

Dentons Crypto Review 2019

Chaining Blocks

Genesis Edition – Kicking off the Dentons Crypto Review

What did 2019 bring for blockchain and crypto assets? We are delighted to present the first edition of the Dentons Crypto Review newsletter – the Genesis Edition, in which we have summarized the most important developments in the area of blockchain and crypto assets in Germany. All “chaining blocks” of the Crypto Review collect and present information similar to how a blockchain works: all the editions will be linked to each other.

Financial
regulation

Legislative
developments

Court
proceedings
and decisions

Legal Tech

Dentons
Global Reach

Dentons
Team

■ Financial regulation

Security tokens on the rise

The German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* (“**BaFin**”)) has stated that a token is regarded as a security if all of the following criteria are met:

- transferability of the token;
- tradability of the token on the financial markets;
- embodiment of membership participation rights or contractual rights in the token; and
- no classification of the token as a pure instrument of payment.

A token classified as a security falls within the scope of various capital market law requirements.

[Read the full article](#)

New prospectus regime – “need to know”

On October 2, 2019, we published an overview of the most significant deviations from the old prospectus regime and highlighted potential pitfalls. It is supposed to provide a profound understanding of the new prospectus regime and all previous legal frameworks in connection with the prospectus regime.

[Read the full article](#)

New German rules on crypto assets

On November 29, 2019, the German legislator adopted new rules on crypto assets. These new rules have been adopted as part of the implementation of Directive (EU) 2018/843 of May 30, 2018 (“**5th AML Directive**”). Under the 5th AML Directive, the domestic law of EU member states has to provide that custodian wallet providers are subject to anti-money laundering requirements. In this context, “custodian wallet providers” are defined as entities that provide services to safeguard private cryptographic keys on behalf of their customers, to hold, store

and transfer virtual currencies. Rather than amending the German Anti-Money Laundering Act (*Geldwäschegesetz* (“**GWG**”)), the German legislator has decided to take a much broader approach. The new law contains, amongst others, changes to the German Banking Act (*Kreditwesengesetz* (“**KWG**”)), which provide that:

- crypto assets qualify as financial instruments;
- trading with crypto assets and the custody of crypto assets as a service for others require a license from the BaFin as a bank or as an investment firm;
- entities that provide no other financial services than custody are exempted from certain rules that apply to other investment firms.

On December 4, 2019, the BaFin published further guidance on the application procedure. The BaFin also asked firms that intend to rely on the transition period to notify BaFin of such intention before January 1, 2020 on an informal basis.

Firms that provide custody services with respect to crypto assets or other services related to crypto assets are advised to consider the implications of the new rules, in particular whether they need to obtain a license. Please note the deadline of March 31, 2020, for indicating to BaFin the intention to obtain such a license. Please also note the deadline of November 30, 2020, for the submission of a complete application for a license. Although about one year from now, it should be noted that the preparation of a complete application may require a considerable amount of time and effort.

[Read the full article](#)

■ Legislative developments

Does Germany need a (more) specific framework for DLT?

On September 11, 2018, members of the German national parliament (“**Bundestag**”) requested the creation of a sustainable framework for distributed ledger technology in the financial market (BT-Drs. 19/4217). They proposed in parliament that the Federal Government should take the following measures:

- build up competences within BaFin to deal with the new regulatory challenges with regard to blockchain technology in the financial market;
- ensure that BaFin's view on blockchain technology becomes more transparent;
- create the possibility for companies to voluntarily prepare a prospectus for their tokens to be approved by BaFin prior to a so-called "initial coin offering" (“**ICO**”);
- ensure that the tax authorities are technically able to prepare, detect and trace taxable matters in connection with crypto currencies and token issuances in order to tax them properly;
- examine the legal validity of smart contracts and improve legal certainty for smart contracts;
- support the abolition of the German requirement to issue physical certificates for shares, bonds and special funds, and replace it with a "qualified digital register" (corresponding to the provisions of the Federal Debt Management Act (*Bundesschuldenwesengesetz*) for public debt instruments);
- examine the legal validity of smart contracts and improve legal certainty for smart contracts;
- recommend how the applicable data protection regulations can be complied with, in particular with regard to the "right to be forgotten" and the "right to cancellation" contained in the Regulation (EU) 2016/679 (General Data Protection Regulation (“**GDPR**”));
- check whether banks are account custodians or mere value keepers for their customers when administering the wallet;
- provide clarity on taxation.

