

CÖBALT





Cryptocurrency regulation in Lithuania

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Numbers (\$\$\$)... and the interest is here

Number of ICOs:	Amount raised:
Year 2017 – 343	\$5.5 billion
Year 2018 – 271	\$14 billion (EOS – 4 billion, Telegram – 1.7 billion)

Crypto market CAP (CoinMarketCap)	
13 August 2018	\$216 billion
7 January 2018	\$835 billion (ATH)

Legal overview

- ICOs and activities related to cryptocurrencies (crypto) are regulated under the general laws (such a civil code or laws on securities) – there are no specific laws for crypto.
- There are no licensing requirements just because you make an ICO or engage into activity related to crypto.
- However if your project activity falls under regulated activity, then specific licence may be required. Usually such activity is related to financial services.
- Persons providing financial services are called financial market participants (FMPs). FMPs are not allowed to engage into activity related to crypto (collect, trade, exchange, make ICO, etc.). You could do so only by technically and legally separating your (i) activity as FMP from (ii) your activity related to crypto.

Activities falling under licensing/public offering rules (red-flag in crypto projects)

Licensed or regulated activities are the following:

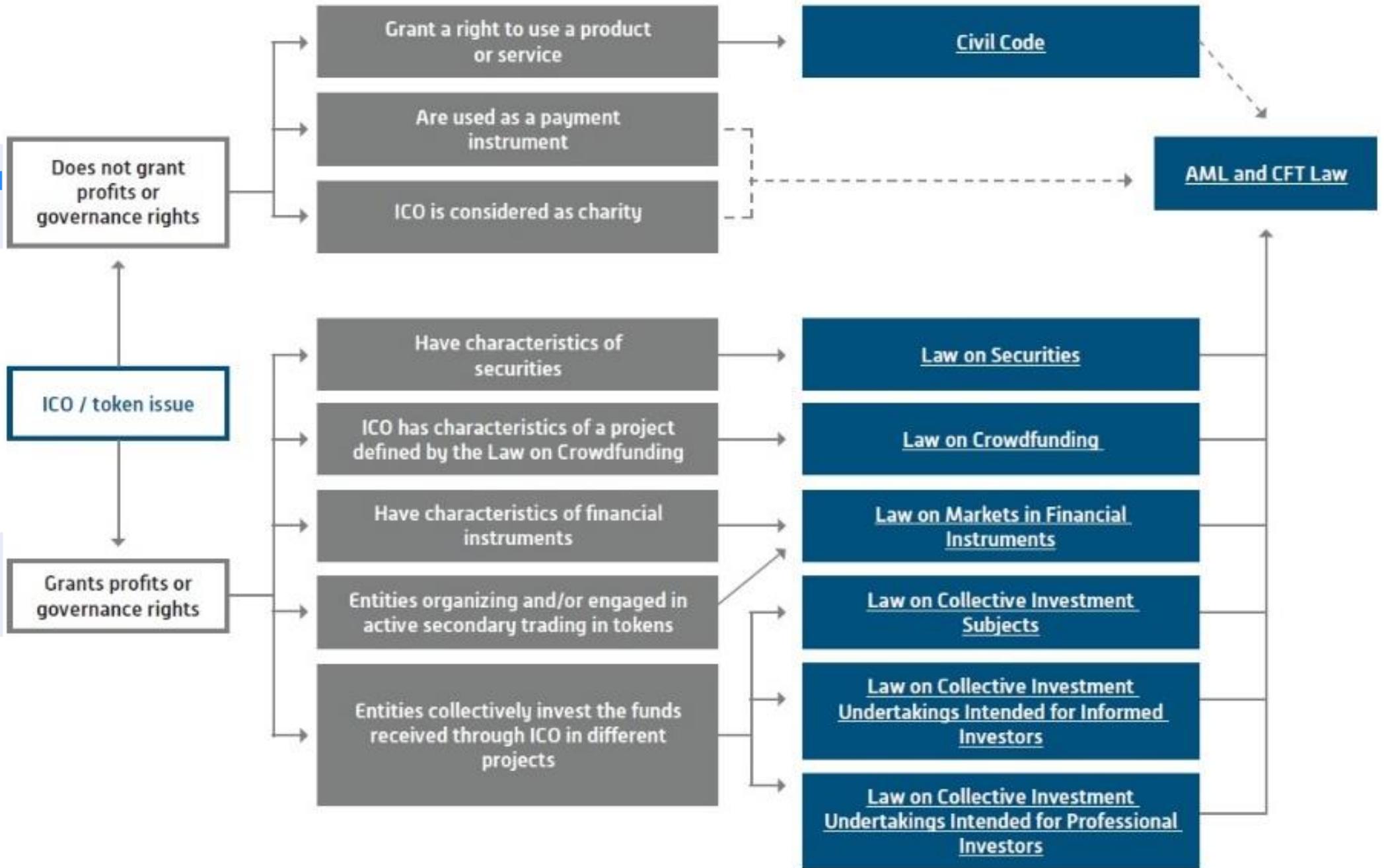
- 1) Collective investment activities. These are investment funds activities, i.e. you collect funds from the investors and use these funds for investing in various projects with a purpose to receive return. In such case, your ICO is a investment fund and you shall receive a fund license.
- 2) Investment services. If you organize distribution of security tokens, then you are providing investment services and you shall receive a license. The same applies to other investment services, e.g. providing investment recommendations, managing investment portfolio, acquiring and selling security tokens on behalf of the clients. If the tokens are not securities – no licensing required.
- 3) Secondary trading of security tokens. If you are an exchange where security tokens are traded, then you shall have a license to execute such activity.

