

Regulation of Virtual Currency

Policy Document

Introductory Statement by Senator Philip Ozouf

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Financial Services, Digital, Competition and Innovation



I am particularly excited to be releasing a policy document on regulation of virtual currency today, on the date of the first major Fintech conference in the Island, 'Fintech Jersey'.

The Government of Jersey has placed a large amount of focus on Fintech because the technologies that are being developed have a huge economic potential for Jersey, as a leading international finance centre, and for the world at large. Ultimately, the technologies being developed today will revolutionise the way we bank, the way we invest, the way companies raise money. It will lead to new products, new services, new lenders and many new opportunities.

And the exciting thing about combining new technology and a free market is that the evolution of this area is uncertain and no-one can predict exactly how these new forms of financial technology will develop.

What governments can do, however, is create the best environment in which this financial innovation can flourish. The release of this policy today, is a stepping stone along that path for Jersey.

When the Government consulted on Regulation of Virtual Currency in July 2015, we stated that the creation of a business-friendly framework that encourages innovation, jobs and growth in both the financial services and digital sectors was a priority.

Virtual currency systems can be significant building blocks of a modern digital economy and the introduction of an appropriate and proportionate regulatory regime in this area is intended to encourage confidence and innovation in the sector.

Following the consultation exercise and further policy consideration, the Government has arrived at a policy position in respect of the regulation of virtual currency. Ultimately, the aim of this policy is to further enhance Jersey's proposition as a world leading Fintech jurisdiction.

The consultation exercise received a significant level of response. The Government received over 30 full responses from interested parties from around the world and held an open seminar where over 70 individuals discussed topics raised in the consultation. A full feedback paper on the consultation exercise will follow in the near future; however, the policy position has now become clear.

The purpose of the policy document is to outline Jersey's commitment to creating an environment that encourages confidence and innovation in the digital sector whilst protecting the Island from the most prominent money laundering and terrorist financing risks that are presented by virtual currencies in their current form.

It is important to consider that with any rapidly evolving arena, policy cannot be viewed as static. Therefore, Government agrees with responses in the consultation that encouraged ongoing evolution of proportionate regulatory policy.

This ongoing policy evolution can be achieved through Government, the industry and proposed regulator – the Jersey Financial Services Commission ("JFSC") - working together. It is for this reason that this policy includes a recommendation that Digital Jersey establish an industry expert working group to both monitor the effect of this virtual currency policy, as technology and the global landscape evolves. The working group should also ensure that industry can communicate with both the JFSC and the Government on the effect of the policy.

The policy document on regulation should not be viewed as final; it should be viewed as acting as a starting point. Based on the responses to the consultation we think this is a good starting point where Jersey can be the chosen location to both allow existing virtual currency business to innovate and grow whilst attracting new business to our shores.

Equally, during the consultation exercise we asked about new technology such as distributed ledgers and the blockchain and the potential of those technologies for Jersey. Whilst the consultation has not yielded any definitive action that should be taken at this point, this is going to be an area we continue to monitor closely with the JFSC and the industry.

However, this policy alone is not enough. We must continue to build a relationship of understanding between the industry, the Government and the JFSC. This is where Jersey already has a good track record in the financial services industry and can build on that in this sector. By working together, we are stronger.

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This policy is therefore designed to set the groundwork for improving that critical working relationship. It should also allow regulator and Government to understand more about the workings of virtual currency businesses in order to protect the reputation of the Island for everyone's benefit.

In that vein, I would like to thank the different organisations who have worked in conjunction with Government to determine the policy: the JFSC, the Joint Financial Crimes Unit of the States of Jersey Police, the Law Officers' Department, Jersey Finance Limited and Digital Jersey. I hope to bring legislative amendments to implement the policy announced today to the States Assembly in early 2016 for adoption.



Regulation of Virtual Currency Policy

Introduction

- 1.1 The feedback to the Consultation Paper¹ resulted in a significant proportion of the respondents in favour of Option B, namely adopting a position where the interface between fiat and virtual currency is regulated for anti-money laundering and countering the financing of terrorism (“AML/CFT”) purposes. This view was equally reflected in the consultation seminar where there was overwhelming support for initial regulation only being applied at the interface.
- 1.2 There was some demand in response to the consultation to adopt a regime that was in accordance with Option D, namely a fully prudential and conduct of business regime (for example, something similar to BitLicense in New York). However, on balance it was felt that this route was currently premature for Jersey given that virtual currencies are in their relative infancy.
- 1.3 Whilst the option of this form of regime (i.e. Option D) should be considered going forward, the introduction of a full prudential and conduct of business regime at the outset could risk introducing over-burdensome regulation that may not be appropriate for the sector and could stifle innovation.
- 1.4 In considering this policy it was therefore important to consider any precedent examples of regulation in Jersey and elsewhere where comparisons could be drawn with a similar regulatory regime that is already established. In considering regulatory options, the importance of balancing the protection of the Island from money laundering and terrorist financing risk against stifling innovation and growth in this emerging sector were at the forefront of consideration.