On May 8, 2019, the Financial Committee of the Bundestag recommended that the proposal be rejected (BT-Drs.

19/10013). CDU/CSU and SPD members of the committee argued that the motion's criticism of BaFin was excessive, as it is perceived by the industry as a competent and a very active contact. However, they agreed that more staff were necessary.

According to the Financial Committee, rather than providing answers the proposal raised more questions. The CDU/CSU and SPD members drew attention to the fact that the proposal particularly addressed ICOs. However, there was no critical examination of the ICOs that had been observed on the market in the last 24 months. The risks for investors that have been discussed in the public hearing remain unaddressed. In this context, BaFin was expressly praised for its warnings against ICOs and the associated risks at an early stage.

Although the Financial Committee approved some of the points set out in the proposal, it rejected the proposal in its entirety. This is because a motion for a decision of the Bundestag can only be adopted or rejected. It is not possible to accept a few requests that seem legitimate. The Finance Committee of the Bundestag thus followed the expert opinion of Dentons' Claudia Otto, who was invited as an expert at the public hearing. Claudia's statement is available [here](#).

The Key Issues Paper on the Regulatory Treatment of Electronic Securities and Crypto Tokens

On March 7, 2019, together with the Federal Ministry of Justice and Consumer Protection, the Federal Ministry of Finance published a Key Issues Paper on the Regulatory Treatment of Electronic Securities and Crypto Tokens. A consultation process took place in the first half of the year and a public hearing was held on May 7, 2019, in Berlin at the Federal Ministry of Justice and Consumer Protection.

The purpose of the Key Issues Paper is to prepare a legislative proposal, with a focus on enabling the optional electronic issuance of bonds via DLT systems, and to regulate the public offering of certain crypto tokens.

The first step of the legislation shall be limited to electronic bonds; electronic shares in companies will be introduced at a later date.

Libra

On August 5, 2019, members of the German Bundestag asked the Federal Government about its understanding and plans regarding Facebook's planned Libra (BT-Drs. 19/12136). The Federal Government answered on September 9, 2019 (BT-Drs. 19/13053):

"At a meeting in Chantilly, France, on 17 and 18 July, the G7 finance ministers and central bank governors agreed that so-called 'stablecoins', such as Libra, could involve significant risks. It was also agreed that existing rules must not be undermined by 'stablecoins'; the highest standards of financial regulation must be met. Financial stability, investor and consumer protection and the fight against money laundering and terrorist financing should not be undermined. If 'stablecoins' are widely used worldwide, monetary policy issues would also increase. Federal Finance Minister Olaf Scholz explained in Chantilly that currencies belonged in the hands of democratically legitimized governments and central banks."

The Federal Government's blockchain strategy for the financial sector

On October 14, 2019, members of the German Bundestag inquired, inter alia, by when the German government intends to introduce electronic securities and by when rules on the public offering of certain crypto tokens which do not constitute securities within the meaning of the Directive on Markets in Financial Instruments will be introduced. Furthermore, the members asked if the Federal Government sees any fundamental potential in 'stablecoins' becoming an alternative to fiat currencies, and if the introduction of stablecoins would require an authorization as an e-money institution under the Payment Services Supervision Act (*Zahlungsdiensteaufsichtsgesetz* ("ZAG")) (BT-Drs. 19/13993).

The Federal Government replied on November 8, 2019, (BT-Drs. 19/14954) that it was up to the competent legislator whether and when a law would come into force. However, a law on the introduction of electronic securities could enter into force during the current legislative period. A draft law is being prepared.

With regard to European regulation, the Federal Government points out that a national regulation of the public offering of certain crypto tokens would only be an interim solution until a European regulation is in place. The Federal Government refers to an announcement on October 8, 2019, by Valdis Dombrovskis, Vice-President of the European Commission, about his intention to present a legislative proposal for crypto-assets.

With regard to stablecoins, there is a risk that they might have a significant impact on global payment transactions,

in particular on financial stability and monetary policy, depending on their specific design, the ecosystem and the number and importance of the companies involved.

