



Professional Indemnity Insurance

Cryptocurrency - guidance couldn't come soon enough

A recent Europol report¹ highlighted the popularity of Bitcoin transactions at the end of 2017 and the fact that this, together with wider adoption, also led to an increase in the use of cryptocurrencies for illicit transactions. Europol further stated that a lack of (minimum) standards for due diligence and Know-Your-Customer (KYC) regulation through the Fifth Anti-Money Laundering (AML) Directive has created challenges for those dealing with the legal issues surrounding cryptocurrencies.

We are starting to see cryptocurrencies entering into mainstream ownership and transactions. As the value of cryptocurrencies begins to stabilise, perceived criminal associations subside, and younger generations become more influential, undoubtedly this trend will significantly increase.

Cryptocurrency transactions are becoming more common place and as we heard in our recent Willis Towers Watson Cryptocurrency Roundtable event, held in June 2019, the legal profession is receiving an increasing number of cryptocurrency related requests from clients. During the last couple of years we have seen properties purchased using Bitcoin, and the sale price recorded in this currency on the title information documentation at HM Land Registry.

With the inevitable changes to legal and contractual relationships between businesses and individuals as technological advancements continue, law firms need to understand the implications for their businesses. Ensuring client advice and services can be provided with greater certainty, whilst minimising the risk from such transactions, is paramount.

There is an air of nervousness around the involvement of cryptocurrencies in legal transactions due to its perceived association with criminality, but it is likely to become more routine in the legal profession.

The use of cryptocurrencies is anticipated to challenge and change how the legal profession does business and provides legal services to clients. Some law firms are ahead of the curve, but all lawyers will need to build their knowledge and expertise in order to discuss the implications of cryptocurrencies with clients in wide-ranging scenarios such as divorce proceedings, wills and international transactions.

Once more law firms become familiar with conducting cryptocurrency transactions, confidence will grow. The change will take time, but from our Willis Towers Watson Cryptocurrency Roundtable event (2019) the consensus was it will happen. Not so long ago the profession was apprehensive about operating paperless offices, but this is now widely accepted as normal business practice.

1. Europol and Eurojust. (2019). Common Challenges in Combating Cybercrime. <https://www.europol.europa.eu/publications-documents/common-challenges-in-combating-cybercrime>

Our Willis Towers Watson Cryptocurrency Roundtable event (2019) highlighted the following current challenges facing law firms:



Compliance and meeting client needs

As cryptocurrency ownership and transactions increase, lawyers are being approached more frequently for advice.

The challenges:

- **Uncertainty:** currently very little in the way of guidance
- **Complexity:** client requests may be complex involving conveyancing, probate, international transactions and divorce proceedings
- **Know your client and transparency:** thorough client due diligence and source of funds and/or wealth verification is essential to ensure compliance with strict anti-money laundering legislation
- **Risks and costs:** extensive risk and costs involved for law firms. Internal policies and procedures will need to be adapted and staff training provided
- **Competition:** competition and customer servicing issues for firms rejecting clients requiring cryptocurrency advice



Reputation & clarity

The reputation of cryptocurrencies is still poor and perceived as high risk. A lack of understanding about the use of cryptocurrencies remains commonplace.

The challenges:

- Volatile value of cryptocurrency maintains the air of mistrust and obliqueness
- Some cryptocurrency exchanges are comparatively new and/or hidden, adding to transparency issues



Lawtech

As the use of cryptocurrency becomes more mainstream, the requirements for law firms to invest in lawtech will intensify.

The challenges:

- Pressure to invest in new skills and systems will grow as the requirement to handle cryptocurrency transactions, store passwords and other issues become more prevalent
- Investment by smaller law firms is limited in comparison to the larger counterparts
- Concern about the robustness of third-party systems
- Use of blockchain still not fully commercialised, adding to the issue of cryptocurrency transparency



Transactions & client money

As previously mentioned, the involvement of cryptocurrencies in legal transactions is increasing*.

The challenges:

- Uncertainty around the processes required to receive client money and how ledgers are to be maintained
- Current lack of cryptocurrency banking facilities and the perceived high cost of transactions due to relatively few occurring
- Fluctuations in the value of cryptocurrency may create transaction timing challenges and pressures
- Compliance with the SRA Accounts Rules 2011



Classification rules

No guidelines on cryptocurrency and asset classification.

