



Conceptual framework for the regulatory treatment of Virtual Assets in Uruguay

Virtual Assets Working Group - December 2021



BANCO CENTRAL
DEL URUGUAY

Important:

The content of this document is not intended to convey a simplified version of the regulations applicable to supervised institutions. Those interested in knowing the current regulation applicable to their activity should refer to the information published in the regulations section of the Central Bank of Uruguay (CBU) website (www.bcu.gub.uy).

This translated report represents our best effort to provide an English version of the *Conceptual framework for the regulatory treatment of Virtual Assets in Uruguay*. In case of any unintended inconsistency, the original version in Spanish prevails.

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1. Introduction

Given the rapid development of the instruments that are known as "virtual assets" (VAs) and their growing operations both globally and domestically, it is necessary to provide greater certainty and clarity about this phenomenon and its regulatory considerations, with the aim to keep the local market and the different financial services safe.

In this sense, the Central Bank of Uruguay (CBU), in compliance with its purposes, must guarantee the protection of consumers and investors, the proper functioning of the markets, and also mitigate the risks for financial stability and monetary policy that may arise from the use of virtual assets.

This document seeks to provide a conceptual framework aimed at understanding and categorizing the different instruments and their related operations, with the aim of contributing to the analysis of a regulatory approach for VAs in our country.

The report is structured as follows: section 2 explains the objectives and the approach taken in the document; section 3 the scope of the document; section 4 a preliminary analysis of potential risks and benefits for users, the financial system and the central bank; section 5 the regulatory focus and approach; section 6 definition and taxonomy of virtual assets, functions and roles of this category of assets; Section 7 a proposal for defining the regulatory perimeter, and Section 8 guidelines for a possible authorization system.

This document proposes modifications that arose from the knowledge exchange with the financial sector, virtual asset service providers (VASPs), software companies, law firms, consulting firms, public bodies, representatives of academia and regulators from other jurisdictions.

2. Objectives and approach

An internal Working Group on Virtual Assets (VAWG) was established in 2021 to carry out the activities summarized below:

- Internal research and analysis, integrating the perspectives of the different CBU services involved.
- Preparation of the first version of the *Conceptual Framework*, which lays the foundation for a shared understanding of this phenomenon.
- Meetings with some industry participants and other regulators to exchange ideas and improve the conceptual framework document.

The published Conceptual Framework document seeks to share the result of the work carried out by the VAWG, reflect its perspective, and invite the wide range of stakeholders to contribute to the discussion by providing written feedback on the questions included in each section. The information will be treated confidentially and will be included in an aggregated manner, without identifying the parties involved.

Inputs received will be discussed by the VAWG, but will not be binding on the approach that may finally be carried out at the institutional level.

Feedback should be sent by email to the Innovation Office (innova@bcu.gub.uy).

3. Scope

The considerations set forth in this report will be of a non-binding nature and will of course be subject to changes as progress is made in future stages of work.

The following are considered outside the scope of this document:

- Regulatory changes necessary to adequately cover operations with VAs.
- Analysis & discussion on the issuance of virtual assets through transaction validation processes, commonly known as mining.
- Analysis & discussion on central bank digital currencies (CBDC).

4. Preliminary analysis of potential risks and benefits for users, the financial system and the central bank

Virtual assets can pose risks to financial stability and prices, compromising the objectives of promoting soundness, solvency, efficiency and development of the financial and payment systems. The materialization of the risks will depend on the extent to which these instruments are used, whether as securities, means of payment

or for other purposes. It will also depend on their links with the financial system and the response of the competent authorities.

Although its current scale and links with the formal financial system are relatively low, the increasing global attention and explosive growth in recent times require imminent consideration at the domestic level.

Some virtual assets are presented as instruments that try to serve as currency, means of payment or investment vehicles, among others, highlighting their decentralized nature. In a context of high dynamism, uncertainty and misinformation about the fundamental characteristics of virtual assets and the proposed business models, users could be exposed to excessive risks. Likewise, the exposure could be important for the financial system, the payment system and price stability.

User protection – Without an efficient protection framework, potential fraud and scams using virtual assets and cyber attacks, could expose unsophisticated investors and users to significant losses (financial and of personal data). Regulation, supervision and standard requirements to be met by all operators of virtual assets, are ways to provide protection to users. Also, given the characteristics of the assets and their dynamism, it would be appropriate to provide education, information and warnings about potential risks, good management practices, and the level of protection in each case.

Money laundering and financing of terrorism - The virtual and decentralized nature of many virtual assets allows brokers to operate with great levels of anonymity, regardless of borders, legal frameworks and financial infrastructures. This opens the possibility that virtual assets can be used as a means to finance illegal activities, and as a tool for money laundering. Various international recommendations and good practices are on the agenda to mitigate these risks.

