

APPROVED
by the Board of Bank of Lithuania
at the meeting of 10 October. 2017

POSITION OF THE BANK OF LITHUANIA ON VIRTUAL CURRENCIES AND INITIAL COIN OFFERING

In analysing business models of financial market participants and entities intending to become financial market participants related to virtual currencies, having assessed the position of the European Banking Authority (EBA) and of the European Central Bank (ECB) on virtual currencies as well as risks posed by virtual currencies, and following section 5 of Article 42 of the Law on the Bank of Lithuania, the Bank of Lithuania has prepared its position on virtual currencies and initial coin offering (ICO). The position is intended for existing and potential financial market participants¹ (hereinafter 'financial market participants', FMP), as well as entities intending to organize initial offering of virtual currency coins (hereinafter 'coins') or to provide the possibility for Lithuanian investors to invest in this product type. It should be noted that this position cannot be regarded as official interpretation of the legislation. Since the Bank of Lithuania makes decisions taking into account the entirety of actual circumstances, this position cannot be regarded as the decision of the Bank of Lithuania in a specific case.

Virtual currency shall mean uncontrolled and unregulated digital money, which may be used as a means of payment, but is issued into circulation and guaranteed by an institution other than the central bank (European Banking Authority, 2013, ²). Virtual currency may exist in a variety of forms: from virtual currency used in online computer games and social networks to a means of payment which may be used in real life. In addition, virtual currency may not only be used for payment, but may also comprise means of accumulation for saving or investment purposes, for example, derivatives, commodities or securities.

I. ON SEPARATION OF THE FINANCIAL SERVICES PROVISION ACTIVITIES FROM THE ACTIVITIES ASSOCIATED WITH VIRTUAL CURRENCIES

On 31 January 2014, the Bank of Lithuania, with regard to the warning of the EBA of virtual currencies, published its position³, warning the consumers of the potential risks of virtual currency. On 16 July 2014, the Bank of Lithuania, with regard to the EBA opinion on virtual currency⁴, suggested that credit institutions, payment institutions and electronic money institutions refrain from the purchase, storage or sale of virtual currency in order to reduce the risk arising from the interaction of virtual currency schemes and regulated financial services, including the risks associated with money laundering and other financial crimes, as well as the obscurity and uncertainty of the financial capacity of market participants participating in virtual currency schemes⁵. The Bank of Lithuania has also provided responses to individual financial market participants, informing them that the activities associated with virtual currency are not compatible with the provision of financial services and thus the activities associated with virtual currency should be separated from those of a payment institution or electronic money institution.

¹ Financial market participants shall mean the financial market participants supervised by the Bank of Lithuania and specified in section 1 of Article 42 of the Law on the Bank of Lithuania.

² <https://www.eba.europa.eu/documents/10180/598344/EBA+Warning+on+Virtual+Currencies.pdf>

³ http://www.lb.lt/lietuvos_bankas_perspeja_del_virtualiu_valiutu_naudojimo

⁴ <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf>

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http://www.lb.lt/eba_siulo_galimus_reikalavimus_del_virtualiu_valiutu_reguliavimo_rezimo_ir_teikia_patarima_finansu_istaigoms_del_siu_valiutu_isigijimo_laikymo_ar_pardavimo

Taking into account the relevance of the matter to financial market participants and in order to shape a single practice for financial market participants with regard to the separation of their financial services provision activities from the activities associated with virtual currencies, the Bank of Lithuania hereby presents **the criteria and requirements**, which, in its opinion, should be observed by financial market participants:

1. Financial market participants providing financial services⁶ should not participate in activities or provide services associated with virtual currencies.

Activities and services associated with virtual currencies shall include the purchase, storage or sale of virtual currency, organizing ICO or distribution of coins, providing the possibility to pay for goods or services in virtual currency, execution of transactions in virtual currency, virtual currency exchange activity, investment in virtual currency, except when it is considered investment in financial instruments, establishment of funds intended for investment in virtual currencies, virtual currency account management, and other similar activities.

