Blockchain and Digital Assets News and Trends June 2020

Achieving Digital Transformation and Securing Digital Assets

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To remain competitive, companies find themselves increasing their efforts to digitally transform their businesses by developing new offerings based on emerging technologies and integrating these technologies into existing product and service offerings.

This is our sixth monthly bulletin for 2020, aiming to help companies identify important and significant legal developments governing the use and acceptance of blockchain technology, smart contracts and digital assets.

While the use cases for blockchain technology are vast, from copyright protection to voting, most of the current adoption is in the financial services section and the focus of this bulletin will be primarily on the use of blockchain and or smart contracts in that sector. With respect to digital assets, we have organized our approach to this topic by discussing it in terms of traditional asset type or function (although the types and functions may overlap), that is, digital assets as:

- Securities
- Virtual currencies
- Commodities
- Deposits, accounts, intangibles
- Negotiable instruments
- Electronic chattel paper
- Digitized assets

Digital assets can themselves be assets or instead can reflect the ownership of an underlying asset. For example, electronic records that are the equivalents of negotiable instruments and electronic chattel paper would be digital assets, as would an electronic recording of a security interest in the underlying asset, such as recording title to real or personal property and the use of tokens to represent revenue streams from otherwise illiquid assets such as patents and commercial real estate (sometimes referred to as a “tokenized” or digitized asset).

In addition to reporting on the law and regulation governing blockchain, smart contracts and digital assets, this bulletin will discuss the legal developments supporting the infrastructure and ecosystems that enable the use and acceptance of these new technologies.

Each issue will feature in-depth insight on a timely and important current topic. In this issue, we review the Presidio Principles issued by the World Economic Forum.

For related information regarding digital transformation, please see our monthly bulletin, eSignature and ePayment News and Trends.

INSIGHT

World Economic Forum announces Presidio Principles as a foundation of blockchain ecosystem design
By Nick Pullman and Mark Radcliffe

The World Economic Forum’s Global Blockchain Council unveiled its Presidio Principles on May 22, 2020, outlining the organization’s foundational values for a decentralized future. In its announcement, the WEF noted that blockchain technology is a pillar of the Fourth Industrial Revolution, enabling “new business and governance models that help enhance security,
accountability, and transparency for people worldwide.” The Presidio Principles focus on data ownership, control, and portability, each of which are furthered through use of blockchain technology. Find out more.

FEDERAL DEVELOPMENTS

Virtual currency

- Federal Reserve Bank publishes research paper on CBDCs. On June 1, the Federal Reserve of Philadelphia published a research paper entitled “Central Bank Digital Currency: Central Banking for All” that discusses how the adoption of digital currencies by central banks and how providing private citizens with direct central bank accounts can impact financial sector intermediation. The paper concluded that it could be possible for central banks to use digital currency to provide a substitute for private financial intermediation, but there were substantial risks, including disrupting money markets and becoming an involuntary “deposit monopolist” by drawing deposits away from the commercial banking sector.

- OCC requests public input on financial technology issues. On June 4, the Office of the Comptroller of the Currency (OCC) announced the publication of an Advance Notice of Proposed Rulemaking inviting comment from the public on its regulations for national banks related to digital technology and innovation. The OCC is undertaking a broad effort to modernize its regulations and is particularly interested in comments on (i) activities related to cryptocurrencies and cryptoassets; (ii) the barriers or obstacles to further adoption of crypto-related activities in the banking industry; and (iii) potential uses of distributed ledger technology in banking related activities. Comments must be received by August 3 at regs.comments@occ.treas.gov.

STATE DEVELOPMENTS

Virtual currency

- Louisiana legislature approves virtual currency business licensing bill. On June 1, the Louisiana legislature enacted HB701, the Virtual Currency Businesses Act, to regulate and license virtual currency businesses. The bill awaits the governor’s signature. If it is signed into law, virtual currency businesses wishing to operate in Louisiana must successfully complete a formal application process with the state Office of Financial Institutions.

- New York negotiates MOU with French regulator. On June 3, the New York Department of Financial Services (DFS) announced it has entered into a memorandum of understanding (MOU) with the French Autorité de Contrôle Prudentiel et de Résolution (ACPR) to promote mutual cross-border collaboration in fintech and enable referrals for financial innovators to facilitate entry into both markets. Under the MOU, DFS and ACPR will share regulatory best practices and expertise. In the press release, the DFS superintendent said the MOU “will foster collaboration to support cross-border fintech developments, providing entrepreneurs speed to market opportunities in New York and France.”