Financial stability - Systemic risks to financial and macroeconomic stability appear more distant, but equally latent. These include the potential weakening of transmission channels of monetary policy, reduction in tax collection, risks to financial stability due to contagion, exposure to common risk and increased procyclicality, as well as detrimental effects on users and supervised institutions that could lead to an increase in the aggregate level of risk in the financial sector. The monitoring of exposure and the implementation of adequate coverage and risk management by the supervised institutions are potential strategies to mitigate these risks.

Reputation - There are other risks that could directly affect the Central Bank. They can be grouped under the heading of reputational risk: the Bank's credibility and prestige could suffer if no actions are taken or if there is an inappropriate regulatory approach.

On the one hand, if any of the aforementioned risks materialize, the Bank will be questioned about its role in risk prevention and resolution, even in cases where the

Bank has no power, as some of the terms used for some virtual assets, such as *cryptocurrency*, may suggest otherwise. Taking proactive measures aimed at mitigating risks and anticipating situations such as the above, could help reduce the impact of this type of risk.

On the other hand, excessive regulation, arising for example from lack of understanding on the nature, potential efficiency gains and risks of virtual assets, could also lead to a situation with detrimental consequences for the purposes of efficiency and development of the financial system. The possibility of using virtual assets to arbitrage existing regulations is also something to be considered. The in-depth analysis of the different categories of virtual assets for their characterization within existing legal and regulatory instruments, as well promoting changes to keep an adequate balance between solidity, solvency, efficiency and development, requires agile and flexible work methodologies given the dynamics of virtual assets.

Potential benefits - Lastly, virtual assets could also bring potential benefits. There are numerous statements by regulators and international organizations on the advantages of the correct use of VA and what this could mean for the efficiency and interoperability of securities markets and payment systems.

As in scenarios of technological progress, uncertainty is high, and the materialization of such gains will depend on the uses made by the industry in specific business models. Establishing rules that are clear, balanced and proportional to the risks identified, will be decisive for including these instruments in a risk controlled framework, protecting users and aimed at the healthy development of the markets.

Are there other risks or benefits, in addition to those mentioned above, that the CBU should consider in the development of its work in this field?

5. Regulatory focus, strategy and approach

Regarding the regulatory strategy, there are two possible approaches:

- Promote the adoption of a Virtual Assets Law that generically regulates all aspects of this asset category (not only those that are the responsibility of the Central Bank of Uruguay). This solution has been adopted by countries like Argentina¹ and México².
- Analyze the current legal framework and the need to promote changes in laws and regulations in cases where operations with virtual assets are understood to be within the competence of the Central Bank of Uruguay. In this case, the approach will be to make the necessary adjustments to the current regulations to effectively capture technological developments, recognizing that it is a new way of performing a pre-existing (financial) function. Some countries such as the UK and Switzerland have adopted this approach.

This working group proposes to adopt the second approach, to develop a regulatory response in our country. Efforts will be made to identify the necessary adjustments to existing laws and regulations, which may be consolidated in one or several bills.

Although it is recognized that VAs may have, in certain cases, economic purposes similar to regulated financial instruments, it is considered that the regulatory framework would not be linearly suitable to them. Distributed registry technology or Distributed Ledger Technology (DLT) simplifies the arrangement of players that participate in the issuance, distribution and trading of instruments, and may differ significantly from the structure observed in currently regulated markets.

6. Definitions

Following are some definitions adopted in the conceptual approach to the instruments and operations related to Virtual Assets. They are largely based on the work done by the UK³ and FATF⁴, however as the group's work continues, they are likely to be modified and improved.

¹ Cryptocurrency regulation bill

<https://www4.hcdn.gob.ar/dependencias/dsecretaria/Periodo2020/PDF2020/TP2020/6055-D-2020.pdf>

² "Fintech Law" http://www.diputados.gob.mx/LeyesBiblio/pdf/LRITF_200521.pdf

³ Cryptoassets taskforce, comprised of representatives from BoE, FCA and HMT.

⁴ <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets-2021.html>

Virtual Asset

The term “virtual asset” (VA) refers to a digital representation of value or contractual rights that can be stored, transferred and traded electronically using distributed ledger technology (DLT) or similar technology.

Although most virtual asset operations are based on the use of blockchains, it is important to understand that this is only one of the different types of “distributed ledger technologies” or “DLTs”. Other types include directed acyclic graphs (DAGs), such as IOTA⁵; and proprietary technology such as Hashgraph⁶ or Holochain⁷.

The term "similar technology" referred to in the proposed definition, seeks to provide it with greater adaptability to technological developments that may occur in the future. It aims to understand the technology of the distributed ledger with high levels of security and reliability, in the absence of a central body in charge of its maintenance and updating.

