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COMMITTEE ON INTERNATIONAL MONETARY LAW

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Introduction

Since the last Conference of the ILA, held in Washington, DC, USA, in April 2014, the Committee (generally known by its acronym, MOCOMILA) has held four meetings: in Vienna, Austria (19-20 September 2014), Beijing, China (9-10 April 2015), Berlin, Germany (4-5 September 2015), and Athens, Greece (3-4 June 2016). The Vienna meeting was held at the Oesterreichische Nationalbank (OeNB) and focused on two themes: Eurozone Developments (including the SSM) and legal implications of sanctions (with particular regard to Ukraine). It included talks by Mr Ewald Nowotny and Mr Claus Raidl, the Governor and President of the OeNB. That meeting was the last for our valued colleague, Mr Bertold Wahlig, and we wish him all best wishes. The Beijing conference, hosted by the People's Bank of China (PBOC), also focused on two issues: the proper place of the contemporary central bank and the international role of RMB. It featured talks by Mr Zhou Xiaochuan, Governor of the PBOC, and Dr Ma Jun, Chief Economist of the Research Bureau of the PBOC. Our Berlin conference was also very special for the committee, as it was our 100th meeting. The meeting, hosted by the Deutsche Bundesbank at the historic Berlin-Brandenburg Academy of Sciences and Humanities, included a retrospective on the work of the committee since its founding. It then focused on issues surrounding payment and settlement. The meeting included talks by Mr Jochen Metzger and Mr Olaf Christmann, the head of the payment system department and director in the legal department at the Deutsche Bundesbank. The Athens meeting was organized under the auspices of the Hellenic Bank Association and of the Bank of Greece and was held at the premises of the European Public Law

Organization (EPLO). It featured presentations by Professor Louka Katseli, Chairwoman of the National Bank of Greece and the Hellenic Bank Association, Professor Spyridon Flogaitis, Director of the EPLO, and Professor John Mourmouras, Deputy Governor of the Bank of Greece.

The subjects of the foregoing meetings and other topics discussed by the Committee are reflected in the following sections of this report.

I. An Early History of MOCOMILA (by Mr L Buchheit)

II. Ethics in Finance: A Progress Report (by Mr T Baxter)

III. Decided cases in London and New York (by Sir Ross Cranston)

IV. The Operation of the European Banking Union: Institutional Developments (July 2014 – March 2016) (by Professor C Gortsos)

V. Payments Recent Developments: Virtual Currencies (by Professor B Geva)

VI. The East African Community Monetary Union (by Professor A Mugasha)

VII. Crowdfunding in International and National Regulatory Frameworks (by Dr K P Follak)

This report reflects the views of the individual members and not necessarily those of any institutions with which they are affiliated.

At our meeting in Beijing, MOCOMILA endorsed and confirmed the statement contained in its report to the Berlin meeting of the ILA in 2004, as accepted by the ILA before and since. This states MOCOMILA's policy as follows:

"The Committee has recently endorsed its longstanding membership policy. In addition to the ILA's general policy for renewing Committee mandates and membership every four years, there are essentially three elements to the practice of MOCOMILA. First, the Committee should consist of a group of experts in monetary law with a balance of representation from institutions (central banks and international financial institutions), academia and private practice of law. Second, members must be in a position to actively participate in the work of the Committee, including through participation in the Committee's twice yearly annual meetings (not necessarily every time, but regularly) and in contributions to its seminars and publications. Third, consistent with its established practice, the Committee will invite prospective new members first to attend Committee meetings as Observers in order to determine whether each such person is in a position to contribute to the work of the Committee; only afterwards would nomination to membership by the ILA Executive Committee be sought."

I. An Early History of MOCOMILA

The International Law Association was founded in October 1873. Its original name, "The Association for the Reform and Codification of the Law of Nations," was changed to the International Law Association in 1895. The Monetary Law Committee of the ILA was established by the Executive Council of the ILA in 1951. The original rapporteur was F.A. Mann and the President was Max Gutzwiller.

The records show that on at least four occasions the ILA discussed issues of monetary law before MOCOMILA was formed in 1951.

The 31st Conference of the ILA in 1922 (held, appropriately enough, in Buenos Aires) discussed the Negotiation of External Loans with Foreign Governments. After a lengthy presentation by Charles Cheney Hyde, the Chairman of the meeting endorsed the opinion of the British representative that loans to foreign governments – because they were not then enforceable in legal proceedings – were "not a matter for our International Law Association at all." Although the minutes of this meeting endeavor to lay a soft blanket over the points of disagreement, it is clear that some participants had a

strong negative reaction to the view that loans to foreign governments were not a fit subject for lawyers to discuss. They reminded their colleagues of the pernicious consequences that can follow from the non-payment of such loans, and of the views of the Argentine jurist, Dr Luis Drago, on the use of force to compel payment of foreign loans.[1]

In 1926, at the 34th Conference in Vienna, one of the topics was "Rules Relating to the Rate of Exchange."

At the 38th Conference in Budapest in 1934, the ILA considered "Payments in Gold and in Foreign Currencies" (this was one year after the U.S. Congress, as a matter of public policy, abrogated the gold clause in obligations subject to U.S. jurisdiction). At both the 39th and 40th Conferences (1936 and 1938), Gold Clause issues were also discussed.

To give you some idea of priorities, however, over this same period the ILA considered matters of divorce law at five separate Conferences.

At its 45th Conference in Lucerne in 1952, the ILA instructed the International Monetary Law Committee, "to submit to the I.L.A. a statement of principles relating to such questions of Monetary Law as the Committee may select and for this purpose to keep in close touch with international and national authorities dealing with monetary administration and with the local branches of the Association."

Representatives of the IMF and the Bank for International Settlements have regularly attended Committee meetings, starting with the Committee's first meeting 64 years ago.

At that first meeting of MOCOMILA, Dr. Mann announced that "our task is to harmonize international monetary law." He encouraged MOCOMILA to aim high – seeking nothing less than a "comprehensive scheme for international legislation on monetary matters."

In its first report to the ILA, MOCOMILA said that it had resolved "to devote its attention primarily to practical questions rather than matters of academic interest." It therefore designated the following topics "with a view to developing principles recommended for general acceptance":

(i) the conflict of laws relating to exchange controls;

(ii) the law of protective clauses (gold clauses, index clauses, etc.) "with special reference to their efficacy in the event of legislative interferences";

(iii) the determination of the money of account with special reference to certain types of contracts such as insurance, sale, agency and negotiable instruments;

(iv) international investments and their protection by international monetary law;

(v) the enforcement of foreign currency obligations; and

(vi) international cooperation in monetary matters.

In this same initial report, MOCOMILA opined that the "branch of monetary law which is most urgently in need of international clarification is the conflict of laws relating to exchange controls."

Much of the Committee's attention – and much of its scorn – was directed at Article VIII(2)(b) of the IMF Articles of Agreement,[2] a provision that the Committee found "so obscure that it cannot afford any authoritative guidance to the solution of our problem."

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[1] *See* Luis Drago, *State Loans in Their Relation to International Policy*, 1 American Journal of Int'l Law 692 (1907) (warning of the danger of allowing public debts to be collected *manu militari*).

[2] Article VIII(2)(b) reads as follows:

> Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this

Dr. Mann led the discussion of Article VIII(2)(b). He urged the Committee to treat the Bretton Woods Agreements as a *fait accompli* and to accord them a degree of "respect, goodwill and loyalty" commensurate with a multilateral treaty of great magnitude. It was now an "inescapable fact," he said, that some exchange controls – sanctioned by the IMF – had "become respectable." "Much of our old learning," he therefore concluded, "has become obsolete."

Not every member of the Committee was as prepared as Dr. Mann to go gentle into the good night of Bretton Woods. One member, Mr. Eder (nationality not clear from the record), "expressed almost total disagreement" with Dr. Mann's reports on Article VIII(2)(b). Based on his personal experience, Mr. Eder regarded exchange controls as simple theft; a violation of the "plighted faith of governments great and small." About Bretton Woods, Mr. Eder had this to say:

> [I]f we are to be faithful to the high standards of our profession, we must condemn [the Bretton Woods Agreement]. The International Monetary Fund was foredoomed to failure, as was pointed out by many at the time of its drafting and signature. It is being more or less openly violated by several governments. The latest report of the Fund is a confession of failure. The fundamental vice of the Bretton Woods Agreement, from a lawyer's standpoint, is that it purports to legalize devaluation of economics.

Exchange controls, and in particular the implications of Article VIII(2)(b), occupied the attention of the Committee well into the 1960s.

President Nixon took the United States off the gold standard in August 1971. Unmoored from gold, commercial parties looked for ways to "maintain value in real terms" in international payments. This subject preoccupied the Committee's attention during the 1970s. MOCOMILA meetings in the 1970s considered the use of "value clauses," Special Drawing Rights as a unit of account in international conventions, European Currency Units (ECU) and "real value" (compensatory purchasing power) clauses.

The global sovereign debt crisis that started in August 1982 with Mexico's default set much of the agenda for the Committee's meetings in the 1980s.

In the early decades of the Committee's existence, perhaps guided by the person or spirit of Dr. Mann, MOCOMILA saw its task as attempting to harmonize international monetary law. This led to the promulgation of draft conventions and statements of principles by the Committee to a far greater extent than is attempted by the 21st century MOCOMILA.

The Committee has, however, always shown a degree of topicality in the issues it discusses. Exchange controls in the 1950s and 60s. Monetary rules in the absence of the gold standard in the 1970s. Sovereign debt crises in the 1980s. And the development of the euro in the 1990s.

II. Ethics in Finance: A Progress Report

A. Introduction

There is a new focus on ethics in finance in the aftermath of the financial crisis. This development arises out of increasing public hostility toward the financial services industry, hostility that is rooted in a loss of trust. This loss of trust appears to result from a series of different incidents where bankers have engaged in significant misconduct.

Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

The manipulation of the LIBOR rate to advantage certain financial institutions' proprietary positions is one. This was then followed by a different scheme, where bankers traded ahead of their customers in foreign exchange markets, in a technique that is called "front running." This technique generates profit by exploiting a customer's confidential trading information. The fact that the foreign exchange misconduct closely followed the LIBOR misconduct contributed to a widespread perception about standards.

