

Letter of 8 March 2018 from Minister of Finance Wopke Hoekstra to the House of Representatives providing an initial assessment of developments in cryptocurrencies

Further to the undertaking I gave to Jan Paternotte MP¹ during the plenary debate of 31 January 2018 on the Financial Markets Transparency Act, I hereby inform the House in writing of developments relating to Bitcoin and other cryptocurrencies. This letter fulfils the undertaking and also honours the joint motion by Erik Ronnes MP (Christian Democratic Alliance (CDA)) and Henk Nijboer MP (Labour Party (PvdA)) regarding Bitcoin futures and other high-risk derivatives such as binary options.² The letter also fulfils my undertakings to Ronald van der Linde MP (People's Party for Freedom and Democracy (VVD)) and Farid Azarkan MP (DENK) to consider applicable legislation and the guidelines on public-sector investments in cryptocurrencies.³ I have also enclosed answers to the written questions posed by Martin Van Rooijen MP (50Plus) on this topic with this letter.

1. Introduction

International interest in Bitcoin and other cryptocurrencies has soared in recent years. In a short amount of time the number of Dutch investors in cryptocurrencies has also greatly increased. A recent study by Kantar TNS found that around half a million Dutch households own cryptocurrencies.⁴ Investing in Bitcoin or other cryptocurrencies is not without risk. It is for good reason that national and European supervisory authorities have repeatedly warned that investors should carefully consider the risks of buying cryptocurrencies and derivatives such as Bitcoin futures. Unlike funds held in a savings account, an investment in a cryptocurrency is not protected by the deposit guarantee scheme and there is generally no central issuer that can be held responsible for abuses. There are also concerns that cryptocurrencies can be used in criminal transactions such as fraud and money laundering.⁵

This letter is an initial assessment of developments in cryptocurrencies and ways to restrict their improper use and mitigate the risks to consumers. The appendix provides background information on the technology underlying cryptocurrencies, a summary of regulations in a selection of other countries and an overview of the applicable laws and the powers of the supervisory authorities.

2. Cryptocurrencies and cryptocurrency services

Many different kinds of cryptocurrency services are available. I make a distinction between:

- i) trade in cryptocurrencies;
- ii) initial coin offerings (ICOs) of new cryptocurrencies;
- iii) cryptocurrency derivatives (e.g. Bitcoin futures);
- iv) other high-risk financial products (e.g. binary options).

i) Trade in Bitcoins and other cryptocurrencies

A cryptocurrency is a digital medium of exchange that can be traded without the intervention of a central (i.e. official) counterparty. Owing to their digital nature, cryptocurrencies are inherently transnational. Introduced in 2009, Bitcoin was the first cryptocurrency. There are now more than 1,500 cryptocurrencies in circulation and a substantial number have already disappeared. Most transactions in cryptocurrencies take place on a trading platform, where they can be bought

¹ Debate of 13 December 2017, as communicated to me by letter (reference 2017Z17867).

² Parliamentary Papers, House of Representatives, 2017/2018, 34 769, no. 14.

³ Proceedings of the House of Representatives, 2017-2018 no. 33-5-1.

⁴ See Kantar TNS study of 8 February 2018: <http://www.tns-nipo.com/nieuws/persberichten/aantal-nederlandse-beleggers-cryptovaluta-geexplod>. The total value of investments relative to total household savings and invested capital is limited (0.1% of the total).

⁵ See also the Financial Intelligence Unit – Netherlands position paper for the cryptocurrency/ICO hearing of 24 January 2018.

against payment with regular currency or exchanged for other cryptocurrencies ('coins for coins').

ii) Initial coin offerings of new cryptocurrencies or tokens

New types of cryptocurrencies or tokens⁶ can come onto the market by means of initial coin offerings (ICOs). New cryptocurrencies or tokens can sometimes be bought using regular currency such as euros and dollars, but they are usually bought in exchange for existing cryptocurrencies. ICOs can finance new or existing products and services, but can also be purely speculative.

iii) Bitcoin futures and other cryptocurrency derivatives

A Bitcoin future is a specific type of cryptocurrency derivative. It is used to speculate on the future value or performance of the underlying instrument, the Bitcoin. It has been possible to trade Bitcoin futures on the US Chicago Mercantile Exchange (CME) and the Chicago Board Options Exchange (CBOE) since 1 December 2017.

iv) Binary options and other high-risk financial products

Binary options are also specific derivatives that can be used to speculate on the future value or performance of an underlying instrument. The underlying instrument can be a cryptocurrency, a share, gold or an exchange rate. A binary option can have only one of two outcomes: an increase or a decrease in the value of the underlying instrument. Most binary options have a very short life, often from just a few minutes to a couple of hours.

3. Approach to control the risks inherent in cryptocurrencies

My assessment of potential policy and regulation to control the risks inherent in cryptocurrencies is based on the following principles.

- i) Gaps in consumer and investor protection must be closed wherever possible but the measures must be proportionate.
- ii) The integrity of the financial system must be guaranteed.
- iii) The innovative technology behind cryptocurrencies, such as the use of cryptography and distributed ledger technology (DLT), must be retained.
- iv) The transnational nature of cryptocurrencies requires an international approach. National rules may be difficult to enforce or could simply be circumvented.

