ASSOCIATE, FRESHFIELDS



Freshfields

Global bitcoin regulation is incredibly patchy at the moment. Some regulators are initiating outright bans on the currency, or anything to do with it; others are almost completely ignoring it or shoehorning it into existing regulation. We’re seeing a wide spectrum, from full regulation to semi-regulation with a light touch.

Iceland, Thailand and Vietnam have been particularly anti-bitcoin. The position is also quite unclear in Russia and China. Russia’s ministry of finance last year came out with a very sweeping ban, and although it softened a bit in a new draft last week, it’s still quite draconian. On the other hand, President Putin has shown interest in it, and the Central Bank of Russia has had meetings with bitcoin companies. So the position in Russia is quite unclear.

In the UK the position is different. Companies like Coinfloor have been actively trying to gain regulation from the Financial Conduct



Authority, which has been saying it doesn't have the jurisdiction. Bitcoin doesn't affect enough people, so there's no consumer protection imperative for it to impose regulation at this moment. It's the same with the Bank of England, which published bulletins in March saying it's really interested in this area but it's not systemically important right now in the UK.

JH: WHICH COUNTRY HAS THE MOST PROGRESSIVE APPROACH TOWARDS BITCOIN REGULATION?

In terms of a regulatory framework that would be the state of New York with its BitLicense approach. BitLicense is an approval process. If you're doing any virtual currency business activity in or involving New York, or with a New York resident, you need to be regulated. This means there are minimum capital requirements; requirements for the protection of customer assets, and requirements to keep records in an appropriate manner. If you change your business, you have to inform the regulator. It's all basically to ensure the safety and soundness of those businesses, and for consumer protection.

BitLicense is very controversial. But Benjamin Lawsky, the state's superintendent of financial services, was quite progressive on this, taking two years to carry out a full consultation to avoid shoehorning bitcoin into their existing regulatory framework. As a result, some bitcoin companies have left New York completely. However, the state does have a framework for the regulation of bitcoin and other virtual currencies and I see other jurisdictions eventually going down that route.

JH: HAVE GOVERNMENTS BEEN TRYING TO TAX BITCOIN TRANSACTIONS?

The US has been treating bitcoin very much like a commodity and trying to tax it accordingly. The UK position has been rather the opposite, treating it as a currency.

PAUL LEVY: DOES THAT MEAN IT'S COVERED WITHIN EXISTING LEGISLATION?

It depends on the jurisdiction. In the US, the Commodities Futures Trading Commission (CFTC) has always seen it as a commodity, and says it's already within the scope of its regulation

“The US has been treating bitcoin very much like a commodity and trying to tax it accordingly. The UK position has been rather the opposite, treating it as a currency.”



Hannah Netherton

SENIOR ASSOCIATE, OLSWANG



OLSWANG

[* READ HANNAH'S ARTICLE](#)

JH: HANNAH WROTE A REALLY INTERESTING PIECE FOR THE GUARDIAN* WHICH HIGHLIGHTS HOW US AND CANADIAN ORGANISATIONS ARE MAKING BITCOIN AVAILABLE TO THEIR EMPLOYEES AS A BENEFIT AND TO PAY THEM. WHAT'S GOING ON IN THE US AND CANADA WITH THESE ORGANISATIONS?

The use of bitcoin is not particularly widespread at the moment. But some organisations in North America in particular are interested in making bitcoin available as a staff benefit. There are three categories. The first is those who are already operating in the bitcoin sphere and want to offer this for their staff because it adds to the overall bitcoin ecosystem.

The second category are technology businesses, who think there's a certain cashé to be able to say that they're offering bitcoin to staff. Also, IT and tech-experienced people working for those organisations, think it's cool to be able to receive some kind of pay in bitcoin.

The third category consists of organisations that have many international contractual payments and benefit from cutting annual transaction costs. Apart from that, interestingly, there is no particular financial incentive for organisations to pay their staff in bitcoin. In my experience it's seen as more of a recruitment incentive, to be able to hire a certain type of person who is likeminded.

JH: HOW DO YOU THINK THIS COULD EVOLVE, AND WHY HAS OLSWANG BECOME INTERESTED IN IT?