There have been unsettling incidents involving traditional banking businesses. Here, there were disturbing examples of bankers "robo-signing" foreclosure papers, and ignoring customer rights and protections that depended on an intelligent and careful review of what was said in those papers. Further, there were real consequences to this behavior – families were displaced from their homes. Wholesale residential mortgage operations also saw abuses, although they were different in kind from the robo-signing that was done in retail residential mortgage foreclosures. In the wholesale space, bankers were packaging up loans that did not meet the represented underwriting criteria. The loans wer passed to securitizers, who used this "product" to back securities being sold to buyers. These buyers thought they were getting securities backed by good loans, which they were not. The crisis showed a different reality. With respect to both the retail and the wholesale practices, bankers allowed themselves to be portrayed as untrustworthy people who would engage in misconduct for money.

Popular post-crisis movies like *The Big Short* depicted bankers as predators, who would exploit any and every profit opportunity without regard to the impact on the customer. This depiction no doubt contributed to an overall loss of trust in banks. An earlier genre of popular movie, with *It's a Wonderful Life* being the best example, depicted the banker of an earlier time as a person deeply invested in the community who put the customer's interest ahead of his own. Both may have an element of caricature, but in the post-crisis era, the banker became a villain.

B. The New Focus on Culture

Since the crisis, some financial industry supervisors observed the new reality and called for reform.[3] They lamented that the industry had lost the trust of the people it served, and looked for things to do to restore trust. After considering a range of ideas, supervisors started thinking about cultural change as a necessary method to restore trust.

At the outset, many industry participants and industry apologists expressed skepticism about the effort to transform culture. Some attacked the concept as vague and ephemeral, and contrasted it to "harder" supervisory concepts like capital and liquidity. Others considered the idea as lacking in substance. Others studied the literature and came to appreciate that there was substance to what was being described as an ethical culture, and culture could meaningfully affect behavior.[4] These commentators focused on intellectual leaders like Professor Onora O'Neil, who describe qualities like honesty, competence and reliability. These individual characteristics comprise the foundation of trustworthiness – a predicate to trust.[5]

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[3] *See* Christine Lagarde, "Economic Inclusion and Financial Integrity," Address to the Conference on Inclusive Capitalism, May 27, 2014, *available at* https://www.imf.org/external/np/speeches/2014/052714.htm ("Trust is the lifeblood of the modern business economy. . . . To restore trust, we need a shift toward greater integrity and accountability. We need a stronger and systematic ethical dimension."); Mark Carney, "Rebuilding Trust in Global Banking," Speech at 7th Annual Thomas d'Aquino Lecture on Leadership, Ontario, Feb. 25, 2013, *available at* http://www.bankofcanada.ca/2013/02/rebuilding-trust-global-banking ("The real economy relies on the financial system. And the financial system depends on trust. Indeed, trust is imbedded in the language of finance. The word credit is derived from the Latin, *credere*, which means 'to have trust in.'"); William C. Dudley, "Enhancing Financial Stability by Improving Culture in the Financial Services Industry," Remarks at the Workshop on Reforming Culture and Behavior in the Financial Services Industry, Oct. 20, 2014, *available at* https://www.newyorkfed.org/newsevents/speeches/2014/dud141020a.html ("Unless the financial industry can rebuild the public trust, it cannot effectively perform its essential functions. For this reason alone, the industry must do much better.").

[4] *See Supervision of Behavior and Culture: Foundations, Practice & Future Developments* (Mirea Raaijmakers, ed. 2015). *See also* Dan Awrey, William Blair, and David Kershaw, *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?* 38 Del. J. Corp. L. 191 (2013) (summarizing academic literature).

[5] *See generally* Onora O'Neal, *A Question of Trust* 15-17, 23-24, and 43-47 (2002) (distinguishing trust from trustworthiness). *See also* Onora O'Neill, "What we don't understand about trust," TED Talk (June 2013),

Further, a number of financial institution leaders began to appreciate that culture lies at the root of recent scandals.[6] These firms now understand that placing an emphasis on personal qualities like honesty, competence and reliability can translate into changed banker behavior. Leaders began incorporating such characteristics into their training programs and performance systems, and have started to see the benefits.

C. Translating Ethical Concepts into Real World Behavior

One prominent illustration of this has come in the United Kingdom, which has emphasized individual accountability through the new Senior Managers and Certification Regimes and through new, enforceable conduct rules.[7] Under these rules, a banker "must act with integrity" and "with due skill, care, and diligence." Further, bankers must be "open and cooperative" with regulators. To accompany these general principles, there is specific guidance as to what a banker should *not* do. For example, it would offend the integrity principle if a banker were to mislead a client about the risks of an investment.[8] With respect to the principle requiring competence, there is specific guidance that putting a customer into an unsuitable investment would fail the competency test.[9] It is not surprising that there is also guidance to the effect that a failure to supply a regulator with requested documents would violate the principle that a banker be "open and cooperative."[10]

The official sector within the United Kingdom is not alone. From within the industry on both sides of the Atlantic, there have been some notable developments. In the area of performance management, many financial institutions have introduced ethical components into their formalized appraisal systems. It has become common practice to see concepts like honesty, competence and reliability appear in the appraisal process. The appraisal process has become more qualitative, in sharp contrast to past practice where quantitative measures, like an employee's contribution to profit and loss, was the principal determinant of good performance. This is in line with the Group of Thirty's ambitious challenge to the industry to place quantitative and qualitative components on equal footing—that is, 50-50 parity between "how results are achieved" and "what is achieved."[11]

This change with respect to the appraisal process has a direct connection to compensation, because most compensation systems in the financial services industry are performance based. The appraisal is the measure of performance. Therefore, the introduction of cultural scoring now can have a direct impact on the level of an individual's compensation.

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available at https://www.ted.com/talks/onora_o_neill_what_we_don_t_understand_about_trust?language=en ("And I think that [assessing trustworthiness] requires us to look at three things. Are they competent? Are they honest? Are they reliable? And if we find that a person is competent in the relevant matters, and reliable and honest, we'll have a pretty good reason to trust them, because they'll be trustworthy.").

[6] *See* Federal Advisory Council and Board of Governors, Record of Meeting, May 8, 2015, *available at* http://www.federalreserve.gov/aboutthefed/fac-20150512.pdf ("Regulators and the banking industry have worked extensively to restore financial stability through a series of mechanisms and rules that establish appropriate levels of capital, liquidity, and leverage. . . . As often as not, however, the challenges faced in recent years have been behavioral and cultural; post-crisis episodes such as LIBOR and foreign exchange manipulation provide hard evidence that there remains work to be done.").

[7] *See* Financial Conduct Authority, "Strengthening accountability in banking: Final rules (CP 15/22)," July 2015, App'x A ("Code of Conduct Sourcebook") at §§ 4.1-4.2, *available at* https://www.fca.org.uk/news/cp15-22-strengthening-accountability-in-banking-final-rules.

[8] *Id.* at § 4.1.1(3)(a).

[9] *Id.* at § 4.1.3(2).

[10] *Id.* at § 4.1.11(2)(c).

[11] Group of Thirty, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform* 62 (July 2015).

Discipline is another visible component of a material change in practice. At the Federal Reserve Bank of New York's most recent culture conference, one financial institution senior executive related anecdotal evidence of a marked change in practice in an unforgettable fashion. "In the past," he explained, an employee who engaged in significant misconduct would be "escorted secretly to the back door, his jacket would be pulled up over his head, and he would exit the bank anonymously, never to be seen or heard from again."[12] The bank population would not know what happened to the person, or why. The executive explained that the current situation was dramatically different. He said that "today, the same individual would be discharged, his conduct would be transparent to the bank population, and he would leave through the front door, escorted by security personnel with their boots to his back." By making examples of bankers who do not meet the bank's ethical standards, financial companies accomplish three distinct objectives. First, they send a most powerful message to the employee population about conduct that is impermissible. Second, they deter employees from making bad choices. Third, they send a powerful message to all stakeholders that will help to restore trust.

The fact that senior executives of financial institutions are speaking about ethical issues is noteworthy. Even more important is that they are "walking the talk" about such matters, meaning they are taking affirmative actions that show their words have meaning. Disciplining malefactors is one example. In many different financial institutions, there are disciplinary committees considering how the organization should act to influence culture, and these committees are reporting up to the "C" suite. Some have also created "ethical champions" within the organization, typically a responsible senior officer who is the "guardian of the corporation's integrity."[13]

D. Momentum for the Movement to Restore Trust

As noted above, considerable skepticism greeted the initial call for reform of the industry's ethical culture. Over the last two years, this skepticism has abated. In its place we see the beginning of a reform movement.

Several months ago, the Group of Thirty published its report on ethical culture.[14] This highly respected body of financial industry leaders affirmed the need to restore trust and applauded the effort to accomplish the goal through culture. The Financial Stability Board has also picked up the trend. It published influential guidance on risk culture in April 2014[15] and sponsored a conference on culture in May of 2016. The Basel Committee picked up the theme of culture in its July 2015 Corporate Governance Principles.[16] The European Systemic Risk Board also addressed culture in its June 2015 Report on Misconduct Risk.[17] The Bank of England and other UK authorities sponsored the Fair and Effective Markets Review.[18] De Nederlandsche Bank has pioneered new approaches to group conduct

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[12] *See* Federal Reserve Bank of New York, *Summary of Reforming Culture and Behavior in the Financial Services Industry: Workshop on Progress and Challenges* 8 (November 2015), *available at* https://www.newyorkfed.org/medialibrary/media/newsevents/events/banking/2015/culture_workshop_summary_2015.pdf.

[13] Thomas C. Baxter, Jr., "Reflections on the New Compliance Landscape," Remarks at the "New Compliance Landscape: Increasing Roles-Increasing Risks" Conference, New York City, July 24, 2014, *available at* http://www.newyorkfed.org/newsevents/speeches/2014/bax072314.html (citing E. Norman Veasey and Christine DiGuglielmo, Indispensable Counsel: The Chief Legal Officer in the New Reality (Oxford Univ. Press 2012)).

[14] *See supra* n.11.