3.1 Approach to trade in Bitcoin and other cryptocurrencies

Holders and traders of cryptocurrencies are exposed to heightened counterparty and cyber risks because assurances cannot be given on the service providers' performance. There have already been serious cases of fraud and hacking.⁷ Cryptocurrencies also carry financial risks on account of the immature and unregulated nature of the market. Consumers and investors must be fully aware of the risks and the lack of safeguards similar to those accompanying regular financial services. As requested in the Ronnes/Nijboer motion, I will consult with credit card companies to discuss possible measures relating to the purchase of cryptocurrencies by credit card.⁸

An effective approach with proportionate regulation of the trade in Bitcoin and other cryptocurrencies is a complex matter. Many countries are struggling with this issue because the current supervisory framework and instruments are not sufficiently geared to cryptocurrencies. The European Commission, Germany and

⁶ Where cryptocurrencies are used solely as a medium of exchange and have no intrinsic value, tokens are the digital representation of promises on goods, services or claims, i.e. a kind of digital voucher or negotiable instrument.

⁷ See, for example, 'Japan raps Coincheck, orders broader checks after \$530 million cryptocurrency theft', *Reuters*, 28 January 2018 and 'Special Report: Twice burned – How Mt. Gox's Bitcoin customers could lose again', *Reuters*, 16 November 2017.

⁸ This point will be developed further following vote of 6 March 2018.

France are seeking further talks on the regulatory framework. Supervisory authorities in the United States have also called for further regulatory talks in light of the risks (an overview of the international playing field is included in the appendix). Given the decentralised and transnational nature of cryptocurrencies, they are unlikely to be banned. A ban would probably be difficult to enforce.⁹ I am therefore in favour of placing cryptocurrencies in an appropriate regulatory framework in order to prevent their improper use while retaining the potential of the underlying technology (see appendix).

The transnational nature of the trade in cryptocurrencies requires a coordinated international approach. If the Netherlands were to move unilaterally, it may legitimise activities without being able to enforce the regulations effectively. Internationally, there is a growing consensus and sense of urgency on this matter. The finance ministers and the heads of the central banks of France and Germany, for instance, are calling for a discussion of cryptocurrencies in the G20. The Netherlands supports this initiative and wishes to play a leading role in the EU and international response. I thus intend to discuss further regulatory steps with like-minded member states in the EU.

Also in the international context, the Netherlands will raise the subject of cryptocurrencies in its capacity as a member of the Financial Action Task Force (FATF), which aims to combat money laundering and terrorist and criminal financing. Money laundering and other improper uses of cryptocurrencies must be tackled in order to guarantee the integrity of the financial system. In particular, the conversion of cryptocurrency into regular currency must not go undetected. The Netherlands has therefore worked actively within the EU on an amendment of the Fourth Anti-Money Laundering Directive.¹⁰ The amendment will make trading platforms for cryptocurrencies and providers of digital wallets (including those used for cryptocurrencies) subject to the same rules as banks and other financial undertakings. In practice, these institutions will be subject to customer screening obligations and must verify their clients' identities. Furthermore, they must be registered, comply with the reliability and suitability criteria and report unusual transactions to the national Financial Intelligence Unit (FIU). Allowing for the customary legislative procedure, I expect the new rules to enter into force at the end of 2019. The amendment of the Fourth Anti-Money Laundering Directive will probably also help prevent tax evasion.

I would note that the economic value of all cryptocurrencies held by private individuals must be taken into account on the reference date of the relevant tax year in order to calculate the capital yield tax base in box 3 for income tax purposes. Taxpayers must declare such holdings, as well as business profits and income from other activities relating to cryptocurrencies.

In summary, I will:

- i) continue my efforts to make consumers and investors aware of the risks inherent in cryptocurrencies and enter into discussions with credit card companies. My efforts will be supported by the warnings issued by national and EU supervisory authorities. I agree with the advice given in earlier public statements: look before you leap;
- ii) actively work to place EU and international trade in cryptocurrencies in an appropriate regulatory framework, in order to tackle improper use effectively. To this end, I will also consult with supervisory authorities;
- iii) implement the amended Fourth Anti-Money Laundering Directive in order to combat the integrity risks of cryptocurrencies by increasing the

⁹ De Nederlandsche Bank (DNB) made the same point in its position paper for the cryptocurrency/ICO hearing of 24 January 2018.

¹⁰ For the Netherlands' position on the proposed directive, see Parliamentary Papers, House of Representatives, 2015-16, 22112, no. 2199.

transparency of cryptocurrency trading services. In consultation with national supervisory authorities and other relevant parties, I will consider the most effective way to frame the obligations for trading platforms and digital wallet providers. After implementing the amended Fourth Anti-Money Laundering Directive, the effectiveness of the measures taken will be assessed and a decision will be taken as to whether additional steps are desirable.¹¹

Mr Azarkan (DENK) also asked whether public authorities invested in cryptocurrencies. Guidelines on local authorities' investment in cryptocurrencies are laid down in the Local Authorities Financing Act and secondary legislation. Local authorities may accordingly enter into loans, deposit or invest funds, or give guarantees only in the exercise of their public duties. Cash balances must be held with the national treasury. Local authorities define their public duties themselves on reasoned and transparent grounds and must be aware of the risks inherent in their investment decisions. Central government is neither an active nor a speculative investor and does not invest in cryptocurrencies.

