



Regulatory Update June 24, 2019

In this update, we talk about Facebook's Libra whitepaper, a FINRA enforcement action for undisclosed cryptocurrency mining, and South Korean crypto exchanges changing their terms to take liability for hacks.

Facebook Releases Whitepaper for its Libra Blockchain: Regulatory Implications

Facebook's Libra Association released its highly-anticipated [whitepaper](#) describing its plans to create "a simple global currency ...designed and governed as a public good" in order to make money transfer as easy and cheap as sending a text message. According to the paper, a unit of currency will be called "Libra" and built on the open source Libra Blockchain (a permissioned blockchain that may transition to a permissionless system in the future). Libra will be fully backed by a reserve of low-volatility assets, which it says will include "a basket of bank deposits and short-term government securities." The

paper says that this backing separates Libra from stablecoins "pegged" to various assets or currencies.

The Libra Reserves will be managed by the Libra Association – an "independent" non-profit organization founded to handle Libra governance and operate the validator nodes of the Libra Blockchain. Members pay a \$10 million membership fee that entitles them to one vote and proportionate dividends earned from interest off the Reserves.¹ Its 27 "[Founding Members](#)" include Facebook through its newly-formed subsidiary Calibra (more on Calibra below), Mastercard, PayPal, Visa, Stripe, Uber, Spotify, Coinbase, and Xapo. It hopes to have 100 members by mid-2020.

Will Libra Answer Gaps in Regulation?

The paper argues that the present financial system is plagued by shortfalls to which blockchain and cryptocurrency projects have failed to provide a suitable remedy. It asserts that many projects have attempted to "bypass regulation as opposed to

¹ Members must also meet at least 2 of the following criteria: (i) More than \$1 billion USD in market value or greater than \$500 million USD customer balances; (ii) Reach greater than 20 million people a year, multinationally; or (iii) Recognized as a top-100 industry leader by a third-party sector-specific association or media company.

innovating on compliance and regulatory fronts to improve the effectiveness of anti-money laundering.” To this, the paper provides that Libra will be a collaborative effort with regulators and industry experts to ensure the sustainability, security, and trust underpinning the project.

Though the exact extent of its regulatory consultation is unclear, Facebook’s Calibra,² which will develop wallets and other applications for Libra use, has been [registered](#) as a “money services business” (MSB) with the Department of Treasury’s FinCEN and has [registered](#) as a money transmitter in seven states. The paper asserts that Calibra intends to register as such in states “that treat cryptocurrencies as the equivalent of money.” This will require implementation of AML, KYC, and CTF procedures for its users.

Government Backlash

While the paper purports to describe a project developed with regulatory collaboration, authorities worldwide were quick to speak out on the plans. The French finance minister [stated](#) that Libra simply cannot happen. German European

Parliament member Markus Ferber [expressed](#) concern about Libra becoming a “shadow bank.” Meanwhile, Swiss National Bank member Thomas Moser [said](#) he feels “pretty relaxed” about the whole thing.

In the U.S., Congresswoman Maxine Waters said that, through Libra, “Facebook is continuing its unchecked expansion and extending its reach into the lives of its users.” Senator Sherrod Brown took to Twitter to [express](#) similar concerns, stating that Libra cannot proceed “without oversight.”

While Libra isn’t set to launch until next year, the Senate Banking Committee has already scheduled a hearing for 10 a.m. on July 16 entitled “Examining Facebook’s Proposed Digital Currency and Data Privacy Considerations.” Similarly, the House of Representatives scheduled a meeting (“Examining Facebook’s Proposed Cryptocurrency and Its Impact on Consumers, Investors, and the American Financial System”) for the following day.

FINRA Fines Ex-Merrill Representative for Undisclosed Cryptocurrency Mining

The U.S. Financial Industry Regulatory Authority (FINRA) has begun to take notice

² The paper states Calibra was created “to ensure separation between social and financial data and to build and operate services on its behalf on top of the Libra network.”

of activities by registered securities representative associated with member firms involving digital assets and potential violations of FINRA rules. Last week, it [fined](#) an ex-Merrill Lynch general securities representative (GSR), Kyung Soo Kim, \$5,000 for allegedly operating a cryptocurrency mining business without disclosing the activity beforehand to his firm in violation of FINRA Rules 3720 and 2010.

[FINRA Rule 3720](#) requires that GSRs provide prior written notice to their firm before engaging in any outside business activity for which they receive or expect compensation, while [Rule 2010](#) generally requires representatives to adhere to “high standards of commercial honor and just and equitable principles of trade.”

Without admitting or denying the findings, Kim entered a [Letter of Acceptance, Waiver and Consent \(AWC\)](#) on May 22 that FINRA accepted on June 10 in order to settle the matter pursuant to [FINRA Rule 9216](#) – the rule governing uncontested enforcement actions. The letter described how Kim incorporated an entity in December 2017, operated as its sole shareholder and director, and caused that entity to enter into a contract with another company for

hardware and software to conduct mining activities.

Kim also received a one-month suspension from association with any FINRA member firm, although Merrill had already terminated his employment in March 2018 as a result of the non-disclosure.

While this enforcement appeared clear-cut, other aspects of crypto assets and firms wishing to deal in them are creating a backlog at FINRA. Earlier this week, CoinDesk [reported](#) that about 40 broker-dealer applications from firms interested in crypto are pending before the self-regulatory organization. FINRA’s media relations director stated that these applications pose new, complex issues for the agency but it is “in the process of working through them,” although some have been pending for more than a year. Lawyers interviewed for the article suggested that FINRA is waiting for SEC guidance before moving forward.

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Terms of Use and Hacking? Korean Crypto Exchanges Update Terms to Take Liability for Hacks

Pursuant to a “corrective recommendation” issued by the South Korean Fair Trade Commission (FTC), [five Korean crypto exchanges](#) have amended their applicable Terms of Use and Service to take liability for future hacking incidents and cybersecurity breaches. The changes comes in the wake of \$X in hacks suffered by South Korean crypto exchanges alone in 2018.

The popular crypto exchange Bithumb altered its [Terms of Service](#) to include language imposing hacking liability on the exchange after two attacks in the past year where hackers made off with over \$50 million in digital assets. At the time of the attacks, Bithumb’s terms disclaimed liability for cyberattacks or malfunctions except in the presence of willful or gross negligence, leaving affected users with no avenue of recourse. Despite its terms at that time, the exchange promised to return lost funds to users amid rumors that a portion of the Bithumb attacks could have been an inside job, though only a portion of the lost funds were ever reimbursed to affected users.

The push for more regulated cryptocurrency exchanges comes as a part of South Korean regulators’ initiative to create a safer and more regulated environment for cryptocurrency trading.

Quick Take

- Jake Chervinsky: [Thread on the Financial Action Task Force \(FATF\)'s New Crypto Guidelines](#)

Other News

- CoinDesk: [CFTC Approves LedgerX to Settle Futures in Real Bitcoin](#)
- Cointelegraph: [Ex-Employee Sues Zcash Operator in \\$2 Million Lawsuit Over Unpaid Stocks](#)

Something to Listen To

- What Bitcoin Did Podcast: [Brian Quintenz on How the CFTC Regulates Cryptocurrencies](#)

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