Olswang operates primarily in media technology with a lot of start-up clients, and this is something that we've seen people starting to become interested in. I've heard from other employers in the City that they receive the odd query; it's certainly not large scale at the moment. But as with lots of things, the idea is starting to strengthen. People are becoming interested in how they might go about setting up a payroll system as a client, even if it's significantly more heavily regulated than in the US.

“Banks and other leading institutions have tended to steer clear of bitcoin because of the reputational risk.”

Siân Jones

REGULATORY COMPLIANCE CONSULTANT

COINSULT
VIRTUAL CURRENCY CONSULTANCY

JH: IS BITCOIN A COMMODITY OR A CURRENCY?

It depends where you are. Some jurisdictions have taken a view that it's like money, others that it's more like a commodity. Most have chosen to make no decision, waiting for lawyers to make a lot of money on the first case that sets the law. There have been a few limited decisions in the US, primarily in criminal cases where bitcoin is considered to be money for the purposes of the particular fraud or money laundering offense. Beyond that, the jury is out.

Member Question: Hasn't the European Court of Justice decided that bitcoin is a currency and not a commodity?

That case is an interesting one and concerns the definition under VAT. It's a very specific matter that was referred to the court, to do

with a one-man Swedish bitcoin exchange, over whether a business owner's mark-up margins are taxable in Sweden for VAT. The tax authority said 'yes'; he thought the answer should be 'no', and took it to court. A Swedish court declined to make a judgement, as it had never dealt with this before, and passed it to the European court, on the grounds that Europe sets all VAT legislation.

The question brought before the European Court was whether or not certain specific exemptions for a financial payment market services – whether bitcoin or more particularly bitcoin exchange equities – fell within that definition. The decision hasn't yet been made final; the court works through verbal hearings and written submissions. But a preliminary decision by a senior lawyer in the court system ruled that it was more like a currency for the purposes I've just outlined, and therefore ought to be exempt.

That anticipated decisions by the judges that might not happen for a year or more.

JH: SOMEONE WHO WORKS IN INNOVATION IN AN INVESTMENT BANK TOLD ME THAT FINANCIAL INSTITUTIONS CAN'T HANDLE BITCOIN AT THE MOMENT, HOWEVER THEY HAVE TO EXPERIMENT. SHOULD THEY GO AHEAD, AND RUN THE RISK OF USING BITCOIN THAT COULD HAVE COME FROM AN ILLEGITIMATE SOURCE? OR SHOULD THEY CREATE THEIR OWN CURRENCY?

In the UK, bitcoin and virtual currencies aren't regulated and banks and other institutions aren't prevented from buying, selling or holding them. The European Banking Authority, in its report of summer last year, said that banks and other regulated institutions should not buy, sell or hold, but nobody has brought in any laws or regulations to prevent that happening.

In practice, banks and other leading institutions have tended to steer clear of bitcoin because of the reputational risk. There are significant asset and liability risks depending on which bank you are, management or not management. Some banks, even in arguably very heavily regulated

jurisdictions like Germany, believe it's a manageable risk. Older world institutions take a more conservative approach.

PL: ARE SOME BANKS MORE PROGRESSIVE THAN OTHERS IN THE UK?

The short answer is 'no'. The UK is particularly risk averse: some banks have faced very heavy fines for money laundering overseas. They're still recovering from that scandal and this isn't a big enough deal for them to risk getting burned. For banks, as with anything, it's about risk reward, and in this case, the high risk of letting something go through that they shouldn't have, through not understanding the issues, is not perceived to be worth the small reward.

JH: OBI, COULD THE ANSWER BE FOR THE BANK OF ENGLAND TO INTRODUCE A DIGITAL STERLING?

Obi Nwosu: No, a digital sterling wouldn't scale right now. Bitcoin and the bitcoin blockchain are so frighteningly early. A lot of these cases are just not practical when you look at the fundamental technology. If you try to implement a digital sterling, currently it would break the bitcoin blockchain.



Dr Nicolas Courtois

UNIVERSITY COLLEGE LONDON

JH: HOW COULD BITCOIN BE REGULATED?