[15] Financial Stability Board, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture* (April 2014), *available at* http://www.fsb.org/wp-content/uploads/140407.pdf?page_moved=1.

[16] Basel Committee on Banking Supervision, *Corporate Governance Principles for Banks* (July 2015), *available at* http://www.bis.org/bcbs/publ/d328.pdf.

[17] European Systemic Risk Board, *Report on Misconduct Risk in the Banking Sector* (June 2015), *available at* https://www.esrb.europa.eu/pub/pdf/other/150625_report_misconduct_risk.en.pdf.

[18] Fair and Effective Markets Review, *Final Report* (June 2015), *available at* http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf.

by boards and senior management committees.[19] And, recently, the Financial Industry Regulatory Authority ("FINRA") announced it would pilot an examination of some of its members to probe the progress that securities firms are making with respect to culture.[20]

The real test, of course, is the impact on public trust, which is closely correlated to a real change in the conduct of bankers. When the public starts to see a change in banker behavior, with a commensurate effect on trustworthiness in the financial community, this will be significant progress. At this point, we may not have not seen substantial evidence that banker behavior and industry perception have changed. But the "green shoots" that are the first sign of spring are observable, and many are hopeful that the corner has been turned in restoring trust.

E. Future Steps Forward

In the near term, there are some other initiatives that might materially impact the ethical culture of the financial services industry.

One of the steps being discussed in the United States concerns a database containing the names of bankers who have been discharged because of misconduct.[21] The database would be supported by Federal statutory law that would require financial institutions to report to the database. It would also immunize reporters from civil liability for misreporting, while at the same time containing due process protections for anyone who is adversely affected by a false report. The law would also require financial institutions to make a proper inquiry of the database before finalizing a hire for a significant position. The database is intended to solve the "rolling bad apples" problem, where a banker is discharged by one financial institution for misconduct, and goes on to commit the same misconduct at a successor employer. Because of a fear of civil liability, financial institutions respond to inquiries about former employees with their "names, ranks and dates of service." They do not reveal that such former personnel have engaged in bad acts. Consequently, employers make employment decisions on the basis of imperfect information about a candidate's prior conduct. The database would help employers make decisions that are better informed. Presumably, this additional information would have the salutary effect of stopping the bad apple from rolling.

A different step has been taken in the United Kingdom. There, employers must now report any actual or suspected misconduct by current or former employees to a central regulatory database.[22] Only the official sector will have access to this database. The new regulatory scheme also imposes a bank-to-bank inquiry and reporting requirement.[23] A supervised firm must check the industry references of prospective managers, material risk takers, or customer advisors. An institution must, upon receipt of an inquiry, relay any conclusions it has made as to whether a former employee violated any law, regulation, or conduct rule. In addition, the Banking Standards Board has commenced operation, and it promises to reset the bar for good conduct in the financial services industry within the United Kingdom. The Board will obtain much needed agreement as to what is better practice for financial professionals, and then this will become the standard for operating in the United Kingdom.

In the Netherlands, De Nederlandsche Bank is exploring several highly advanced examination protocols directed at culture. In addition, bankers are expected to execute a pledge where they will individually commit to certain conduct standards. We may soon be able to look to the Netherlands to see whether the ethical culture in Netherlands' financial institutions has been affected by these efforts to address culture.

D. Conclusion

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[19] *See supra* n.4.

[20] *See* FINRA, 2016 Regulatory and Examination Priorities Letter (January 2016), *available at* http://www.finra.org/industry/2016-regulatory-and-examination-priorities-letter.

[21] *See* Dudley, *supra* n. 3.

[22] *See* FCA CP14/13, PRA CP14/14 (July 2014).

[23] *See* FCA CP 15/31, PRA CP 36/15 (Oct. 2015).

There have been significant reforms of the financial services industry in the post-crisis period. Traditional measures addressing the capital and liquidity of individual institutions have materially improved the safety and soundness of the industry. The new focus on ethical culture has the promise of restoring a loss of trust in the industry. The effort to build a sound ethical culture in industry participants has the potential to get at the root cause of the loss of trust, and that root cause is the bad behavior of bankers. We look forward with anticipation and hope to see this change realized.

III. Decided cases in London and New York

The Global Financial Crisis was the catalyst for a considerable volume of litigation. Some of this has revolved around the insolvency of financial institutions such as Lehman. But in the leading financial centres of London and New York some has involved claims for losses suffered in the crisis. Claims have been brought by financial institutions, corporations and investors in an attempt to find deep pockets for compensation. Both England and New York are common law jurisdictions and both share a similar judicial philosophy to resolving financial disputes. The following is concerned with claims advanced at common law, rather than under the securities laws.

One of the most extraordinary of these claims was against the New York Fed in relation to its rescue of AIG. Although he failed with his private law claims for breach of fiduciary duties by the New York Fed (*Starr International Company Inc* v *Federal Reserve Bank of New York*, 742 F.3d 37 (2d Cir. 2014)), the major shareholder in AIG has had some success in the US Court of Federal Claims. In a judgment in early July 2015 the court held that although there was no entitlement to damages, the New York Fed had exceeded its mandate with the rescue. The government is appealing.

Indeed most private law claims have failed in both England and New York. There is a strong ethos of freedom of contract in commercial dealings, with the courts assuming that the parties can look after their own interests. If one side misrepresents a matter, the other side is assumed to be able to spot it or to take the trouble to uncover the real position. As a result of a case litigated over the Russian financial crisis in the late 1990s (*Peekay Intermark Ltd* v *Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386; [2006] 2 Lloyd's Rep. 511), England has a doctrine of contractual estoppel. A contract can set out a basis of contracting, which can well fly in the face of the facts, but which the parties are estopped from denying. Thus the contract terms can acknowledge that the contract contains the entire agreement between the parties, that there have been no other representations than those set out in the contract, and that the parties have not relied on any other representations in entering into the contract.

Titan Steel Wheels Ltd v *Royal Bank of Scotland plc* [2010] EWHC 211 (Comm); [2012] 1 C.L.C. 191 is an example of how contractual estoppel was applied post crisis. It concerned derivatives the bank provided in June and September 2007, which turned sour. The company (a substantial European manufacturer) claimed that it should have been advised not to enter the transactions and that the advice it received was wrong. The judge held that if the bank had chosen to give advice it would have avoided any responsibility since the terms of the contract relieved it not only from any obligation to give advice but provided that any statements were not to be treated as advice, nor could they be relied upon by Titan, whether or not they did constitute advice.

An exceptional case in the English courts where an investor was able to establish a misrepresentation about an investment in a bond issued by AIG, which turned bad in the crisis, was *Rubenstein* v *HSBC Bank plc* [2012] EWCA Civ 1184; [2013] 1 All E.R. (Comm) 915, but that was really a consumer case.

There is a resonance with the English approach to misrepresentation and the duty to advise in contract doctrine in New York law. Thus under New York law sophisticated parties will be expected to protect themselves from misrepresentation and are permitted to do so by contractual provisions. Indeed, failure to take such steps means that, as a matter of law, they cannot establish the justifiable reliance which the doctrine of fraud demands. This was restated by the majority of the New York Supreme Court, Appellate Division, in *ACA Financial Guaranty Corp.* v *Goldman Sachs*, 106 A.D.3d 494, 967 N.Y.S.2d 1 (2013). (An appeal from that decision was dismissed by New York's highest court, the Court of Appeals: 22 N.Y.3d 909, 998 N.E.2d 392, 975 N.Y.S.2d 729.) There the plaintiff bond insurance company alleged that Goldman Sachs fraudulently induced it to issue a financial guarantee for a portion of an investment by misrepresenting that a non-party hedge fund was taking a long

position in the investment, whereas it was actually a short seller. The court held (over a strong dissent) that the lower court had been in error in denying Goldman Sachs' motion to dismiss the causes of action.

HSH Nordbank AG v *UBS AG*, 95 A.D.3d 185, 941 N.Y.S.2d 59 (2012) was an action in fraud on what was essentially a credit-default-swap transaction. On appeal the Appellate Division of the New York State Supreme Court held that one reason the plaintiff bank could not sustain the action was that the contractual documentation contained a series of disclaimers that it was not relying on any representations made to it.

Negligence as a basis of action against financial institutions for losses suffered has not fared well in either England or New York. The advantage if it can be established is that it enables claims against parties who have no contract with the financial institution; the disadvantage is that both English and New York law restrict liability. In *Torre Asset Funding Ltd* v *Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) a property investment company collapsed with the onset of the crisis. It had been funded through a number of interrelated agreements. The bank was the agent bank at the mezzanine level and Torre one of the funders at that level. With the collapse Torre was left empty handed and unsuccessfully advanced various claims against the bank, including one in negligent misstatement.

New York law limits negligent misrepresentation to situations involving actual privity of contract between the parties or a relationship so close as to approach that of privity. *Anschutz Corp* v *Merrill Lynch & Co*, 690 F.3d 98 (2d Cir. 2012), was a case where a number of claims were advanced under federal and state law regarding offerings of securities. Separate but related allegations in negligent misrepresentation failed against the credit rating agencies, Moody's and Standard & Poor's, for the ratings they had given the securities.

Onerous obligations flow if a fiduciary relationship (a relationship of trust and confidence) can be established in English and New York law. The essence of a fiduciary relationship is that the fiduciary must subordinate its own interests to those of its principal. Outside the historical categories where fiduciary relationships have been held to exist (trustee-beneficiary, agent-principal, director-corporation, etc.), English courts are generally hostile to the infiltration of the fiduciary concept into the commercial context and accept that parties can exclude the fiduciary concept by contract. Fiduciary law has got no further in the context of financial dealings. As with English law, parties under New York law are able to contract out of any possible fiduciary duties: *Bank of America, N.A. v. Bear Stearns Asset Management*, 969 F. Supp. 2d 339 (S.D.N.Y. 2013).