Comparison with Regulation of Money Service Business

- 1.5 The current regulation of Money Service Business in Jersey uses a number of concepts that could be applied to regulation of virtual currency. Critically it deals with those in the business of “exchanging” fiat money and this is relevant to the concept embodied in Option B of the consultation, namely regulating the interface between fiat and virtual currency for AML/CFT purposes.
- 1.6 All persons who carry on Money Service Business by way of business are currently subject to the provisions of the Money Laundering (Jersey) Order 2008 (the “Money Laundering Order”).

¹

<http://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/C%20Regulation%20of%20Virtual%20Currency%20Final%20Consultation%20Paper%2020150708%20GP.pdf>

- 1.7 Under the regime that exists for the regulation of Money Service Business, there is a threshold on “turnover”² of the business before the business is required to register with the JFSC, pay a fee and be authorised to carry on Money Services Business. Registration and authorisation results in supervision by the JFSC.
- 1.8 In any instance, there is, however, a requirement to notify the JFSC that you are carrying on Money Service Business even if your turnover does not reach the threshold. Notification carries with it no fee, but importantly ensures that all persons carrying on Money Service Business in Jersey are known to the JFSC. This allows for the JFSC to build a good profile of the businesses in this sector.
- 1.9 Where a business does not meet the threshold requiring them to be registered and be authorised by the JFSC to carry on Money Services Business but has still notified the JFSC that they are carrying on Money Service Business, the JFSC still has powers to investigate the business for breaches of legislation where this is necessary, for example, to counter financial crime.

Application of a regime to Virtual Currencies

- 1.10 After considering the various comparisons that exist between Money Service Business and the exchange of virtual currencies, it has been determined that a policy should be put in place that draws comparisons with the Money Service Business regime but that appropriately acknowledges the differences of the virtual currency sector.
- 1.11 The main money laundering and terrorist financing risk that was identified in the risk assessment on virtual currencies was the inherent *pseudonymity of virtual currency ownership*. In order to appropriately address that *pseudonymity*, the policy position should therefore be based on that applied for Money Service Business.
- 1.12 It is therefore proposed that the Money Laundering Order will apply to all persons³ who, by way of business, exchange fiat currencies for virtual currencies and vice versa – these businesses will be known as “virtual currency exchangers”.
- 1.13 During the consultation, this Option was presented as Option B and it was noted that the definition of virtual currency exchangers would cover those who were “*acting as an interface between legacy financial systems and virtual currencies, e.g. virtual currency exchanges and Bitcoin ATM operators*”.

² Calculated on the basis of the cumulative value of each transaction to purchase or sell a currency in an accounting period (measured in GBP at the time of the transaction).

³ Persons in or operating from within Jersey or any Jersey legal person.

- 1.14 Inter alia, the Money Laundering Order requires: the appointment of a money laundering compliance officer and money laundering reporting officer; policies and procedures to prevent and detect money laundering and terrorist financing; the application of customer due diligence measures (identification measures and ongoing monitoring); and record-keeping.
- 1.15 Identification measures under the Money Laundering Order will apply to every business relationship⁴ and to each one-off transaction of €1,000 (or equivalent) or more, in line with Money Service Business. Therefore identification measures need not be applied to any single one-off transaction (not forming part of a series of linked transactions) carried out by a virtual currency exchanger that is less than €1,000.
- 1.16 Those virtual currency exchangers whose annual turnover⁵ is equal to or exceeds £150,000 must be registered with the JFSC under the Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008. Such exchangers will be subject to supervision and an annual fee will be payable to the JFSC.
- 1.17 Otherwise, in order to avoid having to register, any person whose annual turnover is less than £150,000 will be required to notify the JFSC that they are carrying on virtual currency exchange. Such a business will be known as an “exempted virtual currency exchanger”.
- 1.18 Legislation will set out how long an exempted virtual currency exchanger has to submit an application to the JFSC to be registered once its annual turnover equals or exceeds £150,000 and what will happen if the JFSC refuses to register such an applicant. Legislation will also set out how a registered person may surrender its licence where its annual turnover in a subsequent calendar year is less than £150,000. A fee will be payable to the JFSC at the time of an application to be registered.
- 1.19 The JFSC will supervise compliance of virtual currency exchangers with the Money Laundering Order and other AML/CFT legislation - except exempted virtual currency exchangers. However, the JFSC will still have the necessary powers to investigate exempted virtual currency exchangers compliance with the Money Laundering Order and other AML/CFT legislation – as and when necessary.
- 1.20 The approach outlined above creates a regime where proportionate regulation can be introduced based on business turnover. A concept that was raised in the consultation responses was the idea of a “regulatory sandpit”, where businesses with a lower turnover will have to apply requirements (such

⁴ “Business relationship” means a business, professional or commercial relationship between a relevant person and a customer, which is expected by the relevant person, at the time when contact is established, to have an element of duration.