3.2. Approach to the offering of new cryptocurrencies or tokens

Current legislation generally does not classify a cryptocurrency or token in issue as a financial instrument or investment asset. The customary rules on the offering of financial instruments, such as the prospectus and licensing rules, therefore often do not apply. Furthermore, there are no specific rules that the Dutch Authority for the Financial Markets (AFM) can enforce regarding the structure of platforms that trade in cryptocurrencies or tokens. The generic consumer protection standards overseen by the Netherlands Authority for Consumers and Markets (ACM) do apply, including the requirements to provide information and a cooling-off period for internet sales. However, these standards provide a lower level of protection.¹² Both a conventional flotation and a bond issue on the one hand and an ICO on the other are a means to raise capital from investors. It must be determined whether investors in ICOs can be given the same protection as investors in a conventional flotation or bond issue. The current framework is inadequate in this respect. I will therefore:

- i) seek an EU-wide approach to ICOs. I will seek a leading role with like-minded countries in this long-term undertaking;
- ii) in anticipation of an EU-wide approach, consult with financial supervisory authorities to identify enforcement pathways within the current regulatory framework.

3.3 Approach to derivatives: futures and binary options¹³

The AFM and the European Securities and Markets Authority (ESMA) have concerns regarding the sale of derivatives such as binary options to non-professional investors, in view of their inherent risks.¹⁴ Supervisory authorities must be able to keep a critical eye on the sale of such derivatives – especially cryptocurrency derivatives– to non-professional investors, and intervene where necessary. The entry into force of the Markets in Financial Instruments Regulation (MiFIR)¹⁵ on 3 January 2018 gave supervisors product intervention powers to prohibit or restrict the sale of financial instruments. As the problem is not confined to the Dutch

¹¹ The European Commission has already announced it will evaluate the need for and desirability of keeping a register of the users of virtual currencies as part of a compromise on a new article 65 of the Fourth Anti-Money Laundering Directive. The Netherlands will actively support such an evaluation. The full text of the agreement reached to amend the Fourth Anti-Money Laundering Directive is available at <http://data.consilium.europa.eu/doc/document/ST-15849-2017-INIT/en/pdf>.

¹² See the ACM's position paper for the cryptocurrency/ICO hearing of 24 January 2018.

¹³ As requested in the Ronnes/Nijboer motion. Parliamentary Papers, House of Representatives, 2017/2018, 34 769, no. 14.

¹⁴ <https://www.afm.nl/nl-nl/nieuws/2016/jul/risico-beleggen-cfd>.

¹⁵ Regulation (EU) no. 600/2014 of the European Parliament and of the Council of 15 May 2014 on the Markets in Financial Instruments and amending Regulation (EU) no. 648/2012.

market, I agree with the AFM that measures should be taken at EU level wherever possible.¹⁶ The AFM is working with other EU supervisory authorities and ESMA on such measures. ESMA completed a market consultation on 5 February 2018, in which it announced its intention to prohibit the sale of binary options to retail investors and impose restrictions on the sale of other high-risk products.¹⁷ ESMA's consultation also asked whether restrictions should be imposed on cryptocurrency derivatives. If ESMA does not take sufficient measures in an EU context, I will ask the AFM how it can take measures in its capacity as the competent authority. I am in any event preparing national measures to impose stricter criteria on advertisements for high-risk financial products. In summary:

- i) the Netherlands recognises the importance of taking action in the near future to bring the sale of high-risk derivatives (including cryptocurrency derivatives) to the attention of EU supervisory authorities;
- ii) if no or insufficient measures are taken at EU level, I will consult with the AFM to discuss the measures it can take at national level;
- iii) the AFM will in any event have the power to prohibit advertisements for high-risk financial products such as binary options aimed at consumers in the Netherlands. This power is expected to enter into force on 1 July 2018.

4. Conclusion

Cryptocurrencies are a new phenomenon and the current supervisory and regulatory framework is inadequate. In view of the transnational nature of the market, an EU-wide and international approach is needed to close the gaps. Discussions on the approach to be adopted have already started but a decision has not yet been taken. I will actively work in an EU context to set rules for cryptocurrencies in order to prevent their improper use and will bring the Dutch position to the attention of the relevant supervisory authorities, especially with regard to the risks inherent in cryptocurrency derivatives. This letter explains the steps I will take in the coming period. I expect to send an update to the House in the second half of the year.

¹⁶ See the AFM's position paper for the cryptocurrency/ICO hearing of 24 January 2018.

¹⁷ <https://www.esma.europa.eu/press-news/esma-news/esma-consults-potential-cfd-and-binary-options-measures-protect-retail>.