

# DECIPHERING CRYPTOCURRENCY

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Category: [Archive](#)







**We spoke to Miguel Sánchez Monjo, a partner in the Cuatrecasas Financial Services and Investment Funds area, to learn more about cryptocurrencies and their possibilities as a type of investment. Miguel, a great connoisseur of the subject, offers us a broad view of the matter, which, nevertheless, highlights key aspects both for the effective development of the sector in our country and for potential consumers. He also reminds us of the importance of its original purpose as a payment method, which the new Visa and Paypal projects have already taken on and which, together with others, will continue to transform our daily lives.**





### **Is it a good time to invest in cryptocurrencies? Are they really the "digital gold", as some people are calling them?**

The cryptocurrency market has been steadily growing for several years now. This growth has greatly accelerated in the last year within the context of general digitalisation of payments and investments as a result of the COVID 19 health crisis. In recent months, the interest in and demand for this kind of assets has increased for several reasons, as well as the number of cryptocurrencies and service providers, both of exchange and custodian platforms.

As regards whether it is a good time to buy this kind of asset, we should consider the different purposes that cryptocurrencies may have. One of them is, of course, using them as an investment instrument. As with any other type of investment in more common assets, it is crucial to understand what we would be buying and its main risks; in this case, in particular, high volatility of certain cryptocurrencies, i.e., considerable price fluctuations, both upward and downward, in very short periods of time. Therefore, it is difficult to tell generally when a good time would be to buy these assets, as this also depends on each investor's timeframe and whether, ultimately, an investor is looking to obtain a profit (or has the capacity to bear losses) in the short, medium or long term.

Beyond any discussion as to the intrinsic value that some cryptocurrencies may have, and in relation to user timeframe, cryptocurrencies may also have a role as a means of payment, which is precisely their original purpose. In other words, cryptocurrencies may also be bought to carry out transactions on electronic commerce platforms that accept them. In fact, the new Visa and Paypal projects for allowing payments in cryptocurrencies with their cards and platforms entail a new boost to the use of cryptocurrencies and their acceptance as another means of payment.

### **Is investing in cryptocurrencies really, as it is usually said, for everyone?**

This does not seem to be what the Spanish regulator believes. For example, the draft Circular on advertising crypto assets (including cryptocurrencies that may be invested in) prepared by the CNMV and submitted to public consultation in June of this year provides that advertising on crypto

assets must expressly indicate that, in addition to not being regulated, *"they may not be suitable for retail investors and the entire investment may be lost."*

As mentioned before, as with any other financial asset, it is essential to have a good understanding of what cryptocurrency involve. In other words, it is vital to understand the basic notions of how they work, how they are held by custodians and how they may be exchanged for currencies of legal tender, as well as their risks, including, in particular, the risk of losing the amount invested. It does not seem that this knowledge is currently held by the public.

**As this is a recent phenomenon, we imagine that there are not many lawyers specialising in these matters. What are the main issues of which a lawyer specialising in this kind of investment or fund must have a firm understanding? What kind of Legal advice does an investor in cryptocurrencies need?**

Extensive knowledge of financial regulation is essential for any lawyer who wishes to advise on cryptocurrencies.

First, it is important to have expertise in payment methods and systems in general in relation to the purposes of cryptocurrencies in this regard.

In addition, the future EU regulation on crypto assets (MiCA) will replicate the main rules set out in the EU MiFID II Directive for investment products and instruments for the crypto assets market (i.e., the Directive applicable to the marketing and investment in shares, bonds, investment funds and financial derivatives, etc.), so knowledge of this Directive will be essential for understanding the direction of the crypto assets sector in general.

Likewise, as many of the platforms operating in this sector are international, it is important to be aware of how all of this legislation and the supervisors' criteria affect the cross-border activities of these companies not established in Spain.

All this knowledge must also be combined with certain notions in other fields: for example, the regulation of securities issues (IPOs) to be able to understand initial coin offerings of cryptocurrencies (ICOs); anti-money laundering legislation, since virtual currency exchange and custodian platforms are subject to such legislation; and the actual blockchain technology that underlies such assets.

Tax advice to entities and users is also important here, especially following the approval of the new law on measures to prevent and combat tax fraud. Under this law, companies operating in this sector must submit certain information to the tax authorities regarding their customers' transactions and account balances. Customers also have an obligation to report information to the tax authorities regarding the cryptocurrencies that they have deposited abroad.

Intellectual property practice is also important in the processes of design, issuance and exchange of cryptocurrencies.

**What can we learn from the cases that are arising and other fraud incidents in the sector?**

These situations arise partly because of the delay in approving a sector's well-developed regulation. Since the platforms that operate with cryptocurrencies are generally not regulated, there is no register of authorised companies that potential users may check to verify that the platform with which they wish to operate has been authorised or registered by a regulator. This situation should start to change in the short term when the register of virtual currency exchange and custodian platforms of the Bank of Spain is established in the next weeks.