IV. The Operation of the European Banking Union: Institutional Developments (July 2014-March 2016)

A. General Overview

(a) The Creation of a European Banking Union ('EBU') was tabled at the Euro Area Summit of 29 June 2012, amidst the current fiscal crisis in the euro area, which became manifest in 2010. The establishment of the EBU is aimed at creating a 'Europeanised bank safety net' consisting of three 'main' pillars:

- a Single Supervisory Mechanism exclusively for the banking sector (*i.e.*, not for the other two sectors of the financial system, insurance and securities) and mainly for credit institutions legally incorporated in euro area Member States, with regard to their micro-prudential supervision (see below under B),

- a Single Resolution Mechanism for unviable credit institutions (also mainly incorporated in euro area Member States), and a Single Resolution Fund to cover any resulting funding gaps, provided that a decision is made on the resolution of such credit institutions (see below under C), and

- a single deposit guarantee scheme and a single deposit guarantee fund (see below under D).

The most significant institutional developments towards establishing the EBU took place in the course of 2013 and 2014, in an exceptionally short timeframe under enormous political pressure (reflecting the widespread loss of public trust in the financial system, at least in some Member States). With the exception of the creation of a single deposit guarantee scheme, on which there are current developments, all the other main components of the EBU, *which apply mainly (but not exclusively) to the euro area Member States*, are in place.

(b) The new EU institutional framework on the EBU is coupled with a 'single rulebook,' adopted by the European Parliament and the EcoFin Council and further detailed by the European Commission and European Banking Authority ('EBA'). It is mainly a child of the recent (2007-2009) international financial crisis, is *applicable across all EU Member States* as part of the single market for financial services, is based on a 'total harmonisation approach,' and contains substantive rules on:

- the prudential regulation and supervision of credit institutions, in accordance with the provisions of the Capital Requirements Regulation ('CRR') and the fully amended version of the Capital Requirements Directive ('CRD IV'),
- their recovery and resolution, in accordance with the provisions of the Bank Recovery and resolution Directive ('BRRD') of the same institutions, and
- the guarantee of bank deposits, in accordance with the provisions of the Deposit Guarantee Directive ('DGSD') of the same institutions.

(c) The full Europeanisation of the 'bank safety net' presupposes nevertheless further institutional elements. Two of them are already in place:

(i) With the creation of the European Systemic Risk Board **(**'ESRB'), established under Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 "on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board" as part of the European System of Financial Supervision **(**'ESFS'), the macro-prudential oversight of the European financial system became the first – and single until 2014 – component of the Europeanised 'bank safety net.'

(ii) The second is the provision of direct public financial assistance to credit institutions by the European Stability Mechanism ('ESM') under the 'Direct Recapitalisation Instrument' ('DRI'). This instrument entered fully into operation on 8 December 2014, after the requisite national procedures were completed by the euro area Member States, by means of a unanimous Resolution of the ESM Board of Governors. On the same day, the ESM Board of Directors adopted a Guideline on the modalities, including, *inter alia*, the eligibility criteria for the requesting ESM Member and the institution concerned, and the allocation of specific tasks to the Managing Director of the ESM, the Commission, the European Central Bank ('ECB') and, where appropriate, the International Monetary Fund, for providing financial assistance in the form of DRI.

There are, however, two additional elements that have not yet been addressed:

(i) The first is the provision of last resort lending to solvent but illiquid 'significant' credit institutions, directly supervised by the ECB in accordance with the SSMR, also directly by the ECB. Currently, this function is still considered to be a task for the national central banks – members of the Eurosystem. Indeed, 'Emergency Liquidity Assistance' ('ELA') is provided, according to the ECB Governing Council, by the national central banks of the Member States whose currency is the euro, against collateral not eligible for the ECB's monetary policy operations. The ECB Governing Council is allowed to prohibit this, if it is deemed in conflict with the ECB objectives and tasks according to Article 14.4 of the Statute of the ESCB and the ECB.

(ii) The second aspect is the Europeanisation of the regime for the winding-up of insolvent credit institutions, which is governed by Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 "on the reorganisation and winding-up of credit institutions" (as in force after its amendment by Article 117 BRRD). Under this legal act, credit institutions' winding-up proceedings are national and will remain so at least for the foreseeable future, since the discussions on setting up the EBU did not touch upon the prospect of amending this regime.

B. The Single Supervisory Mechanism

1. The Legal Framework

(a) The Single Supervisory Mechanism ('SSM') is based on Council Regulation (EU) No 1024/2013 of 15 October 2013 "conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions" (the 'SSMR'). The institutional framework pertaining to the SSM, which became operative on 4 November 2014, is further specified in:

- several ECB legal acts on the detailed operational arrangements for the implementation its tasks under the SSMR, including Regulation (EU) No 468/2014 of 16 April 2014 "establishing the framework for cooperation within the SSM between the ECB and national competent authorities and with national designated authorities ('SSM Framework Regulation')),"
- an Interinstitutional Agreement between the European Parliament and the ECB of October 2013 "on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the SSM,"
- a Memorandum of Understanding between the Council and the ECB of December 2013 "on the cooperation on procedures related to the SSM," and
- Regulation (EU) No 1022/2013 of the European Parliament and the Council, which amended the Regulation governing the operation of the EBA in order to clarify the relationship between the ECB and the EBA, to prescribe the new tasks and powers of the EBA, and to introduce amendments to the EBA's governance.

2. The Comprehensive Assessment

In view of the assumption of its tasks, the ECB was given the power to ask national competent authorities to provide it, from 3 November 2013, with all relevant information necessary to carry out a 'Comprehensive Assessment,' including a balance-sheet assessment, of the credit institutions of the participating Member States. The ECB, in collaboration with the national competent authorities and supported by the private company *Oliver Wyman Consultants*, conducted since January 2014 the Comprehensive Assessment of the credit institutions and supervised groups to be directly supervised by it, consisting of three (3) components:

- a 'Supervisory Risk Assessment' to review, quantitatively and qualitatively, key risks, including liquidity, leverage and funding,
- an 'Asset Quality Review' to enhance the transparency of bank exposures by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions, and
- a 'stress test,' in collaboration with EBA, to examine the resilience of banks' balance sheet to stress scenarios.

The results of this exercise were published on 26 October 2014 and are contained in the ECB's "Aggregate Report on the Comprehensive Assessment."

3. The Operation of the SSM

(a) The SSMR is based on four (4) main elements:

- conferring specific tasks *on the ECB* for the micro-prudential supervision of certain types of financial firms, in transfer from national competent (supervisory) authorities, *and* establishing the SSM in relation to the *exercise* of these specific tasks,
- specifying the financial firms with regard to which these specific tasks should be conferred on the ECB,
- incorporating the Single Supervisory Mechanism in the ESFS without, in principle, touching upon the tasks of its components, and
- creating 'Chinese walls' within the ECB to ensure the effective separation of its monetary policy and other tasks from its (new) supervisory tasks.

(b) The SSMR confers on the ECB specific tasks *"concerning policies relating to the prudential supervision of credit institutions"* (a phrase taken over *verbatim* from Article 127(6) TFEU), with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the EU and each Member State, which is the main objective of the ECB under the SSMR, and to preventing regulatory arbitrage, fully taking into account and caring for the unity and integrity of the internal market (a duty with which it was assigned). Obviously, this ECB objective is different from the primary objective of the European System of Central Banks under the TFEU, i.e., maintaining price stability. The eventuality of conflicts of interest arising from concurrently pursuing these two objectives was the reason behind the introduction of 'Chinese walls,' separating the monetary and supervisory functions of the ECB in accordance with Article 25 SSMR.

(c) The SSMR applies mainly to 'participating Member States,' which are defined as meaning both the Member States whose currency is the euro *and* the Member States with a derogation having established a 'close cooperation' under Article 7 SSMR.

(d) The assignment to the ECB of specific tasks in relation to the micro-prudential supervision of financial firms exclusively covers credit institutions, 'financial holding companies,' in the context of the conduct of consolidated supervision of banking groups, and 'mixed financial holding companies,' in the context of the conduct of supplementary supervision on financial conglomerates including credit institutions, to the extent that they are incorporated in euro area Member States ('supervised entities'). In addition, Article 6 SSMR established, *in principle*, a 'two-tier system' with regard to the distribution of powers within the SSM, distinguishing between 'significant' and 'less significant' supervised entities, the former being directly supervised, as to the specific tasks conferred upon it, by the ECB, and the latter being supervised by the national competent authorities within the SSM.

C. The Single Resolution Mechanism and the Single Resolution Fund

1. The Single Resolution Mechanism

(a) The Single Resolution Mechanism ('SRM') was established by virtue of Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 "establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (...)" ('SRMR'). The adoption of this Regulation, which entered into force on 19 August 2014, was a necessary complement to the SSMR, as it would be a paradox if credit institutions were directly supervised (by the ECB) at the European level, but, in the event of a need for resolution (upon proposal of the ECB), the relevant decision were to be made at national level. In this context, of particular importance are also:

- the Interinstitutional Agreement between the European Parliament and the Single Resolution Board of 16 December 2015 "on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the Single Resolution Board within the framework of the Single Resolution Mechanism," and
- the Memorandum of Understanding between the Single Resolution Board and the ECB of 22 December 2015 "in respect of cooperation and information exchange."

(b) The objective of the SRMR is the establishment of *uniform rules and a uniform procedure* for the resolution of the specific categories of entities which are established in the participating Member States. These uniform rules and this uniform procedure must be applied by the Single Resolution Board ('Board'), together with the Council, the Commission and the national resolution authorities within the framework of the SRM. The involvement of the Council and the Commission is a by-product of the fact that the Board is an agency and does not have a legal anchor in the TFEU.

(c) The Board, established by the SRMR and operational by 1 January 2015, is responsible for the effective and consistent functioning of the SRM, like the ECB for the SSM. In principle, it is also responsible for drawing up the resolution plans and adopting all resolution decisions relating to credit institutions established in participating Member States, as well as to 'significant' and 'cross-border' groups. On the other hand, national resolution authorities must perform, and are responsible for, specific tasks with regard to other credit institutions and groups, without prejudice to the responsibilities of the Board for the tasks conferred on it by the SRMR.

