

Adoption of new Law on Digital Financial Assets and Digital Currencies

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Speed read

The Russian federal law on digital financial assets and digital currencies (the **Law**) was signed and published on 31 July 2020¹. Most of its provisions will take effect on 1 January 2021 (the **Effective Date**). The Law regulates the arrangements associated with the issuance and circulation of two objects –“digital financial assets” (DFAs) and “digital currencies”. Among other things, the Law introduces the following new concepts:

- “digital currency” is defined as a digital code used as a mean of payment and as a saving tool (an investment), however Russian residents are not allowed to receive digital currencies as payment for goods, works or services. In addition, nobody in Russia is allowed to distribute any information about possible settlements in digital currencies;
- there is a requirement to notify (in essence, declare) the ownership of any digital currency and any transactions with it, and this is a condition to judicial protection of such transactions;

- the rights certified by DFAs become available to the first holder of those DFAs after the crediting of the relevant DFAs to that person in the information system in which the DFAs are issued;
- the Law regulates the roles of both the operator of the information system in which DFAs are issued and the DFA exchange operator, as well as arrangements associated with the circulation of DFAs.

Following lengthy discussions between the market participants over numerous drafts of the bill, the Law is quite a compromise. In particular, the definition of digital currency has become broader to include digital currencies of foreign origin (eg bitcoins). However, Russian residents are not allowed to receive digital currencies as payment for any goods, works or services (which is not consistent with the definition of digital currency as a means of payment).

Below we outline the key innovations contained in the Law which we consider to be the most relevant for our clients' business.²

¹ See Federal Law dated 31.07.2020 No 259-FZ "On Digital Financial Assets, Digital Currency and on the Introduction of Amendments to Certain Legislative Acts of the Russian Federation".

² Please note that we do not aim to give a comprehensive description or analysis of all of the innovations provided for by the Law in this alert.

Digital Financial Assets (DFAs)

- The Law governs arrangements associated with the issuance, recording and circulation of DFAs, as well as the roles of both the operator of the information system in which the DFAs are issued, and the DFA exchange operator.
- Under the Law, DFAs are defined as digital rights certifying one of the following rights (this is an exhaustive list):
 - monetary claims;
 - the power to exercise rights in relation to the registrable securities;
 - the rights to shares in a private joint stock company; and
 - the right to claim a transfer of the registrable securities approved by the DFA issue resolution in accordance with the requirements of the Law,where the issuance, recording and circulation are only possible via making (amending) records in the information system on the basis of a distributed register (blockchain) and in other information systems.
- The Law also defines the distributed register (blockchain) as a set of databases in which the integrity of information is secured on the basis of (an) established algorithm(s).
- One may conclude from the definition of DFA that the provisions of the Law are applicable to certain kinds of "tokens" covered by that definition (primarily, share tokens and credit-tokens).
- Tokens and stablecoins that do not certify rights to any objects referred to in the definition of DFA seem to be beyond the scope of the Law. But this does not exclude that circulation of such objects will be regulated by other laws. For example, the issuance and circulation of certain kinds of utility tokens are already governed by the Federal Law dated 2 August 2019 No 259-FZ "On Raising Investments via Investments Planforms and on the Introduction of Amendments to Certain Legislative Acts of the Russian Federation".
- Utility digital rights are defined as the following digital rights arising from an agreement made in accordance with the investments platform rules: (i) the right to demand a transfer of thing(s); (ii) the right to demand a transfer of exclusive rights to intellectual property assets and/or the rights of use of intellectual property assets; and (iii) the right to demand that any work is done and/or any service is provided.
- The essence of the right (claim), the process for the exercise of the utility digital rights, and the number of the utility digital rights offered are determined by the person raising investments in accordance with the investment platform rules. A utility digital right cannot be a right to claim any property interests which are subject to state registration, and/or the right to claim any property in respect of which the related transactions are subject to state registration or notarisation.
- Additionally, the Law states that the transactions involving utility digital rights, including where the utility digital rights of one kind are exchanged for the utility digital rights of another kind and sale and purchase transactions in relation to the utility digitals rights, may be made, among other things, via the DFA Exchange Operator (as described in more details below).

