

APPROVED
by the Board of the Bank of
Lithuania
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POSITION OF THE BANK OF LITHUANIA ON CRYPTO-ASSETS AND INITIAL COIN OFFERING

In analysing business models of financial market participants or entities intending to become financial market participants related to crypto-assets, having assessed the proposal of the European Commission of 2020 for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets (MiCA)¹, the 2019 report of the European Banking Authority (EBA) on crypto-assets², the position of the European Central Bank on crypto-assets³, the recommendations of the Financial Action Task Force (FATF) on crypto-assets⁴, as well as risks posed by crypto-assets, and following Article 42(12) of the Republic of Lithuania Law on the Bank of Lithuania, the Bank of Lithuania has prepared its Position on Crypto-assets and Initial Coin Offering (ICO).

The Position is intended for existing and potential financial market participants⁵ (hereinafter – financial market participants, FMPs), as well as entities intending to organise initial offerings of crypto-asset coins (hereinafter – coins or tokens) or to provide the possibility for Lithuanian consumers to purchase such products. It should be noted that this position cannot be regarded as official interpretation of the legislation. Since the Bank of Lithuania makes decisions taking into account the entirety of actual circumstances, this position cannot be regarded as the decision of the Bank of Lithuania in a specific case.

Crypto-assets may exist in a variety of forms, such as crypto-assets intended for settlement and payments, crypto-assets associated with traditional currencies or other assets, crypto-assets that provide access to services or goods, and crypto-assets with other characteristics.

For the purposes of this position, the terms in the FATF Recommendations shall apply:

1. “Crypto-asset (virtual asset)” is a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. Crypto-assets do not include digital representations of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations;
2. “Crypto-asset (virtual asset) service provider” is any natural or legal person who is not covered elsewhere in the FATF Recommendations and as businesses conducts one or more of the following activities or operations for or on behalf of another natural or legal person:
 - a) Exchange between crypto-assets and traditional currencies;
 - b) Exchange between one or more forms of crypto-assets;
 - c) Transfer of crypto-assets;
 - d) Safekeeping and/or administration of crypto-assets or instruments enabling control over crypto-assets;
 - e) Participation in and provision of financial services related to an issuer’s offer and/or sale of a virtual asset.

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020PC0593&from=EN>

² <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2545547/67493daa-85a8-4429-aa91-e9a5ed880684/EBA%20Report%20on%20crypto%20assets.pdf>

³ <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf>

⁴ <https://www.fatf-qafi.org/media/fatf/documents/recommendations/RBA-VA-VASPs.pdf>

⁵ Financial market participant shall mean a financial market participant supervised by the Bank of Lithuania as specified in Article 42(1) of the Republic of Lithuania Law on the Bank of Lithuania.

I. ON SEPARATION OF FINANCIAL SERVICES ACTIVITIES FROM ACTIVITIES ASSOCIATED WITH CRYPTO-ASSETS

Taking into account the relevance of the matter to financial market participants and seeking to shape a single practice for financial market participants with regard to the separation of their financial service activities from activities associated with crypto-assets, the Bank of Lithuania hereby presents the **criteria and requirements**, which, in its opinion, should be observed by financial market participants. The criteria and requirements laid down in section I of the Position shall not apply where the activities are related to digitally represented securities, fiat currencies, and other financial instruments which in legal acts are considered to be securities, electronic money, other financial instruments and which are subject to the requirements laid down in legal acts regulating the issuance, distribution and trading as well as other related activities.

On 31 January 2014, with regard to the warning of EBA about "virtual currencies", the Bank of Lithuania published its position⁶ warning consumers of the potential risks posed by "virtual currencies". On 16 July 2014, with regard to the EBA opinion on "virtual currencies"⁷, the Bank of Lithuania suggested that credit institutions, payment institutions and electronic money institutions refrain from the purchase, storage or sale of "virtual currency" in order to reduce the risk arising from the interaction of "virtual currency" schemes and regulated financial services, including risks associated with money laundering and other financial crimes, as well as the obscurity and uncertainty surrounding the financial capacity of market participants participating in "virtual currency" schemes.⁸

The Bank of Lithuania has also provided responses to individual financial market participants, informing them that activities associated with crypto-assets are not compatible with the provision of financial services and thus activities associated with crypto-assets should be separated from those of FMPs.

1. Financial market participants providing financial services⁹ should not participate in activities or provide services associated with crypto-assets.

Activities or services associated with crypto-assets shall include the purchase, storage or sale of crypto-assets, organising ICOs or distribution of coins, execution of transactions in crypto-assets, crypto-asset exchange activities, investment of funds in crypto-assets, and provision of investment services associated with crypto-assets, except when it is considered investment in financial instruments, setting up of funds intended for investment in crypto-assets with the exception of funds intended for professional investors, administration of crypto-asset accounts, and other similar activities. An FMP should not provide conditions to pay in crypto-assets using payment instruments issued by FMPs (e.g. pre-paid, debit or credit cards, etc.), link payment instruments issued by the FMP to crypto-assets accounts, accept crypto-assets with the obligation to repay them with or without interest, issue crypto-asset loans, and accept crypto-assets as collateral (except for cases where crypto-asset tokens are considered to be securities).