The term “crypto asset” is understood as a synonym of the term “virtual asset”. On the other hand, the term "cryptocurrency" is not a synonym of "virtual asset", but refers specifically to those cryptographic⁸ tokens that were designed to fulfill the functions of money and serve as a means of payment, for example, Bitcoin. In this paper, the term "Virtual Asset" will be used, and an attempt will be made to establish a more exhaustive categorization, considering the possible uses of these instruments.

⁵ <http://www.descryptions.com/Iota.pdf>

⁶ https://hedera.com/hh_whitepaper_v2.1-20200815.pdf

⁷ <https://files.holo.host/2018/03/Holo-Green-Paper.pdf>

⁸ At the technology level, virtual assets are recorded as data stored on distributed ledgers (registries) secured by cryptography. These entries or data are called “cryptographic tokens”.

There are two types of cryptographic tokens:

- Native cryptographic tokens: are defined at network level protocol and fulfill the economic function of rewarding the individuals who participate in the validation of transactions in accordance with the rules of the network. The objective of this token is to align the individual incentives of the participants to the collective incentives of the proper functioning of the network, in the absence of a central authority.

It is common for this category to be commonly referred to as "cryptocurrency" since the first native tokens (such as Bitcoin), had the objective of fulfilling the functions of money.

- Non-native cryptographic tokens: were developed later to allow distributed ledger technologies to process more complex transactions and made it possible to run small computer programs, commonly called "smart contracts".

In this way it is possible to create non-native tokens. As in the previous case, they consist of data, but this is done in the context of a smart contract (computer program) instead of at the network protocol level.

Lastly, and excluded from the definition of virtual assets are “cryptographic tokens”, which are not a digital representation of value or contractual rights, e.g. tokens that represent academic qualifications, credentials of any kind, or certificates of identity among others.

6.1. Virtual Asset Taxonomy

For the purpose of this paper, virtual assets will be classified as follows:

Security Virtual Assets

These can bestow rights such as ownership, the reimbursement of a specific sum of money, or the right to a share in future economic benefits, e.g. Debt securities⁹.

Utility Virtual Assets

These allow the holder to exchange it for a specific product or service that is usually provided through decentralized ledger technologies (DLT) or similar, e.g. *fan tokens*¹⁰, which are digital assets that represent your ownership of a voting right.

Stable Virtual Assets

These are virtual assets designed to minimize the volatility in its value. Their aim is to maintain a stable value relative to a specified asset. Stable virtual assets are designed to maintain a stable value relative to fiduciary money. In this VA category, the holder has rights over the reserve assets that back its issuance (if any), while the issuer undertakes to make its reconversion effective at the user's request.

There are two categories of Stable virtual assets:

- Asset-backed: are backed by an asset or a basket of assets. The VA holder has claim rights on the backing assets and there can be distinguished:
 - Issuance backed 100% by only one fiat currency, through deposits in local financial institutions, verifying the definition of electronic money.
 - Issuance backed by a basket of currencies (USD, EUR, etc.) maintaining at all times a collateralization level equal to or greater than 100%.
 - Issuance backed by other schemes, which may involve different currencies and assets with a different collateralization ratio.

⁹ *European Investment Bank issues its first ever digital bond on a public blockchain*, April 2021 (<https://www.eib.org/en/press/all/2021-141-european-investment-bank-eib-issues-its-first-ever-digital-bond-on-a-public-blockchain>)

¹⁰ https://www.chiliz.com/docs/CHZ_whitepaper.pdf

- Algorithmic: include an algorithm that controls the expansion and contraction of supply and adjust them to demand. Issuance is not backed by assets, nor are there any rights for VA holders.

Exchange Virtual Assets

These VA do not provide the same type of rights or access as Securities, Utility, or Stable Virtual Assets but are used as a medium of exchange, or investment, e.g. Bitcoin, Ether, etc.

Finally, it should be noted that in all cases the instrument categorization will follow the principle of substance over form. Therefore, it is necessary to first analyze the characteristics of the instruments, independently of how they are presented and offered in the market.

Are the proposed definitions of VA categories adequate?
Should other aspects be addressed when writing the definitions?
Are there any categories that have not been covered and may require the attention of the CBU as regulator and supervisor of the financial and payment systems?

6.2. Functions and roles

The main players involved in the virtual asset markets could be classified as:

