Oireachtas Library & Research Service
Seirbhís Leabharlainne & Taighde an Oireachtais
Houses of the Oireachtas
Tithe an Oireachtais

L&RS Note

Virtual currencies – the regulatory challenges ahead

Hari Gupta, Senior Researcher, Law

30 June 2020

Abstract

Originally seen as a speculative investment, the popularity of virtual currencies over the past decade sees them becoming mainstream, comprising a form of acceptable tender. Virtual currencies may offer a number of benefits over fiat currencies, allowing for cheap and efficient transactions. However, their perceived strengths may also be weaknesses, as the anonymous nature of transactions allow the ‘currencies' to be used for illicit activities, such as money laundering. The threats they pose to monetary sovereignty have also resulted in push by central banks towards developing their own digital currencies. One thing is certain, virtual currencies are here to stay, and there is a need for regulation to protect consumers and close criminal loopholes.

Contents

This L&RS Note may be cited as:

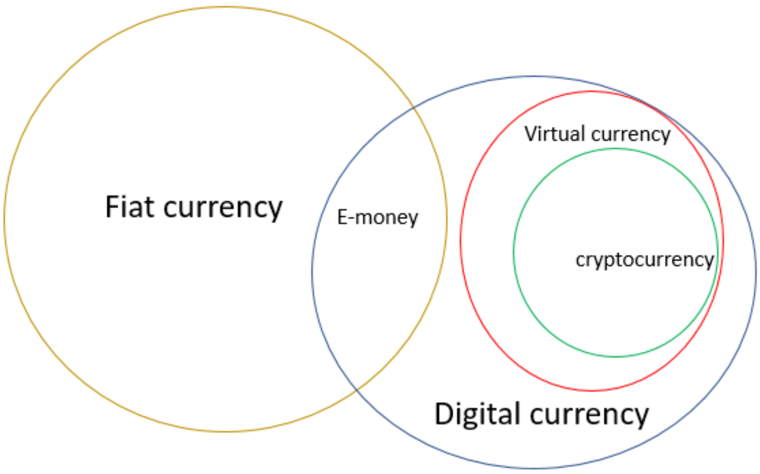
Oireachtas Library & Research Service, 2020, *L&RS Note: Virtual currencies – the regulatory challenges ahead.*

Introduction

A virtual currency is a digital representation of value not guaranteed by a central bank. There are almost 2,400 virtual currencies currently available. They have an estimated total market capitalisation of approximately €220 billion worldwide. The popularity of virtual currencies are a testament to their perceived benefits. However, there are a number of issues associated with the use of virtual currencies, including money laundering concerns, consumer protection concerns and possible threats to monetary sovereignty.

> "Ireland does not have specific laws regulating virtual currencies, but this is expected to change soon"

Figure 1: Relationship between various forms of currency



Benefits of virtual currencies

Virtual currencies are not necessarily bad in themselves. They can provide users with benefits over fiat currencies. Virtual currencies lack hierarchical and ownership structures, giving their users a sense of control over their funds. Furthermore, they are generally accessible and recognised across borders, reducing transaction costs.

Traders of virtual currencies use exchange platforms, and many use blockchain technology, which maintains a ledger – or blockchain – of every single transaction ever completed. A complex mathematical algorithm verifying ownership protects the ledger. Every computer that downloads the relevant blockchain software stores the ledger. A blockchain offers traceable records on the history of an asset and proof of ownership. This transparency provides users with a level of security and simplifies transactions – making them cheaper and faster and allows for immediate settlement of transactions.

Table 1: Definitions of various forms of currency

Type	Defining characteristics	Regulation	Examples
Fiat currency	Issued and guaranteed by a government, not tied to a commodity.	Subject to monetary regulation by Central Bank.	Euro Pound Dollar
Electronic money (e-money)	A digital representation of fiat currency. It does not change the value of the currency.	Subject to the same monetary controls as fiat currencies.	Revolut Paypal Visa Cash
Digital currency	A blanket term to describe any form of currency that only exists electronically.	Depends on the form – includes e-money, virtual currencies and in-game currency.	JPM Coins Microsoft points
Virtual currency	A digital representation of value not guaranteed by a central bank which can be transferred, stored and traded electronically and which is accepted as a means of exchange.	Varies between jurisdiction. For example, they are regulated in Australia, Canada, Mexico and Switzerland, and banned in China, India and South Korea.	Bitcoin Ethereum Ripple
Crypto currency	A subset of virtual currencies, which are mathematics-based, decentralised, convertible, and protected by cryptography.	Same as virtual currencies.	Bitcoin Ethereum Ripple

Type	Defining characteristics	Regulation	Examples
Fiat currency	Issued and guaranteed by a government, not tied to a commodity.	Subject to monetary regulation by Central Bank.	Euro Pound Dollar

Money laundering concerns in Ireland

Ireland does not have specific laws regulating virtual currencies, but this is expected to change soon. It is likely that a Bill will come before the new Dáil to transpose parts of the EU's fifth Anti-Money Laundering Directive (5AMLD). The deadline for Member States to transpose this Directive was 10 January 2020.

