

BITCOIN NOT A FINANCIAL INSTRUMENT – DECISION BY BERLIN COURT

The criminal senate of the higher regional court in Berlin questions BaFin's administrative practice in relation to licensing requirements for virtual currencies.

BAFIN'S ADMINISTRATIVE PRACTICE

Licensable banking business and financial services are defined conclusively in the German Banking Act (*Kreditwesengesetz*, KWG) and include in particular trading and brokerage related activities in relation to financial instruments.

Until now, the German Federal Financial Supervisory Authority (BaFin) has treated virtual currencies – including Bitcoin – as units of account (*Rechnungseinheiten*). Under German law, units of account are financial instruments, regardless of what software, encryption or other technologies have been used. Therefore, German licence requirements would apply if conducting trading or brokerage related activities in relation to virtual currencies in Germany (if targeting German residents, even on a cross-border basis).

Where the application for a licence in Germany is not an option, market participants would need to rely on the narrow reverse solicitation exemption. However, this rules out active targeting of customers located in Germany. BaFin's administrative practice therefore prevented most market participants in the virtual currency sector from actively expanding their activities to the German market.

DECISION OF THE BERLIN COURT

The Criminal Chamber of the Higher Regional Court in Berlin (*Kammergericht*) had to decide whether a person dealing in Bitcoin committed a criminal offence by engaging in licensable activities without a licence.

The court ruled – contrary to BaFin's view – that Bitcoin cannot be considered units of account under the KWG and consequently the underlying activity is not a licensable banking business or financial service. By referring to the reasoning of the German legislature, the court outlined that units of account are monetary units of measure used to represent the real value of an economic item. However, due to the lack of general recognition of Bitcoin as a monetary unit and its unpredictable value, the court held that Bitcoin cannot be considered units of account.

The Berlin court held that it is not the task of a federal authority to intervene in criminal laws. Pursuant to Article 103 of the German Constitution (*Grundgesetz*) an act may only be punished if it was defined by a law as a criminal offence before the act was committed. In this respect, the court outlined that it is the sole responsibility of the legislature to specify the

conditions under which a criminal offence is committed. Conversely, BaFin is not competent to extend the scope of existing criminal laws via its administrative practice.

PRACTICAL RELEVANCE

The decision by the court is important because it generally questions BaFin's view in relation to licensing requirements for virtual currencies, not only for virtual currency platforms but also for other market participants such as distributors and investment advisors.

There may also be more nuanced implications for institutional investors and funds that currently allocate their investments in virtual currencies to existing asset classes, such as structured securities, bonds and other financial instruments, based on BaFin's classification of virtual currencies as financial instruments.

It remains to be seen whether BaFin adjusts its administrative practice in line with the court's ruling.

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