2. The Single Resolution Fund

(a) The SRM is supported by the Single Resolution Fund ('SRF'). The use of the SRF was contingent upon the entry into force of the Intergovernmental Agreement signed by twenty-six (26) EU Member States "on the transfer and mutualisation of contributions to the Single Resolution Fund" ('SRF Agreement' or 'IGA'). This Agreement, which entered into force on 1 January 2016 and to which Sweden and the United Kingdom are not Contracting Parties, provides for the transfer of the funds raised at national level towards the SRF, and the progressive merger of the different funds raised at national level (by the national resolution funds) to be allocated to the SRF's national compartments.

(b) The Board, which is the owner of the SRF, may use it only for the purpose of ensuring the efficient application of the resolution tools and exercise of the resolution powers, and in accordance with the resolution objectives and the principles governing resolution. Neither the EU budget nor the national budgets may, under any circumstances, be held liable for expenses or losses of the SRF.

(c) In principle, the SRF is being financed by credit institutions' *ex-ante* contributions. By the end of the transitional period of eight (8) years from 1 January 2016 the 'available financial means' of the SRF must reach at least 1% of the amount of covered deposits of all credit institutions authorised in the participating Member States ('target level'). During the transitional period, contributions to the SRF must be spread out in time evenly until the target level is reached, with due account to the business cycle's phase and the impact that pro-cyclical contributions may have on the financial position of contributing institutions.

(d) On 17 June 2016 the Council of the EU in its released Conclusions on a roadmap to complete the Banking Union took note of the intention of Member States to start work in September 2016 if and when all participating Member States have fully transposed the BRRD. In this context the Council would also take stock of the bridge financing arrangements, noting that participating Member States are committed to sign the Loan Facility Agreement to the SRF in case of possible funding shortfalls by the time. They also reaffirmed the need to have the common backstop fully operational at the latest by the end of the transitional period and that it may be decided that the backstop may become operational ahead of the transition period in line with certain risk reduction measures such as implementing the Total Loss Absorbing Capacity standard and further harmonisation of options and national discretions currently set out in the CRR/CRDIV.

D. The European Deposit Insurance Scheme and the European Deposit Insurance Fund

(a) Until 2015, the prospect of establishing a European deposit guarantee scheme, as the third main component of the EBU, has only been discussed in terms of principles and 'high-level politics.' Deposit guarantee schemes ('DGSs') remain national, even though their merger or the establishment of cross-border DGSs is not ruled out.

(b) The prospective of creating a 'European Deposit Insurance Scheme' was laid down boldly in the "Five Presidents' Report" of 22 June 2015 entitled: "Completing Europe's Economic and Monetary Union," within the framework of the proposals on the creation of an (EU) 'Financial Union.' Then, on 24 November 2015, the Commission submitted a proposal for a Regulation of the European Parliament and of the Council "amending Regulation EU No 806/2014 in order to establish a European Deposit Insurance Scheme." This scheme (the 'EDIS') is planned to be introduced gradually, in three (3) stages under strict safeguards, and will be built on the existing system, composed of national DGSs, while individual depositors will continue to enjoy the same level of protection (100,000 euros). A European Deposit Insurance Fund (the 'EDIF') will also be created from the outset. It will be financed directly by risk-adjusted credit institutions' contributions. The EDIF's management would be entrusted to the SRB.

(c) According to the proposal, the three phases in the evolution of the EDIS are as follows:

(i) Phase 1: re-insurance: during the first three-years phase (2007-2009), the 're-insurance approach' will apply, whereby a national DGS will have access to EDIS funds only when all its own resources are exhausted, and if it fully complies with the DGS Directive 2014/49/EU. EDIS funds would provide additional funds to a national DGS only up to a certain level. National DGSs can access

the EDIS only when justified, since EDIS funds will only be available, if the relevant rules in the DGSD have been fully applied by the Member State concerned. Use of EDIS funds will be closely monitored, and any EDIS funds found to have been received inappropriately by a national DGS will have to be fully reimbursed.

(ii) Phase 2: co-insurance: in 2020, the EDIS will become a progressively mutualised system ('co-insurance'), still subject to appropriate limits and safeguards against abuse. During this phase, a national DGS will not be required to exhaust its own funds before accessing EDIS funds. The EDIS will be available to contribute a share of the costs from the moment when the DGS is activated and depositors need to be reimbursed, leading to a higher degree of "risk-sharing between national DGSs through the EDIS." The share to be contributed by the EDIS will start at a level of 20% and gradually increase to 100% over a four (4) year period.

(iii) Phase 3: full insurance: the EDIS will fully insure national DGSs as of 2024. This is the same year when the SRF and the requirements of the DGS Directive will be fully phased-in.

(d) On 17 June 2016 the Council of the EU in its released Conclusions on a roadmap to complete the Banking Union listed as a key step that the Council will continue constructive work on EDIS at technical level; further, that negotiations at political level will start as soon as sufficient further progress has been made on the measures on risk reduction. It was also taken note of the intention of Member States to have recourse to an Intergovernmental Agreement (IGA) when political negotiations on EDIS start.

V. Payments Recent Developments: Virtual Currencies

Recent developments in payment and settlement systems have occurred particularly in prepaid cards, mobile payments, and securities settlement. On the regulatory side the highlights are the US Federal Reserve Faster Payments Initiative and the EU Payment Services Directive (PSD)-2. However, the emergence of virtual currencies may have overshadowed all other developments and is the subject of this review.

Originally, virtual currency was narrowly defined to cover either "in-game only" schemes or schemes facilitating only the purchase of virtual goods and services.[24] It was contrasted with digital currency that could be used for the purchase of goods and services in the real economy.[25] Or else, the latter category was limited to cryptocurrencies, discussed further below. In a broad sense, both virtual currencies and cryptocurrencies were considered as types of digital currencies.[26] In this sense, a digital currency or digital money was understood to be an Internet-based medium of exchange distinct from physical (such as banknotes and coins) that exhibits properties similar to physical currencies, but allows for instantaneous transactions and borderless transfer-of-ownership.[27]

Using digital currencies to both narrowly mean cryptocurrencies as well as broadly to cover both virtual currencies and cryptocurrencies has been confusing and led to a new taxonomy. Thus, in a 2012 Report on virtual currency schemes, the ECB provided the following definition: a virtual currency is a type of unregulated digital money which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community.[28]

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[24] *See, e.g,*. Danny Bradbury, "Is Bitcoin a Digital Currency or a Virtual One?" (Published March 19, 2014), *available at* http://www.coindesk.com/bitcoin-digital-currency-virtual-one/. *See also*: https://www.quora.com/What-is-the-difference-between-a-cryptocurrency-a-digital-currency-and-a-virtual-currency.

[25] *See, e.g.,* https://en.wikipedia.org/wiki/Virtual_currency.

[26] https://en.wikipedia.org/wiki/Digital_currency.

[27] Digital currency - Wikipedia, the free encyclopedia, https://en.wikipedia.org/wiki/Digital_currency.

[28] European Central bank/Eurosystem, *Virtual Currency Schemes*, October 2012, at 6, *available at* https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf.

The Report went on to classify virtual currency schemes as: (i) closed; (ii) having unidirectional flow; and (iii) having bidirectional flow. In principle:

- *Closed* schemes have no link with the real economy and are "in-game only" schemes. Having paid a subscription fee, a user earns the virtual money based on his or her online performance.
- Under a *unidirectional-flow scheme* the virtual currency can be purchased with fiat currency but cannot be exchanged back to fiat currency. The virtual currency may be used to purchase virtual goods and services and possibly, depending on the terms of the scheme, also goods and services in the real economy.
- Finally, in a *scheme with a bidirectional flow*, a user can buy and sell the virtual currency for fiat currency and may use the virtual currency to transact for goods and services in both the virtual world and the real world.

In a subsequent report published in February 2015,[29] the ECB questioned whether virtual currency is 'money' and yet recognized that virtual currency may be regulated. Accordingly it revised its definition to say that a virtual currency is: a digital representation of value, not issued by a central bank, credit institution [i.e., 'bank'] or e-money institution, which, in some circumstances, can be used as an alternative to money.[30]

Along the same lines, and while acknowledging "the fast evolving nature of the industry" so that "a universal definition has yet to emerge," an IMF study nevertheless went on to define virtual currencies to be: digital representations of value issued by private developers and denominated in their own unit of account.[31]

Under this taxonomy, besides virtual currency, the other category of digital currency is e-money, loaded on a store-value product,[32] or even bank money that can be accessed through a digital device.[33] However, to the extent that e-money is denominated in the unit of account of an official currency, and is redeemable at par[34] in banknotes and coins of this currency, whether directly or indirectly via bank money, no good purpose is served by treating e-money as a sub-category of a broad category which covers side by side with it virtual currency. The same certainly applies to bank money accessible by means of a digital device. By reference to fiat currency and bank money, instead of highlighting the distinctive nature of virtual money, this taxonomy blurs it.

A similar difficulty also arises in connection with the category of a centralized virtual-currency scheme. Arguably, as long as it is denominated in the unit of account of an official currency, and is redeemable at par[35] in banknotes and coins of this currency, whether directly or indirectly via bank money, it is a type of e-money. Indeed, a centralized system of alternative currency,[36] unlinked to an

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[29] European Central bank/Eurosystem, *Virtual Currency Schemes- a Further Analysis*, February 2015, *available at* https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf.

[30] *Id.*, at 25.

[31] IMF Staff Discussion note *Virtual Currencies and Beyond: Initial Considerations*, January 2016, at 7, *available at* https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf.

[32] IMF Report, *id.*, at 8, and 2012 ECB Report, *supra*, note 28 at 16.

[33] *See, e.g.*, https://www.quora.com/What-is-the-difference-between-a-cryptocurrency-a-digital-currency-and-a-virtual-currency.

[34] Though possibly subject to a transaction fee.

[35] Though possibly subject to a transaction fee.

