

Future Licence Requirement for Crypto-Wallet Providers in Germany

On 20 May 2019, the German Federal Ministry of Finance published a draft bill (*Referentenentwurf* – “**Draft Bill**”) for the implementation of the Fifth Money Laundering Directive (“**AMD 5**”). While most of the Draft Bill is dedicated to amending the German Money Laundering Act (*Geldwäschegesetz* – “**GWG**”), it also broadens the scope of the licensing requirement under the German Banking Act (*Kreditwesengesetz* – “**KWG**”) for certain services related to crypto values, thus “gold-plating” AMD 5 which does not contain a licensing requirement: The Draft Bill introduces a new licensable activity, the custody of crypto values (*Kryptowerte*). Also, by introducing a broad definition of crypto values and qualifying these as “financial instruments” within the meaning of the KWG, arranging and trading activities in crypto-assets will also be subject to licensing requirements if provided in Germany. While such broad definition of financial instruments partly confirms the current view of the regulator, it partly also goes beyond that, in particular as it covers security tokens and investment tokens regardless of whether or not further requirements are met. As a consequence, some firms might have to apply for a licence to the German regulator BaFin by end of 2019.

Background

The AMD 5 entered into force on 10 July 2018 and needs to be implemented by each member state by 10 January 2020. Amongst other changes, the AMD 5 extends the types of persons falling within its scope to entities engaged in exchange services between virtual currencies and fiat currencies (virtual currency exchange platforms), as well as to crypto-wallet providers. The Draft Bill proposes implementing this requirement not by amending the GWG, but by extending the scope of the entities which require a licence under the KWG – and are thus automatically subject to the GWG. This briefing will focus on such amendment to the scope of the licensing requirements.

Current licensing requirements

So far, activities related to crypto values are not explicitly included in the KWG which addresses licensing requirements. Nevertheless, BaFin interprets the existing rules in such a way that various services relating to certain crypto values require a licence under the KWG. In particular, brokerage services in relation to virtual currencies such as Bitcoin have already been regarded by BaFin as licensable financial services.

Amendments to the KWG

The financial services requiring a licence are listed in Sec. 1(1a) Sent. 2 KWG. The Draft Bill supplements the list of licensable financial services (through Sec. 1(1a) Sent. 2 No. 6 KWG) to also include the custody,

management, and safeguarding of crypto values or private cryptographic keys serving to hold, store, and transfer crypto values for the account of others (“**Crypto-Custody Business**”). Also, a definition of crypto values will be added (in Sec. 1(11) Sent. 4 KWG). Accordingly, crypto values are defined as digital representations of a value which has not been issued or guaranteed by any central bank or public authority and which does not have the legal status of a currency or money but is accepted by natural or legal persons as means of exchange or payment or for investment purposes by virtue of an agreement or actual practice, or serving investment purposes and which can be transferred, stored and traded electronically. However, e-money pursuant to the German Payment Services Supervisory Act (*Zahlungsdiensteaufsichtsgesetz* – “**ZAG**”), or a monetary value stored on instruments within the meaning of Sec. 2(1) No. 10 ZAG (“limited network exemption”) or used only for payment transactions pursuant to Sec. 2(1) No. 11 ZAG (“payments within telecommunications networks”), will not be considered crypto values for the purpose of the KWG.

In addition, it is established that crypto values are deemed to be financial instruments within the meaning of the KWG (Sec. 1(11) Sent. 1 No. 10 KWG). As a consequence, all activities which are licensable when performed with respect to financial instruments, including brokering and trading activities, are also subject to a licensing requirement if performed with respect to crypto values.

