

Cryptocurrencies, Bitcoins and Cyrptoassets

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Chapter 22

Cryptocurrencies, Bitcoins and Cryptoassets

Learning Outcomes

Studying this chapter should help you to:

- ✓ Understand the definition of cryptocurrency
- ✓ understand how bitcoins transfers take place
- ✓ understand the cryptocurrency is regulated in the UK.

1 Introduction

Virtual currencies have become quite important, especially since its introduction during the global financial crisis. The development of virtual currencies has been through close study, analysis and a renewed interest on transforming financial technology. In this brief chapter, we are going to discuss the journey of cryptocurrencies, the different types, and how they are regulated in the UK.

2. So, what is Cryptocurrency?

Cryptocurrencies could be described as a medium of exchange. It is accepted that this is a digital or virtual currency which uses cryptography to ensure security and to protect the identity of the sender or receiver. There are different types, including as Solanla, Ethereum, Litecoin and others. This chapter will focus on the most popular and arguably the most valuable, which is Bitcoin. Bitcoin was created by Satoshi Nakamoto in 2008, during the global

financial crisis in 2008. Cryptocurrencies can be used to make payment for services or products; however, their most common use is to trade online. Quite a lot of this trading is for the purposes of making a profit.

Bitcoins have had an interesting journey, mostly because the value has varied/fluctuated since its creation. In 2014, it played a significant part in the collapse of Mt Gox, a Bitcoin exchange based in Japan. The Bitcoin exchange suspended trading in February 2014 and filed for bankruptcy protection from its creditors. In 2017, there was another attack where over £108,000 in Bitcoins were paid by victims in the WannaCry ransomware attack which substantially impacted the NHS and other businesses, globally.

While cryptocurrencies continue to evolve, the method of regulating this in the UK is somewhat limited, given its fluctuations and other major concerns. In 2019, the Financial Conduct Authority published a report which investigated the impact of consumers using cryptocurrencies. One of the findings of this report is that consumers were purchasing cryptocurrencies, with very little information and *understanding* of this type of currency. It seems quite clear indeed that if you do not have all of the relevant information when you are about to engage in the cryptocurrency business, it is quite possible that you could be making a financial decision which could have some lasting consequences in the long run.

3 How do Bitcoin transfers take place?

It is important to note that the origins of cryptocurrency is not from a special or specific regulatory institution. The idea is based on a peer-to-peer system which shields it from interference from the government or other organisations. There two main types of bitcoins, namely Bitcoin Cash and Bitcoin Core. The first, allows the transfers of digital money at very low fees. The second however, is not used as widely, given that the fees attached are quite high and the fact that it takes much longer to transfer.

The innovation of Bitcoins came at a time when it seemed important to restore trust in the financial system, given the effects of the global financial crisis in 2007-2009. Some people have argued that Bitcoins have proven to be more valuable than cash, gold, or some other measurable value. This brings us on to the next point of whether Bitcoins can really be considered to be money or have monetary value. You could describe money to be something which allows you to pay for something with this item, therefore satisfying the argument that Bitcoins can be described as a medium of exchange. You could also say that you can use Bitcoins to quantify whether someone is 'rich' or not. You could probably also say that you can physically measure, in Bitcoins, how much someone has in their 'account'.

4 What are Cryptoassets and how is cryptocurrency regulated in the UK?

Now that we have considered what Bitcoins are, we should turn to defining what Cryptoassets, although they are all part of the same family as cryptocurrencies. The term Cryptoassets is quite broad and when we come to look at this in the last section, you will see that the Financial Conduct Authority does not regard cryptocurrencies as 'money' and chooses the term Cryptoassets. Cryptoassets can be defined as a digital representation of value, which may be transferred or traded electronically. In terms of regulating cryptocurrencies, there are two branches to these. The first, 'regulated tokens' and the second, unregulated tokens. Let's explore these in some detail.

4.1 Regulated Tokens

In this first branch, you have two types, the first, 'security tokens' and the second, 'E-Money tokens'. Security tokens refer to a specific or specified investment which excludes e-money. This type of investment may give rise to some rights such as ownership or the right to future profits, as you might expect with any investment. Then, we have E-money tokens, which meet

the definition under the Electronic Money Regulation which can be found on the Financial Conduct Authorities' website.

4.2 Unregulated tokens

In the second batch, we have unregulated tokens. These types are tokens which are *not* security tokens or E-money tokens. This branch includes Bitcoins, Litecoins, which are usually referred to a Cryptocurrency or sometimes as payment tokens. They do not provide any rights that we have covered above in the regulated coins sections, however, they can be sued as a medium of exchange or a means of investment.



You should now know the meaning of differences in regulated and unregulated tokens.

5 How is Cryptocurrency regulated in the UK?

Cryptocurrencies are outside the scope of the 'regulatory perimeter' of the Financial Conduct Authority. There is acknowledgment that this is indeed an innovative technology as we have covered earlier, however, it is important to also remember that due to its rapid change in features it poses a challenge in terms of offering appropriate regulation. It is also challenging to know whether the regulatory framework would be suitable and fit for purpose.

The cryptocurrency framework in the UK is constantly developing. There is no ban on cryptocurrency trading in the UK, and in the same way, there is no specific regulatory regime designed to regulate Cryptoassets. It seems clear however that the FCA does not accept that

cryptocurrencies can be regarded as 'money' or as a form of currency. This said however, there needs to be some framework which purports to regulate its use and to protect consumers.

In order to decide if cryptocurrency is going to be governed by the UK law, it will depend on whether it falls within the financial regulatory boundaries as established by the Financial Services and Markets Act 2000 and the electronic money regime under the Electronic Money Regulations 2011 and the Payment Services Regulation 2017.

There are plans to review how best to regulate Cryptocurrencies and this is reflected in the reports which have been published over the last few years. The most recent consultation paper was published in January 2021 and addresses the UK's regulatory approach to Cryptoassets and Stablecoins. The current regulatory perimeter needs to be expanded and, in this report, the objectives include protecting financial stability and market integrity. This is important as the right regulatory environment with the right standards will make it easier to mitigate potential risks to financial stability, delivering robust consumer protections. This too is very important, because it means consumers of Cryptoassets will be protected in the same way that other consumers make use of other financial instruments which are used for the same purpose such as making payments; and finally, promoting competition, innovation and supporting UK competitiveness. You could say this is one of the most important, considering that Cryptoassets/Cryptocurrencies are an innovative financial tool, and it is important that consumers have access to a wide range of services and quality products.



**Regulation on Cryptocurrency is a
current work in progress, in the UK.**

6 Recent Case on Cryptocurrencies

There have been a few cases in England which have considered whether Cryptocurrency may be considered as a type of 'property.' In the cases of *Robertson v Persons Unknown* (Unreported) 2019 and *Vorotyntseva v Money-4 Ltd (TIA Nebus.com) and others* [2018] EWHC 2596 (Ch) the courts were willing to accept this position. More recently in the case of *AA v Persons Unknown* [2019] EWHC 3556, the courts reflected on the UK jurisdiction Taskforce's Legal Statement and made a judicial pronouncement that cryptocurrencies are property. This area of law is still developing, as is the regulatory framework.

7 Summary

This brief chapter has considered the broad definition of cryptocurrencies, with a specific focus on Bitcoins. While there is no clear regulatory framework in the UK for this, the key points highlighted in the recent January 2021 consultation paper coupled with the courts judicial pronouncement that cryptocurrencies are a type of property could mean that this type of currency will be regulated soon.