[36] An alternative currency (or private currency) is any currency used as an alternative to the dominant national or multinational currency systems. They are created by an individual, corporation, or organization, they can be created by national, state, or local governments, or they can arise naturally as people begin to use a certain commodity as a currency. Mutual credit is a form of alternative currency, and thus any form of lending that does not go through the banking system can be considered a form of alternative currency. When used in combination

official currency, may exist.[37] An alternative currency which can be used only over the Internet may truly be characterized as virtual currency albeit in the broad sense of the term.[38] At the same time, particularly in relation to the payment and settlement mechanism, in the narrow and yet principal sense, virtual currency schemes are decentralized.[39]

FinCEN is quoted to say that decentralized digital currency is one: "(1) that has no central repository and no single administrator, and (2) that persons may obtain by their own computing or manufacturing effort."[40]

Decentralized virtual currency schemes use encryption techniques, particularly public-key cryptography,[41] to regulate the generation of units of currency and verify payments.[42] The underlying currency is thus called cryptocurrency, which is a digital asset with verifiable mathematical properties that can be transferred directly between users on a distributed ledger without relying on a centralized protocol operator. Both its creation and transfer are premised on 'smart contracts' of which terms are recorded in a computer rather than legal language.

A distributed ledger is an asset database that can be shared across a network of multiple sites, geographies or institutions. Its underlying technology is the blockchain, which is: a type of a database that takes a number of records and puts them in a block … Each block is then chained to the next block, using a cryptographic signature. This allows blockchains to be used like a ledger, which can be shared and corroborated by anyone with the appropriate permissions.[43]

Accuracy of the ledger is corroborated by consensus.

Participants in a cryptocurrency network hold their keys in digital wallets. A payer accesses his or her digital coins stored in the blockchain using his or her private key and sends payment to the payee using the latter's public key. The payee receives payment using his or her private key and the payer's public key. For virtual currencies, specialized trading platforms function as marketplaces while exchanges offer trading services.[44]

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with or when designed to work in combination with national or multinational fiat currencies they can be referred to as complementary currency. Most complementary currencies are also local currencies and are limited to a certain region. Barters are another type of alternative currency. These are actually exchange systems, which only trade items; thus without the use of any currency whatsoever. Finally, LETS (Local Exchange Trading Systems) is a special form of barter which trades points for items, under which for example, one point stands for one worker-hour of work: https://en.wikipedia.org/wiki/Alternative_currency.

[37] Airmiles points fit into this category. Contrary to the 2012 ECB Report, *supra* note 28 at 15, I thus disagree with the classification of frequent-flier programmes as virtual currency schemes.

[38] Facebook Credits, discussed in the 2012 ECB Report *supra* note 28 at 13 is a good example.

[39] In this context, 'decentralized' is used as the opposite of 'centralized.' In fact, as explained below, the operation of a 'decentralized' virtual currency scheme is premised on the operation of a 'distributed' ledger. For the difference among 'centralized,' 'decentralized,' and 'distributed,' *see, e.g.*, http://www2.cffn.ca/usha/part-iii-article-by-pramod-dhakal/129-the-law-of-rule-centralized-decentralized-and-distributed-systems.

[40] https://bitcoinmagazine.com/articles/fincen-bitcoin-users-not-regulated-exchanges-are-1363675774.

[41] Public-key cryptography, or asymmetric cryptography, is any cryptographic system that uses two kinds of keys: *public keys* may be disseminated widely, while *private keys* are known only to the owner. In a public-key encryption system, any person can encrypt a message using the public key (better imagined as a lock) of the receiver and leave it on a public server or transmit it on a public network. Such a message can be decrypted only with the receiver's private key. *See* https://en.wikipedia.org/wiki/Public-key_cryptography.

[42] https://www.google.ca/search?q=crypto+currency&sourceid=ie7&rls=com.microsoft:en-CA:IE-Address&ie=&oe=&gfe_rd=cr&ei=hf3iVpLqJIfdswSny6OAAg&gws_rd=ssl.

[43] UK Government Office for Science, *Distributed Ledger Technology: beyond the block chain* (2016) at 17.

[44] Voluminous information on the mechanics of a cryptocurrency payment is available in the reports and studies cited above as well as in a Report of the Standing Senate Committee on Banking, Trade and Commerce (Canada), *Digital Currency: You Can't Flip This Coin!* (June, 2015).

The emergence and rise of virtual currencies has raised significant legal and regulatory questions. An overarching one is whether a virtual currency is 'money' or 'currency.' In the absence of both physical existence and official status it is not 'currency'; however, is it widely used to exchange value in transactions so as to function as a medium of exchange, storage of value and unit of account and is thus 'money'?[45] This is a matter of importance for both private and public laws. A virtual currency is, however, certainly a means of payment so as to be of interest to central banks in relation to the stability of prices, the financial system, and the payment system. Central banks are also concerned with the lack of legal basis and the risk to their reputation.[46] A more detailed list of regulatory concerns covers in addition to financial stability and monetary policy matters items such as financial integrity, consumer protection, taxation, exchange controls and capital flow management.[47] Underlying many of the concerns are both the fluctuating value of each virtual currency and the absence of central governance authority. And of course there are the 'usual' payment system issues of transparency and fairness of terms and fees, hacking, finality of payment, and the allocation of losses caused by fraud, error or insolvency. In a federal state there may also be an issue as to the appropriate level of government to address each issue.

In the United States, regulatory measures have been taken by individual states.[48] A draft of the Regulation of Virtual Currency Business Act is currently emerging as a project of the National Conference of Commissioners on Uniform State Laws (NCCUSL).[49] Broadly speaking, the project covers licensing; examinations, reports, and records; permissible investments; and enforcement. Subject to some refinements and express exclusions, Section 103(24) of the present draft defines "virtual currency" as "any digital unit of value that is used as a medium of exchange or that substitutes in transaction for money but that is not money." "Money" is defined in Section 103(8) by reference to its issue or designation by a government body.

Sooner or later regulatory and legislative measures will have to take place to accommodate the quickening pace in which virtual currencies evolve.

VI. The East African Community Monetary Union

A. Background

The East African Community (EAC) is comprised of the Republics of Uganda, Kenya, Tanzania, Rwanda, Burundi and South Sudan.[50] The Treaty that established the EAC anticipated other states joining the community in the future subject to meeting key criteria such as geographical proximity, the maintenance of a market driven economy and subscribing to the principles of democracy and the rule of law.[51] The EAC is intended to be a complete union and the Treaty lays down the key integration

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[45] Both 'currency' and 'money,' together with other relevant terms, are defined in the 2015 ECB Report, *supra* note 29 at 33.

[46] The 2012 ECB Report, *supra* note 28 at 22-46. Further discussion including a summary of national responses is available in the 2015 ECB Report, *supra* note 29 at 26 – 33.

[47] *See, e.g.*, IMF Report *supra* note 31 at 24-34.

[48] *See, e.g.*, New York State, Department of Financial Services, New York Codes, Rules and Regulations Title 23. Department of Financial Services, Chapter I, Regulations of the Superintendent of Financial Services Part 200. Virtual Currencies http://www.dfs.ny.gov/legal/regulations/adoptions/dfsp200t.pdf.

[49] The most recent Draft is that of the Drafting Committee Meeting of February 19-21, 2016, *available at* http://www.uniformlaws.org/shared/docs/regulation%20of%20virtual%20currencies/2016feb_RVCBA_Mtg%20Draft.pdf. For a review, *see, e.g.*, http://www.sidley.com/news/2016-02-26_banking_and_financial_services_update.

[50] The Republic of South Sudan was admitted as a member at the 17th Ordinary Summit of EAC Heads of State held in Arusha, Tanzania on 2 March 2016.

[51] Treaty for the Establishment of the East African Community 1999, amended in 2006 and 2007Article 3.

stages of a 'customs union, a common market, subsequently a monetary union, and ultimately a political federation.'[52] The customs union and common market have already been established and are functioning incrementally well.

The Partner States agreed to cooperate on monetary and financial matters, including monetary and fiscal harmonisation, macro-economic coordination, and banking and capital markets development. The Treaty mandates partner states to conclude protocols in each area of cooperation that spell out the objectives and scope of cooperation and integration and the institutional mechanisms for such cooperation and integration. The protocols form an integral part of the treaty.[53]

The EAC Monetary Protocol was signed in November 2013 and announced by the Summit in November 2014.[54] The roadmap attached to the Protocol sets the agreed time for implementation as ten years, thus taking the target date for the single currency to 2024. There are transitional arrangements providing for the progressive coordination of various processes and institutions, in particular the EA Monetary Institute to do preparatory work for the EA Central Bank. While there are fears and at the same time excitement among the population especially after the episodes involving the Euro, the prognosis is that monetary integration is likely to be successful.

There was a prior long history of close cooperation among Uganda, Kenya and Tanzania, including monetary cooperation under the East African Currency Board, which was established in 1905 and issued a joint currency in 1919 but subsequently dissolved. All the countries are members of the African Union, the United Nations and the International Monetary Fund and they receive financial and technical support from the European Union and agencies such as TradeMark East Africa.[55] One would therefore expect the new monetary union to conform to the norms of international monetary law.

B. Legal Framework for EAC Monetary Integration: Protocol on the Establishment of the EAC Monetary Union

The Protocol contains comprehensive provisions on the monetary union, key among which are the following:

(1) *Establishment of Monetary Union*: The Protocol establishes the EAC Monetary Union, which shall be realised progressively and governed by the laws of the Community (Article 2).

(2) *Objective*: The objective of the EAC Monetary Union is to promote and maintain monetary and financial stability aimed at facilitating economic integration to attain sustainable growth and balanced development of the Community (Articles 3, 7, 11).

(3) *Scope of Cooperation in the Monetary Union*: Pursuant to the Treaty obligation to cooperate in monetary and financial matters, the Partner States have agreed to:

a. harmonise and coordinate their fiscal policies;
b. formulate and implement a single monetary policy and a single exchange rate policy;

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[52] Treaty for the Establishment of the East African Community Articles 2(2), 75, 76 and the respective Protocols.

[53] Treaty for the Establishment of the East African Community Article 151.

[54] Protocol on the Establishment of the East African Community Monetary Union 2013. It is in force because it was ratified by each one of the Partner States and the instruments of ratification of all Partner States deposited with the Secretary General (Article 30).

[55] TradeMark East Africa is an organisation funded by a range of governmental development agencies with the aim of facilitating economic development through trade. The investors include agencies from Belgium, Canada, Denmark, Finland, Netherlands, Sweden, UK, and USA.

c. develop and integrate their financial, payment and settlement systems;
d. adopt common principles and rules for the regulation and prudential supervision of the financial system;
e. integrate their financial management systems;
f. harmonise their financial accounting and reporting practices;
g. adopt common policies and standards on statistics; and
h. adopt a single currency (Article 4).