It should be noted that engagement in activities associated with crypto-assets may be incompatible with the legislation regulating FMP activities and may provide grounds for refusal to issue or revoke a licence. For example, Article 4(3) of the Republic of Lithuania Law on Banks stipulates that, in addition to providing financial services, a bank may pursue only such activities, without which it would be impossible to provide financial services, which help provide financial services or are otherwise directly related to the provision of financial services. Furthermore, participation of electronic money and

⁶ http://www.lb.lt/lietuvos_bankas_perspeja_del_virtualiu_valiutu_naudojimo

⁷ <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-8+Opinion+on+Virtual+Currencies.pdf>

⁸ <https://www.lb.lt/lt/naujienos/eba-siulo-galimus-reikalavimus-del-virtualiu-valiutu-reguliavimo-rezimo-ir-teikia-patarima-finansu-istaiqoms-del-siu-valiutu-isiqijimo-laikymo-ar-pardavimo>

⁹ "Financial services" shall mean services defined in the Republic of Lithuania Law on Financial Institutions as well as insurance activities specified in the Republic of Lithuania Law on Insurance.

payment institutions and collective investment undertakings in activities associated with crypto-assets would be incompatible with Article 13(8) and Article 14(10) of the Republic of Lithuania Law on Electronic Money and Electronic Money Institutions, Article 5(8) and Article 7(8) of the Republic of Lithuania Law on Payment Institutions, and Article 4(3-4) of the Republic of Lithuania Law on Collective Investment Undertakings.

2. In line with paragraph 1 of this Position, financial market participants should ensure separation of financial service activities from activities associated with crypto-assets, as well as ensure appropriate and not misleading communication about the nature of services that provided by an FMP.

2.1. When providing financial services to customers, an FMP should not assume risks associated with crypto-assets. Where an FMP provides services together with services associated with crypto-assets and provided by third parties, there must be a clear separation of such services, whereby all liquidity, market (e.g. price developments), credit (e.g. counterparty insolvency), operational (e.g. non-compliance with technical requirements) and other risks associated with crypto-assets must be borne by third parties.

2.2. An FMP should ensure that third-party services associated with crypto-assets and provided in an environment under its management (its website, mobile application, platform, ATM, client email, etc.) are risk-limited (e.g. customer identification of no lower level than that applied by the FMP, limited movement of crypto-assets, crypto-assets coverage with real assets, or application of other mitigating measures).

2.3. An FMP should ensure that, in an environment under its management or in an environment managed by third parties where the FMP provides financial services, information/links provided by the FMP for internal and external communication, the FMP's name, its trademarks or other information that could help identify the FMP or make other links to the FMP, do not create the conditions for misleading customers or create an impression that the FMP provides services associated with crypto-assets and/or such services are supervised and subject to the same security or service standards as those applicable to financial services. In the case where services associated with crypto-assets are also provided in the environment under the FMP's management, the FMP must ensure that users of financial services in the environment under its management are acquainted with the risks that may arise when using such services in a clear, comprehensive and unambiguous manner. Customers must confirm that they understand the risks related to crypto-assets on a regular basis, not only when they start using third-party services. An FMP must ensure that the customer clearly understands that both supervised and unsupervised financial services related to crypto-assets are provided in the same environment, as well as the difference between these services.

3. In providing financial services to customers engaged in activities associated with crypto-assets, financial market participants should ensure compliance with legislative requirements for money laundering (ML) and terrorist financing (TF) prevention and take appropriate measures to manage ML/TF risks.

3.1. Activities and services associated with crypto-assets pose higher ML/TF risk and, therefore, FMPs should take appropriate measures set forth in legislation on the prevention of money laundering and terrorist financing in order to reduce and manage such risks.

3.2. FMPs should ensure that, in the provision of payment or other financial services to business customers associated with crypto-assets, it should be assessed whether such customers are implementing effective ML/TF risk management controls (identification of persons using the services of such customers, fulfilment of know-your-customer requirements, monitoring of transactions, etc.). If the money laundering and/or terrorist financing prevention control of such customers is inadequate, FMPs shall

take additional measures to reduce and manage ML/TF risks.

II. ON INITIAL COIN OFFERING

An ICO shall mean any initial coin offering with the purpose of raising capital or investment for the development of a new product or service, company or its activities. ICOs take place online, using the Distributed Ledger Technology, blockchain, and selling the released coins in crypto-assets or real currencies. Depending on the conditions of a specific issue, released coins may grant different rights to their owners, such as the right to participate in the company management process, the right to receive part of the company's profit, the right to receive part of the company's income, the right to receive interest for invested funds, the right to recover the invested funds and receive additional income through redemption of the coins, the right to use a product or service free of charge or for payment in coins, the right to sell the coins to another person, etc.