INDUSTRY DEVELOPMENTS

Virtual currency

- Cryptocurrency crime and anti-money laundering report suggests 2020 may see second-highest value in crypto crimes. On June 2, CiperTrace, a blockchain analytics firm, published its Spring 2020 Cryptocurrency Crime and Anti-Money Laundering Report. The report covered the first five months of the year and found that 98 percent of crypto crime concerned fraud and misappropriation, as compared to hacks and theft. It also found that 74 percent of bitcoin is moved in exchange-to-exchange cross-border transactions, which “highlights the need for exchanges to adopt appropriate cross-border controls to ensure AML and CTF compliance.” Despite the clear need for cross-border compliance, the report found that, although the total value of cryptocurrency obtained by criminals is near record highs, the amount of criminal funds sent directly to exchanges has dropped by 47 percent since 2019.

Blockchain

- DTCC to explore use of DLT in the settlement of securities. The Depository Trust and Clearing Corporation (DTCC), a financial services company that provides clearing and settlement services for financial markets, on May 18 announced two case studies to evaluate new ways to enhance post-trade processes using distributed ledger technology (DLT). Project Ion deals with settlement processes in public markets, and Project Whitney considers the impact of digitization throughout the private market asset lifecycle.

ENFORCEMENT ACTIONS

FEDERAL

Securities

- Telegram dismisses appeal of preliminary injunction order. Telegram and TON Issuer (collectively, Telegram) stipulated to dismiss their appeal of an order by SDNY Judge P. Kevin Castel preliminarily enjoining distribution of the Grams cryptocurrency. While the stipulation does not specify the reasons or terms for the dismissal, it comes on the heels of Telegram's announcement that it will abandon the TON Blockchain project (previously reported here). The stipulation also does not specify whether Telegram will settle the underlying case with the SEC, which will otherwise proceed. And, without review by the Second Circuit, Judge Castel’s opinion addressing his view of the Howey test as applied to the Grams cryptocurrency will remain unchallenged and will draw extensive comparison, distinction, and analysis in future cryptocurrency litigation (such as in the pending SEC enforcement action against Kik).

On that note, many have questioned whether this case will preclude all use of the SAFT (which Telegram issued to initial investors) as a viable way to raise capital for blockchain project development. SAFT supporters, such as Kik, will undoubtedly attempt to limit Judge Castel’s holding to the facts of this case. SAFT detractors, possibly including the SEC, may paint Judge Castel’s ruling more broadly. SDNY Judge Alvin Hellerstein will have an opportunity to weigh in on these arguments when he adjudicates the dueling motions for summary judgment in the Kik litigation, which also concerns allegations of unregistered public distribution of security tokens through a SAFT.

- SEC obtains default judgment due to forged declaration. On June 1, the SEC obtained a default judgment with terminating sanctions against Blockvest LLC and its founder Reginald Ringgold, in SEC v. Blockvest LLC, et al., case number 3:18-cv-02287. The US District Court for the Southern District of California found that the defendants willfully filed false declarations with the court in an attempt to deceive the court. The SEC's underlying complaint alleged multiple counts of fraud in the offer and sale of unregistered securities in connection with Blockvest’s $2.5 million ICO of BLV tokens.

- SEC freezes assets related to Meta 1 Coin ICO. On May 14, the SEC obtained an emergency freeze of funds raised in a $9 million ICO of Meta 1 Coin. The US District Court for the Western District of Texas froze the assets of Wanda Ironheart Traverse-Warner, Alfred Dowitt Warner Jr. and the Ironheart Trust, each believed to have received funds from the ICO. See our April issue for additional information on the case.

- SEC freezes assets related to operations of Modern Money Team. On June 5, the SEC announced it obtained an asset freeze against David Putram, Jean Paul Ramirez and Angel Rodriguez, who allegedly defrauded investors of more than $12 million as the multi-level marketing business Modern Money Team. The SEC's complaint alleges that the defendants sold interests in a purported cryptocurrency mining operation. In addition to the asset freeze, the complaint seeks permanent injunctions, disgorgement of gains with prejudgment interest and civil penalties.

STATE

Virtual currency

- California court consolidates cases against Ripple Labs. On May 28, the US District Court for the Northern District of California consolidated the cases of Zakinev et al v. Ripple Labs Inc. and Bitcoin Manipulation Abatement LLC v. Ripple Labs Inc. Both cases derive from Ripple’s unregistered securities offering of XRP digital currency and will turn on whether XRP qualifies as a security under federal and California law. See our April and May issues for additional information.