(4) *Pre-requisites for the Monetary Union*: For the purposes of realising the monetary union, partner states should:

- fully implement the customs union and common market;
- harmonise many of the items in Article 4, summarised above; and
- adhere to some quantitative criteria geared to macroeconomic convergence; namely, core inflation (5%), fiscal deficit (6% of GDP) and the ratio of tax to GDP of 25%. (Articles 5 & 6).

(5) *Macroeconomic Policy Framework*: Partner States have agreed to a broad policy framework comprising of fiscal policies, monetary policy and exchange rate policy (Article 7). The framework on fiscal policies demands of Partner States substantial coordination, information disclosure and the avoidance of harmful tax competition, in addition to the creation of an institutional mechanism (Council)[56] to implement the fiscal policies (Article 8).

(6) *Economic Shocks*: Partner States have also agreed to establish mechanisms for monitoring risks, building resilience and managing economic shocks. These mechanisms include measures to avoid or mitigate risk that may originate in a Partner State and threaten the economic stability of the monetary union, and measures for stabilising the monetary union or the economy of a Partner State in the event of an economic shock. Particular mechanisms referred to include an early-warning system and a stabilisation facility for use in the event of a Partner State experiencing or being threatened with a severe exogenous economic shock. There is some flexibility for states to exceed fiscal deficit targets (Article 10).

(7) *Monetary Policy and Institutions*: *EACB as Key Institution*: The Protocol anticipates the creation of an East African Central Bank (EACB), which, together with the national central banks, will form a functionally integrated system of central banks. The EACB shall be independent and shall not be influenced by any Partner State. The Partner States in the single currency area shall provide capital for the bank (as determined by the Council) and the financial rights and obligations of the Partner States in the single currency area in relation to the EACB shall be distributed in accordance with a financial key,[57] determined by the Council, and shall be adjusted every three years (Article 20). The Partner States in the single currency area undertake to transfer reserves to the EACB (Article 12(3) and (4)).

The EACB is mandated to formulate a single monetary policy, which shall be binding on Partner States in the single currency area. The primary objective of monetary policy shall be to achieve and maintain price stability, and also contribute to financial stability, and economic growth and development (Article 11). The EACB shall formulate a single exchange rate

[56] 'Council' means the Council of Ministers of the Community established by Article 9 of the Treaty.

[57] 'Financial Key' means the cost and benefit sharing formula or figure indicating the financial contribution of each Partner State in the single currency area in relation to the East African Central Bank (Article 1, Interpretation).

policy for the single currency area and the exchange rate regime shall be free floating (Article 12(1) and (2)).

Article 21 provides for the establishment of institutions to support the Monetary Union; for example on surveillance, compliance, enforcement and statistics; while Article 23 puts in place transitional institutions; and in particular, the EA Monetary Institute to undertake preparatory work for the Monetary Union.

(8) *Currency*: There will be a new single currency if at least three Partner States that meet the convergence criteria adopt the single currency and, thereby, form the single currency area. The single currency, whose name has not yet been determined, will be legal tender in the single currency area and will be effective on a date determined by the Summit within a ten-year timeline. The single currency shall be used in the payment and settlement systems for the settlement of all transactions in the single currency area, except as otherwise provided by an Act of the Community (Article 18).

(9) *Financial, Payment and Settlement Systems*: The Protocol requires Partner States to develop and operate an efficient, stable and integrated financial system.[58] The 'financial system' is defined very broadly and includes:

a. banking;
b. capital and money markets;
c. insurance;
d. retirement benefits;
e. micro finance; and
f. other financial services.

The financial system shall, among other specified objectives, promote the development of the financial sector, promote financial inclusion and deepening, facilitate regulation and prudential supervision of the financial sector, facilitate the development of the financial system infrastructure,[59] and facilitate the orderly, fair and transparent market conduct of the financial sector (Article 14).

The Partner States are required to develop and implement secure, efficient, reliable and integrated payment and settlement systems so as to ensure the efficient flow of financial transactions within the monetary union. The Partner States have undertaken to adopt an integrated trading and securities depository system and to harmonise and integrate the payment and settlement system financial market infrastructure with other systems (Article 15).

(10) *Measures to address imbalances*: The Protocol enjoins the Council to develop measures to support a Partner State that experiences macroeconomic or structural imbalances arising from the implementation of the Protocol (Article 24).

(11) *Policies, Laws and Systems*: Last but not least, Article 22 requires the harmonisation of policies, laws and systems to support the Monetary Union. One notes, in this regard, an elaborate structure for the approximation and harmonisation of the commercial laws of the EAC that is well funded to

[58] 'Financial system' means interconnected financial institutions, markets, instruments, services, practices and transactions in the Community' (Article 1, Interpretation).

[59] 'Financial market infrastructure' means a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives or other financial transactions (Article 1, Interpretation).

support the regional integration project. There is also the EAC Court of Justice consisting of trial and appellate levels that may in the future be called upon to resolve commercial disputes.[60]

C. Observations

The overarching aims of EAC integration are to foster unity and increase trade among Partner States. Monetary Union is an advanced stage of true and deeper EAC integration and also contributes to the integration process.[61] While the EAC Partner States have yet to agree on the name of the new currency, the name will be decided upon by the Summit (Heads of State) upon the recommendation of the Council. They have also not yet decided the location of the new central bank but there are criteria in place for hosting EAC institutions and they will be followed.

Granted that the target date of 2024 for the full implementation of the monetary union is ambitious, this prospective review believes that the global and local context will result in the irreversible and successful adoption of a single currency and a common currency area. Success is reasonably assured since the Partner States have agreed on differentiated integration (also called 'variable geometry' or 'multi-speed EAC') for the implementation of the monetary union. This is implied in Article 18(2) of the Protocol which provides that the single currency shall be adopted when at least three Partner States meet the requirements. Several historical and economic factors support this prognosis for success. First, the success story of the European monetary union, albeit contested in quite a few circles,[62] has stimulated a renewed interest in monetary union in the region and provided a ready model to emulate. The EAC Partner States are well aware of the history of monetary failure in previous times in this and other regions[63] and have provided in the Protocol fortifications against known problems. For example, the EAC Monetary Union Protocol provisions on economic shocks, risk sharing and addressing imbalances[64] anticipate the recent debate concerning monetary transfers among euro zone countries. Similarly, the EAC right from the outset requires fiscal and capital market harmonisation, which is a structural issue that the European Union is grappling with.[65]

The local context also augurs well for the EAC monetary union. First, free exchange rates and full convertibility are operational in all the Partner States. Secondly, there is little sentimental attachment to the local currencies because they are generally weak, with a cross section of society ranging from astute investors to public servants and farmers preferring a stronger currency over its name. The dollarization[66] of the economies in the top echelons of society and in business circles provides proof of this realistic attitude. Thirdly, the whole process of EAC integration has the support of the supranational institutions (IMF and World Bank), the major foreign countries involved in the region (i.e., the European Union), and the business sector. These factors in combination reduce the hurdles to changing the currency and ceding control of monetary policy and money supply to a common authority.

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[60] Most of the disputes that have so far been to the court relate to human rights, constitutional interpretations and administrative law.

[61] For the thesis that there is a strong political dimension to monetary union, *see* Mario Draghi, "Stability and Prosperity in the Monetary Union" in Project Syndicate, 2 January 2015 *available at* www.project-syndicate.org/print/ecb-eurozone-economic-union-by-mario-draghi.

[62] For the arguments for and against the European monetary integration see Paul Craig and Grainne de Burca, *EU Law Text, Cases and Materials*, 5th edition (Oxford University Press 2011) 701-703.

[63] E.g., the Universal Currency involving Britain, France and US that failed in 1867; the Latin Monetary Union that failed in 1927 and the previous monetary alliance in the form of a common currency zone in the then British East Africa: *see* Benjamin J Cohen, "Monetary Unions" *available at* https://eh.net/encyclopedia/monetary-unions/.

[64] Articles 10 and 24 of the Protocol.

[65] *See, e.g.*, Lydia Prieg, "There's no future for the Eurozone Without Fiscal Union" at www.theguardian.com 9 August 2011.

[66] "Dollarization" is used here to mean the use of the dollar in parallel to or in substitution of the local currency.

The fragility of the economies of the EAC Partner States may also be a strong reason for monetary union to take hold. Monetary union is likely to reduce the cost of conducting regional business (eliminating exchange-rate risk and facilitating region-wide price harmonisation), enhance currency stability and credibility, encourage internal and international tourism, and increase regional and foreign direct investment.[67] In the search for sustainable growth and economic development, the EAC monetary union is a big innovation that has been broadly welcomed.

VII. Crowdfunding in International and National Regulatory Frameworks

A. Background

The EU regulators have defined crowdfunding as "a means of raising finance for projects from 'the crowd,' often by means of an Internet-based platform through which project owners 'pitch' their idea to potential backers, who are typically not professional investors."[68]

The benefit appreciated by the regulators is providing funds for projects which are normally not tackled by banks or other professional financial institutions, at least not at reasonable prices, due to related risks or small size. What are the reasons why authorities are considering regulation?

Crowdfunding is not restricted to charitable aspects. There are two commercial types: lending (commonly known as peer-to-peer lending) and investment-based crowdfunding, providing functions normally reserved to strictly regulated institutions such as banks and investment firms. The relevant authorities are bank supervisors, when loan contracts, and securities regulators, as far as profit sharing and securities are involved.

In Europe, crowdfunding is still a medium-sized market segment. The UK has taken the lead with loan-based crowdfunding at almost GBP 1.3bn and investment-based crowdfunding at GBP 84m (new business in 2014).[69] In the USA, maximum amounts in the range of US$ 170m and 3,800 private investors for single office developments have been achieved. The biggest market seems to be the People's Republic of China, estimated at some 2,316 lending platforms with RMB 82.5bn (US$ 12.5bn) transactions in July 2015 alone and over 100 investment based platforms raising RMB 915m (US$ 139m) in that year.[70]

B. Crowdfunding Parties and Basic Regulatory Approaches

Three parties are involved in a crowdfunding transaction and could be targeted by regulators:

- The operator of the platform – typically, he would be neither lender/investor nor borrower/recipient of funds, but rather intermediary;
- The owner of the project to be financed, i.e., the recipient of the funds respectively the borrower or obligor of related financial instruments; and
- The lender or investor.