⁵ The cumulative value of each transaction to purchase or sell a fiat or virtual currency in a calendar year (measured in GBP at the time of the transaction).

as those contained in the Money Laundering Order) but will not be proactively supervised and will not pay a fee for regulation. This approach achieves that aim.

- 1.21 In line with the legislative amendments to be brought forward, the JFSC will in due course consult on extending the scope of Codes of Practice for Regulated Financial Services Business (set out in the AML/CFT Handbook for Regulated Financial Services Business) to include virtual currency exchangers. The effect of this will be to require all virtual currency exchangers (including exempted currency exchangers) to comply with these Codes, such as the requirement to conduct a business risk assessment.
- 1.22 The JFSC will also look to make any modifications to guidance in the AML/CFT Handbook for Regulated Financial Services Business that may be necessary to cover virtual currency exchangers. However, these modifications may be made subsequent to the introduction of the legislative regime.

High Value Dealer Regime and Virtual Currency

- 1.23 A regime already exists in Jersey that deals with those businesses who are High Value Dealers.
- 1.24 These are persons who, by way of business, trade in goods when they receive, in respect of any transaction, a payment or payments in cash of at least €15,000 (or equivalent) in total, whether the transaction is executed in a single operation or in several operations which appear to be linked.
- 1.25 If a person is a High Value Dealer a registration requirement is triggered which invokes supervision.
- 1.26 In the context of virtual currencies, it is considered that a dealer who is willing to accept a payment or payments of €15,000 or more (or equivalent) in virtual currency should equally be covered by the High Value Dealer regime.
- 1.27 Therefore, legislative amendments will be brought forward to extend the application of the High Value Dealer regime to include virtual currency.

Implementation, on-going monitoring and evolution of the regulatory regime

- 1.28 It is acknowledged that in the implementation of any regime in an area where the evolution of technology continues at a rapid pace, both the implementation and the monitoring of any regulatory regime are critical to its overall success.
- 1.29 It was noted in the responses to the consultation that it may be desirable in due course for Jersey to look to adopt a regime in accordance with Option D,

namely a fully prudential and conduct of business regime (for example, something similar to BitLicense in New York).

- 1.30 This policy on regulation should not be viewed as static. It should be viewed as acting as a starting point. Based on the responses to the consultation we think this is a good starting point where Jersey can be the chosen location to both allow existing virtual currency business to innovate and grow whilst attracting new business to our shores.
- 1.31 However, in order for such a regime to be a success and to exist to both support growth and innovation and maintain Jersey's position as a leading International Finance Centre upholding high regulatory standards, that regime must be the right regime for the industry.
- 1.32 It is for this reason that this policy is delivered hand in hand with the recommendation of the creation of an industry expert working group (organised through Digital Jersey) that can act both to monitor the effect of the regulatory policy as technology and the global landscape evolves and also to ensure that industry can communicate with both the JFSC and the Government on the effect of regulation.

Distributed ledger technology

- 1.33 During the consultation process, it was noted that some brief and preliminary discussion between the Channel Islands has occurred regarding whether regulation of the underlying "*distributed ledger*"⁶ technology would be advantageous in providing confidence to the marketplace that the Channel Islands are suitable jurisdictions in which to conduct distributed ledger technology based business.
- 1.34 The vast majority of respondents acknowledged that whilst this area had significant potential for future growth, it was evolving at such a rapid rate that any "technical quality standard" risked soon becoming outdated. There were also responses to indicate that it was unclear what a standard might look like at this stage of innovation in blockchain technology and it was better to monitor the situation until the position became clearer.
- 1.35 The Government acknowledges the huge potential of distributed ledger technology to change the future of finance. Whilst no clear route forward in respect of a standard appears to exist at this point in time, we are conscious that the area should be actively monitored in order to ensure that the Island is equipped to adapt to opportunities offered by this emerging area.

⁶ Which would include, for example, a *Blockchain*

- 1.36 In order to look at this area most effectively, the future potential of distributed ledger and blockchain technology for Jersey will be actively monitored by a group containing representatives from the Government, the JFSC and Digital Jersey.

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