DFA issuance, recording and circulation

- The Law regulates in detail the roles of the operator of the information system in which the DFAs are issued and the DFA exchange operator, as well as the arrangements for circulation of DFAs.
- The rights certified by DFAs become available to the first holder of the DFAs after the crediting of the DFAs to that person is recorded in the information system in which the DFAs are issued.
- DFAs may only be issued by a legal entity or an individual entrepreneur on the basis of a decision which must: (i) be documented in electronic form; (ii) be published online; and (iii) contain a description of the relevant DFAs as required by the Law. In particular, the decision must refer to the information system in which the DFAs are issued and the operator of such information system.
- The subsequent recording, circulation and transfers of the DFAs are to be performed in the information system in which the DFAs have been issued in accordance with the rules of that information system.
- As a general rule, the rights certified by DFAs are transferred to a new holder (and any restriction or encumbrance in relation to the DFAs arises) after that transfer (or restriction or encumbrance) is recorded in the relevant information system in accordance with the rules of that information system.
- An information system in which DFAs are issued, circulated and recorded is maintained by a specialised entity (the **Information System Operator**). The Law sets out quite detailed requirements for the Information System Operator. It must be a Russian legal entity (among other things, it could be a credit institution, an entity entitled to engage in depositary activity or an entity entitled to act as market operator) and must be included in the register of information system operators maintained by the Bank of Russia. The Law sets out qualification criteria for an Information System Operator's chief executive and other officers. Additional criteria may also be applied by the Bank of Russia.
- Any Information System Operator must maintain a register of information system users in accordance with a set procedure, and take responsibility for any violations or disruptions in the relevant information system.
- Any transactions with DFAs are to be made via another specialised entity (the **DFA Exchange Operator**) ensuring the execution of DFA transactions either by collecting and comparing differently directed bids, or by participating in a DFA transaction at its own expense as a party to that transaction, for the benefit of a third party.
- A DFA Exchange Operator may be (i) a credit institution; (ii) a market operator; or (iii) a Russian legal entity having share capital and net assets (or, in relation to a non-profit entity, aggregate annual property contributions from its members) of at least RUB50 million and otherwise compliant with the Law and regulations of the Bank of Russia. It must be included in the register of DFA exchange operators maintained by the Bank of Russia. There are also some qualification criteria for DFA Exchange Operator's chief executive and other officers. Similarly to the Information System Operator, the DFA Exchange Operator must also adopt the Bank of Russia's rules.
- The same person may act as both the Information System Operator and the DFA Exchange Operator, to the extent that person qualifies for both roles.
- Both the Information System Operator and the DFA Exchange Operator have an obligation to identify clients and to collect and submit clients' details and details of their transactions as and when required by applicable anti-money laundering and counter-terrorism law.
- The Information System Operator and the DFA Exchange Operator may recognise persons as qualified investors if formally requested to do so under the applicable securities law.
- The Bank of Russia may establish criteria for any specific class of DFAs that may only be purchased by qualified investors, or may be purchased by non-qualified investors only within certain limits. Where a non-qualified investor buys any DFAs that may only be purchased by qualified investors, or buys any DFAs in excess of the applicable limit, the relevant operator must, at the request of that non-qualified investor, purchase the relevant DFAs from that investor and indemnify that investor against any incurred expenses, unless that investor was recognised as a qualified investor due to a misrepresentation made by them.
- There are special rules for DFAs certifying the power to exercise any rights attached to shares in a private joint stock company, or the right to claim a transfer of such shares. For example: (i) no DFA offering is allowed if a private joint stock company has previously issued shares in ordinary (book-entry) form; (ii) no state registration is required for an offering of shares in the form of DFAs; and (iii) shares in a public joint stock company cannot be issued in the form of DFAs.
- There are also special requirements for the advertisement of DFAs. No advertisement is permitted until a resolution on the DFA issue has been published. Any advertisement materials may not promise any profit on the DFAs or contain any projections in relation to the growth of their market value must state the name of the DFA issuer, indicate the website displaying the resolution on the DFA issue and summarise any restrictions for non-qualified investors, as well as warning the readers that the DFAs are a "highly risky" financial instrument associated with a potential loss of money.