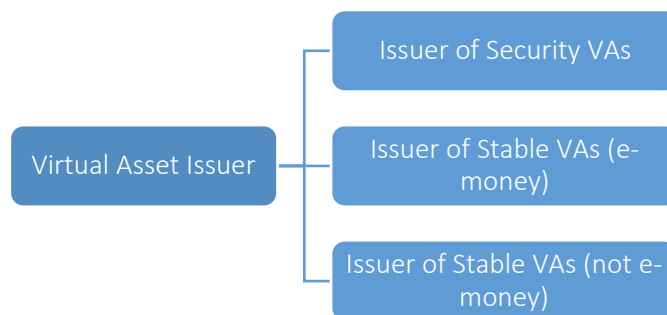
- Developers and issuers of virtual assets: they design and issue virtual assets on their own account or on behalf of third parties. It includes agents that issue virtual assets through an ICO (initial coin offering), as well as those who contribute to the programming of the protocols for the issuance, distribution and trading of virtual assets.
- Miners (transaction processors): agents in charge of verifying transactions in exchange for remuneration paid in virtual assets by the ordering parties of said transactions, with the possibility also of receiving remuneration in new VA units issued, in accordance with the corresponding protocol.
- E-wallet and virtual asset custodian service providers: they offer a secure infrastructure for the storage of private keys that grant access to virtual assets.
- Users: includes individuals and institutions that use virtual assets for investment and exchange purposes.
- Virtual asset trading and exchange platforms: responsible for facilitating transactions between the parties.

- Intermediaries and advisers: they facilitate buying and selling VAs in exchange for money or other virtual assets. Includes brokers and ATM.

The following sections will address establishing a regulatory perimeter, however, there are two players that could be subject to the regulation: Issuers of Virtual Assets and Virtual Assets Service Providers (VASPs).

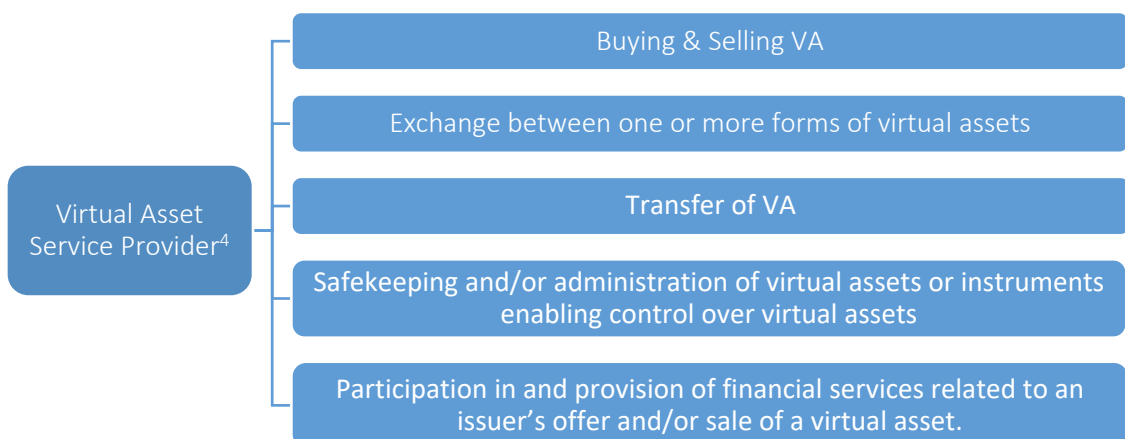
6.2.1. Issuers of Virtual Assets

VA Issuer is any natural or legal person that issues any type of virtual asset included within the regulatory perimeter, or requests the admission of regulated virtual assets, in a virtual asset trading platform.



6.2.2. Virtual Assets Service Providers

Virtual Asset Service Provider (VASP) is any entity that regularly and professionally provides one or more virtual asset services to third parties, as presented in the following diagram:



The term Virtual Asset Services Providers⁶ refers to the services or activities in relation to any virtual asset, as listed below:

- I. Exchange virtual assets for fiat money: any service where a VA can be exchanged for money and vice versa.
- II. Exchange of virtual assets for other virtual assets: the services where a VA can be exchanged for another VA.

In items i. and ii., the activities are included regardless of the role adopted by the VASP, which could be acting as a principal vis-à-vis the user, as a central counterpart for the settlement of transactions, or under another form of intermediation to facilitate the transaction.

- III. Transfer of virtual assets:
Includes services performed on behalf of third parties that allow a user to transfer ownership or control of a VA to another user, or transfer VAs between addresses or accounts belonging to the same user.

This service requires that the VASP maintains control of the VA to be transferred. Note that the control does not necessarily have to be unilateral or exclusive to the VASP. VASP control also includes when transfers occur under multiple signature transaction schemes (multisig), where the signature with more than one private key is required for the transaction to be processed correctly.

- IV. Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets by third parties.

The FATF conceptualization of these activities must be understood in a broad sense. Any entity that exercises control over a VA owned by a third party may be providing services that fall under this category.

Custody consists in the safekeeping or control, on behalf of third parties, of virtual assets or the means of access to these virtual assets, in the form of private cryptographic keys.

The term “administration” also includes the management of VAs for the account and order of a third party. It is the discretionary and personalized administration and implies conveying orders on behalf of third parties, without the need for prior reception of these by the third party.

The term “control” is the ability to hold, trade, transfer, or spend the VA. As in the previous item, this does not mean that control must necessarily be unilateral, but rather that it can also be exercised in a shared manner through multiple signature schemes in transactions.