Once this register is operational, it will also be easier for regulators to warn the public about unregistered platforms operating in Spain or that could be fraudulent, in the same way as it currently happens in the financial sector with the warnings of the CNMV and other international regulators.

**This type of investment which, until relatively recently, were something intangible or abstract, are starting to "materialise" physically through the ATMs of the companies marketing these assets. Is this already a reality with which we must learn to live?**

Yes. This type of ATM already exists in some parts of Spain. They connect to an exchange platform and allow us to purchase cryptocurrencies by inserting cash and sell cryptocurrencies that we have in our wallet, instantly receiving cash in exchange.

With the new legislation on anti-money laundering, all companies providing these services of exchange of virtual currencies for fiat currency and custody of cryptocurrencies must be registered with the Bank of Spain, which will give greater security to the users of these ATMs and their operators.

**According to the most recent survey by Intertrust Global, 98% of financial directors state that their investment fund will have investments in Bitcoin by 2026. Which funds are already doing it in Europe? And in Spain? What are the main barriers for these funds to operate?**

Yes. On an international level, there are funds already investing in cryptocurrencies through various different means, despite the regulatory barriers for launching these funds (notably when they are intended for retail investors).

In Spain, the CNMV published in May its interpretation of the possibilities that Spanish open-ended investment funds (i.e., those that offer certain liquidity to investors) have of investing in these assets. UCITS funds (i.e., the harmonised funds that are usually marketed to retail investors) may invest in cryptocurrencies indirectly; in other words, through other financial instruments whose return is linked to such currencies, provided that they do not include an embedded derivative (i.e., products such as Exchange Traded Commodities (ETCs), Exchange Traded Notes (ETNs) and "delta one" products are excluded), and they are traded on a daily basis. As regards Spanish hedge funds (FILs), which may only be marketed to professional investors or to those who invest at least €100,000 in the fund and state that they are aware of the risks (notwithstanding the legislative initiative of the Spanish Ministry of Economy to extend the possibility of marketing to other retail investors), they may invest in cryptocurrency derivatives, provided that they do not imply delivery of the cryptocurrency to the fund.

However, none of these funds can buy cryptocurrencies directly. To carry out this transaction, the only possibility is to create an EICC (closed-ended collective investment scheme). This kind of fund, which must be registered with the CNMV, is quite flexible in terms of its investment policy, although its active marketing is restricted to professional investors, i.e., to institutional investors and to those who have extensive knowledge of financial markets. In addition, from a tax point of view, this kind of fund currently lacks efficient tax arrangements.

**While some banks have openly stated their interest in this kind of investment, such as BBVA (through its Swiss subsidiary and after a two-year trial has recently launched a Bitcoin purchase service for its private banking customers) becoming the first bank in the Eurozone to offer such a service, other banks have declared war on cryptocurrencies arguing public interest. Are there real or objective reasons for doing so, or is it the same fear of change as when online purchasing and services such as Paypal began? In any case, it would seem that the issue has sparked debate. Do you think that such opposing positions only cause confusion for the ordinary citizen?**

Banks are receiving a growing number of enquiries from customers interested in using cryptocurrencies as a means of payment or as an investment instrument, although they are generally reluctant to launch and promote this line of business.

It is possible that EU regulators, including the Bank of Spain, registering digital currency exchange and custodian platforms will gradually start to change the perception of this sector. Although such

register has resulted from anti-money laundering legislation and is confined primarily to ensure compliance by these platforms with such legislation, it will make it possible to identify those platforms that are compliant from a regulatory perspective.

In any event, the turning point will most likely not take place until the entry into force of the future MiCA Regulation, expected in 2024, which will set out provisions governing the entire European crypto asset market and its platforms, in which banks themselves may also participate as they are deemed to be authorised to provide services in respect of such assets.

**On July 1<sup>st</sup>, the German Fund Location Act entered into force, authorising special national funds ("Spezialfonds") to invest up to 20% of the funds they manage in digital assets such as Bitcoin. The measure has been hailed by experts in Germany as a boost for the nation to establish itself as a hub for financial investment. Could something similar soon happen in Spain?**

As we have said, the CNMV has already clarified its interpretation of the possibilities that Spanish funds have for investing (indirectly) in cryptocurrencies within the scope of current legislation. In addition, there is a type of fund in Spain, the EICC, that can already invest in cryptocurrencies directly, although marketing them is restricted to professional investors.

In any case, right now, it is difficult to envisage any new local regulation ahead of the approval and entry into force of the future MiCA Regulation, given that this regulation will determine the entire regulatory framework for the European Union.

For the time being, before such legislation is approved, the Spanish authorities are laying down some regulatory foundations in this area, as is the case of the forthcoming register of service providers of the Bank of Spain and the future circular of the CNMV on advertising of crypto assets, which seeks to make the general public aware of the implications of investing in cryptocurrencies.

By Desiré Vidal

to read the full interview on issue number 107 click [here](#).