Persons generally seek different objectives when purchasing coins: support a certain project, become a shareholder of the company, receive interest or return on investment, earn from the rising price of coins and their resale in the secondary market, pay in coins for a developed product or service, etc.

Although organisation of ICOs is not regulated by specific legislation, taking into account different ICO models and different characteristics of coins, the Bank of Lithuania would like to point out to ICO organisers and coin distributors that, in some cases, such activity may be subject to the requirements of the legislation of the Republic of Lithuania.

It should also be noted that the fact that a specific ICO model is subject to one of the following regulatory regimes means that respective entities must observe the restrictions set forth in section 1 of this Position, i.e. supervised financial market participants should not participate in activities or provide services associated with crypto-assets and should comply with other criteria and requirements set forth in section 1 of this Position.

1. **Application of the Republic of Lithuania Law on Securities.** In those cases where coins released through an ICO have characteristics of securities (grant the right of ownership, management of the company, or grant other rights to shareholders, such as the right to receive part of the company's profit in the form of, e.g. dividends, provide for payment of interest or redemption of coins, etc.) and may be transferred to other persons as well as traded in the secondary market or at organised trading venues, their offering is subject to the provisions of the Republic of Lithuania Law on Securities. Prior to starting the distribution of security tokens in Lithuania, a prospectus, approved by the Bank of Lithuania or a competent authority of another EU Member State, should be drawn up and made publicly available (except for derogations provided for by the Republic of Lithuania Law on Securities). On 17 October 2019, the Bank of Lithuania issued Guidelines on Security Token Offering (STO)¹⁰ intended to provide more regulatory clarity for market participants and greater protection for investors. The Guidelines reflect the approach of the Bank of Lithuania to tokens as a financial instrument, with the main focus on their categorisation (which tokens should be considered as having the characteristics of securities or of other financial instruments), contain specific examples, provide recommendations on the release of security tokens, and explain what legal framework should apply.

2. **Application of the Republic of Lithuania Law on Crowdfunding.** In those cases where an ICO has characteristics of a project defined by the Republic of Lithuania Law on Crowdfunding (a project designed to meet business, professional, scientific, research and other needs, for the implementation of which the project owner is seeking to raise funds from the public by borrowing from funders or granting them the right to participate in company management and its capital formation), the operator of the platform used for the ICO may be subject to the requirements of the Republic of Lithuania Law on Crowdfunding.

¹⁰ <https://www.e-tar.lt/portal/lt/legalAct/e1018840f18111e99681cd81dcdca52c>

3. **Application of laws regulating the activities of collective investment undertakings.** In those cases where the entity releasing the coins collectively invests the funds received through an ICO in different projects (not necessarily associated with crypto-assets) with the purpose of receiving return for coin holders, the activities of such entity may be subject to legislation regulating the activities of collective investment undertakings.

4. **Application of laws regulating the provision of investment services.** In those cases where coins released through an ICO have the characteristics of financial instruments (e.g. transferable securities, money market instruments, derivatives or other instruments specified in the Republic of Lithuania Law on Markets in Financial Instruments), they may only be distributed by licensed financial intermediaries subject to the requirements of the Law on Markets in Financial Instruments.

5. **Application of laws regulating the secondary market.** In those cases where coins released through an ICO have characteristics of transferable securities, money market instruments, derivatives or any other financial instruments specified in the Republic of Lithuania Law on Markets in Financial Instruments, entities organising and/or engaged in active secondary trading in coins or entities operating trading platforms used for secondary trading in coins may be subject to the Republic of Lithuania Law on Markets in Financial Instruments.

6. **Formation of a newly established FMP's capital through ICOs.** If funds collected through an ICO are intended for the formation of the capital of a newly established FMP, the capital formation requirements applicable to a specific form of financial institution shall apply. For example, in the case of establishment or licensing of a bank, according to the requirements of the Law on Banks and subordinate legislation, information about the persons that acquired a qualifying holding of the authorised capital and/or voting rights, evidence that the bank has the required initial capital, and information about the origin of such capital must be submitted. Organising ICOs with the purpose of forming the initial capital of a newly established FMP by yielding in crypto-assets and then converting them into traditional currency should not prevent identification of the primary holder, consignor or investor of crypto-assets, including the activities that generated these crypto-assets and the measures used for their transfer. The newly established FMP should make it possible to trace the entire crypto-assets movement scheme, from their initial acquisition and sale to redemption.

It should be noted that, when deciding on the application and scope of specific legislation of the Republic of Lithuania for specific ICO, the conditions of the relevant ICO should be analysed and assessed.

This Position shall be reviewed periodically at least every six months and updated when necessary.