Parts of the 5AMLD aim to increase the regulation of virtual currencies. Entities that hold, store or transfer virtual currencies would fall within the regulatory regime. Entities would need to identify customers and report any suspicious activity to the Financial Intelligence Unit of An Garda Síochána. New legislation would likely remove a level of anonymity from virtual currency transactions. This would make virtual currency exchanges, and their users, more transparent.

The regulatory regime may still have its limits. It can only regulate established virtual currency exchanges and wallets. This leaves entities that transact outside the regime unregulated. It is these entities that may pose the biggest risk of money laundering. Thus, it may be necessary to expand the category of entities subject to the anti-money laundering rules. Legislators could potentially amend the rules to include anyone who facilitates the creation and exchange of virtual currencies.

Consumer protection concerns

Blockchain technology allows for high levels of anonymity. It is also susceptible to threats of hacking. Identity and personal data theft, and the disclosure of confidential information may also take place. The fact that unauthorised or incorrect debits are not reversable compound these threats. Furthermore, there is no specific legal protection against losses for consumers.

The anonymity feature of virtual currencies may be of interest to parties with a need or desire to move money around without oversight. The currencies provide an ideal exchange mechanism for those engaged in immoral activities. Criminals use them in tax evasion, theft, trafficking, counterfeiting, money-laundering and terrorism funding.

A popular method of launching a new virtual currency is through an initial coin offering (ICO). ICOs are a means of crowdfunding (funding a project by raising money from a large number of people). The initiator allocates a quantity of the new virtual currency to investors via 'tokens'. An investor may pay for tokens using legal tender or other virtual currencies. Upon launch, these tokens become units of the new virtual currency.

Alarmingly, research has shown that a majority of ICOs are scams. Some countries have banned ICOs, due to the inherent risks and regulatory difficulties associated with them. These jurisdictions include China, South Korea, Macau, and Pakistan. In 2018, some large technology companies including Twitter, Facebook and Google banned all advertisements relating to ICOs and virtual currencies from their platforms.

Regulatory oversight may be the only sustainable means of addressing these issues.

The Covid-19 crisis has made it more difficult to raise funds through ICOs so blockchain start-ups have started to switch their focus towards venture capitalists. The crisis has not affected the popularity of established virtual currencies. The value of popular cryptocurrencies such as Ethereum and Bitcoin, although highly volatile, shot up 30% over the initial lockdown periods.

Threats to monetary sovereignty

In June 2019, Facebook announced plans to release its own virtual currency Libra, which is due to launch this year. If launched as conceived, Libra could become a major alternative payment mechanism to fiat currencies. Facebook has the funds and reach to provide a secure alternative payment system without becoming an official bank. This could affect the ability of central banks to control monetary policy.

The European Central Bank and the central banks of the UK, Japan, Sweden and Switzerland met in January 2020. They agreed to form a working group to assess the value of issuing digital currencies. Reports attribute these developments to the monetary threat posed by Libra. The People's Bank of China has also reacted, recently filing more than 80 patents related to digitalising the renminbi (the national currency of China).

In early April 2020, the Banque de France took a further step towards using a digital Euro. It launched an experimental program to test the integration of a digital euro in settlement procedures. The Banque de France stated that the trial was aimed at showing how traditional interbank settlements could be carried out using digital currency. It also sought to identify any benefits of central bank digital currency and to analyse the effects of central bank digital currency on financial stability and monetary policy.

A draft US Covid-19 stimulus bill put forward by the US Democratic Party, originally included provision to establish a digital US dollar to provide a more efficient means of making payments to people and businesses hit by Covid-19-induced economic turmoil. However, the proposal was not included in the final draft.

Paths to regulation and safe participation

In 2018, the European Commission released a targeted financial technology Action Plan. It mentions both crowdfunding and ICOs. The plan proposes new legislation to make it easier for consumers to take part in crowdfunding platforms on an EU-wide basis. However, it also promotes transparency, regulatory supervision and consumer protection measures.

In Ireland, existing financial services legislation may apply to tokens issued in an ICO. This would occur if the Central Bank considered the tokens to be a transferable security. Although, the Central Bank has formally warned consumers of risks associated with and ICOs, there may be some merit in considering regulatory consumer protection legislation.

Final words

One thing is certain, virtual currencies are here to stay. A regulatory regime could help to:

- protect consumers;
- buffer the effects on monetary sovereignty; and
- close criminal loopholes.

Contact:

Houses of the Oireachtas
Leinster House
Kildare Street
Dublin 2
D02 XR20

www.oireachtas.ie
Tel: +353 (0)1 6183000 or 076 1001700
Twitter: @OireachtasNews

Library & Research Service
Tel: +353 (0)1 6184701
Email: library.and.research@oireachtas.ie

Connect with us