As to whether a company issuing stablecoins requires a license to conduct electronic money business pursuant to Section 11 (1) of the ZAG, it depends on the specific structure of the stablecoin. Issuing and trading stablecoins may also qualify as deposit-taking business ("*Einlagengeschäft*") within the meaning of the KWG, or an investment fund within the meaning of the German Investment Code (*Kapitalanlagegesetzbuch* ("KAGB)).

Regulatory sandboxes for fintech companies and blockchain technology

On October 28, 2019, members of the Bundestag proposed the implementation of regulatory sandboxes (BT-Drs. 19/14527):

"Regulatory sandboxes' are programs accompanied by financial supervisors in which start-ups can test their products in a less regulated framework. The aim is to prevent excessive regulatory requirements from hampering innovation. The system has already been introduced in several countries."

The Federal Government replied on November 13, 2019 (BT-Drs. 19/15103):

"The actual effects of regulatory sandboxes cannot be measured meaningfully. This is due to the heterogeneity of the design of the regulatory sandboxes. Thus, the Federal Government cannot assess such effects."

Therefore, the German government is not planning to introduce a regulatory sandbox for fintechs in the near future before discussions, especially on the European level, will be concluded. Of key importance is so-called "symmetrical regulation", assuming that businesses with the same risks should also be subject to the same rules. So far, the Federal Government sees no reason to deviate from this principle.

Nonetheless, the German Federal Ministry of Economics and Energy, in cooperation with other federal ministries, plans to establish so-called "real laboratories" as testing grounds for innovation and regulation ("real lab strategy"). Similar to the principle of regulatory sandboxes in real laboratories, innovations are limited in time and space by making use of, for example, experimental clauses. However, in contrast to a regulatory sandbox, real laboratories do not aim to deregulate or reduce standards. Gaining knowledge for future regulations is the main goal, not testing digital innovations under real conditions.

For more details check the database of the Bundestag [here](#).

■ Court proceedings and decisions

Why the savedroid case could be the turning point in German and European cryptosphere

Our lawyer Claudia Otto represents various consumers in civil proceedings before the District Court (Landgericht) of Frankfurt am Main. These consumers took part in the so-called savedroid ICO during the first quarter of 2018. They transferred money to savedroid AG. In the savedroid database and, in two cases, in the Ethereum blockchain, the transferred amounts were displayed in SVD (the transferred amount in EUR multiplied by 100). Due to savedroid advertising a crypto savings app, the consumers say they believed they were taking part in a new way of saving money. The money transferred was, they believed, to be used to build this savings app, which at a later time could also be used for repayment purposes. In addition, the “SVD token” was supposed to gain in value. However, up until today, the app has not been made available as promised. The SVD tokens cannot be used as promised.



The case mainly focuses on one question: what kind of contract did the parties conclude (if a contract was concluded at all)? Savedroid AG argues that it “sold” SVD tokens. It is unclear though, what SVD tokens are in a legal sense. In addition, the app plays a significant role regarding the use of the SVD tokens. However, in order to use them at some indefinite time in the future, the user has to agree to terms and conditions of a Liechtenstein company, savedroid FL GmbH.

In the first hearing, savedroid AG argued that SVD tokens were supposed to be an object of speculation, i.e. a financial instrument, even though this was expressly excluded in the ICO’s documentation. The second case was moved up to be ruled by a panel of judges; the three judges considered its economic significance to be far beyond the individual case and more difficult with regard to the (technical) details. In the hearing before the panel, savedroid AG did not deny that the true motivation of the ICO was to offer financial instruments to the consumers. The judgement is expected to be pronounced in mid-March.

■ Legal Tech

The role of Legal Tech and how it changes the balance of power in the market

Although each individual case is different, there is often at least one identical central element that allows for automating legal services. Even the differences repeat themselves, only in a less frequent manner. The simplest approach is to identify repetitive circumstances, to label and structure them as well as to develop the respective solutions to the specific problems. By doing so, a lot of time can be saved in the long run, which of course can also have a positive effect on costs. Probably the most important task is to obtain at least one detailed, well prepared judgment which can be referred to in subsequent proceedings.

Although the plaintiffs are consumers, the learning effects for institutional clients are enormous. Last but not least, lawmakers keep an eye on these proceedings in order to be able to close legislative loopholes.

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Locations in purple represent Dentons offices.
Locations in blue represent associate firms, offices and special alliances.
Locations in green represent proposed combinations that have not yet been formalized.
Locations in gray represent Brazil Strategic Alliance.

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