Activities falling under licensing/public offering rules

Regulated activities are the following:

- 4) Crowdfunding platform operation. Crowdfunding is a mean of funding, when through a special platform a project is announced and persons (investors) finance such project through that platform (in loan or equity investments). You shall be included in the list of allowed operators in order to run crowdfunding platform. If you issue security tokens through such platform, then securities laws shall apply nevertheless.
- 5) Payment institution. A payment institution is a FMP, which has the right to execute and deliver fiat payments from one person to another.
- 6) If you want to establish a bank, credit institution, fund, insurance company – you always shall receive license irrespectively you collected the funds through ICO or not.
- 7) Issuance of security tokens. If you issue a security token, then you tokens shall be issued in accordance with the securities laws (explained further in detail).

- If you fall under the regulated activity, which are mentioned previously in points 1-7, then you shall be considered as the financial market participant (FMP). FMPs can execute their activity only with approval by the Bank of Lithuania.
- FMPs are not allowed to engage into activity related to cryptocurrencies (collect, trade, exchange etc.). You could do so only by technically and legally separating your activity as FMP from your activity related to cryptocurrencies.



---> Applied indirectly through requirements to the virtual currency exchanges and wallet services operators

KYC/AML requirements

If you are making an ICO or otherwise try to collect funds, you should execute proper KYC/AML. Otherwise, this may restrict your option to „cash out“ funds collected through ICO.

Usually, the following information about investors is collected:

- 1) name and surname;
- 2) date of birth;
- 3) citizenship;
- 4) passport/ID copy;
- 5) picture.

However major banks require investor to be present at a bank or remote identification method can be applied. However then person shall have qualified electronic signature, special high level recognition system, direct video streaming, collection of data from public sources.

With application of thorough KYC/AML requirements, it's simply impossible to make a successful ICO.

5th anti-money laundering (AML) directive

This 5th AML directive will be applied to:

- 1) providers engaged in exchange services between virtual currencies and fiat currencies (i.e. exchanges, such as Binance); and
- 2) as custodian wallet providers.

Thus above mentioned persons will be obligated to identify their customers within directive requirements (e.g. currently such obligation is applied to banks).

The directive shall be applied no later than 10 January 2020 (national laws have to be amended).

SECURITY TOKEN ISSUANCE

Let's repeat the basics. Well known types of securities

Well known types of securities:

- shares;
- investment funds' units;
- bonds;
- options;
- futures.

Definition of security

Security is an obligation of the issuer (ICO company) to a token (security) holder. Security is like a promise to give/get something, the same is with the security token, because it is simply a security.