Practical consequences for licensing requirements

Crypto-Custody Business as a new financial service

So far, the custody of crypto values does not qualify as a licensable financial service in Germany. However, if implemented as proposed in the Draft Bill, providers of Crypto-Custody Business will not only become subject to AML requirements, but will also require a licence under the KWG and will thus be subject to the on-going supervision of BaFin (not as banks, but as financial services institutions (*Finanzdienstleistungsinstitute*)). This will affect in particular service providers who, apart from the Crypto-Custody Business, do not provide any other financial service in relation to crypto values for

which they already today would require a licence, such as, for example, providers of web wallets or mobile wallets. Thus, BaFin is not only put in a position to monitor their compliance with anti-money-laundering provisions, but also to use its supervisory powers to ensure customer protection in a dynamic business field associated with new types of risks.

Crypto values as a new financial instrument

The new definition of a crypto value is very broad and seeks to cover all potential use cases of ‘crypto assets’ and extends to cover tokens with exchange of value functionality as well as payment functions (e.g. virtual currencies) and tokens serving for investment purposes such as security tokens and investment tokens which could be categorised as capital investments, debt securities, or investment fund units. At the same time, the definition excludes domestic and foreign legal tenders (i.e. fiat currencies) but also e-money, composite payment systems (*Verbundzahlungssysteme*) and payment transactions of providers of electronic communications networks and services. Moreover, electronic gift cards are generally not covered by the definition of crypto value. As a consequence, the classification of crypto values as a financial instrument therefore no longer requires a complex case-by-case analysis as BaFin had required so far. Rather, it is now sufficient that crypto values are actually used as a means of payment or for investment purposes. As before, utility tokens, i.e. tokens which are merely intended to digitally provide access to an application or service, do not constitute financial instruments in this sense.

With this broad definition of crypto value, the Draft Bill for practical purposes confirms BaFin’s approach that virtual currencies such as Bitcoin (already now) qualify as financial instruments within the meaning of the KWG in the form of “units of account” (*Rechnungseinheiten*): Last year, the Berlin Court of Appeal opposed this classification in a criminal case ruling. With the inclusion of crypto values as financial instruments in the KWG, the discussions following this court decision will de facto come to an end. But the Draft Bill goes even beyond the current view of BaFin as it not only covers virtual currencies, but also includes security tokens and investments tokens which under BaFin’s current view

only qualify as financial instruments where certain additional requirements were met. Therefore, in the future, brokerage or advisory services relating to crypto values would have to be classified as financial services which require a licence. In the case of foreign providers, this only applies if they actively target the German market.

Effects on the WpHG

Notwithstanding the amendments to the KWG, the Draft Bill does not affect the German Securities Trading Act (*Wertpapierhandelsgesetz* – “**WpHG**”).

In particular, the definitions of ‘investment services’ and ‘financial instruments’ in accordance with Sec. 2(8) and Sec. 2(4) WpHG have not been amended. Therefore, crypto wallet providers and other entities providing services relating to crypto values are not subject to the WpHG and the conduct and organisational rules for investment firms contained therein (which are to a large extent an implementation of the MiFID II organisation and conduct rules).

OUTLOOK

Subjecting the custody, management, and safeguarding of crypto values to AML requirements is not surprising as this is required by AMD 5. However, using AMD 5 as an opportunity to extend the scope of licensing requirements in the context of crypto values under the KWG is a form of “gold-plating”. In line with previous indications, Germany thus “front-runs” discussions at EU level on the regulatory treatment of crypto values which are in full swing. However, the German legislator has apparently decided not to wait for harmonised requirements from Brussels.

As the next step a consultation with stakeholders is expected to take place shortly and subject to any amendments by the Ministry of Finance following the consultation, the Draft Bill will be put to vote in the

Federal Cabinet. If the Draft Bill passes the vote, it is very likely that it will also be formally adopted by the German Bundestag with the majority of the governing coalition. Insofar, crypto wallet providers and other entities providing services relating to crypto values in Germany should make the necessary preparations in good time to ensure that in the event that the Draft Bill enters into force by no later than 10 January 2020 (the end of the implementation deadline for AMD 5), they do not provide licensable financial services without a licence, which could result in BaFin prohibiting the respective business or, under certain circumstances, impose an administrative fine or pass the matter on to the criminal prosecutor.

Key contacts

If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy.



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