It should be noted that engagement in activities associated with virtual currencies is not the provision of financial services and, therefore, participation of FMP in such activity may be incompatible with legislation regulating their activities, and would be the grounds for the refusal to issue a licence or revoke one. For example, paragraph 3 of Article 4 of the Law on Banks provides that, in addition to providing financial services, a bank shall be entitled to only engage in such other activities, without which it would be impossible to provide financial services, which help provide financial services or is otherwise directly related to the provision of financial services. Participation of electronic money and payment institutions and collective investment undertakings in activities associated with virtual currencies would be incompatible with section 8 of Article 5 and section 11 of Article 6 of the Law on Payment Institutions, section 8 of Article 11 and section 11 of Article 12 of the Law on Electronic Money and Electronic Money Institutions, sections 3 and 4 of Article 4 of the Law on Collective Investment Undertakings, etc.

2. In line with paragraph 1 of this Position, FMP should ensure actual separation of the financial services provision activity from activities associated with virtual currencies, as well as ensure appropriate and not misleading communication about the nature of services provided by FMP, i.e.

2.1. when providing financial services to customers, FMP should not link financial services to the services associated with virtual currencies provided by third parties, i.e. not provide the conditions to pay in virtual currency using payment instruments issued by FMP⁷ (e.g. pre-paid, debit or credit cards), not link the payment instruments issued by FMP to virtual currency accounts, etc.

2.2. FMP shall not directly or indirectly associate the name of FMP, brands owned by FMP and FMP domain with activities associated with virtual currencies in internal and external communication.

2.3. FMP shall ensure that, in the environment managed by FMP (FMP website, mobile application, platform, ATM, customer's online account, etc.) or in the environment managed by third parties where the FMP provide financial services, the information/references provided by FMP for internal and external communication does not create the conditions for misleading the customers or create an impression that the FMP is providing services associated with virtual currencies and/or such services are supervised and subject to the same security or service standards as financial services.

⁶ Financial services shall mean the services defined in the Law on Financial Institutions as well as insurance activities specified in the Law on Insurance.

⁷ Payment instrument shall mean any personalised device(s) and/or certain procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order (section 27 of Article 2 of the Law on Payments).

3. In providing financial services to customers who are engaged in activities associated with virtual currencies, FMP should ensure compliance with the requirements of money laundering and terrorist financing prevention legislation, and take appropriate measures to manage the risk of money laundering and/or terrorist financing:

3.1. Activities and services associated with virtual currencies pose a greater risk of money laundering and/or terrorist financing and, therefore, FMP should take appropriate measures set forth in money laundering and terrorist financing prevention legislation in order to reduce and manage the risks.

3.2. FMP should ensure that, in the provision of payment⁸ or other financial services to business customers associated with the virtual currency sale and exchange activity, execution of transactions in virtual currency, etc., it should be assessed whether such customer is implementing effective money laundering and/or terrorist financing risk management controls (identification of persons using the services of such customers, fulfilment of know-your-customer requirements, ensuring the monitoring of transactions, etc.). If the money laundering and/or terrorist financing prevention control of such a customer is inadequate, FMP shall take additional measures to reduce and manage the risk of money laundering and/or terrorist financing.

II. ON INITIAL COIN OFFERING

ICO shall mean any initial coin offering with the purpose of attracting capital or investment for the development of a new product or service, company or its activity. ICO takes place online, using the distributed ledger technology (blockchain), and released coins are sold for virtual or real currency. Depending on the conditions of a specific issue, released coins may grant different rights to their owners, such as the right to participate in the company management process, the right to receive part of the company's profit, the right to receive part of the company's income, the right to receive interest for invested funds, the right to recover the invested funds and receive additional income through redemption of the coins, the right to use a product or service free of charge or for payment in coins, the right to sell the coins to another person, etc.