- Texas securities board orders cryptocurrency mining company to cease offerings. On June 5, the Texas State Securities Board announced the entry of an emergency cease and desist order against Coinvaultpro, a New York entity, for making illegal and fraudulent offerings of cryptocurrency mining investments to Texas residents via the website www.coinvaultpro.com. The order alleges registration violations, fraud and deceptive statements, including misrepresenting the identities of the company’s management team and satisfied investors through the use of photographs of models or unrelated persons.

SPOTLIGHT ON INTERNATIONAL DEVELOPMENTS

Blockchain

- OCC

- DFS

- ACPR

- OCC

- DFS

- Louisiana legislature

- New York Department of Financial Services (DFS)

- DFS

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Bank of Russia developing blockchain-based platform for digital mortgages. As of May 28, the Bank of Russia is reportedly developing a blockchain-based digital mortgage platform. The bank already submitted the project proposal to the government for consideration.

Virtual currency

Australian central bank official speaks on the impact of COVID-19. On June 4, 2020, Michele Bullock, Assistant Governor of the Reserve Bank of Australia, gave a speech on the potential implications of the coronavirus disease 2019 (COVID-19) pandemic on the payments system. She noted that the impact of the COVID-19 pandemic has demonstrated that the shift to electronic payments may not be as difficult as originally thought and that the pandemic is accelerating the transition to electronic payments. The speech highlighted significant increases in customer awareness of digital currencies and the potential competitive impact of digital currencies on payment processing costs for merchants as adoption spreads. Ms. Bullock further noted that these changes are putting substantial pressure on the checking and ATM systems, as the high fixed costs of maintain those systems are becoming so significant that there is active interest in closing the entire checking system and in significant consolidation among ATM networks.

Canadian regulator adds virtual currency businesses as MSBs. On June 1, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) updated its guidance for money services businesses (MSBs). The update includes businesses dealing in virtual currency as MSBs subject to regulator oversight. Virtual currency exchange and transfer services must register with FINTRAC and otherwise participate in its compliance program.

Canadian securities regulator finds cryptocurrency exchange operates as a Ponzi scheme. The Ontario Securities Commission (OSC) released a report on June 11 entitled “QuadrigaCX: A Review by Staff of the Ontario Securities Commission.” The report finds that Gerald Cotten, founder and CEO of the now-defunct cryptocurrency exchange QuadrigaCX, caused the downfall of the platform through fraud. Cotten appropriated exchange assets for his personal use, causing losses to more than 76,000 investors, in amounts in excess of $215 million. The QuadrigaCX bankruptcy trustee was able to recover or identify only $46 million in assets to return to investors.

French Societe Generale performs first financial transaction settled with a CBDC. On May 14, the Societe Generale SFH reportedly issued €40 million of covered bonds as security tokens (OFH tokens) directly registered on a public blockchain. These OFH tokens were fully subscribed and the issuer was paid in a digital form of euros issued by the Banque de France through a blockchain platform.

Iranian President directs development of national strategy for crypto mining. On May 21, Hassan Rouhani, President of Iran, chairing Iran’s economic coordination headquarters, reportedly told officials from the Central Bank of Iran, Ministry of Energy, and information and communication technology ministries to develop a national strategy for crypto mining, including regulating mining and revenue.

Russian parliament considers harsh draft bills regulating cryptocurrencies. Two draft bills were reportedly sent to the State Duma on May 21. The first bill would prohibit the issuance of, and operations with, digital currencies in the nation. Distributing information about such activities would also be prohibited under the bill. The second bill would impose criminal sanctions for operations with digital assets without government approval, punishable with fines or prison.

For more information

Please visit our Coronavirus Resource Center and subscribe to our mailing list to receive alerts, webinar invitations and other publications to help you navigate this challenging time.

Trending

Coronavirus: US federal and state governments work quickly to enable remote online notarization and SBA PPP loans to meet global crisis

OCIE announces 2020 examination priorities

More from DLA Piper

Fifth Money Laundering Directive - Summary of changes to UK AML law

In case you missed it

Legal Developments in Categorising and Tracing Cryptoassets – DLA FiBrief blog

DoD’s new cybersecurity compliance program – what you need to know

Our analysis of the July 31 FCA policy statement PS19/22: Guidance on Cryptoassets, which sets out the FCA’s final guidance on whether dealings involving cryptoassets require authorization under FSMA.

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The latest issue of our bulletin Bank Regulatory News and Trends

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WEF’s foundational values for a decentralized future.

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