Digital currency (Cryptocurrency)

- Digital currency is defined in the Law as a set of electronic data (a digital code or symbol) contained in an information system:
 - which is and/or may be offered as a payment instrument (ie a mean of exchange to acquire goods and services) and/or as an investment;
 - which is not backed by the Russian or any foreign and/or international currency; and
 - in respect of which there is no person responsible to each holder of that electronic data apart from the operator and/or information system components which are only obliged to ensure that the procedure for generation and registration of such electronic data within the information system (or for alteration of previous registration entries) is consistent with its rules.
- There is no reference in the Law to the use of any cryptography, blockchain or other cryptocurrency-related technologies.
- The Law clarifies that its provisions do not apply to the circulation of non-cash and electronic funds or to the issuance, recording and circulation of uncertificated securities.



Circulation of digital currency in Russia

- The key legal development affecting digital currency is a ban on the acceptance of digital currency by Russian residents as consideration for any goods, works, services or other items. There is a certain contradiction here as the mere concept of cryptocurrency set forth in the same document suggests that it may be used as a payment instrument.
- This ban extends to legal entities established under Russian law, as well as to the branches, representative offices and other subdivisions of foreign legal entities and individuals that are residing in Russia for at least 183 days during the next 12 months.
- Furthermore, such persons are required to notify tax authorities (ie to declare) of the digital currency in their possession, as well as of any civil law transactions and/or operations involving such digital currency. This being the case, any claims in respect of undeclared digital currency, or any undeclared transaction involving digital currency, will not be enforceable.
- Additionally, no person is allowed to distribute any information in Russia on digital currency being offered or accepted as consideration.
- It appears that the issuance and circulation of digital currency are going to be covered more specifically by a separate federal law. Such law will govern the activities relating to the arrangement of issuance and circulation of digital currencies, as well as issuances carried out using Russian information infrastructure, any equipment located in Russia and domain names and network addresses belonging to the Russian domain extension.
- The Law recognises digital currency as a property item rather than a digital right. Certain specific amendments are being introduced in this regard to the Federal Law “On Insolvency (Bankruptcy)”, the Federal Law “On Enforcement Proceedings” and the Federal Law “On Countering Corruption”. Corresponding amendments may also have to be made to the Russian Civil Code.

As we see it, the Law – which has been enacted after much debate in professional circles – is an attempt to find a compromise.

In particular, the concept of digital currency has been made universal and, therefore, may be applied not only to the cryptoassets generated within the Russian information systems under the supervision of the Bank of Russia but, for example, to bitcoins as well. This is an improvement given that the initial intention was that the Russian Civil Code, the law on crowdfunding and the draft bill on DFAs would provide for the Russian origin of cryptoassets, which would take the entire array of global cryptoassets beyond the legal regime and dim the outlook for the Russian cryptomarket.

The previous version of the draft bill was mostly prohibitive, imposing administrative and criminal liability in most of the cases. The relevant provisions on administrative and criminal liability were ultimately removed from the Law, but that does not mean that they will not be later introduced by other federal laws. The Law also makes reference to certain laws that will govern mining operations and the procedure for arranging the issuance and circulation of digital currency in Russia, however, it cannot be ruled out that such laws will impose other restrictions on these operations. According to certain legal experts, the final version of the Law does not appear as draconian as the previous drafts, but still epitomises the battle of the Bank of Russia against quasi-money instruments.

In this alert, we have sought to highlight the most important legal developments that will have a material impact on how transactions are structured and how the relevant Russian law legal opinions are drafted – after the Effective Date.

We would welcome opportunities to discuss the Law in greater detail with our clients; please do not hesitate to contact us.

Key contacts

If you require advice on any of the matters raised in this alert, please contact the author listed below or your usual contact at Allen & Overy.



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