Most of the custodial wallets provide services included in this category, since they hold the private keys on behalf of third parties, and control the Virtual Assets related to that private keys.

VA administration services according to user instructions would also fall within this category.

- V. Participants and providers of financial services related to an issuer's offer and/or sale of a virtual asset.

The FATF definition of VASP seeks to cover activities related to ICOs (initial coin offerings). ICOs are generally a means of raising funds for new projects. This paragraph covers persons who participate in, or provide financial services related to an issuer's offer and/or sale of a virtual asset through activities such as ICOs. These services can be provided in the context of the issuance, offer, sale, distribution, circulation in the market and trading of the ICOs.

To enhance clarity, the sole act of issuing a VA is not a service on its own included in item (v) of the FATF definition of VASP. However, the offer and/or sale of the VA and “any persons which conduct the exchange and transfer of the issued VAs as a business for or on behalf of another person would be a covered service”.

Lastly, the mere creation of software to issue a VA does not make the programmer a VASP, unless that person also performs the functions captured by the definition, i.e. in the framework of a business model for, or on behalf of another person.

In addition to FATF's VA guidance, the inclusion of activities under the definition of VASP at the local level is being considered:

- (i) Virtual asset advisory services:

The act of providing customized or specific recommendations to a third party, either at the request of that third party, or at the initiative of the virtual asset service provider that gives the advice, about the acquisition or sale of one or more virtual assets, or about the use of virtual asset services.

- (ii) Lending with own funds or from authorized sources:

Refers to granting loans with own resources or sources of funding allowed by the regulation.

(iii) Administration of peer-to-peer trading platforms:

Administration of a web application or other electronic means to mediate between buyers and sellers of virtual assets.

6.2.3. Decentralized finance apps and developers

In some cases, the activities and functions listed in the previous sections can be carried out through DeFi (decentralized finance) protocols or applications.

These applications consist of computer programs that aim to facilitate the issuance, exchange, transfer and other more complex financial services with virtual assets, such as crowdfunding, derivative products and portfolio management.

In this case, there are no intermediaries; the users are involved in direct transactions between individuals using the functionalities provided by the application.

The updated FATF guidance makes clear that a DeFi application is not, itself, a VASP under the FATF Standards because the standards do not apply to underlying software or technology. However, the creators, owners, operators, or anyone who exercises significant control or influence over such applications may fall under the definition of VASP to the extent that it is actively providing virtual asset services, regardless of whether the service is promoted as a decentralized application.

Consequently, a person involved in the development or sale of a DeFi application would not fall under the definition of VASP by the sole performance of this activity. However, if the person also uses the application developed to provide the virtual asset services listed above, he or she would fall under the definition of a VASP.

Do the roles and functions mentioned above include all the players that participate in Virtual Asset markets?

Are there any functions that have not been mentioned and that may require the attention of the CBU as regulator and supervisor of the financial and payment systems?

Are there any incompatible functions, in the sense that they should not be carried out by the same participant in order to have a healthy market?

Are there any incompatible activities carried out by the entities currently included in the CBU's regulation and supervision perimeter?

7. Proposal to define the CBU's regulatory perimeter of Virtual Assets

Given the wide variety of virtual assets and the different activities that VASPs can provide, it is important to propose an objective framework of action to determine whether or not an activity should be regulated by the Central Bank. To this end, the

following scheme is proposed based on questions about the type of virtual assets and their economic use.

7.1. Operations with Security Virtual Assets

In this case, the type of VA is related to the definition of security provided for in the Securities Market Law:

Art. 13 Law 18,627 – “Securities shall be understood, for the purposes of this law, as transferable goods or rights, included or not in a document, that meet the requirements established by current regulations. Included in this concept are shares, negotiable obligations, futures markets, options, investment fund shares, securities, and in general all credit or investment rights.”

The Compilation of Securities Market Regulations in its Article 3.1 establishes that "Securities are considered to be assets or transferable rights that are issued in physical or book-entry form, and that confer credit or investment rights on their holders (...)"

Beyond the fact that it may be considered convenient to make adjustments to the current definitions, with the aim of resolving uncertainties and providing greater clarity to market participants, Security Virtual Assets would represent a new form of a preexisting financial instrument.

However, some characteristics, such as transferability, could be greatly facilitated compared to the current modalities, and this may cause variations in risk assessments and would require regulatory attention.

Possible uses:

1. Investment: It is necessary to determine whether it is a direct or indirect investment.
 1. a) Direct: it takes the form of an investment in securities, therefore, it would be included within the regulatory perimeter.
 1. b) Indirect: made through a traditional financial instrument that refers to a Security VA. Both the traditional financial instrument and the underlying virtual asset would be included in the regulatory perimeter, and would have to comply with the rules established for these instruments.
2. Capital raising: capital raising through VA Securities (e.g. through VAs similar to bonds, shares or others) would be included in the regulatory perimeter.

