Virtual currencies

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The European Parliament adopted by 542 votes to 51, with 11 abstentions, a resolution on virtual currencies (VCs).

Members recalled that virtual currencies (a universally applicable definition is not yet established) are most notably based on distributed ledger technology (DLT), the technological basis for more than 600 virtual currency schemes, which facilitates 'peer-to-peer' exchange, the most prominent of which to date is **Bitcoin**. It was launched in 2009 and currently holds a market share among DLT based virtual currencies of almost 90 %, with a market value of the outstanding Bitcoins of around EUR 5 billion, it has not yet reached systemic dimensions.

Distributed ledger technology includes databases with varying levels of trust and resilience, with the potential to process large numbers of transactions rapidly, and with transformational capacity not only in the area of virtual currencies but also in fintech more broadly speaking.

Investments in DLT are an integral part of the ongoing fintech innovation cycle and have totalled more than EUR 1 billion to date, from both venture capital funding and corporate investment.

Opportunities and risks of VCs and DLT in the rapidly evolving technological landscape of payments: Parliament stressed that VCs and DLT have the potential to contribute positively to citizens' welfare and economic development, including in the financial sector, by means of:

- **lowering transaction and operational costs for payments and especially cross-border transfer of funds**, quite possibly to well below 1 %, compared to the traditional 2 % – 4 % for online payment systems –, and to more than 7 % on average for the cross border transfer of remittances, hence, in an optimistic estimate, potentially reducing total global costs for remittances by up to EUR 20 billion;
- reducing the cost of access to finance even without a traditional bank account, thereby potentially contributing to financial inclusion;
- enhancing the resilience and, depending on the architecture of the scheme, the speed of payment systems and trade in goods and services thanks to the inherently decentralised architecture of DLT, which might continue to operate reliably even if parts of its network were to malfunction or to be hacked;
- enabling systems that combine ease of use, low transaction and operational costs and a high degree of privacy, but without full anonymity so that transactions are traceable to a certain extent.

However, virtual currencies and distributed ledger technology schemes entail risks which need to be addressed appropriately so as to enhance their trustworthiness, including in the present circumstances, namely:

- the **absence of flexible, but resilient and reliable, governance structures** or indeed a definition of such structures, especially in some DLT applications such as Bitcoin, which creates uncertainty and consumer or – more broadly – user protection problems, especially in the event of challenges unforeseen by the original software designers;
- the **high volatility** of virtual currencies and the potential for speculative bubbles, and the absence of traditional forms of regulatory supervision, safeguards and protection, issues which are especially challenging for consumers;
- potential sources of **financial instability** that might be associated with derivative products;
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the potential for **'black market'** transactions, money laundering, terrorist financing, tax fraud and evasion and other criminal activities:
- the energy consumption of running certain VCs which, according to the UK Government Chief Scientific Adviser's report on DLT, in the case of Bitcoin has been estimated to be in excess of 1 GW.

The resolution suggested that addressing these risks will:

- **require enhanced regulatory capacity**, including technical expertise;
- **require the development of a sound legal framework** that keeps up with innovation, ensuring a timely and proportionate response if and when the use of some distributed ledger technology applications becomes systemically relevant.

Employing distributed ledger technology beyond payments: Parliament pointed out that clearing, settlement and other post-trade management processes currently cost the global financial industry well in excess of EUR 50 billion per year, and that this and bank reconciliation processes are areas where the use of distributed ledger technology might turn out to be transformational in terms of efficiency, speed, and resilience, but would also raise new regulatory challenges.

Members recognised the still unfolding potential of distributed ledger technology **well beyond the financial sector**, including crypto-equity crowdfunding, dispute mediation services, in particular in the financial and juridical sectors, and the potential of smart contracts combined with digital signatures, applications allowing for heightened data security and synergies with the development of the Internet of Things.

Parliament also encouraged government agencies to test distributed ledger technology systems after conducting proper impact analyses in order to improve the provision of services to citizens and of e-government solutions, in compliance with EU data protection rules.

Smart regulation towards fostering innovation and safeguarding integrity: Members called for a proportionate regulatory approach at EU level so as not to stifle innovation or add superfluous costs to it at this early stage, while taking seriously the regulatory challenges that the widespread use of virtual currencies and distributed ledger technology might pose. They called on the Commission to promote a **shared and inclusive governance** of the distributed ledger technology.

The resolution pointed out that key EU legislation, such as the European Market Infrastructure Regulation (EMIR), the Central Securities Depositories Regulation (CSDR), the Settlement Finality Directive (SFD), MiFID/MiFIR, UCITs and the Alternative Investment Fund Managers Directive (AIFMD), could provide a regulatory framework in line with the activities carried out.

More tailor-made legislation might be needed.

Members welcomed the Commission's suggestions for including **VC exchange platforms** in the Anti-Money-Laundering Directive (AMLD) in order to end the anonymity associated with such platforms; expects that any proposal in this regard will be targeted, justified by means of a full analysis of the risks associated with VCs, and based on a thorough impact assessment.

They recommended that the Commission draw up a **comprehensive analysis of virtual currencies** and, on the basis of this assessment, consider, if appropriate, revising the relevant EU legislation in light of the new possibilities afforded by new technological developments.

The resolution called for the creation of a **horizontal Task Force on distributed ledger technology** led by the Commission, consisting of technical and regulatory experts, in order to:

(i) provide the necessary technical and regulatory expertise across the various sectors of pertinent distributed ledger technology applications; (ii) analyse the benefits and risks of distributed ledger technology; (iii) develop stress tests for all relevant aspects of virtual currencies and other distributed ledger technology schemes that reach a level of use that would make them systemically important for stability.

Lastly, the Commission is urged to develop, in cooperation with the Member States and the virtual currencies industry, **guidelines with the aim of guaranteeing that correct, clear and complete information** is provided for existing and future virtual currency users.