The challenges:

- Uncertainty about whether a cryptocurrency falls under the category of personal property
- Question over whether a third category of personal property is required
- If cryptocurrency is not an asset, it cannot be owned, purchased, sold or transferred, and insolvency laws do not apply



Lack of guidance

There is little in the way of guidance and legal certainty.

The challenges:

- With the existing level of guidance and legal certainty, it remains challenging for the legal profession to fully advise clients whilst maintaining compliance with legislative and regulatory obligations

The need for guidance and legal certainty

With the issue of cryptocurrencies coming more to the fore, the legal profession needs robust guidance and legal certainty. This is a view shared by law enforcement as the recent joint report published by Europol and Eurojust on combating cybercrime (Europol and Eurojust, 2019, p. 12)² suggests that the lack of (minimum) standards for dealing with client due diligence creates further challenges for fighting cybercrime and conducting investigations. It is anticipated that the transposition of 5MLD in January 2020 will lead to further guidance and certainty.

The Financial Action Task Force (FATF) has recently published its latest Guidance for a Risk Based Approach to Virtual Assets and Virtual Asset Service Providers³. This guidance builds on the first report prepared by FATF in June 2014⁴ about virtual currencies; setting out the key definitions, and identifying potential money laundering and terrorist financing risks. The report was published in response to the rise in the use of cryptocurrencies and associated payment mechanisms, and the initial guidance published in June 2015⁵ which addressed money laundering and terrorist financing risks associated with cryptocurrency payment products and services.

There are a number of additional initiatives underway, including:

Law Society research

In February of this year, the Law Society produced a Lawtech Adoption Report⁶, providing a flavour of the challenges law firms are currently facing. Cryptocurrencies are considered within the report, which found that:

- There is increasing pressure on legal firms to invest in lawtech
- Significant barriers to adoption still remain
- Lawtech lags behind insurtech and tech in other sectors
- Rising awareness that lawtech is important, the legal market is changing, and law firms that adopt new technology will have a competitive advantage over those that do not
- Lawtech is still nascent and less 'disruptive' than other types of technology
- Different segments of the market are at different stages of maturity when it comes to lawtech adoption
- UK lawtech remains a thriving sector for emerging technologies
- New technology skills are required in the legal sector
- In relation to cryptocurrencies, several firms are looking at blockchain but the technology is two to four years away from being fully commercialised
- Firms are engaging universities to consider the legal and commercial implications of cryptocurrencies

2. Europol and Eurojust (2019). Common Challenges in Combating Cybercrime. <https://www.europol.europa.eu/publications-documents/common-challenges-in-combating-cybercrime>
3. Financial Action Task Force. (2019). Guidance for a Risk Based Approach. Virtual Assets and Virtual Asset Service Providers. <https://www.fatf-gafi.org/media/fatf/documents/recommendations/RBA-VA-VASPs.pdf>
4. Financial Action Task Force. (2014). FATF Report. Virtual Currencies. Key Definitions and Potential AML/CTF Risks. <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-ctf-risks.pdf>
5. Financial Action Task Force. (2015). Guidance for a Risk Based Approach. Virtual Currencies. <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf>
6. The Law Society. (2019). Lawtech Adoption Research. <https://www.lawsociety.org.uk/support-services/research-trends/lawtech-adoption-report/>

The LawTech Delivery Panel

The UK Jurisdiction Taskforce of the government-backed LawTech Delivery Panel⁷ is looking at the legal status of self-executing smart contracts and the nature of cryptoassets, and if they need to be classified as a new type of personal property in law in England and Wales. The Panel is aiming to publish an authoritative statement by the end of this summer about whether cryptocurrencies can be treated as property or not, and whether law reform is necessary.

7. <https://www.lawgazette.co.uk/law/cryptoassets-a-new-category-of-personal-property/5070732.article>

The future

It is widely accepted the use of cryptocurrencies will increase and become commonplace within the legal profession. In time, there will be further guidance on how to minimise exposure to the risks arising from such transactions, and to ensure compliance with regulatory and legislative obligations. Any confusion and misconceptions about the use of cryptocurrency will be replaced with a greater understanding and we should witness law firms transition to the modern way of providing legal services effortlessly and confidently.



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