

A Game Changer for Cryptocurrency in Germany? Court Holds No License Required to Trade Bitcoins

IN SHORT

The Court Decision: On September 25, 2018, the Higher Regional Court of Berlin held that bitcoins would *not* qualify as financial instruments for the purposes of the German Banking Act (*Kreditwesengesetz*, "KWG"), thus dismissing the licensing requirement for bitcoin-related investment activities in Germany.

The German Regulator's View: The decision is in contrast to the position of the German regulator, the Federal Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "BaFin")—that bitcoins qualify as financial instruments in the form of "units of account" (*Rechnungseinheiten*) and therefore related investment services or activities require a license under the KWG.

Looking Ahead: The qualification of bitcoins as financial instruments brings activities involving bitcoins within the scope of financial regulation, so the decision could be a door opener for virtual currencies to escape regulation in Germany. However, the BaFin has indicated that it considers the court decision to apply only to the facts of the case and does not change its position and administrative practice regarding the licensing requirement.

The defendant was prosecuted for operating a bitcoin trading platform without having obtained a license for providing investment services, which would be a criminal offense under the KWG if bitcoins were to qualify as financial instruments. After the defendant was convicted in the court of first instance and acquitted by the Regional Court of Berlin, the prosecutor lodged an appeal to the Higher Regional Court of Berlin.

Discussion of the Ruling

The Higher Regional Court held that the defendant's activity did not constitute a regulated activity under the KWG because bitcoins do not qualify as units of account. According to the court, a unit of account needs to be comparable to a "currency," and bitcoins are not comparable to a currency. That is because there is no one issuer of bitcoins, they are not accepted as a means of payment, and they lack a stable value that makes them ineligible as a means of comparing the value of goods or services against a common measure, as is the case with legal currencies. Therefore, bitcoins do not qualify as units of account and, as a consequence, do not qualify as a financial instrument under the KWG.



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Interestingly, the court and the BaFin are aligned on their conclusion that bitcoins are not comparable to a currency. However, their respective interpretations of the term "unit of account" are very different. In contrast to the BaFin, the court construed the term more narrowly and concluded that a unit of account would need to be "comparable to a currency." That is based on a historic interpretation of the term and a comparison of the meaning given to such term in other German statutes. The court also points out that the term "units of account" was introduced into the KWG long before virtual currencies came to market, and the legislative materials provide no indication that the term was intended to encompass virtual currencies.

It should be noted that "units of account" as a subcategory of the definition of "financial instruments" is a special feature of the KWG and is not a subcategory of the European definition of "financial instruments" under the Markets in Financial Instruments Directive ("MiFID II"). The decision has therefore less relevance in defining "financial instruments" as the term is used in MiFID and corresponding European legislation, such as the Prospectus Directive, which rely on term's definition in MiFID for their scope of application. Consequently, the immediate effects of this decision are limited to Germany, although it remains to be seen how this decision may influence other European countries and the European Union in their consideration of

whether to regulate aspects of the virtual currency market.

Putting the Decision in Perspective

This decision should be considered relative to positions in the area of digital assets recently taken by other EU market authorities. France, for instance, has just enacted a new proposal whereby tokens would be defined as any intangible asset representing, in electronic form, any right that may be issued, held, or transferred through a distributed ledger technology that directly or indirectly identifies its owner. In Spain, the Securities Commission has stated in an official communication to professionals that tokens may constitute a financial instrument depending on the factual analysis of their structure, rights, and obligations on a case-by-case basis, and the Financial Conduct Authority has confirmed it will take the same approach under UK rules.

FOUR KEY TAKEAWAYS

1. The German regulator, since 2013, has taken the view that bitcoins qualify as "units of account" and, therefore, as financial instruments. The qualification of bitcoins as financial instruments meant that certain trading activities in respect of bitcoins required a license under the German Banking Act (KWG).
2. The Higher Regional Court of Berlin held that contrary to the BaFin, bitcoins do *not* qualify as "units of account," and therefore the related trading activity in the case at question did not require a license under the KWG.
3. In response to the decision, the BaFin has announced that it considers the decision to be constrained to the facts of the case and will not change its position. Market participants should therefore continue to be cautious when engaging in activities relating to bitcoins and other virtual currencies in Germany or offering financial services in respect of virtual currencies to customers in Germany.
4. This position does not apply in other EU jurisdictions. Therefore, any cross-border activity should involve a legal analysis to ensure compliance with local laws and regulations.



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