Below are basic features, which would qualify token as a security (token):

- right to receive interest, profit or income;
- token price is backed by the asset value (asset backed token);
- obligation of the issuer to redeem (buy back) the token;
- right to convert the token into the shares of the issuer;
- right to have influence over the management of the issuer (e.g. voting rights).

If your token have one of these, then it is a SECURITY TOKEN.

So what are the implications? (1)

If your token is a security (i.e. security token), then the laws regulating securities come into the game.

In Lithuania, it has two major implications:

- 1) public offering rules comes into effect – your token has to be issued in accordance with the specific rules established by the laws;
- 2) security tokens have to be registered within the securities manager (which must be a brokerage firm or a bank – entity licensed by the Bank of Lithuania) and depository (CSD).

In case of non-compliance penalties can be applied.

So what are the implications? (2) Public offering rules

If you make a public ICO, then you shall prepare a prospectus (complicated), which shall be approved by the Bank of Lithuania in advance, unless exemptions below exist.

Exemptions:

- 1) security tokens are offered up to 150 natural or legal persons in every EU member state (not including professional investors);
- 2) the total consideration of the offer in the EU, calculated over a period of 12 months, does not exceed EUR 5,000,000. In this case, only informational document about the issuer and the offering of the securities shall be prepared.

Informational document as an option

Opting for informational document is a solution if you want to make a security token ICO as it does not need to be approved by Bank of Lithuania. However informational document does not provide „passporting“ option, thus preparation of informational document in Lithuania is fine, but does not mean that offering will comply with the laws of other EU countries.

Informational document shall include such data as:

- 1) information about the publically offered security tokens and their issuance, secondary trading possibilities (i.e. exchanges);
- 2) basic information about the company, management and shareholders of the company;
- 3) business description;
- 4) prospects of income;
- 5) risks.

ICOs under the securities laws look possible

The Bank of Lithuania looks positively (no formal decision yet), that ICO can be legally done under applicable securities laws in Lithuania.

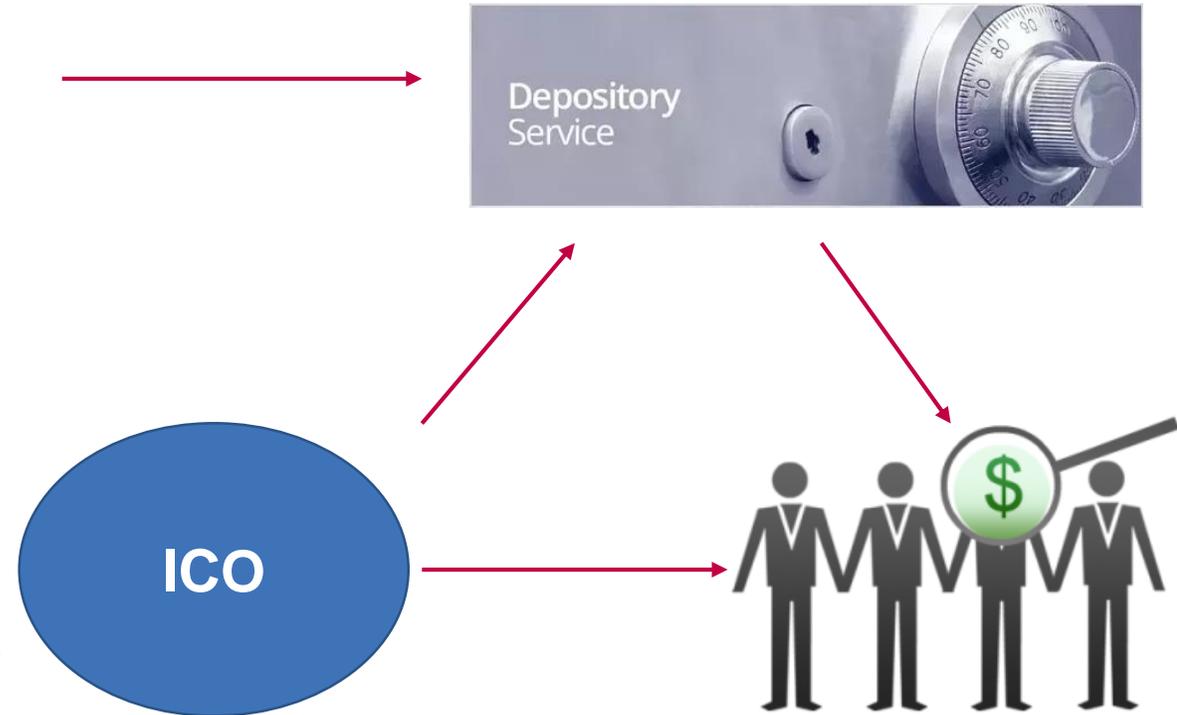
This requires proper smart contract and KYC/AML procedures to be concluded. It is important to know, who actually sits behind specific private wallet number.