Investors generally seek different objectives by purchasing coins: supporting a relevant project, becoming a shareholder of the company, receiving interest or returns on investment, earning from the rising price of coins and their resale in the secondary market, payment in coins for a developed product or service, etc.

Although organizing ICO is not regulated by specific legislation, taking into account different ICO models and different characteristics of coins, the Bank of Lithuania would like to point out to ICO organizers and coin distributors that, in some cases, such activity may be subject to the requirements of the legislation of the Republic of Lithuania.

It should also be noted that the fact that a specific ICO model is subject to any of the following regulatory regimes means that respective entities must observe the restrictions set forth in section 1 of this Position, i.e. supervised financial market participants should not participate in activities or provide services associated with virtual currencies and should comply with other criteria and requirements set forth in section 1 of this Position.

1. **Application of the Law on Securities.** In those cases where coins released during ICO have characteristics of securities (grant the right of ownership, company management, or grant other rights to the shareholders, such as the right to receive part of the company's profit in the form of dividend or otherwise, provide for payment of interest or redemption of coins, etc.) and may be transferred to other persons as well as traded in the secondary market or at organized trading venues, their offering is subject to the provisions of the Law on Securities. Prior to starting the

⁸ For example, opening a payment account and keeping funds in it, possibility to pay for the services associated with virtual currency by payment card (card-acquiring) or other payment instrument or by credit transfer, etc.

distribution of such coins in Lithuania, a prospectus, approved by the Bank of Lithuania or a competent authority of another EU Member State, should be drawn up and published (except for derogations provided for by the Law on Securities).

2. **Application of the Law on Crowdfunding.** In those cases where ICO has characteristics of a project defined by the Law on Crowdfunding (a project designed to meet business, professional, scientific, research and other needs, for the implementation of which the project owner is seeking to raise funds from the public by borrowing from funders or granting them the right to participate in company management and its capital formation), the operator of the platform used for the ICO may be subject to the requirements of the Law on Crowdfunding.

3. **Application of laws regulating the activities of collective investment undertakings.** In those cases where the entity releasing the coins collectively invests the funds received through ICO in different projects (not necessarily associated with virtual currencies) with the purpose of receiving returns for coin holders, the activities of such entity may be subject to the legislation regulating the activities of collective investment undertakings.

4. **Application of laws regulating the provision of investment services.** In those cases where coins released during ICO have characteristics of financial instruments (transferable securities, money market instruments, options, futures, swaps and any other derivatives contracts or other derivatives), they may be distributed only by licensed financial intermediaries subject to the requirements of the Law on Markets in Financial Instruments.

5. **Application of laws regulating the secondary market.** In those cases where coins released during ICO have characteristics of financial instruments (transferable securities, money market instruments, options, futures, swaps and any other derivatives contracts or financial derivatives), the entities organizing and/or engaged in active secondary trading in coins or the entities operating trading platforms used for secondary trading in coins may be subject to the Law on Markets in Financial Instruments.

6. **Formation of a newly established FMP capital through ICO.** If the funds collected during ICO are intended for the formation of the capital of a newly established FMP, the capital formation requirements applicable to a specific form of financial institution shall apply. For example, in the case of establishment or licensing of a bank, according to the requirements of the Law on Banks and subordinate legislation, information about the persons holding the qualifying share of the authorized capital and/or voting rights must be presented, as well as data confirming that the bank has the required minimum capital; information about the origin of such capital must also be submitted. Organizing ICO with the purpose of forming the minimum capital of a newly established FMP by yielding investment in virtual currency and then converting it into traditional currency (distributed by central banks) should not prevent identification of the primary holder, consignor or investor of virtual currency, including the activities it was received from and the measures it was transferred by. The newly established FMP should make it possible to trace the entire scheme of the movement of virtual currency, from its initial acquisition and sale to redemption.

It should be noted that, when deciding on the application and scope of specific legislation of the Republic of Lithuania for specific ICO, the conditions of the relevant ICO should be analysed and assessed.