Currently, two types of regulatory approaches are employed by regulators:[71]

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[67] *See, e.g.*, Abdirashid Duale, "The Pros and Cons of EAC Monetary Union" in African Business Magazine, 5 November 2014.

[68] ESMA/2014/1560, Advice, Investment-based Crowdfunding, p.4.

[69] Financial Conduct Authority (FCA), "A review of the regulatory regime for crowdfunding and the promotion of non-readily realisable securities by other media, " February 2015, p.3.

[70] Zhou/Arner/Buckley, "Regulation of Digital Financial Services in China," University of Hong Kong Faculty of Law Research Paper No. 2015/044, p.18.

[71] For a comprehensive overview *see* OICV-IOSCO, Crowfdfunding 2015 Survey Responses Report, *available at* www.iosco.org/library/pubdocs/pdf/IOSCOPD520.pdf.

- Applying the general regulatory frameworks with certain waivers, in particular from licensing, registration and prospectus requirements. Frequently, these general frameworks have been updated by regulations addressing investor protection; and
- Establishing specific regimes for crowdfunding and extending regulatory provisions into areas that would otherwise be unregulated, including requirements on registration, and on the conduct of business, in particular in order to address investor protection.

C. Reaction by International Standard-setting Bodies

Whereas the bank regulators – the Basel Committee on Banking Supervision (BCBS) – have not yet tackled the issue, in particular peer-to-peer lending, the International Organization of Securities Commissions (IOSCO) has published a statement[72] based on a recent survey.[73] The IOSCO refrained from proposing a common international approach at this stage, highlighting "that most regulatory regimes for crowdfunding have only recently been implemented." Nevertheless, the standard-setter "believes regulators should pay attention to the additional risks related to crowdfunding," and recommends that "…for the purpose of investor protection, regulators and policy makers should note some of the measures taken thus far by regulators to address these inherent risks related to crowdfunding…"[74] Notwithstanding the IOSCO's current wait-and-see attitude, the items identified by the statement might give an indication of future regulatory subjects.

D. Situation at EU Community Level

The EU regulators have been dealing with crowdfunding since 2013, starting with a formal Commission consultation process, which ended up with the following results:

(a) Crowdfunding is part of the EU work plan related to small and medium-sized enterprises (SME);
(b) Establishment of the European Crowdfunding Stakeholder Forum (ECSF), an expert group;
(c) advice and opinion of the European Securities and Markets Authority (ESMA) re. investment-based crowdfunding;[75]
(d) opinion on lending-based crowdfunding by the European Banking Authority (EBA).[76]

The common conclusion is that the "EU financial services rules were not designed with the industry in mind," and that the application of EU laws highly depends on the related individual models. "Both the EBA and the ESMA have advised the Commission to consider direct regulation, addressed to platform operators: Given the significant risk currently not addressed at EU level … ESMA considers that developing an EU-level regime could be considered."[77] "ESMA advises the EU institutions to consider whether there is a case for action at EU level…"[78]

Until further action has been taken, two general regulatory frameworks are applicable in the EU:

(a) Banking regulation. However, the parties of lending-based platforms do not fall inside the perimeter of credit institutions as defined by EU legislation, because

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[72] OICV-IOSCO Statement on Addressing Regulation of Crowdfunding, December 2015, *available at* www.iosco.org/library/pubdocs/pdf/IOSCOPD521.pdf.

[73] *See supra* note 71.

[74] *Supra* note 72.

[75] ESMA/2014/1378 and 1560.

[76] EBA/OP/2015/03.

[77] *Supra* note 68.

[78] ESMA/2014/1560, p. 28.

neither party carries out both lending while at the same time accepting deposits or other moneys from the public. But banking regulation can come into play in national jurisdictions with a wider definition of banking activities, such as Germany.

(b) Regulation on investment firms and markets in financial instruments, the so-called MIFID/MIFR (Markets in Financial Instruments) framework. Typically, a platform in its capacity as investment intermediary would not meet the criteria of a Multilateral Trading Facility, the basic model of all exchanges, because typically only one seller per instrument would be involved. However, the project owner or obligor of related funding instruments might be subject to certain regulations of the Markets in Financial Instruments framework, in particular the Prospectus Directive (2003/71/EC, as amended).

(c) There are a couple of further EU laws which are potentially applicable, but are restricted to specific fields depending on the individual crowdfunding business model.[79]

E. Selected National Regimes

(a) People's Republic of China

The authorities have taken up the subject with the 2015 Guideline on the Promotion of the Health Development of Internet Finance entrusting the People's Bank of China (PBOC) with the lead in respect of the regulation of Digital Financial Services (DFS).[80] The guideline itself defines high-level principles for DFS regulation such as preservation of clients' reserve funds, risk disclosure, consumer protection, internet security and prohibition of money laundering and crime.[81]

According to the guideline, the China Banking Regulation Commission (CBRC) is mainly responsible for the lending-based aspect, in particular peer-to-peer lending platforms, whereas the China Security Regulating Commission (CSRC) deals with equity-based crowdfunding and fund management.

The CBRC issued a Circular on Risk Associated with Peer-to-Peer Lending as early as 2011[82] - which, however, merely defined a number of related risks. On 28 December 2015, the CBRC published a consultation paper on "Temporary Regulatory Measures for Internet Finance Intermediaries' Activities" addressing registration and other issues.

The CSRC and the Securities Association of China published a joint consultation draft of Measures on the Administration of Equity Crowd Funding in December 2014[83] including entry criteria, obligations and liabilities, and regulatory requirements, intended to be a self-discipline instrument of the industry.

(b) France

France has issued a comprehensive framework for both lending-based crowdfunding, regulated by the Autorité de Contrôle Prudentiel et de Résolution (ACPR)[84] and investment-based crowdfunding (subscription of equity and debt securities), regulated by the Autorité des Marchés Financiers (AMF).

(c) Germany

The German legislators have not established a specific comprehensive regime for crowdfunding.[85] Basically, the general regulatory frameworks are applied, in particular as far as licensing requirements

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[79] For a comprehensive overview see ESMA/2014/1560.

[80] Zhou *supra* note 70, p. 4.

[81] Zhou, *supra* note 70, p. 37.

[82] CBRC Circular No. 254, 23.08.2011; see Zhou (*supra* note 70), p. 28.

[83] Zhou *supra* note 70, p. 28.

[84] Order of 30th May 2014.

are concerned. However, a few overarching regulations for both lending- and investment-based crowdfunding are included in the Capital Investment Act ("VermAnlG") as amended by the Act on the Protection of Small Investors of 3rd July 2015.[86] The VermAnlG is applied to all public offerings of Financial Instruments as defined by § 1 sect. 1 and 2 of the VermAnlG. The recent amendment has introduced a catchall paragraph with § 1 sect. 2 no.7 including all other instruments giving a claim on interest and repayment or on any monetary remuneration for temporary allocation or usufruct of money, which has come into force on 1 January 2016.

As far as crowdfunding is concerned, a few specific exemptions have been introduced by §§ 2 and 2a-2c of the VermAnlG. These exemptions are mainly related to the publication of prospectuses and to the mandatory audit of issuers' annual financial statements. They are restricted to small and medium sized transactions.

Investors can cancel without reason and without penalty within 14 days after closing related contracts.

(d) UK

The Financial Conduct Authority (FCA) has issued specific and separate regulation on investment- and on lending-based crowdfunding taking effect from 1 April 2014 with its Policy Statement 14/4.[87]

- In respect of peer-to-peer lending, a new regulated activity of "operating an electronic system in relation to lending" has been defined to cover the platform's arrangements with both consumer-lenders and borrowers.
- In respect of investment-based crowdfunding, the scope of regulation encompasses platforms that allow persons to invest in new or established businesses by buying shares or debt securities. These investments are defined as "non readily realisable securities."

Whereas the full range of FCA consumer protection is always applied, all investment-based crowdfunding platforms targeting retail consumers are subject to additional investor-related restrictions.

(e) USA

As far as lending-based funding is concerned, the general rules on lending activities apply. In respect of investment-based crowdfunding, the US SEC has adopted a framework re. securities-based crowdfunding on 30 October 2015, which is incorporated in Title III of the JOBS Act as a federal exemption under the general securities laws.[88] An explanatory SEC "Investor Bulletin Crowdfunding for Investors" has been published on 16 February 2016.[89]

The final rules, Regulation Crowdfunding, permit individuals to invest in securities-based crowdfunding transactions subject to certain investment limits.

As far as the scope of application is concerned, all transactions making use of the new rules and related exemptions have to be channelled through an SEC-registered intermediary, either a broker-dealer or a funding portal.

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[85] For an overview, *see* the BaFin's (German Federal Financial Supervisory Authority) publications: *Crowdfunding*, BaFin Journal June 2014, p. 10, and *Crowdfunding im Licht des Aufsichtsrechts*, BaFin Journal September 2012, p. 11.

[86] German Federal Law Gazette (BGBl). I, 2015, p. 1245.

[87] "The FCA's regulatory approach to crowdfunding over the Internet, and the promotion of non-readily realisable securities by other media," PS 14/4, March 2014.

[88] Final rule: 17 CFR Parts 200, 227, 232, 239, 240, 249, 269, 274, with further amendments to the Securities Act Rules 147 and 504.

[89] *Available at* www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html/.

F. Conclusions

As the general frameworks on banking and securities regulation have not been designed with the crowdfunding industry in mind, and as their application highly depends on individual business models, some convergence is desirable from a regulatory perspective in order to avoid regulatory arbitrage, create a level business field and ensure that market participants can have confidence on a reliable basis. Further, as an Internet-based activity, crowdfunding has a strong potential for cross-border activities. The different national frameworks, even within the EU, are one of the key challenges posed to international platforms that wish to act globally. This is why a moderate regulation on the basis of minimum harmonisation might be in the best interest of the new developing industry.