Any VASP that operates with these VAs will be carrying out a regulated activity based on the Stock Market legal and regulatory framework, with the adjustments that will be determined.

7.2. Operations with Utility Virtual Assets

Operations with Utility VAs will be included depending on the use given to these virtual assets.

Possible uses:

1. Exchange and payment: would be assimilated to barter or payment in kind, and therefore would be excluded from the regulatory perimeter.
2. Investment: It is necessary to determine whether it is a direct or indirect investment.
 2. a) Direct investment: would be assimilated to investments in real assets with expectations of appreciation, therefore would be excluded from the regulatory perimeter.
 2. b) Indirect, made through a traditional financial instrument that refers to a Security VA: this is the case, for example, of future products, options or other contracts where the underlying instrument is a Utility VA. This case is included within the regulatory perimeter and must comply with the rules established for this instrument. The regulation would not apply to the Utility VA but to the financial instrument instead.
3. Capital raising: capital raising through Utility VA is similar to non-financial crowdfunding schemes (e.g. reward or donation), and therefore would not be included in the scope of regulation.

7.3. Operations with Stable Virtual Assets

At the theoretical level, this category presents the greatest opportunities in terms of improvements in the efficiency of payment systems, by enabling cost reductions and improvements in interoperability under a regulation that effectively counteracts related risks. In the past year, there has been a significant increase in its use for making payments and transfers, and therefore has the greatest potential to acquire systemic importance. Likewise, value stabilization mechanisms backed by fiduciary currencies could lead to fractional systems with high risks for users and the stability of the financial system in the absence of regulation. Thus, this category should be included in the regulatory perimeter.

In the particular case of single-currency collateralized Stable VA, it is necessary to assess whether they fall under the definition of electronic money (e-money). In all other cases, a specific framework for this type of issuer will apply, different from the framework for the issuer of virtual assets and securities.

a. VAs Stable that fall under the definition of electronic money

It must be determined whether the VA meets the characteristics established in article 2 of Law No. 19,210 of 04/29/2014 and Article 80 of the Compilation of Payment System Regulations, which establish that electronic money instruments represent a monetary value that constitutes a claim on the issuer, such as prepaid cards, e-wallets or other similar instruments, in accordance with what is established in the regulation, with the following characteristics:

- A. the monetary value shall be stored in electronic means, such as a chip in a card, a mobile phone, a computer hard drive or server;
- B. it must be accepted as payment by entities or persons other than the issuer and have cancellation effect;
- C. it must be issued for an amount equal to the funds received by the issuer;
- D. it must be convertible into cash by the issuer at the request of the holder, but only the unused monetary amount of the electronic money instrument issued;
- E. it must not accrue interest.

In this case, the issuer of the stable VA will be considered the issuer of electronic money and will be regulated according to the regulations in force for the Payment System.

b. Asset-backed stable VAs, which do not meet the definition of e-money.

In the remaining cases, a regulatory response proportionate to the risks identified for both users and the financial system as a whole should be considered.

The ability of issuers to deliver on their promise to maintain stability in the value of VAs issued, as well as to reconvert VAs into fiat currency at all times, will largely depend on the risk profile of reserve assets, their governance scheme, and the type of legal right acquired by the VA holder.

The approach to be adopted in this category must effectively address the business reality of the proposed stable VA arrangement. A substantial aspect for the discussion of its treatment is whether it is a financial intermediation operation, in which case it should be subject to the corresponding requirements. Otherwise, the approach could refer to what is defined in the Security VA category.

c. Unbacked (algorithmic) stable VAs and stable VAs backed by other virtual assets.

The issuance of the remaining categories of VA Stable would not be admitted by the regulation due to the higher level of risks that they entail. However, their circulation

would be allowed and their exchanges (whether for money or for other virtual assets) should be included within the CBU's regulatory perimeter.

- Algorithmic Stable VA: has higher operational risk since the stability of the value will depend on how efficiently the system manages the working capital. In turn, unit issuance and destruction procedures can hinder traceability and increase the risk of money laundering and terrorist financing. Lastly, the absence of claim rights on asset reserves may pose higher risks from the perspective of user protection.
- VA Stable backed by other virtual assets: leads to an accumulation of risks (those from the underlying VA and those from the VA stable).

7.4. Operations with Exchange Virtual Assets.

Operations with exchange VAs will be included in the perimeter depending on the use given to these virtual assets.

Possible uses:

1. Exchange and payment: would be assimilated to barter or payment in kind and therefore would be excluded from the regulatory perimeter. The acceptance of this type of VA to settle an obligation will be subject to the will of the parties involved.

However, in the event that the regular use of an exchange VA as a payment instrument affects the functioning of the National Payment System, the Central Bank of Uruguay may exercise its control and surveillance (article 3 of Law 16,696 and article 19 of Law 18,573 dated 09/13/2009).