I've been focusing on the question of source code regulation. I never believed it was really secure; each time you connect to the Wi-Fi network somebody can potentially break into your computer. Bitcoin is even worse than open source, because it does not have a founder and there will be nobody to blame if things go wrong. So I advocate the source code be used in such a way that we know who the author of the code is, and that they're held liable, subject to evaluation by government or private agencies.

JH: SO YOU'RE SAYING THAT ONCE REGULATION OF THE BITCOIN SOURCE CODE IS ESTABLISHED, THEN REGULATION IN GENERAL WOULD BECOME EASIER?

It's just about the source code. You don't have to regulate the market, you just have to be sure there's a place where you can put your money that's safe. It's a question of taking care to have something that will not fail you.

Above the level of authentication and security sit governments who arbitrate and decide what's secure and not secure. That's a bigger concern for those of us who are anxious about open source consensus. But who governs it? Who decides which model stays and what the source actually needs? I don't see the bitcoin community solving this problem. Expecting a bitcoin government to magically emerge out of nowhere just won't work – it will lead to disaster.

Obi Nwosu: There's a heated discussion in the bitcoin community around whether we should increase the size of each block in the bitcoin blockchain. At the heart of the issue is how changes in bitcoin are governed. That will be resolved by the bitcoin community. If necessary, the blockchain will be forked, so you'll have two versions. Market forces will cause one to become stronger than the other, and over a period of time



that's the development that will succeed. Or we may see two viable currencies emerging from bitcoin; bitcoin classic and bitcoin new.

JH: WHAT ABOUT THE OTHER VIRTUAL CURRENCIES BESIDES BITCOIN THAT ARE OUT THERE?

Siân Jones: Bitcoin currently accounts for about 86% of the total market cap. As somebody who gets paid in bitcoin, I actually quite like a digital sterling, and interestingly it's something that the Bank of England is very seriously researching (as I learned recently from conversations with the chief cashier there), as are other central banks, in Europe and North America. We're likely talking about something ten years down the line: it won't happen overnight. It might not look or be the same as bitcoin but it's a very real possibility.

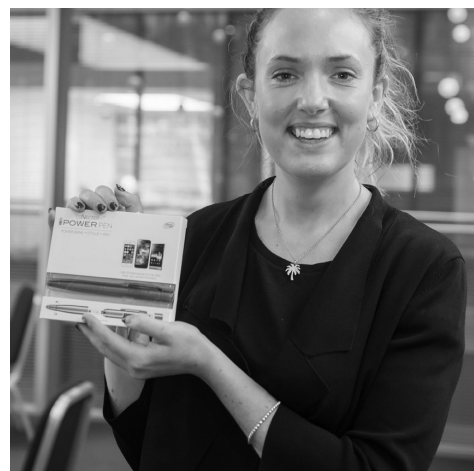
Returning to the point made earlier about the New York bit license, the wording talks about business activities and transactions involving New York or New Yorkers. But it actually affects everyone everywhere in the world, because America tends to treat the whole world as its jurisdiction, particularly in financial and in other matters, unlike Europe, which is more concerned with what happens on its own doorstep.

Also, the term 'involving' is very broad and I think quite new; it's considered by some US lawyers to be unenforceable and unconstitutional. Unfortunately, someone has to be prosecuted and found guilty for an appeal to be made to the Supreme Court (any volunteers?) The reality is, if you're carrying out a transaction in London for a client based in Germany with a counter-party in France you have to establish, through enhanced diligence, whether or not there's any involvement with New York or a New Yorker. It could be some business relationship at some point in the past.

The indication, therefore, is that you've got to apply the rules wherever you are in the world, whether or not you try to exclude the US or New York in particular. I believe this is not fully understood. The reason why it's very important is because the penalty for carrying out any transactions without having a BitLicence is a jail term, and as we know, the US authorities are aggressive about seeking extradition of foreign nationals deemed to have broken US laws.

“Expecting a bitcoin government to magically emerge out of nowhere just won't work – it will lead to disaster.”





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**If you know someone within a leading organisation
who would like to become a member of the
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