However there is a practical obstacle

Security tokens shall be accounted in the security tokens holders' personal securities accounts, which shall be managed only by a brokerage firm or a bank holding a license to provide such services (**ST Accountant**).

ST Accountant shall have documents proving who is the owner of the token (KYC/AML apply).

Further transactions of the token has to be accounted by the ST Accountant. ST Accountant shall have documents proving such transaction and documents identifying each further holder of the token.



Solution of the practical obstacle?

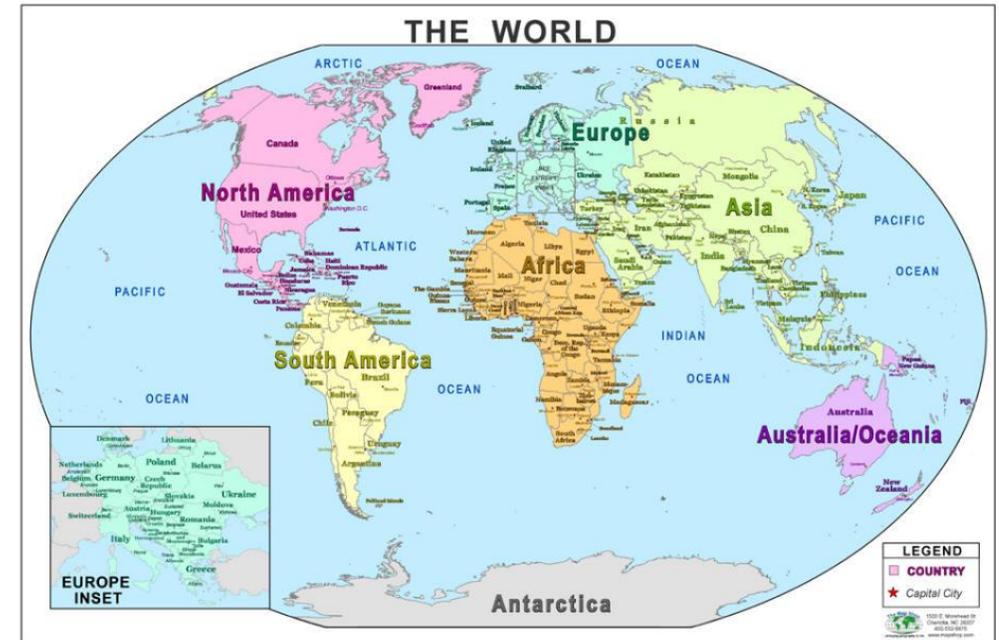
We think a solution can be a specific exchange/platform, where only whitelisted (KYC/AML applied) persons can trade the tokens.

If these technical issues are solved – it is possible to have a functional security token system.

Going out of Lithuania

Remember, even if a security token is legally offered in Lithuania, the offering shall be executed in all other jurisdictions under their local laws, which are different from the Lithuanian ones.

This can be avoided in EU by ‘passporting’, if the ICO prospectus (IPO requirements apply) is prepared and approved by the Bank of Lithuania (the same as in case of IPO). However this is complicated, expensive, time-consuming and never have been done (so unclear whether state institutions would actually approve it).



ICO guidelines

- Lithuania's ICO guidelines available at:
- <http://finmin.lrv.lt/uploads/finmin/documents/files/ICO%20Guidelines%20Lithuania.pdf>



Thank You for the attention!

In case of questions, do not hesitate to contact me:

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