2. Investment: It is necessary to determine whether it is a direct or indirect investment.

2.a) Direct investment: would be assimilated to investments in real assets with expectations of appreciation, therefore would be excluded from the regulatory perimeter.

2.b) Indirect, made through a traditional financial instrument that refers to a VA Securities: this is the case, for example, of futures products, options or other contracts where the underlying instrument is a VA Securities. These are included within the regulatory perimeter and must comply with the rules established for this instrument. The regulation would not apply to the exchange VA but to the financial instrument instead.

3. Capital raising: capital raising through Exchange VA is similar to non-financial crowdfunding schemes (e.g. reward or donation), where the user receives an

intangible good as compensation for his contribution, therefore would not be included in the regulation perimeter.

7.5. Exchange of VA for money and Exchange between different forms of VAs.

The following VA exchange modalities will be included within the scope of action of the CBU when they are carried out regularly and professionally on behalf of third parties:

- Exchange of VAs for money, regardless of the type of VA involved in the transaction.
- Exchange between two or more forms of VAs, as long as at least one of the VAs involved in the transaction is included in the proposed regulation perimeter (Security VA or stable VA).

Following is a summary of the proposed regulatory perimeter:

Type of Virtual Assets	Regulation criteria	Applicable regulation
1. Security Virtual Assets	Regulated – whatever its use	Securities Market
2. Utility Virtual Assets	Not Regulated, however financial instruments with underlying Utility VA will be regulated Regulated – purchase, sale and exchange, under the conditions described.	
3. Stable Virtual Assets (e-money)	Regulated – Stable VA: issuance is backed 100% by a single currency and falls under the definition of e-money.	Payment System
4. Stable Virtual Assets (not e-money)	Regulated – Issuance Accepted: VA backed by currency or baskets of assets Not allowed: Algorithmic VAs or backed by other VAs. Regulated – purchase, sale and exchange, under the conditions described.	To be determined, may require a specific regulation.
5. Virtual Assets Exchange	Not Regulated in terms of use as a means of payment or direct investment by individuals or companies. Regulated	

- Purchase, sale and exchange, under the conditions described.	Money Laundering
- If it is a means of payment that affects the National Payment System.	Payment System /
- If it is used as a tool for regulated financial or payment services (transfers, remittances, payment and collection services).	Financial System
In the future, these operations could be included in other VA categories.	

Is the proposed regulatory perimeter considered appropriate for the characteristics of the operations?

8. Authorizations

8.1. Virtual Asset Issuers

Entities that are not currently registered with the Central Bank of Uruguay and intend to issue Virtual Assets, must request a license according to the type of VA to be issued:

- a) VAs with issuance included in the regulatory perimeter:
 - Security VA: subject to the rules established in the Securities Market Law for issuers of securities.
 - Stable VA - Electronic Money: these VA issuers fall under the definition of Electronic Money Issuers and are subject to the regulations of the Payment System.
 - Stable VA - Not Electronic Money: It is necessary to determine if the issuance of the VA falls under the scope of financial intermediation, if it can be related to the issuance of securities, or if it should require a specific regulation. Further study of this area is required in order to prepare a proposal.

- b) VAs with issuance not included in the regulatory perimeter:
 - Utility VA: its issuance will not require authorization by the CBU.
 - Exchange VA: its issuance will not require authorization by the CBU.

However, it is considered important to continue monitoring the operations with these instruments because if they are used as a means of payment and are used regularly, they may be relevant to the objectives of the CBU.

8.2. Virtual Asset Service Providers (VASPs)

Entities that are not currently registered with the Central Bank of Uruguay and intend to regularly and professionally provide Virtual Asset Services (under the terms previously defined), must apply for a VASP license.

VASPs are not to execute incompatible functions as per current regulations (issuance, purchase, custody, registration of VA Securities).

Three types of services with progressive levels of risk are defined for VASPs:

- I) Facilitate the offer and/or sale of virtual assets Utility and Exchange, without having control over the clients' VAs. Mediation between buyers and sellers of VAs and providing advice on investments with VAs are also considered in this category.
- II) VA services such as offer and/or sale, exchange, transfers, custody, granting loans, and other activities of a similar nature, funding the operations exclusively with their own resources or permitted sources of funding and without incurring in financial intermediation.
- III) In addition to the above services, carrying out financial intermediation and providing financial services related to the offer and/or sale of a Virtual Asset by its issuer.

For these purposes, a preliminary categorization of VASPs is proposed based on the activities they carry out and their associated risks:

Category	Virtual Asset Service	Example business model
VASP Type I	<ul style="list-style-type: none"> - Non-regulated virtual asset offer and/or sale services, exclusively. - Mediation in the offer and/or sale of VAs. - Investment advice on VAs. 	<ul style="list-style-type: none"> - <i>Virtual asset exchange house</i> where VAs Exchange or Utility are bought and sold without offering custody services for those VAs. - Bitcoin (or other Exchange or Utility VAs) ATM.
VASP Type II	<ul style="list-style-type: none"> - Includes VASP Type I activities - Financial services of exchange, transfers, custody, loans and others of a similar nature, funding the operations through the permitted sources of funding and without incurring in financial intermediation. 	<ul style="list-style-type: none"> - Custodial wallets of VAs. - <i>Virtual asset exchange</i> as long as the operation is carried out with own funds. - Virtual asset custody services

Category	Virtual Asset Service	Example business model
VASP Type III	<ul style="list-style-type: none"> - Includes VASP Type II activities - Financial intermediation with VAs included in the regulation perimeter. - Financial services related to the offer and sale of a Virtual Asset by its issuer (ICO). 	<ul style="list-style-type: none"> - Virtual asset exchange based on order listings. - People responsible for the operation decentralized <i>exchanges</i> that operate with regulated VAs. - People responsible for the operation decentralized finance applications that operate with regulated VAs. - Platforms to facilitate the issuance, distribution and trading of VAs.

The business models mentioned above are aimed to provide examples for each category, but it is not a complete list of every possible item or option. Appropriate definitions and characterizations will require an in-depth analysis of the activities that market participants seek to develop, and how they implement their operations.

One aspect to consider in the regulation development process is to establish whether these are exclusive purpose activities or not (as for other financial activities). This seeks to identify the risks of carrying out regulated and non-regulated activities simultaneously.

8.3. Determining the territorial extent for authorizations

To determine the territorial scope of application, the first element to be considered is if the company or the administration office is incorporated in the country. If it is not, then the type of activity and the evidence that it is being carried out in the country must be examined (e.g. if it promotes its services in the country).

When a company is not incorporated and does not carry out activities in Uruguay, but has a client in Uruguay, it is probably considered that it is not carrying out activities in the country. An example of this would be the case of a virtual asset *exchange* that is registered in another jurisdiction and does not have offices or agents in Uruguay, but allows Uruguayan clients to open accounts and buy, sell or own virtual assets. At first, it would be considered that the business is not being conducted in the country, therefore it would be beyond the boundaries of national laws. However, it would require a case by case analysis.

Note that this is the approach adopted by the United Kingdom¹¹.

¹¹ <https://www.fca.org.uk/cryptoassets-aml-ctf-regime/register>

8.4. Operations with Virtual Assets carried out by entities currently included in the regulatory perimeter

8.4.1. Virtual Assets Services

Entities currently regulated by the CBU and duly registered must not apply for a new authorization for providing Virtual Assets services. However, they have the obligation to notify the start of these activities.

Institutions may only offer Virtual Asset Services assimilated to the activities permitted in their license. If necessary, the regulations applicable to each type of institution could be adjusted to explicitly include virtual asset services into the permitted operations of the licenses.

It is necessary to conduct a detailed analysis of all possible virtual asset services and the operations allowed in each type of license granted by the CBU.

8.4.2. Virtual Asset Issuance

The proposed authorization regime for VA issuance corresponds to the category of the VA to be issued, recognizing that in certain cases a VA may be a new form of a pre-existing financial instrument.

VAs whose issuance is included in the regulatory perimeter:

- Security VA: entities authorized to issue publicly traded securities will not require prior registration. However, each issuance must be registered in advance.

The rest of the entities must previously request registration.

- Stable VA - Electronic Money: entities authorized to issue e-money will require prior authorization to start operations with a Stable VA (e-money).

The rest of the entities must also request authorization, for which they must comply with the business limitations of each license granted by the CBU.

- Stable VA - Not Electronic Money: It is necessary to determine if the issuance of the VA falls under the scope of financial intermediation, or if it is similar to the issuance of a security. Further analysis in this area is required to outline a proposal.

VA whose issuance is not included in the regulatory perimeter:

- Utility VA: its issuance will not require authorization. For example, it could be assimilated to issuing loyalty points.

- Exchange VA: its issuance will not require authorization.

8.4.3. Use of Virtual Assets as a technology for providing a regulated financial service

In cases where the Virtual Asset is used as a technological means to facilitate providing a regulated financial service, the regulations in force for that activity will apply.

Such is the case, for example, of institutions that propose:

- To provide fund transfer services using a Virtual Asset to facilitate cross-border operations;
- To provide payment and collection services using virtual assets.
- To perform financial intermediation using Virtual Assets, such as through a VA Stable
- Electronic Money.

Are there any difficulties or obstacles to implement frameworks for the prevention of money laundering and financing of terrorism in the functions and types of entity proposed?

Are there any risks or obstacles involved in including Virtual Asset operations to the markets currently regulated and supervised by the CBU?